

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

4901 E. Sunrise Drive • Suite 711  
Tucson • Arizona • 85718

Tel (USA): 520.327.2482 • Fax: 520.322.9850  
Email: [info@sov-advisers.com](mailto:info@sov-advisers.com)  
Website: <http://www.sov-advisers.com>

September 1, 2006

Mr. Brian G. Cartwright, General Counsel  
Office of the General Counsel

Ms. Linda Thomsen, Director  
Division of Enforcement

Mr. John W. White, Director  
Division of Corporation Finance

United States Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Re: Recent actions evidencing failure to comply with disclosure obligations of registered sovereign issuers under the federal securities laws of the United States in respect to the offer, sale and trading of sovereign debt securities of the People's Republic of China: violations of Rule 10b-5 and Section 10(b) of the Exchange Act.

Dear Mr. Cartwright, Ms. Thomson and Mr. White:

We respectfully write to your attention concerning the matter of the defaulted sovereign debt of the Government of China as this matter pertains to the disclosure requirements affecting recent, as well as future, offers, sales and trading of debt securities of the Government of China and its state-owned enterprises within the United States.<sup>1</sup>

In the United States, the disclosure obligations for registered sovereign issuances are governed by the Securities and Exchange Commission's Schedule B, which affirmatively requires only minimal disclosure including pricing, payments schedule, and volume. However, an affirmative obligation by registered sovereign issuers to speak with respect to additional disclosure does exist in that statements made in connection with an offering of securities, although literally true, may not be misleading through their incompleteness as specified by Rule 10b-5 and Section 10(b) of

---

<sup>1</sup> Please refer to the complaint dated March 31, 2005 filed with the SEC Division of Market Regulation describing the wrongful actions of the underwriters of recent offerings of debt securities of the Government of China and the credit rating agencies in the matter of selectively ignoring the full faith and credit sovereign debt of the Government of China presently existing unpaid and in a state of default: (<http://www.globalsecuritieswatch.org/SEC.pdf>). The complaint was subsequently the subject of a comprehensive internal review by the SEC at the request of numerous members of the United States Congress: (<http://www.globalsecuritieswatch.org/congress.html>). See also the letter dated May 24, 2005 addressed to the SEC Chairman by the Honorable Jim Saxton, Chairman of the Joint Economic Committee: ([http://www.globalsecuritieswatch.org/chairman\\_saxton\\_demand\\_for\\_investigation.pdf](http://www.globalsecuritieswatch.org/chairman_saxton_demand_for_investigation.pdf)). We are informed that the facts and circumstances described in the complaint were influential in the recent passage of legislation (HR 2990) reforming federal regulatory oversight of the credit rating agencies.

the Exchange Act.<sup>2</sup> Under Rule 10b-5 and Section 10(b) of the Exchange Act, a duty is imposed upon an issuer to refrain from disclosing materially incomplete statements (i.e., the prohibition against "half-truths").

Accordingly, a source of a sovereign's obligation to disclose additional risks in the offering documents arises from additional disclosure which the sovereign volunteers. In the event that a registered sovereign issuer may elect to provide additional disclosure beyond the requirements imposed by SEC Schedule B, such statements must constitute full and complete disclosure and not be misleading through their incompleteness. Under Rule 10b-5, statements that are literally true can create liability if they create a materially misleading interpretation because they omit some key fact (or, in other words, are "half-truths"). The duty not to make "half-truths" under Rule 10b-5 applies to both registered and non-registered sovereign bond issuances.

We refer now to the inadequate disclosure contained in the prospectus dated October 16, 2003 and in the prospectus supplement dated October 22, 2003 pertaining to the registered offering, sale and issuance of sovereign obligations of the People's Republic of China, and offer several obvious examples of disclosure obligations required by Rule 10b-5 and Section 10(b) of the Exchange Act which are omitted from mention in the above offering document.<sup>3</sup>

Examples of failures to fully disclose key facts, constituting violations of Rule 10b-5 and Section 10(b) of the Exchange Act:

1. Voluntary Disclosure: Debt Record (page 69 of the prospectus) –

"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."

