



**Sovereign Advisers®**  
**Specialists in Risk Metrics Analytics**

4901 E. Sunrise Drive • Suite 711  
Tucson • Arizona • 85718  
Tel (USA): 520.615.4525 • Fax: 520.322.9850  
Email: sovereign\_advisers@yahoo.com

Via Certified Mail, Electronic Mail and Facsimile

March 31, 2005

Mr. Michael Macchiaroli, Associate Director  
Division of Market Regulation  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: On Behalf of Defaulted Creditors of the Government of China:

COMPLAINT

Misleading Sovereign Credit Ratings and Inadequate Disclosure Pertaining to the Offer, Sale and Trading of Debt Securities of the People's Republic of China: Deceptive Practices and Violations of International Law.

Dear Mr. Macchiaroli:

The following matter is pertinent to the supervisory and regulatory mandate of the Division of Market Regulation with respect to the operation of the nation's securities markets generally, and specifically the diligent enforcement of regulations governing the operation of the Nationally Recognized Statistical Rating Organizations ("NRSROs"). Accordingly, on behalf of defaulted creditors of the Government of China including the United States bondholders organized as the American Bondholders Foundation, we present the following concerns and Complaint to your attention.<sup>1</sup>

---

<sup>1</sup> As referenced herein, the term "ABF affiliated bondholders" shall be interpreted to refer to U.S. citizens affiliated with the American Bondholders Foundation, who are holders of full faith and credit sovereign obligations of the Chinese Government on which that government has defaulted and continues to evade payment. As referenced herein, the term "other defaulted creditors" shall be interpreted to refer generally to all defaulted creditors holding full faith and credit sovereign obligations of the Chinese Government, regardless of domicile, who continue to suffer discriminatory treatment regarding settlement of claims. As used herein, the term "other defaulted creditors" shall specifically exclude reference to citizens of Great Britain who participated in the 1987 settlement accord between Britain and the Government of China, and shall also specifically exclude reference to citizens of France, who are presently engaged in negotiations with the Government of China regarding settlement of defaulted obligations held by French citizens.

## SECTION 1

### **American Bondholders Foundation and Claims of American Citizens Holding Defaulted Full Faith and Credit Sovereign Bonds of the Government of China.**

#### §1.01 Defaulted Chinese Government Bonds

The American Bondholders Foundation (the “ABF”) is the incorporated national organization representing the consolidated claims of thousands of United States bondholders who are holders of full faith and credit sovereign bonds issued by the Government of China and on which that government has defaulted and continues to evade payment to both American citizens and non-U.S. bondholders.<sup>2</sup> The most prevalent among the defaulted series of bonds which are the subject of the ABF collection action is the Chinese Government Five Per Cent Reorganization Gold Loan. This series of bonds was issued by the Government of China as a full faith and credit obligation of the Chinese Government and was sold to investors in the United States and Europe by a global syndicate of international banks. The bonds were scheduled to mature in 1960. The language of the bond certificates, as well as the language of the Loan Agreement authorizing the bond issue, mandated that the obligations were to be considered as binding upon the Government of China and its successors.<sup>3</sup> The obligations which are the subject of the ABF collection action have been valued by a recognized specialist in international bond valuation in accordance with the provisions of the debt covenants as specified in the Loan Agreement. All such bonds which have been tendered for collection are presently held in trust by the ABF.<sup>4</sup>

---

<sup>2</sup> The ABF is a U.S. corporation duly incorporated under the laws of the state of Delaware. The ABF and its members have retained the law firm of Stites & HARBISON to act as counsel in the matter of collecting on the defaulted Chinese government debt. On June 13, 2001, at the direction of the White House Counsel, the United States Department of State and the Securities and Exchange Commission, the ABF contacted the Foreign Bondholders Protective Council (the “FBPC”) to initiate collection proceedings on these defaulted obligations. The FBPC was created by Presidential Executive Order to assist U.S. citizens in collecting on defaulted debts of foreign issuers and has successfully completed collection of 47 previous defaulted bond settlements. The ABF has been featured extensively by the international print and broadcast media, including the British Broadcast Corporation, Financial Times, Wall Street Journal, Associated Press, Bloomberg Financial News, USA Today, Congressional Quarterly, Voice of America, Business Week and Barron’s Financial News. The ABF has also hosted a congressional forum with the participation of the National Congress of American Indians. Federally-recognized American Indian tribes constitute eligible recipients of the charitable and humanitarian programs to be funded from the 30% contribution of debt collection proceeds. The charitable and humanitarian programs will be administered under the auspices of the affiliated ABF foundation.

<sup>3</sup> Under established conventions of international law, a successor government is responsible for payment of the sovereign obligations of a predecessor government. In fact, the language which appears on the bond certificates which are the subject of the ABF collection action explicitly states: “These obligations are intended to be binding upon the Government of China and any Successor Government”.

<sup>4</sup> Note that the bonds held by ABF affiliated bondholders are exclusive of similar bonds acquired by the United States Government Office of Foreign Asset Management through the Trading with the Enemy Act and presently held by the “public-at-large”.

§1.02 1987 Discriminatory Settlement

Although repeated demands by individual bondholders to China for payment of these obligations have been ignored for years by the Chinese Government, the People's Republic of China has previously settled payment with the citizens of Great Britain on their holdings of defaulted bonds from this series in 1987.<sup>5</sup>

§1.03 Statement of Intent to Resume Payments and Continued Evasion of Payments

Subsequent to defaulting on the external bonded debt represented by this series of bonds, the Government of China pledged its intention to resume service on the debt when economic conditions permitted, although the People's Republic of China has not made any payments to date on the bonds to the ABF affiliated bondholders or to other defaulted creditors.<sup>6</sup> The continued evasion of payment by the Chinese Government on this series of defaulted bonds represents a discriminatory attempt to evade payment of full faith and credit sovereign debt by a government which possesses the financial ability to honor its nation's valid and binding obligations.<sup>7</sup>

§1.04 Recent Settlement Precedents

In addition to general principles of international law, there exist several recent precedents that are applicable to the situation described herein:

▶ 1986

The Government of the Soviet Union settled the claims of British citizens who were holders of defaulted pre-1917 Russian government bonds.

