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LAW AND PRACTICE UNDER RULE 102(E)

Rule 102(e) authorizes the SEC to discipline professionals if the Commission finds that they have engaged in "improper professional conduct," among other grounds. The authors discuss the background of the rule, the persons subject to it, the standards for professional conduct, and the procedures in matters requiring notice and hearing. They then report on their survey of some 48 Commission disciplinary cases brought against 64 respondents since January 1, 2014. They close by noting that in certain cases the SEC may proceed with discipline without notice or hearing.

By Gregory G. Ballard, Kevin A. Burke, and Neil D. Corcoran *

Rule 102(e), which allows the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") to censure, suspend, or disbar any person for violating certain standards of conduct in practicing before the Commission, marks its 80th birthday this year.[1] The rule, contained in the agency's Rules of Practice, has experienced a turbulent history, with alternating periods of infrequent use and aggressive enforcement, accompanied by criticisms and significant amendments. This article examines the history and current law governing actions brought by the Commission pursuant to Rule 102(e), as well as trends and key issues faced by practitioners who defend accountants and attorneys charged with violating the rule.

BACKGROUND

Promulgated for the purpose of providing a means for the Commission to protect the integrity of its own processes, Rule 102(e) in its current version affords the Commission broad power, in certain circumstances, to regulate the conduct of professionals, including accountants and attorneys, "to ensure that th[ose] professionals on whom it relies 'perform their tasks diligently and with a reasonable degree of competence.'"[2] Although Rule 102(e) applies on its face

[1] In 1935, shortly after it was created, the SEC promulgated its Rules of Practice, including Rule 2(e) which would eventually be rechristened as Rule 102(e). *Touche Ross & Co. v. SEC*, 609 F.2d 570, 578 n.13 (2d Cir. 1979).

[2] *Marrie v. SEC*, 374 F.3d 1196, 1200 (D.D.C. 2004) (quoting *Touche*, 609 F.2d at 582)).

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IN THIS ISSUE

● ***LAW AND PRACTICE UNDER RULE 102(e)***

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to "any person," and specifically references "attorney[s] . . . accountant[s], engineer[s] or other expert[s],"[3] the rule is generally applied to attorneys and accountants.

The Commission's use of the rule has changed significantly over time. Used only sparingly during the first half of its life,[4] Rule 102(e) took on increased significance during the 1970's and 1980's when the Commission brought "wave-upon-wave" of actions against deemed "gatekeepers" to the capital markets, including securities professionals, accountants, and lawyers.[5] One commentator colorfully described this era as a "'reign of terror' on broker-dealers, accountants, and attorneys."[6] This escalation sparked significant debate and criticism due to the severity of the sanctions, the relatively limited procedural protections, uncertainty over the rule's statutory authority, and the vagueness of the standard for "improper professional conduct."[7] Respondents enjoyed some success in countering the aggressive enforcement efforts under the rule.[8]

Some of these issues have been resolved. Questions over the rule's statutory authority, for example, were largely addressed by the appellate courts and Congress. The Second Circuit rejected an argument that the SEC lacked authority to enact the rule, holding that while "there is no express statutory provision authorizing the Commission to discipline professionals appearing before it," Rule 102(e) – promulgated pursuant to its statutory rulemaking authority – represents an attempt by the Commission to protect the integrity of its own processes and "[a]s such the Rule is 'reasonably related" to the purposes of the securities laws."[9] The Court noted further that the "Commission's authority to discipline professionals has long been distinguished from the execution of its substantive enforcement functions."[10] Other Circuits subsequently adopted this position.[11] Thereafter, as part of the Sarbanes-Oxley Act of 2002, Congress incorporated language nearly identical to Rule 102(e)(1)(ii) into Section 4C of the Securities Exchange Act of 1934.[12] Similarly, complaints regarding the vagueness of the standard for "improper professional conduct" raised by commentators as well as courts, most notably in *Checkosky I*[13] and *Checkosky II*,[14] have been addressed by subsequent amendments to the rule (discussed below). However, professionals continue to face the threat of potentially career-ending sanctions that can appear to be out of proportion to the conduct alleged, and criticisms persist regarding the lack of procedural safeguards in the administrative context.[15]

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[3] 17 C.F.R. § 201.102(e)(1) and (2).