Omission: This statement is misleading to offerees and prospective purchasers. Both the prospectus and the prospectus supplement intentionally omit any mention 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 while continuing to evade the claims of American bondholders.

---

<sup>2</sup> The lack of meaningful affirmative disclosure obligations in the Schedule B context, elevates the importance of the obligation not to speak in "half-truths". See James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Competition*, L. & Contemp. Problems, Autumn 1992, at 177, 192-193 (cited at 13, *An Empirical Study of Securities Disclosure Practices*, authored by Mitu Gulati and Stephen Choi, Duke Law School Working Paper, 2006).

<sup>3</sup> Registration no. 333-108727. (ISIN US712219AJ30 / CUSIP 712219AJ3). See prospectus dated October 16, 2003 and the prospectus supplement dated October 22, 2003: (<http://www.sec.gov/Archives/edgar/data/909321/000114554903001347/u98681p1e424b5.htm>).

As we have previously described, neither the prospectus nor the prospectus supplement contain any mention whatsoever regarding the existence of defaulted full faith and credit sovereign debt of the Government of China which remains unpaid in a state of default, and for which the People's Republic of China is liable for repayment under settled international law as the internationally-recognized successor government of China, and which government continues to engage in actions evidencing both selective default and discriminatory settlement under settled international law.<sup>4</sup> Such actions act to create the risk of seizure of proceeds of any securities offering by the Government of China or any of its state owned enterprises and also act to expose purchasers of sovereign obligations issued by the People's Republic of China to the risk of injunctions preventing discriminatory payments to such purchasers.

2. Voluntary Disclosure: External Debt (page 67 of the prospectus) – Note: this section contains extensive narrative and numerous schedules referencing the outstanding obligations and external debt of the Government of China. No mention is made regarding the existence of defaulted sovereign debt of the Government of China. An excerpt of this section appears below:

“Loans are the primary source of external debt. Non-trade loans accounted for approximately 84.4% of the total external debt outstanding at December 31, 2002. Commercial loans (i.e., loans obtained from any source on commercial terms), official primary government loans (i.e., loans obtained on favorable terms from foreign governments and international financial organizations including the World Bank and Asian Development Bank) and other types of debt financing accounted for approximately 53.5%, 30.9% and 15.6%, respectively, of total external debt in the form of loans at December 31, 2002. The central government's current policy is to continue to

---

<sup>4</sup> The U.S. registration statement including the prospectus and prospectus supplement pertaining to the 2003 sovereign bond offering and sale by the People's Republic of China was prepared by the U.S. law firm of Sidley Austin Brown & Wood LLP. We note that this is the same law firm that, through its predecessor firm of Brown & Wood LLP, admitted to orchestrating an artifice which was then operated as a knowingly fraudulent tax shelter scheme and which defrauded the U.S. Treasury out of an estimated \$2.5 billion in tax revenues, and which firm then agreed to make a \$40 million payment to settle a civil class action lawsuit for tax shelter fraud in connection with the very recent KPMG case. This settlement is in addition to separate actions brought by the U.S. Department of Justice and the Internal Revenue Service in the largest criminal tax case ever. Sidley Austin was also the subject of a special inquiry conducted by the Senate Permanent Subcommittee on Investigations. Apparently, this law firm not only engineered the fraudulent tax shelter scheme, but also issued a knowingly fraudulent tax opinion to support the massive multi-billion dollar scheme. We note that Sidley Austin also concealed the fact of a public hearing entitled, “U.S.-China Ties: Reassessing the Economic Relationship” conducted by the House Committee on International Relations, which invited and did include testimony pertaining to the existence of defaulted sovereign debt of the Government of China, and which occurred prior to the date of the 2003 prospectus supplement. We further note the fact that Sidley Austin concealed the existence of a House Concurrent Resolution (“H.Con.Res.60”) in the United States Congress which specifically referenced the existence of the defaulted sovereign debt of the Government of China. We also note that subsequent to the receipt of constructive notice provided by the letter prepared by the law firm of Stites & Harbison dated December 31, 2003, that Sidley Austin failed to take any action to amend the 2003 U.S. registration statement and prospectus. Such failure evidences the application of a reckless standard of care.

seek loans from foreign governments and international financial institutions to finance infrastructure projects in China. At the end of 2002, the total outstanding external debt was US\$168.5 billion."