▶ 1987

The Government of the People's Republic of China settled the claims of British citizens who were holders of an identical series of defaulted Chinese government obligations as the ABF affiliated bondholders.

---

<sup>5</sup> The People's Republic of China negotiated a settlement accord with British bondholders in June of 1987.

<sup>6</sup> See letter dated December 11, 1979 from Mr. J. Brian Attwood, Assistant Secretary for Congressional Relations, U.S. Department of State, addressed to the Honorable Charles A. Vanik, Chairman of the Subcommittee on Trade, Committee of Ways and Means, U.S. House of Representatives.

<sup>7</sup> A complete set of Memorandums addressed to the United States Congress have been prepared by the law firm of Stites & Harbison PLLC which present a comprehensive analysis and discussion, including relevant authorities, of the liability of the Government of the People's Republic of China for payment of the bonds held in trust by the ABF affiliated bondholders. This set of Memorandums may be viewed at the following URL: <http://www.globalsecuritieswatch.org/s&hmemorandums.html>

According to the Global Association of Risk Professionals, the People's Republic of China presently has in excess of \$610 billion in foreign exchange reserves, representing an increase of over \$200 billion during the past twelve months. "China Vows Better Forex Management". *RiskAlert*. February 22, 2005.

▶ 1996

The Government of Russia settled the claims of French citizens who were holders of defaulted pre-1917 Russian government bonds.

▶ 2004

Recently, the People's Republic of China has notified the Government of France that it intends to settle the claims of French citizens who are holders of an identical series of defaulted Chinese government obligations as the ABF affiliated bondholders.

§1.05 Selective Default and Discriminatory Settlement Practices

Despite the obligation of the People's Republic of China to honor the claims of the ABF affiliated bondholders and other defaulted creditors under international law, the Chinese Government continues to blatantly disregard these claims and continues its discriminatory treatment of United States citizens and other defaulted creditors in an attempt to evade payment. As a direct result, the ABF affiliated bondholders as well as other defaulted creditors are victims of **both selective default and discriminatory settlement** (i.e., selective repudiation of this specific series of obligations by the People's Republic of China and the exclusionary settlement with British citizens in 1987).<sup>8</sup> Accordingly, in addition to other venues, the ABF is pursuing the resolution of affiliated bondholders' claims through the United States Congress. Members of the 107<sup>th</sup> United States Congress, including the House Majority Leader and the Chairman of the House Financial Services Committee, signed a letter to President George W. Bush expressing the support of the Congress for the Government of China to settle the claims of the ABF affiliated bondholders. Subsequently, the 108<sup>th</sup> Congress held a televised hearing in the U.S. House of Representatives on this matter.<sup>9</sup>

---

<sup>8</sup> See Aide Memoire issued by the Chinese Ministry of Foreign Affairs, included as pages 81-82 of the American Society of International Law, International Legal Materials, 221.L.M75 (1983), wherein the People's Republic of China declared "The Chinese Government recognizes no external debts incurred by the defunct Chinese Governments and has no obligation to repay them ...". For the matter of discrimination against the claims of United States citizens and non-U.S. bondholders, excluding citizens of Great Britain, refer to the provisions of the 1987 treaty between China and Great Britain which provides for settlement and payment of bondholder claims of British nationals and which does not provide for any payment on the claims of American or non-U.S. bondholders.

<sup>9</sup> It has long been the policy of the United States Department of State that intervention by the United States Government in bondholder disputes is appropriate in situations involving either debt repudiation or discrimination. See policy letter addressed to the Honorable Charles A. Vanik, Chairman, Subcommittee on Trade Committee on Ways and Means, United States House of Representatives, authored by J. Brian Atwood, Assistant Secretary of State for Congressional Relations (December 11, 1979), stating that examples in which intervention by the United States Government is appropriate in resolving the bondholder claims of U.S. citizens includes the following: (1) situations in which the obligations are repudiated; and (2) situations in which American nationals are discriminated against. On October 21, 2003, Ms. Jonna Z. Bianco, President of the American Bondholders Foundation presented testimony in the United States Congress on this issue during the televised public hearing conducted by the International Relations Committee of the U.S. House of Representatives. Other witnesses presented additional testimony at this hearing regarding the U.S.-China economic relationship, specifically addressing the loss of approximately

§1.06 Deceptive Practices and Misleading Investor Information: New Sovereign Bond Issues

Having provided some background on this important issue, please allow us to now direct your attention to certain recent events related to the situation described above, which we believe merits further investigation. On behalf of the American Bondholders Foundation and other defaulted creditors of the Government of China, the specific complaints described below are hereby presented to your attention. The ABF affiliated bondholders and other defaulted creditors continue to suffer economic harm as a result of the actions of the Government of the People's Republic of China acting in concert with the major credit rating agencies and the complicity of various underwriters including Morgan Stanley, J.P. Morgan, Goldman Sachs, Citigroup and others which are actively assisting the People's Republic of China in the issuance of new debt securities in the global capital markets. Such actions, evidencing a blatant disregard for accepted conventions of international law, established international credit rating protocols and appropriate disclosure standards as described in the following sections, represent a grave threat to the integrity of the international capital markets.

**SECTION 2**

**The Government of China Continues to Evade Settlement of Bondholders' Claims and Continues to Sell Sovereign Bonds in the International Capital Markets in Reliance on Deceptive Practices Including Misleading Credit Ratings and Concealment of an Outstanding Series of Full Faith and Credit Sovereign Bonds Remaining in Default.**

§2.01 Recent Issuance of New Sovereign Bonds

Despite ignoring the claims of the existing bondholders in violation of international law, The Government of the People's Republic of China continues to access the international capital markets through the periodic issuance of global sovereign bond issues. During the most recent bond sales in 2003 and again in 2004, the Government of the People's Republic of China sold in excess of \$3 billion in global sovereign bonds to investors in the United States, Europe and Asia.