[4] Rel. No. 33-7593 (1998) (Johnson, N., dissenting).

[5] Rel. No. 33-7593 (1998) (Johnson, N., dissenting) (citing Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 Yale J. on Reg. 149, 171-74 (1990)).

[6] Rel. No. 33-7593 (1998) (Johnson, N., dissenting) (citing Dennis J. Block & Jonathan M. Hoff, *SEC Moves Against Attorneys Under the Remedies Act*, N.Y.L.J., Sept. 23, 1993).

[7] *See*, *e.g.*, Harold Marsh, Jr., *Rule 2(e) Proceedings*, 35 Bus. Law. 987, 996 (1980); Robert A. Downing & Richard L. Miller, Jr., *The Distortion and Misuse of Rule 2(e)*, 54 Notre Dame L. Rev. 774, 782 (1979).

[8] *Checkosky v. SEC*, 139 F.3d 221, 226 (D.C. Cir. 1998) (*Checkosky II*) (concluding there were "'strong signs' that the Commission was unlikely to provide a uniform theory 'anytime soon'" as to the intended scope of the rule's coverage).

[9] *Touche*, 609 F.2d at 582.

[10] *Marrie*, 374 F.3d at 1205.

[11] *Sheldon v. SEC*, 45 F.3d 1515, 1518 (11th Cir. 1995); *Davy v. SEC*, 792 F.2d 1418, 1421 (9th Cir. 1986); *Checkosky v. SEC*, 23 F.3d 452, 455-56 (D.C. Cir. 1994).

[12] *Compare* 15 U.S.C. § 78d-3(a)(2) *with* 17 C.F.R. § 201.102(e)(1)(ii); s*ee C.F.T.C. v. Schor*, 478 U.S. 833, 846 (1986) ("It is well established that when Congress revisits a statute giving rise to a longstanding administrative interpretation without pertinent change, the 'congressional failure to revise or repeal the agency's interpretation is persuasive evidence that the interpretation is the one intended by Congress.") (quoting *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 274-75 (1974)).

[13] *Checkosky I*, 23 F.3d at 454.

[14] *Checkosky II*, 139 F.3d at 222.

[15] *See*, *e.g.*, Hon. Jed S. Rakoff, PLI Secs. Reg. Inst. Keynote Address: Is the SEC Becoming a Law Unto Itself? (Nov. 5,

WHO IS SUBJECT TO RULE 102

In its current form, Rule 102(e) authorizes the Commission to "deny, temporarily or permanently, the privilege of appearing or practicing before [the Commission] in any way."[16] The Commission has adopted a broad definition of what constitutes "practicing before the Commission." As defined by Rule 102(f), "practicing before the Commission" means "transacting any business with the Commission," and includes the preparation of "any statement, opinion, or other paper by any attorney, accountant, engineer, or other professional, or expert, filed with the Commission in any registration statement, notification, application, report, or other document with the consent of such attorney, accountant, engineer, or other professional, or expert."[17]

Practicing before the Commission may encompass the direct participation by accountants and attorneys in the substantive preparation of documents or reports filed with the Commission such as registration statements, or periodic filings such as annual reports on Form 10-K or quarterly reports on Form 10-Q.[18] This is true whether or not the person signs or is named as having participated in the preparation of the document.[19] It also may include the provision of written or oral advice concerning any such filing or anything relating to federal securities laws.[20]