"The Ministry of Finance, on behalf of the central government, has raised funds in the international capital markets through various debt securities and bond issues since 1993. The Ministry of Finance's principal objective is to set up benchmarks for other Chinese borrowers. Several state-owned financial institutions and enterprises have also issued debt securities in the international capital markets with the approval of the State Council."

"Unless the central government expressly provides otherwise, the central government does not guarantee or provide any direct or indirect credit support to any entity in China. However, debtors that have their external debt registered with the State Administration of Foreign Exchange have the right to buy foreign currencies as permitted by the central government at the China Foreign Exchange Trading System rate in order to service the interest and principal payments on their registered external debt."

Omission: The language of this section intentionally conceals the existence of a significant liability of the People's Republic of China under the successor government doctrine of settled international law espousing continuity of obligations. The failure to disclose the existence of the defaulted sovereign debt of the Government of China and the existence of a defaulted class of creditors also exposes purchasers of the offered obligations to the risk of judicial and other actions brought by the class of defaulted creditors, the existence of which remains undisclosed, and whose actions to recover payment on the defaulted obligations would reasonably be considered to be adverse to the interests of purchasers of newly-offered obligations. The concealment of the defaulted sovereign debt of the Government of China also acts to intentionally deceive prospective purchasers as to the actual risk of non-repayment inherent to the actions of the Government of China towards its defaulted creditors and the refusal to honor repayment of its outstanding defaulted sovereign debt.

3. Voluntary Disclosure: Recent Developments (page S-6 of prospectus supplement) --

"The credit ratings accorded to China's debt securities by the rating agencies are not recommendations to purchase, hold or sell the notes to the extent such ratings do not comment as to market price or suitability for you. Any rating may not remain in effect for any given period of time or may be revised or withdrawn entirely by a rating agency in the future if in its judgment circumstances so warrant, and if any such rating is so revised or withdrawn, we are under no obligation to update this prospectus supplement. On 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. On October 22, 2003, Standard & Poor's Ratings Group affirmed its BBB senior unsecured foreign currency credit rating for China. The outlook is positive. On October 13, 2003, Fitch IBCA, Inc. 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."

Omission: Any mention of the specific risks to purchasers arising as a result of the suspension of the sovereign credit rating of the Government of China owing to a credible and reasonably foreseeable threat of litigation seeking recovery of payment on the defaulted sovereign debt of the Government of China. Although the language of this section of the prospectus supplement does acknowledge the generic possibility of the withdrawal of the sovereign credit rating of the Government of China, the language fails to disclose the existence of known facts evidencing the falsity of the prevailing sovereign credit rating classifications assigned to the Government of China by Standard and Poor's Ratings Service, Moody's Investors Service, and Fitch Ratings and the attendant prospect for litigation in this regard.<sup>5</sup> The generic risk disclosure language offered in this section fails to fully disclose the existence of the actual and known specific risks attributable to the failure to disclose the existence of the defaulted sovereign debt of the Government of China, and which risks would reasonably be expected and foreseeable to cause the occurrence of suspension of the sovereign ratings assigned to the Government of China (i.e., the risk that suspension may occur as a result of an action brought in the future against the credit rating agencies by defaulted creditors of the Government of China). Such actions brought by defaulted creditors would reasonably be expected to include recovery of damages sustained as a consequence of a tort injury (e.g., the "taking" of the defaulted creditors' ability to enforce the debt contract occurring as a direct consequence of the intentional assignment of a knowingly fraudulent credit rating classification to the Government of China).

4. Voluntary Disclosure: General Information (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."

Omission: At the time of the dates appearing on the prospectus and the prospectus supplement, there existed a reasonably anticipated prospect for litigation in the form of a judicial action for recovery of repayment of the defaulted sovereign debt of the Government of China, including imposition of injunctions and restraining orders acting to adversely affect the flow of payments to selected classes of creditors, halt trading in affected securities, and the possible seizure of offering proceeds or interest payments by defaulted creditors.