§2.02 Global Sale of New Sovereign Bonds in the U.S., Europe and Asia

The 2003 Chinese Government global sovereign bond offering was registered in the United States, Luxembourg and Hong Kong, and was sold throughout Europe, the United States and Asia.<sup>10</sup> The 2004 Chinese Government global sovereign bond offering was registered in Luxembourg and Hong Kong, and was sold throughout Europe and Asia.<sup>11</sup>

---

three million manufacturing jobs from the U.S. to China since mid-2000. Witnesses presenting testimony included representatives of the National Association of Manufacturers and the AFL-CIO. A transcript of the testimony presented at the hearing conducted by the House International Relations Committee on October 21, 2003 may be viewed at either of the following Congressional web-links:

[http://www.house.gov/International\\_Relations/108/bian2021.htm](http://www.house.gov/International_Relations/108/bian2021.htm)

<http://www.nist.gov/hearings/2003/uschina.html>

<sup>10</sup> According to the prospectus supplement dated October 16, 2003 filed with the United States Securities and Exchange Commission, the lead underwriters participating in the offer and sale of People's Republic of

§2.03 Comparative Summary of Chinese Government Sovereign Bond Issues

Exhibit 2.01 provides a comparative summary of recent Chinese Government sovereign bond sales in the international capital markets.

[This space intentionally left blank]

---

China sovereign bond offering (common code 017941941; ISIN US712219AJ30; CUSIP 712219AJ3) include the following firms: Goldman Sachs (Asia) LLC, J.P. Morgan Securities, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Banc One Capital Markets, Inc., Citigroup Global Markets, Inc., Credit Suisse First Boston LLC, Daiwa Securities SMBC Europe Limited, The Hong Kong and Shanghai Banking Corporation Limited, ICEA Securities Limited, Lehman Brothers International (Europe), Morgan Stanley & Co. International Limited, and Nomura International plc. The notes were registered and listed for trading with the Luxembourg and Hong Kong Exchanges.

<sup>11</sup> Public notice published in the *Wall Street Journal*. October 22, 2004. The lead underwriters include the following firms: Goldman Sachs Group Inc., J.P. Morgan Chase & Co., Merrill Lynch & Co., Morgan Stanley, BNP Paribas SA, Deutsche Bank AG, and UBS AG.

**Exhibit 2.01**  
**People's Republic of China**  
**Global Sovereign Bond Issuance Summary**

YEAR OF ISSUANCE	DENOMINATION / AMOUNT	REGISTRATION / EXCHANGE LISTING	LEAD UNDERWRITERS
Pre-1986	<p>Various series of Chinese Government global sovereign bonds enter into default including the Chinese Government Five Per Cent Reorganization Gold Loan issued for £25 million sterling</p> <p>The Government of the People's Republic of China ignores international bondholders' claims and leaves bonds in default including the Chinese Government Five Per Cent Reorganization Gold Loan series due to mature in 1960</p> <p>The Government of the People's Republic of China enters into an exclusionary settlement with citizens of Great Britain in 1987 of the defaulted Chinese Government Five Per Cent Reorganization Gold Loan and continues to discriminate against bondholders in other countries</p> <p>After selectively defaulting on its outstanding global sovereign bonds the Government of China re-accesses the international capital markets and commences issuing new series of global sovereign bonds</p>	<p>Great Britain</p> <p>France</p> <p>Germany</p> <p>Japan</p> <p>Russia</p>	<p>The following firms acted as the lead underwriters of the Chinese Government Five Per Cent Reorganization Gold Loan:</p> <p>Banque de L'Indo-Chine; Deutsch-Asiatische Bank (Deutsche Bank); Hong Kong &amp; Shanghai Banking Corporation (HSBC); Russo-Asiatic Bank; Yokohama Specie Bank Limited</p>
1986 – 2002 <sup>12</sup>	\$8.5 Billion <sup>13</sup> (Low Estimate) / \$13 Billion <sup>14</sup> (High Estimate)	(N/A)	(N/A)
2003 <sup>15</sup>	<p><u>Tranches:</u></p> <p>\$1 Billion (Due 2013)</p> <p>€400 Million (Due 2008)</p>	<p>United States (Registration No. 333-108727)</p> <p>Luxembourg</p> <p>Hong Kong</p>	<p>Goldman Sachs (Asia); J.P. Morgan Securities; Merrill Lynch; Banc One Capital Markets; Citigroup Global Markets; Credit Suisse First Boston; Daiwa Securities SMBC Europe; Hong Kong and Shanghai Banking Corporation; ICEA Securities; Lehman Brothers International (Europe); Morgan Stanley &amp; Co. International; Nomura International</p>
2004 <sup>16</sup>	<p><u>Tranches:</u></p> <p>\$500 Million (Due 2009)</p> <p>€1 Billion (Due 2014)</p>	<p>Luxembourg</p> <p>Hong Kong</p>	<p>Goldman Sachs Group; J.P. Morgan Chase &amp; Co.; Merrill Lynch; Morgan Stanley; BNP Paribas; Deutsche Bank; UBS</p>

<sup>12</sup> Reliable data for the indicated period unavailable. Estimates of the amount of long-term foreign currency sovereign bonds issued by the Government of the People's Republic of China for the period 1986 – 2002 vary depending upon source. According to a report published by the William J. Casey Institute Center for Security Policy, the People's Republic of China had issued sovereign bonds in the amount of \$4.2 billion which were outstanding in the United States as of mid-2001. *Watch this Space: Beijing Says it Won't Bring Sovereign Bond to U.S. Capital Markets – But For How Long?* Publication no. 01-C31. William J. Casey Institute Center for Security Policy. May 21, 2001.

<sup>13</sup> Source: U.S.-China Economic and Security Review Commission Report to the United States Congress (2002). All amounts which are stated in dollar figures represent United States dollars.

<sup>14</sup> Source: *Foreign Participation in Local-Currency Bond Markets*. John D. Burger and Francis E. Warnock. International Finance Discussion Paper No. 794. Board of Governors of the Federal Reserve System. February 2004.

<sup>15</sup> Source: Prospectus supplement dated October 16, 2003 filed with the United States Securities and Exchange Commission.

<sup>16</sup> Source: Notice of bond offering appearing in the *Wall Street Journal*. October 18, 2004.