What constitutes "practicing" before the Commission has been construed broadly by courts and focuses on the actual duties and conduct of an individual rather than, for example, an employment title. The recent decisions in *Prince* and *Brown* are instructive.[21] Both decisions involve Gary Prince, the former CFO of a satellite company. After pleading guilty to two counts of federal securities law violations in federal district court, Prince was barred from practicing before the Commission as an accountant pursuant to Rule 102(e). The satellite company subsequently rehired Prince in a new, full-time, non-officer, purportedly non-accounting role with restricted authority and a focus on mergers and acquisitions. In that capacity, however, Prince not only reviewed and commented on drafts of the company's public filings, including Form 10-Ks and 10-Qs, but occasionally drafted the sections concerning mergers and acquisitions. He also admitted to having discussed those sections of the financial statements with members of the company's accounting staff. Notably, most of this involvement occurred during a brief period when Prince pitched in to assist while a colleague was on maternity leave. In a subsequent action by the Division of Enforcement against Prince asserting additional violations of federal securities laws, the D.C. District Court found that Prince's conduct had violated the Commission's order banning him from practicing before the Commission, and issued a permanent injunction. The court found that his conduct – particularly with respect to two e-mails he sent while his colleague was on maternity leave and in which he recommended how a particular reserve should be taken and recorded in the 10-K – constituted "practicing" before the Commission because it determined "how particular data should be treated in the financial statements."[22]

SUSPENSION OR DISBARMENT AFTER NOTICE AND HEARING

The Commission may only discipline an individual under Rule 102(e)(1) if that individual is afforded "notice and opportunity for hearing in the matter."[23]

footnote continued from previous page…

2014)(noting unfair aspects of administrative proceedings). On the other hand, at least one Commissioner has expressed the view that the Commission has been too lenient in settlements. In a much-publicized dissent from the Commission's decision to accept a settlement offer from the former CFO of Affiliated Computer Systems, Commissioner Louis Aguilar strongly rebuked the Division of Enforcement for not seeking stiffer penalties and went on to discuss the enforcement program more broadly. He wrote: "Beyond this particular matter, I am concerned that the Commission is entering into a practice of accepting settlements without appropriately charging fraud and imposing Rule 102(e) suspensions against accountants in financial reporting and disclosure cases." Louis A. Aguilar, *Dissenting Statement in the Matter of Lynn R. Blodgett and Kevin R. Kyser* (Aug. 28, 2014), *available at* http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370542787855.

[16] 17 C.F.R. § 201.102(e)(1).

[17] 17 C.F.R. § 201.102(f).

[18] Marsh, 35 Bus. Law. at 994.

[19] *Id*.

[20] *Id*.

[21] *SEC v. Brown*, 878 F.Supp.2d 109, 127 (D.D.C. 2012) (denying the motions for summary judgment filed by Prince and other defendants); *SEC v. Prince*, 942 F.Supp.2d 108, 154 (D.D.C. 2013) (judgment against Prince after bench trial).

[22] *Prince*, 942 F.Supp.2d at 150.

[23] 17 C.F.R. § 201.102(e)(1).

Rule 102(e)(1) authorizes the Commission to censure or suspend a person – temporarily or permanently – from practicing before it after notice and opportunity for three types of conduct:

(i) failing to possess the requisite qualifications to represent others;

(ii) lacking character or integrity, or having engaged in unethical or improper professional conduct; and

(iii) willfully violating, or willfully aiding and abetting the violation of, any provision of the federal securities laws, or the rules or regulations.[24]

Lacking Requisite Qualifications

The first ground upon which the SEC may seek to censure or suspend an individual from practicing before the Commission is lack of requisite qualifications.[25] The term "requisite qualifications" is neither defined nor explained in the text or commentary to Rule 102(e). One would imagine that it would encompass a situation in which an individual who signed an opinion letter as an accountant or attorney was not, in fact, licensed to practice as such. If and how far the term might extend beyond that situation remains unclear. The Commission has not recently relied on the provision as the basis for initiating a Rule 102(e) proceeding.[26]

Lacking Character or Integrity, or Engaging in Unethical or Improper Professional Conduct

The second ground upon which the SEC may seek to censure or suspend an individual is when a person practicing before the Commission is found to be "lacking in character or integrity," or to have engaged in "improper professional conduct."[27] Historically, enforcement efforts under the rule have focused on alleged violations predicated on respondents' "improper professional conduct."