---

<sup>5</sup> The three Nationally Recognized Statistical Rating Organizations named above command a dominant position of the rating business, comprising a 94% market share.

The American Bondholders Foundation, comprising a large group of affiliated U.S. persons holding defaulted sovereign debt of the Government of China, was organized in early 2001 to consolidate the claims of defaulted creditors of the Government of China and was actively engaged along with other parties in both the United States as well as outside the United States, in efforts, including possible judicial action(s), to recover repayment of the defaulted full faith and credit sovereign debt of the Government of China prior to, at the time of, and subsequent to the dates of the prospectus and prospectus supplement, and remains actively engaged in such recovery efforts at present. Such efforts, which were widely publicized at the time and so should have been known to the parties responsible for preparing the prospectus and the prospectus supplement, would have been reasonably anticipated as of the dates of the prospectus and the prospectus supplement to produce judicial and other action(s) affecting various creditors of the Government of China, including purchasers of the 2003 sovereign bond offering.<sup>6</sup>

The language of this section completely fails to disclose not only the risks to purchasers of litigation in connection with recovery of the defaulted sovereign debt of the Government of China, but also fails to disclose the engagement of the United States Congress on behalf of the interests of the defaulted class of U.S. creditors of the Government of China, and the reasonably foreseeable and highly potential prospect of political and legislative action(s) by the United States Congress to enforce fair trade and commerce practices and which may adversely affect both the liquidity and the market price of sovereign bonds issued by the Government of China on which that government selectively honors payment while refusing to honor payment to its defaulted creditors in violation of both settled international law and the established *pari passu* legal doctrine prohibiting discriminatory payments among creditors.<sup>7</sup> We have previously noted that public testimony was provided at a public hearing prior to the date of the prospectus supplement before the House International Relations Committee on October 21, 2003 describing the very pertinent issue of the unpaid full faith and credit sovereign debt of the Government of China existing in a state of default, as the Government of China continues

---

<sup>6</sup> See news article entitled, *U.S. Holders of Pre-1949 China Bonds Sue Rating Agencies*. EuroWeek (July 21, 2006). See also, the letter prepared by Sovereign Advisers addressed to the McGraw-Hill Companies dated May 18, 2006, providing constructive notice of the taking of defaulted creditors' ability to enforce collection of the defaulted sovereign debt of the Government of China as a result of the intentional application of a reckless standard of care in developing the previous as well as the prevailing sovereign credit rating classifications assigned to the long-term foreign currency debt of the Government of China and which wrongful practices enabled the Government of China to resume international financing while avoiding repayment of the Government of China's defaulted sovereign debt. Identical versions of this letter were also delivered to Moody's Investors Service and Fitch Ratings, providing each firm with constructive notice.

<sup>7</sup> See information describing the effect on holders of sovereign debt as a result of the Belgian Court's decision in *Elliott Associates*, as well as letters from members of the United States Congress endorsing regulatory enforcement relating to matters pertinent to full disclosure and recovery of repayment of the defaulted full faith and credit sovereign debt of the Government of China: (<http://www.globalsecuritieswatch.org>).

to evade repayment to defaulted creditors through actions evidencing a pattern of selective default and discriminatory settlement.<sup>8</sup>

In particular regard to litigation disclosure, please note the existence of at least one civil lawsuit against the Government of China which is presently pending in the U.S. District Court for the Southern District of New York comprising a judicial action for recovery of repayment on the defaulted sovereign debt of the Government of China.<sup>9</sup> The occurrence of this action was reasonably foreseeable in October 2003, and the attendant risks to investors in newly-offered debt securities of the Government of China were not disclosed to the investing public which relied on the 2003 prospectus and prospectus supplement, many of whom may have been induced to purchase the offered securities owing to concealment of both the existence of the full faith and credit sovereign debt of the Government of China which remains unpaid in a state of default, as well as the attendant risks posed by this fact, including recent actions evidencing both selective default and discriminatory settlement by the Government of China.<sup>10</sup>