### SECTION 3

#### **Inappropriate and Misleading Sovereign Credit Rating of the Long-Term Foreign Currency Debt of the Government of the People's Republic of China.**

##### §3.01 Improper and Misleading Credit Rating Classifications Assigned to the Government of China

The three major nationally-recognized statistical rating organizations (“NRSROs”), commonly referred to as credit rating agencies (i.e., Moody’s Investors Service, Standard and Poor’s Rating Group and Fitch Ratings) continue their deceptive practice of selectively disregarding pertinent facts associated with the situation described herein, particularly the “*willingness to pay*” metric, which represents a significant and continuing component of embedded risk implicit to general obligations of the Chinese Government.<sup>17</sup>

##### §3.02 Current Credit Ratings Ignore Repudiation of Sovereign Debt and Selective Default

According to representatives of the U.S. Department of State, the People’s Republic of China explicitly repudiated all bond claims originating prior to its 1949 assumption of the Government of China.<sup>18</sup> Since the assumption and payment of any valid outstanding obligations of a pre-existing government by a recognized successor government is a basic tenant of international law, the refusal of the People’s Republic of China to abide by this established convention violates accepted principles of international trade and commerce and demonstrates its unwillingness to comply with commonly accepted standards of conduct.<sup>19</sup> The People’s Republic of China explicitly acknowledged its responsibility for payment of pre-1949 Chinese sovereign bonds pursuant to the 1987 accord which settled the claims of British citizens, thereby establishing a precedent for collection by other bondholders. Despite the 1987 accord with British bondholders, the People’s Republic of China continues to attempt to evade payment to the ABF affiliated bondholders and other defaulted creditors holding the identical series of full faith and credit sovereign bonds.<sup>20</sup> Such an attitude, manifested as a form of institutionalized behavior, is inconsistent with increased recognition of the quality of the Chinese Government’s international obligations.

---

<sup>17</sup> Nationally Recognized Statistical Rating Organizations (“NRSROs”). The three organizations historically comprising this classification of credit rating service providers are Moody’s Investors Service, Standard and Poor’s Rating Group and Fitch Ratings. Dominion Bond Rating Service was recognized in 2003 as a fourth NRSRO. A.M. Best was recently recognized as the fifth NRSRO.

<sup>18</sup> Aide Memoire issued by the Chinese Ministry of Foreign Affairs, included as pages 81-82 of the American Society of International Law, International Legal Materials, 221.L.M75 (1983), wherein the People’s Republic of China declared “The Chinese Government recognizes no external debts incurred by the defunct Chinese Governments and has no obligation to repay them ...”.

<sup>19</sup> See *Restatement (Third) of the Foreign Relations Law of the United States*, Section 712(2) and “Creditors Claims in International Law”, *The International Lawyer*, Volume 34, page 235, Spring 2000. See also, for example, the recent United Nations Security Council resolution on weapons inspections in Iraq which stipulates that a subsequent government in Iraq following a regime change will remain liable for predecessor national debt obligations.

<sup>20</sup> The 1987 agreement with Great Britain did not provide any settlement for non-British citizens.



§3.03 Credit Rating Agencies Continue to Discriminate Against Defaulted Creditors

In preparation for the October 2003 global sovereign bond sale, the major credit rating agencies conducted a review of the long-term foreign currency sovereign debt rating of the People's Republic of China. Prior to such review, the omission of significant and material aspects from the prevailing rating assessments of the Chinese Government, including the situation described above, was explicitly brought to the attention of the chief executive officers of Moody's Investors Service, Standard and Poor's Rating Group and Fitch Ratings in a letter dated November 27, 2002 authored by Ms. Jonna Z. Bianco, President of the American Bondholders Foundation.<sup>21</sup> To date, no acknowledgement or response to this letter has been received from any of the three major credit rating agencies.

§3.04 Credit Rating Agencies Act to Facilitate Chinese Government's Global Bond Sale

On October 13, 2003 Fitch Ratings affirmed its investment grade assessment and assigned a "positive" outlook. On October 15, 2003 Moody's Investors Service announced that it was upgrading the long-term foreign currency sovereign credit rating of the Chinese Government from the previous A3 rating to a newly-assigned rating of A2. Incredibly, on October 22, 2003, the very day after the United States Congress House of Representatives International Relations Committee conducted a televised public hearing on the ABF issue, Standard and Poor's Corporation actually affirmed its investment grade assessment of the long-term foreign currency sovereign credit rating of the Chinese Government and assigned a "positive" outlook. Coincidentally, each of these development occurred during October, 2003, the same month that the Government of the People's Republic of China filed a prospectus with the SEC for the offer and sale of \$1 billion in government notes.

§3.05 Summary of Ratings Action Preceding Chinese Government's 2003 Global Sovereign Bond Sale

The following is a summary of actions taken by the major credit rating agencies during the month of October, 2003:

- ▶ October 13, 2003  
Fitch Ratings affirmed the long-term foreign currency rating of China at A-. The rating outlook is positive. This rating applies to all of China's senior unsecured long-term sovereign debt issues.
- ▶ October 15, 2003  
Moody's Investors Service, Inc. upgraded China's sovereign rating from A3 to A2 for long-term foreign-currency denominated debt. The rating outlook is stable.

---

<sup>21</sup> The full faith and credit sovereign obligations of the Chinese Government referenced herein exist in a state of "discriminatory repudiation" due to the 1987 settlement with British bondholders which excluded non-British bondholders, and the pending settlement-in-progress with respect to French bondholders which is also expected to exclude U.S. bondholders, among others.

▶ October 22, 2003

Standard & Poor's Ratings Group affirmed its BBB senior unsecured foreign currency credit rating for China. The outlook is positive.<sup>22</sup>

§3.06 Current Credit Ratings Ignore Defaulted Series of Full Faith and Credit Sovereign Obligations

The intentional and willful omission of the existence of a significant dollar value of defaulted obligations of the Chinese Government in the prevailing debt rating assessments of the People's Republic of China constitutes a blatant rejection of the generally accepted international standard that the degree of rigor exercised in assessing the adequacy of issuer disclosures should be strengthened rather than relaxed. Such egregious and spurious conduct is outrageous, particularly in light of the fact that the circumstances described herein were previously brought to the explicit attention of the three major credit rating agencies by the ABF. In light of the persistent evasion by the Chinese Government with respect to payment of its defaulted sovereign obligations and the potential financial impact arising from the emergence of a significant liability, the present credit rating classifications assigned to the Chinese Government are inappropriate and misleading.