By its terms, Rule 102(e)(1)(ii) does not establish new professional conduct standards governing accountants or lawyers.[28] Rather, the rule provides an avenue for the Commission to sanction professionals found to have engaged in improper conduct under professional conduct rules that are already in place. In this context, the relevant professional standards for accountants include Generally Accepted Accounting Principles ("GAAP"), Generally Accepted Auditing Standards ("GAAS"), and the standards promulgated by the Public Company Accounting Oversight Board (the "PCAOB").

In *Dearlove*, for example, the Division of Enforcement commenced Rule 102(e)(1) proceedings against an audit partner at an accounting firm alleging that he had violated the applicable professional standards with respect to auditing certain related-party transactions and that this constituted "improper professional conduct" sufficient to suspend him from practicing before the Commission.[29] The auditor argued that in order to demonstrate the "unreasonable" conduct necessary under the amended rule, the Division of Enforcement was required to elicit expert testimony that established something other than conduct below the standard of due professional care set forth in GAAS. The D.C. Circuit disagreed, noting that the "SEC need not establish a standard of care separate from the GAAS in order to give meaning to Rule 102(e)(1)(iv)(B)(2)."

With respect to attorneys, as discussed in *Altman*, the governing standards are the codes of professional responsibility promulgated by various national and state bar associations.[30] This is based on the reasoning that attorneys are on notice of their duty to comply with the professional rules set forth by the various bar associations to which they are members, and therefore can be held to those same duties and standards when appearing before the Commission. As the Commission has stated, it "perceives no unfairness whatsoever in holding those professionals who practice before [it] to generally recognized norms of professional conduct . . . whether or not such norms had previously been explicitly adopted or endorsed by the Commission" because "[t]o do so upsets no justifiable expectations,

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[24] 17 C.F.R. § 201.102(e)(1)(i)-(iii).

[25] 17 C.F.R. § 201.102(e)(1)(i).

[26] A review of SEC releases issued in the past three years relating to 102(e) proceedings confirms that there have been no proceedings litigated based solely on 102(e)(1)(i). *In re Hatfield*, Rel. No. 34-73763 (2014) ("There is no litigated case in which a respondent was sanctioned pursuant to Rule 102(e)(1)(i) alone."); 17 *Civil Liabilities: Enforcement & Litigation* § 2:115, n.6 (November 2014) (noting that "in the 54 Rule 102(e) proceedings reviewed for this section, none relied on Rule 102(e)(1)(i)").

[27] 17 C.F.R. § 201.102(e)(1)(ii).

[28] Rel. No. 33-7593 (1998) ("The Commission does not seek to use Rule 102(2)(1(ii) to establish new standards for the accounting profession.").

[29] *Dearlove v. SEC*, 573 F.3d 801, 803 (D.C. Cir. 2009).

[30] *Altman v. SEC*, 666 F.3d 1322, 1326-27 (D.C. Cir. 2011).

since the professional is already subject to those norms."[31] As was made clear in *Altman*, the attorney need not be subject to disciplinary action by the bar association prior to the Commission taking action pursuant to Rule 102(e).