Please be advised that regardless of the ultimate disposition of the specific instance referenced in this section (i.e., *Marvin L. Morris vs. People's Republic of China*), we expect additional parallel and derivative actions to subsequently occur as a result of this action. The continuing evasion by the Government of China as respects repayment of its defaulted sovereign debt necessitates the aggressive prosecution of judicial actions for recovery. We anticipate the filing of additional civil suits by various parties seeking recovery of the defaulted sovereign debt of the Government of China in both U.S. courts and in various foreign jurisdictions as well. We also anticipate the imminent filing of numerous petitions requesting the grant of injunctions and restraining orders both in the United States and abroad pursuant to a concerted recovery action to collect repayment of this debt.

---

<sup>8</sup> See transcript of testimony provided at the public hearing conducted by the House Committee on International Relations on October 21, 2003 entitled, "U.S.-China Ties: Reassessing the Economic Relationship": ([http://www.house.gov/International\\_Relations/108/bian2021.htm](http://www.house.gov/International_Relations/108/bian2021.htm)). This publicly televised testimony was presented to members of the House Committee on International Relations prior to the date of the prospectus supplement (October 22, 2003), yet the circumstances described in the Congressional testimony were intentionally and wrongfully omitted from disclosure in both the prospectus and the prospectus supplement. Both the prospectus and the prospectus supplement noticeably fail to disclose any reference to, or mention of, the letter sent by the law firm of Stites & Harbison PLLC to the Ministry of Finance of the People's Republic of China demanding payment of the claims of defaulted U.S. creditors of the Government of China (copy enclosed).

<sup>9</sup> See *Marvin L. Morris, Jr. vs. People's Republic of China* (05 CIV 4470) presently pending in the U.S. District Court for the Southern District of New York: ([http://www.globalsecuritieswatch.org/civil\\_complaint.pdf](http://www.globalsecuritieswatch.org/civil_complaint.pdf)).

<sup>10</sup> The Government of China continues to ignore the claims of U.S. bondholders who are victims of both selective default and discriminatory settlement by the Government of China (see the 1987 treaty with Great Britain which settled the claims of British bondholders), which continues to attempt to evade repayment in flagrant violation of accepted conventions of international trade and commerce including rejection of the successor government doctrine of settled international law.

Accordingly, the grant of such injunctions and restraining orders may reasonably be expected to include any of the following on either a pre-judgment or post-judgment basis:

1. Injunction(s) enjoining and prohibiting the offer or sale of securities of the Government of China or any of its state-owned enterprises;
2. Injunction(s) enjoining and prohibiting the transmittal of any proceeds derived from any securities offering by the Government of China or any of its state-owned enterprises;<sup>11</sup>
3. Injunction(s) enjoining and prohibiting the Government of China from making discriminatory payments to other creditors in circumvention of payments to defaulted creditors;<sup>12</sup>
4. Injunction(s) enjoining and suspending publication of the sovereign credit rating assigned to the Government of China;<sup>13</sup>
5. Injunction(s) enjoining and suspending trading activities involving any securities of the Government of China or any of its state-owned enterprises; and
6. Enforcement of judgments attaching commercial assets of the Government of China, including the seizure of proceeds from the offer and sale of securities.

The potential for such actions poses material risks to investors holding outstanding obligations of the Government of China which that government selectively honors and on which the Government of China continues to make discriminatory payments, as well as to investors in future debt securities issued by the Government of China.

In light of the voluntary disclosures contained in the 2003 prospectus and the prospectus supplement, the intentional omissions of the "full and complete story" (including material facts and attendant risk factors) constitute violations of Rule 10b-5 and Section 10(b) of the Exchange Act.

In the absence of proactive regulatory enforcement mandating full and complete disclosure as required by Rule 10b-5 and Section 10(b) of the Exchange Act, we are concerned that investors who have purchased previous debt securities issued by the Government of China, as well as investors solicited for future offerings of debt securities issued by the Government of China or its state-owned enterprises, may in light of the inadequate disclosure offered in connection with such offerings and sale, constitute induced purchasers whom have not been fully apprised of the attendant risks associated with any investment in such securities. We are therefore confident that the Commission will act promptly to ensure full compliance with the disclosure obligation imposed by the federal securities laws, and specifically Rule 10b-5 and Section 10(b) of the Exchange Act, in connection with future registered offerings in the United States by the Government of China and its state-owned enterprises.