§3.07 Current Credit Ratings Selectively Ignore Pertinent Risk Metrics

As revealed below, not only do the current rating classifications assigned to the long-term foreign currency debt of the People's Republic of China by the three major credit rating agencies ignore the existence of a defaulted series of full faith and credit sovereign obligations of the Chinese Government remaining in default, the current rating classifications also do not reflect an accurate assessment of the following material risk metrics:

**Judicial risk** (i.e., pari passu risk of interest attachment / coupon seizure by defaulted creditors);

**Legislative risk** (i.e., risk of U.S. and foreign jurisdiction capital markets or trade sanctions);

**Liquidity risk** (i.e., risk of U.S. regulatory agency sanctions imposed on dealers and ban on quotation pursuant to the Johnson Debt Default Act);

**Repayment risk** accruing from the "willingness to pay" metric (i.e., evasion of payment on outstanding full faith and credit sovereign obligations in violation of international law and reassessment of the PRC's willingness to honor outstanding obligations in the event of future adverse economic conditions); and

**International setoff risk** (i.e., vulnerability to international setoff, adversely affecting the PRC's balance of payments position and impairing the PRC's ability to maintain its current level of external debt).<sup>23</sup>

---

<sup>22</sup> Source: People's Republic of China offering prospectus for the offer and sale of sovereign obligations of the Government of China filed with the U.S. Securities and Exchange Commission. October 16, 2003.

<sup>23</sup> The Global Association of Risk Professionals recently reported on the downgrade of the long-term credit of the People's Republic of China by our firm to sub-investment grade status. The justification for the downgrade of the PRC's credit rating is predicated upon the continuing evasion of payment on a series of defaulted full faith and credit sovereign bonds of the Chinese Government (e.g., the Chinese Government

§3.08 Comparative Summary of Chinese Government Sovereign Debt Rating Classifications

Exhibit 3.01 presents a comparative analysis of the appropriate and inappropriate rating classifications for the long-term foreign currency debt of the People's Republic of China.<sup>24</sup>

[This space intentionally left blank]

---

Five Per Cent Reorganization Gold Loan). Discriminatory settlements of the defaulted sovereign series increases the risk of interest payments seizure by defaulted creditors. The article may be viewed online at the following URL: <http://www.garp.com/risknews/newsfeed.asp?Category=10&MyFile=2004-09-21-9418.html>

<sup>24</sup> The definition for each specific rating classification was obtained from the respective credit rating agency website, utilizing the following URLs: Standard and Poor's: <http://www2.standardandpoors.com> Moody's Investors Service: <http://www.moody.com> Fitch Ratings: <http://www.fitchratings.com> The Japan credit rating agency Rating and Investment Information, Inc. ("R&I") currently assigns an inappropriate "A" sovereign rating classification to the long-term foreign currency debt of the People's Republic of China. The appropriate R&I rating classification for the long-term foreign currency debt of the People's Republic of China should be "CCC", indicating the existence of defaulted debt.

## Exhibit 3.01

### People's Republic of China Long-Term Foreign Currency Sovereign Debt Rating

CREDIT RATING AGENCY	INAPPROPRIATE CREDIT RATING	DEFINITION
Standard & Poor's	BBB+	An obligor rated "BBB" has adequate capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments. The addition of a "+" symbol denotes the relative standing within the assigned rating classification. <sup>25</sup>
Moody's	A2	Bonds which are rated "A" possess many favorable investment attributes and are to be considered as upper medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment some time in the future. The addition of a "2" denotes mid-range ranking within the assigned rating classification.
Fitch Ratings	A-	High credit quality. "A" ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.
CREDIT RATING AGENCY	APPROPRIATE CREDIT RATING	DEFINITION
Standard & Poor's	SD (Selective Default) <sup>26</sup>	An obligor rated "SD" (Selective Default) has failed to pay one or more of its financial obligations (rated or unrated) when it came due. An "SD" rating is assigned when Standard & Poor's believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner. <sup>27</sup>
Moody's	Ba (high range)  Caa (low range)	Bonds which are rated "Ba" are judged to have speculative elements; their future cannot be considered as well-assured. Often the protection of interest and principal payments may be very moderate, and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class. Bonds which are rated "Caa" are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest. <sup>28</sup>
Fitch Ratings	DDD  RD (Proposed)	Default. Entities rated in this category have defaulted on some or all of their obligations. Entities rated "DDD" have the highest prospect for resumption of performance or continued operation with or without a formal reorganization process. Proposed new rating classification: a newly introduced rating of "RD" (Restrictive Default) is proposed for assignment to an issuer (including sovereigns) in cases in which the issuer has defaulted on one or more of its financial commitments, although it continues to meet other obligations.

<sup>25</sup> When applied to debt issued by a sovereign issuer, this rating classification denotes an investment grade debt rating for an issuer which has no full faith and credit sovereign obligations remaining in default.

<sup>26</sup> Recent instances in which Standard and Poor's has assigned an "SD" rating classification to the long-term foreign currency debt of a sovereign issuer include Russia in 1998 (which defaulted on its domestic obligations while continuing to service its eurobonds); Argentina, following its sovereign debt default in December 2001 and subsequent restructuring, including an exchange offer to existing bondholders; and the Dominican Republic in 2005 (which became delinquent on payments owed to commercial bank creditors while continuing to service its bonded debt). The "SD" rating remained in full force and effect until all outstanding defaulted obligations were resolved.

<sup>27</sup> A prime example of selective default is the entire series of full faith and credit sovereign obligations issued as the Chinese Government Five Per Cent Reorganization Gold Loan, scheduled to mature in 1960 and which series remains in default as an external payment obligation of the successor government of China (i.e., the People's Republic of China, which was established on October 1, 1949). The People's Republic of China replaced the Republic of China in the United Nations as the recognized government of China on November 23, 1971 and was subsequently recognized as the government of all China. Taiwan publicly renounced any claim to the government of all China in 1991.

<sup>28</sup> This rating classification is appropriate with respect to acknowledging the judicial risk inherent to investment in such obligations arising from the discriminatory treatment of different classes of creditors.

§3.09 Current Credit Ratings Ignore International Law and Comparability Among Creditors

Under international law, the Government of the People's Republic of China is responsible for payment of the sovereign obligations of the predecessor government (i.e., is the obligor for such obligations). The U.S. Foreign Sovereign Immunity Act does not convey protection to debtor governments in sovereign debt defaults and has been interpreted by U.S. courts to define post-default sovereign bond sales as a "commercial activity" which constitutes an exemption from immunity.<sup>29</sup> The continued payment of selected obligations while simultaneously evading payment on an entire series of defaulted full faith and credit sovereign obligations which remain outstanding in default also constitutes a blatant violation of the doctrine of *pari passu* as interpreted by the Belgian commercial courts and represents a direct contravention of the doctrine of comparability among creditors.<sup>30</sup>

§3.10 Improper Credit Rating Classifications Mislead Investors and Risk Credit Markets Contagion

The deceptive practices perpetrated upon the investing public by the major credit rating agencies in the instance described herein represent an explicit repudiation of the doctrine of comparability of treatment with respect to creditors holding full faith and credit sovereign obligations of the Chinese Government. The outrageously unconscionable conduct of the three major credit rating agencies in this matter demonstrates a willful and deliberate disregard of the objective facts and circumstances and is inconsistent with the important role of the major credit rating agencies as independent evaluators upon which the public-at-large may depend in confidence.<sup>31</sup> The blatant failure of the major credit rating agencies to conduct an objective analysis of the pertinent facts and circumstances, resulting in the assignment of inappropriate and misleading sovereign credit ratings to the long-term foreign currency debt of the People's Republic of China, ignores the existence of outstanding full faith and credit sovereign obligations which have been repudiated through the process of selective default and discriminatory settlement and serves not only to erode the credibility of the agencies but also acts to establish a dangerous precedent for stimulating a credit markets contagion by emboldening unscrupulous issuers to attempt to evade payment of similar obligations. The prevailing and disgraceful situation evidenced by the willful disregard of established rating protocols by the credit rating agencies in concert with lax

---

<sup>29</sup> Republic of Argentina v. Weltover, Inc. 504 U.S. 607 (1992). Docket Number: 91-763.

<sup>30</sup> Elliott Associates, L.P., General Docket No. 2000/QR/92 (Court of Appeals of Brussels, 8th Chamber, Sept. 26, 2000). See also, Republic of Nicaragua v. LNC Investments and Euroclear Bank SA (Injunction issued against paying agent by Belgian Commercial Court, Sept. 8, 2003).

<sup>31</sup> See the revealing comment by Indiana University's Dr. Scott Kennedy, who specializes in China's political economy: "If you have any credibility, you would probably be rating everything junk in China." See also the statement: "China doesn't adhere to international accounting standards. To make matters worse, the government issues misleading statistics." According to Mr. Brian Colton, an analyst who rates China's sovereign bonds for Fitch Ratings (Hong Kong): "Sometimes you have a column of figures that don't add up to the total at the bottom. It's that bad." *Wall Street Journal*, January 5, 2004. See also the statement by Mr. Gordon Chang, former partner at Paul, Weiss, Rifkind, Wharton & Garrison in Beijing: "China has less borrowing capacity than many people think; it is not as creditworthy as many people think." *Watch this Space: Beijing Says it Won't Bring Sovereign Bond to U.S. Capital Markets – But For How Long?* Publication no. 01-C31. William J. Casey Institute Center for Security Policy. May 21, 2001.

enforcement of established protocols is highly conducive to the propagation of such a contagion. Immediate corrective action is mandated to restore the integrity of the ratings universe.

#### SECTION 4

##### **Inadequate Disclosure of Registration Statements and Offering Documents Pertaining to the Offer and Sale of Sovereign Bonds of the Government of the People's Republic of China.**

###### §4.01 Omission of Material Facts and Concealment of Investor Information

Our concerns in this regard involve the grossly inadequate disclosure of investor risk in the bond offering registration statements and offering documents. We note with concern the following two specific failures:

- (a) Failure to disclose the existence of a series of full faith and credit sovereign bonds remaining in default and on which the Chinese Government continues to evade payment to the ABF affiliated bondholders as well as to other defaulted creditors in violation of international law; and
- (b) Failure to disclose the potential risks associated with settlement of securities transactions involving the issuance and trading of full faith and credit sovereign obligations of the Government of the People's Republic of China.

###### §4.02 Inadequate Disclosure by the Government of the People's Republic of China

In a letter addressed to the United States Securities and Exchange Commission (the "SEC") dated January 8, 2003, Mr. B. Riney Green, a partner of the law firm of Stites & Harbison articulated specific concerns regarding the extent of disclosure provided pursuant to offerings of securities within the U.S. capital markets by the Government of the People's Republic of China and its state-owned entities.<sup>32</sup> The following issues were brought to the attention of the SEC as examples of inadequate disclosure in securities offering filings and investor documents related to offerings of securities by the People's Republic of China:

1. Misleading Chinese Government economic data;
2. Political instability of the Chinese Government; and
3. Risk of debt repudiation.

###### §4.03 Material Omissions of Fact Enables the Chinese Government to Circumvent Defaulted Creditors

The issues described above adversely affect the resolution of both the ABF and unaffiliated bondholders' claims since the Government of the People's Republic of China continues to enjoy

---

<sup>32</sup> Letter dated January 8, 2003 from Stites & Harbison PLLC addressed to the Honorable Harvey L. Pitt, Chairman, U.S. Securities and Exchange Commission and Mr. Alan Beller, Director, Corporate Finance Division, U.S. Securities and Exchange Commission.

unfettered access to the international capital markets without any disclosure of the situation described herein, and thus has little incentive to settle the claims of defaulted creditors. The Chinese Government and its U.S. and European underwriters continue to omit mention of material disclosures related to, among other omissions, the situation described herein. For example, the People's Republic of China sovereign bond offering prospectus filed with the U.S. Securities and Exchange Commission on October 16, 2003 for the offer and sale of \$1 billion in ten year debt securities contains no mention or reference to the ABF collection action or to any existing defaulted full faith and credit sovereign debt of the Chinese government.<sup>33</sup>

§4.04 Misleading Statements Appear in the Prospectus Supplement for China's 2003 Global Bond Sale

The following excerpted statements appear in the prospectus and the prospectus supplement of the People's Republic of China dated October 16, 2003 describing the offering of \$1 billion of ten year notes:

▶ Page S-11 of the Prospectus Supplement:

“China is neither involved in any litigation, arbitration or administrative proceedings which are material in the context of the issue of the notes nor aware of any such litigation, arbitration or administrative proceedings, whether pending or threatened.”