---

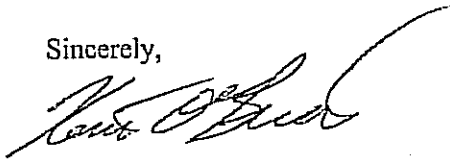
<sup>11</sup> An example would be a grant of injunction either preventing any public offering(s) of securities of a bank owned by the Government of China or preventing the inter-jurisdictional transfer of any proceeds of such securities offering(s) to the Government of China or any of its state-owned enterprises.

<sup>12</sup> See Elliott Associates, L.P., General Docket no. 2000/QR/92 (Court of Appeals of Brussels, 8<sup>th</sup> Chamber, Sept. 26, 2000). The Court granted Elliott's *ex parte* petition for a restraining order against Euroclear.

<sup>13</sup> Please refer to copy of letter dated May 18, 2006 addressed to Mr. Harold McGraw III, Chairman of the McGraw-Hill Companies (copy enclosed).



Sincerely,



Kevin O'Brien  
President

KO:jwc

- Enclosures:
1. Copy of letter prepared by the law firm of Stites & Harbison PLLC addressed to the Ministry of Finance of the People's Republic of China dated February 5, 2002, evidencing a demand for payment of the defaulted full faith and credit sovereign debt of the Government of China held by United States bondholders.
  2. Copy of letter prepared by the law firm of Stites & Harbison PLLC addressed to the United States Securities and Exchange Commission dated January 8, 2003, providing notice to the primary regulatory agency of the United States Government responsible for enforcement of the federal securities laws regarding inadequacy of disclosure referencing undisclosed risk factors pertinent to compliance with the disclosure obligation of Chinese Government issuers engaging in U.S.-registered securities offerings.
  3. Copy of letter prepared by the law firm of Stites & Harbison PLLC addressed to the law firm of Sidley Austin Brown & Wood LLP dated December 31, 2003, providing constructive notice of the existence of full faith and credit sovereign debt of the Government of China which presently remains unpaid in a state of default, and including a schedule referencing such debt, prepared by the Foreign Bondholders Protective Council.
  4. Copy of letter prepared by Sovereign Advisers addressed to the McGraw-Hill Companies dated May 18, 2006, providing constructive notice of the taking of defaulted creditors' ability to enforce collection of the defaulted sovereign debt of the Government of China as a result of the intentional application of a reckless standard of care in developing the previous as well as the prevailing sovereign credit rating classifications assigned to the long-term foreign currency debt of the Government of China and which wrongful practices enabled the Government of China to resume international financing while avoiding repayment of the Government of China's defaulted sovereign debt. Identical versions of this letter were also delivered to Moody's Investors Service and Fitch Ratings, providing each firm with constructive notice.

cc: Members of the 109<sup>th</sup> United States Congress

Honorable F. James Sensenbrenner, Jr., Chair  
U.S. House of Representatives Committee on the Judiciary

Honorable Sue Kelly, Chair  
U.S. House of Representatives Subcommittee on Oversight and Investigations

Honorable Norm Coleman, Chair  
Senate Permanent Subcommittee on Investigations

Honorable Michael J. Garcia  
United States Attorney for the Southern District of New York

Honorable Eliot Spitzer  
Attorney General for the State of New York

Honorable Robert M. Morgenthau  
New York County District Attorney for the District of Manhattan

Mr. Russ Iuculano, Executive Director  
North American Securities Administrators Association

Mr. Thurbert E. Baker, President  
National Association of Attorneys General

Mr. Eddy Wymeersch, Chairman  
Committee of European Securities Regulators

[57 Foreign Securities Commissions]

Mr. Ronald Scott Moss, Esq.  
Moss & Associates, P.C.

Mr. John Petty, President  
Foreign Bondholders Protective Council

Ms. Jonna Bianco, President  
American Bondholders Foundation