“Except as disclosed in this prospectus supplement and the accompanying prospectus, there has been no significant change in the condition (financial, political, economic or otherwise) or the affairs of China which is material in the context of the issue of the notes since December 31, 2002.”

These statements are misleading to prospective investors for the following reasons:

1. The legal counsel to the American Bondholders Foundation has served a formal notice of demand for payment of the defaulted Chinese Government securities to the Minister of Finance of the People's Republic of China in Beijing, as well as to the Embassy of the People's Republic of China in Washington, D.C. This fact constitutes an implied threat of litigation;
2. The prospectus supplement omits mention of the existence of a significant quantity of defaulted full faith and credit sovereign obligations of the Chinese Government;
3. The prospectus supplement omits mention of the Chinese Government's continued discrimination against the ABF affiliated bondholders as well as other defaulted creditors,

---

<sup>33</sup> People's Republic of China. Securities prospectus dated October 16, 2003. U.S. Securities and Exchange Commission EDGAR web-link:

<http://www.sec.gov/Archives/edgar/data/909321/000114554903001347/u98681p1e424b5.htm>

The concealment of the existence of a defaulted series of full faith and credit sovereign obligations of the Chinese Government occurred again in 2004, whereby the registration statement and prospectus for the People's Republic of China sovereign bond offering omitted disclosure of the above fact.

and omits reference to the continuing refusal of the Government of China to honor the claims of the ABF affiliated bondholders as well as other defaulted creditors in violation of accepted conventions of international law;

4. The prospectus supplement omits mention of the recent public record testimony on this matter in the United States Congress;
5. The prospectus supplement omits mention of the Congressional Resolution (House Concurrent Resolution 60) introduced in the United States House of Representatives; and
6. The prospectus supplement omits mention of the recent initiation of settlement negotiations by the Chinese Government with citizens of France regarding settlement of the same series of bonds held by French citizens.

The preceding factors are directly related to China's economic affairs.

#### §4.05 Concealment of Existence of Defaulted Series of Bonds in the Prospectus Supplement

- ▶ Page 69 of the Prospectus:

##### **“Debt Record**

The central government has always paid when due the full amount of principal of, any interest and premium on, and any amortization or sinking fund requirements of, external and internal indebtedness incurred by it since the PRC was founded in 1949.”

This statement is misleading to prospective investors for the following reason:

1. The complete omission of the existence of pre-1949 defaulted full faith and credit sovereign obligations of the Government of China, which under accepted conventions of international law, the payment obligation for such indebtedness was incurred by the central government of China in 1949 and on which that government has since settled with British bondholders and is presently in the process of negotiating a settlement with French bondholders, while continuing to exclude the claims of the ABF affiliated bondholders as well as other defaulted creditors.

#### §4.06 Greater Disclosure Mandated for Chinese Government Bond Sales

The situation described herein, involving a significant amount of outstanding defaulted Chinese Government debt obligations, and the Chinese Government's continuing refusal to acknowledge or honor such obligations in violation of accepted principles of international law, and the related ABF collection action, merits disclosure as a material aspect of any offering of full faith and credit sovereign obligations of the Government of the People's Republic of China.



§4.07 Similar Concerns Expressed by Industry Observers and Watchdog Organizations

Additional concerns regarding inadequate disclosure of the material risks implicit to the offer and sale of securities of the Chinese Government, or instrumentalities thereof, has recently been reiterated by each of the following:

- ▶ The Wall Street Journal;
- ▶ The Hong Kong Credit and Collection Management Association; and
- ▶ The U.S.-China Security Review Commission.<sup>34</sup>

§4.08 Inadequate Disclosure Concerns Corroborated by Findings of U.S. Congressional Commission

Pertinent to this Complaint are certain “*Key Findings*” of the recent U.S.-China Economic and Security Review Commission Report to the United States Congress. The conclusions presented in the section entitled “China’s Presence in U.S. Capital Markets” identify serious concerns related to inadequate disclosure of the material risks implicit to the offer and sale of securities of the Chinese Government and instrumentalities thereof. Such concerns are summarized in the following excerpts from the report:

- ▶ “The U.S. Government lacks adequate institutional mechanisms to monitor national security concerns raised by Chinese and other foreign entities seeking to raise capital or otherwise trade their securities in the U.S. debt and equity markets. Moreover, Security (*sic*) and Exchange Commission (SEC) reporting requirements for foreign registrants provide insufficient disclosure to the investing public of the national security risks related to certain foreign entities’ global business activities, including the material risks associated with entities that do business in terrorist-sponsoring states.”
- ▶ “Chinese issuers have raised an estimated \$20 billion over the past decade from international bond offerings denominated in U.S. dollars.”
- ▶ “China has also raised significant sums internationally through its sovereign and corporate bond offerings. As shown in Figure 6.2, Chinese sovereign bonds garnered \$8.5 billion and corporate bonds raised \$26 billion from 1986 through 2001.”

---

<sup>34</sup> See “China Stocks Evoke the Ghost of Bubble Past”, *Wall Street Journal* (January 27, 2004), which stated “Chinese companies, for example, don’t adhere to U.S. or international accounting standards. And credit-rating agencies are unable to rate most of the Chinese companies listing overseas because of a lack of transparency and disclosure. Finally, the Chinese Government is involved in one way or another in most of the companies listed on the markets”. See also “Credit Ratings in China can be Mere Guesswork”, *Wall Street Journal* (January 5, 2004), which stated “But faulty accounting, poor corporate governance and a lack of disclosure hamper the raters’ efforts. To make matters worse, the Government issues misleading statistics.” For national security concerns posed by inadequate disclosure associated with offerings of Chinese securities in the U.S. capital markets, see Report to Congress of the U.S.–China Security Review Commission: “The National Security Implications of the Economic Relationship Between the United States and China”. Chapter Six, *China’s Presence in the U.S. Capital Markets*. The U.S.–China Security Review Commission. July 2002.

- ▶ “Marc Lackritz, President of the Securities Industry Association, testified that Chinese entities had raised \$48.3 billion in equity capital overseas from 1991-2000, and that about 7 percent of this amount – or \$3.4 billion – had been raised through targeted U.S. offerings. He further indicated that Chinese issuers of debt raised around \$9.7 billion in the U.S. markets during that time period. A report prepared for the Commission on China’s fundraising activities in the U.S. equity markets concludes that Chinese firms raised approximately \$14.6 billion through IPOs in U.S. capital markets from 1999-2001, representing 73 percent of the \$20 billion Chinese firms raised in total through overseas IPOs during that time period.”
- ▶ “The Chinese Government’s bond offerings, which have been purchased by U.S. institutional and other investors, provide scant detail on the use of the proceeds raised from such offerings.”<sup>35</sup>
- ▶ “The presence of Chinese debt and equity offerings in the U.S. capital markets raises U.S. national security concerns that have not been adequately examined to date. The Commission is concerned about the identities and nature of the Chinese companies accessing the U.S. capital markets. Specifically, the extent to which they have ties to the People’s Liberation Army or components of China’s defense industry, intelligence services, or are assisting in the proliferation of weapons of mass destruction ballistic missile delivery systems.<sup>36</sup> The Commission is also concerned with those entities operating in U.S.-sanctioned countries, or are otherwise engaged in activities inimical to U.S. interests.”
- ▶ “The PRC is using U.S. capital markets as a source of central government funding for military and commercial development and as a means of cloaking U.S. technology acquisition efforts by its front companies with a patina of regularity and respectability.”
- ▶ “Overlaying these specific concerns is the issue of Chinese sovereign debt issuances. Since China’s bond prospectuses generally provide little detail as to how the proceeds will be spent, the significant monies raised by these offerings could be finding their way into military spending and other activities that are harmful to U.S. security interests. Because money is fungible, funds raised by China from its general-purpose bonds are

---

<sup>35</sup> This specific finding would appear to be at odds with the explicit message of the February 17, 2004 full-page display advertisement in the *Wall Street Journal* by Morgan Stanley, entitled “Look Out World, Here We Come”, which aggressively touts the profits to be made in Chinese stocks. See also the recent quarter-page display advertisement in the *Wall Street Journal* by Fred Alger & Company, Inc., distributor of the China Growth Fund, entitled “The Bull. The Bear. And Now The Dragon”. This advertisement references China’s \$1.3 trillion GDP (2003) and China’s no. 2 global ranking for purchasing power as reasons to invest in Chinese securities.

<sup>36</sup> See also the recent public statement: “The bond market is going to become the principal funding agency for the proliferation of weapons of mass destruction in the twenty-first century” (statement by the Honorable Roger W. Robinson, Jr., former Senior Director of International Economic Affairs at the National Security Council and presently Commissioner and Vice Chairman of the U.S.–China Economic and Security Review Commission). For an additional example, “Chinese-made missiles capable of penetrating an M1 Abrams tank are being smuggled into Iraq.” *Newsweek*. February 16, 2004 (page 33).

just as useful for military and other security-related purposes as funds raised by a PLA-affiliated company.”

- ▶ “The Commission is concerned about the use of the U.S. capital markets as a source of funding for the Chinese military and intelligence services and for Chinese companies assisting in the proliferation of weapons of mass destruction or ballistic missile delivery systems. This activity not only poses direct security concerns, but raises issues regarding investor transparency and material risk as well. Given this dynamic, the Commission is troubled that neither the U.S. Government nor the U.S. investment community is adequately evaluating security-related risks related to China’s fundraising in the U.S. capital markets.”

The foregoing conclusions by a bipartisan congressional investigative commission are indicative of the seriousness of the implications regarding inadequate disclosure of risk by Chinese securities issuers including the Chinese Government. Past defaults by the Chinese Government remain outstanding and unresolved. The present practices engaged in by the major credit rating agencies and the bond underwriters pursuant to the offer and sale of newly-issued debt obligations of the Chinese Government pose a significant risk to the investing public.

Thank you for allowing us to express our concerns regarding the grave dangers to the investing public posed by the situation described herein, and to seek your assistance in resolving this matter including restrictions on the offer, sale and trading of recent and newly-issued sovereign bonds of the People’s Republic of China until such time as the concerns addressed in this Complaint have been resolved and the appropriate debt rating classifications have been assigned. If I may answer any questions or provide the Division of Market Regulation with additional information, please do not hesitate to contact me directly at (520) 615-4525. Ms. Jonna Z. Bianco, the President of the American Bondholders Foundation, may be contacted at (931) 359-8781.

Sincerely,

Kevin O’Brien  
President  
KO:jwc

cc: United States House of Representatives Banking and Finance Committee  
United States House of Representatives Judiciary Committee  
United States House of Representatives Appropriations Committee  
United States Senate Banking and Finance Committee  
United States Senate Judiciary Committee  
United States Senate Appropriations Committee  
National Association of State Securities Commissioners  
National Association of State Insurance Supervisors  
National Association of State Attorney Generals  
National Association of State Retirement Administrators

Division of Market Regulation  
March 31, 2005  
Page Twenty

National Association of State Auditors, Comptrollers and Treasurers  
National Conference on Public Employee Retirement Systems  
National Conference of State Legislators  
National Council on Teacher Retirement  
Mr. David Brown, Investor Protection and Securities Bureau Chief, New York State  
Department of Law Office of the Attorney General  
Mr. John Petty, President, Foreign Bondholders Protective Council Inc.  
Ms. Jonna Z. Bianco, President, American Bondholders Foundation