The question of what state of mind must accompany a violation of professional standards, as noted above, had been the subject of much debate. The issue came to a head in the D.C. Circuit Court of Appeals decision in *Checkosky II*. Having remanded the case for clarification and an explanation from the Commission as to whether simple negligence could constitute a violation of the rule, and whether recklessness meant a "higher form of ordinary negligence," or a "lesser form of intent," the court determined that the Commission had failed to "articulate an intelligible standard for 'improper professional conduct'" on the part of accountants.[32] The court concluded that, in light of the "strong signs" that the Commission was unlikely to provide a uniform theory "anytime soon," the matter should be remanded with instructions to dismiss the charges.[33]

In the wake of this decision, the SEC amended Rule 102(e) to address this concern, at least as it applies to accountants, and to articulate more clearly the standard for "improper professional conduct." Under the amended definition, "improper professional conduct" can mean recklessness.[34] Specifically, the amendments added language to the rule, which clarifies that "improper professional conduct" includes "[i]ntentional or knowing conduct, including reckless conduct that results in a violation of applicable professional standards."[35] As the Adopting Release explains, "clearly, an accountant who intentionally or knowingly, including recklessly, violates the professional standards conclusively demonstrates a lack of competence to appear before the Commission" and "pose[s] a threat to the Commission's processes."[36] The Commission stated that "for purposes of consistency under the federal securities laws," it was adopting the definition of recklessness employed by the courts for substantive violations of the federal securities laws: "an extreme departure from the standard of ordinary care."[37]

In addition, the Commission specified two types of negligent conduct that could constitute professional misconduct under the rule. The first type is defined as "a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows or should know that heightened scrutiny is warranted."[38] The Adopting Release explains that "highly unreasonable" is "an objective standard," which is "higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) and Rule 10b-5 of the Exchange Act."[39] The Adopting Release similarly provides that "heightened scrutiny" is an "objective standard," which "could be warranted when matters are important or material, or when warning signals or other factors should alert an accountant of a heightened risk, or as set forth in applicable professional standards."[40]

The second standard for negligent conduct is satisfied with a showing of "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards that indicate a lack of competence to practice before the Commission."[41] Unlike the "highly unreasonable conduct" standard, "unreasonable" connotes, according to the Adopting Release, "an ordinary or simple negligence standard."[42] Further, according to the Adopting Release, "repeated instances" under the rule means "more than once . . . [and] may encompass as few as two separate instances of unreasonable conduct occurring within one audit, or separate instances of unreasonable conduct within different audits."[43]

As interpreted by the Commission, the rule may be implicated even where no investor is harmed and the financial statements at issue are not misstated. According to one Commission decision, "[a]n auditor who fails to audit properly under GAAS . . . should not be shielded because the audited financial statements

[31] *Id.* at 1326 (quoting *In re Carter and Johnson*, Rel. No. 34-17597 (1981)).

[32] *Marrie*, 374 F.3d at 1202.

[33] *Checkosky II*, 139 F.3d at 226-27.

[34] *Marrie*, 374 F.3d at 1198.

[35] 17 C.F.R. § 201.102(e)(1)(iv)(A); *see also Marrie*, 374 F.3d at 1203.

[36] Rel. No. 33-7593 (1998).

[37] *Id.*

[38] 17 C.F.R. § 201.102(e)(1)(iv)(B)(1).

[39] Rel. No. 33-7593 (1998).

[40] *Id.*

[41] 17 C.F.R. § 201.102(e)(1)(iv)(B)(2).

[42] Rel. No. 33-7593 (1998).

[43] *Id.*

fortuitously turn out to be accurate or not materially misleading."[44] Moreover, the Commission stated that "good faith" would not be a valid defense to reckless conduct, although it may "remain relevant in determining the appropriate sanction."

As the Commission has stated, however, the rule is not intended to cover all forms of professional misconduct. Rather, it "addresses that category of professional conduct that threatens harm to the Commission's processes."[45] In other words, the rule is remedial, designed "to encourage professionals to adhere to professional standards," not merely to be an "additional weapon" in the "enforcement arsenal." In amending the rule, the Commission noted that it "is not meant . . . to encompass every professional misstep," and a "single judgment error, for example, even if unreasonable when made, may not indicate a lack of competence to practice before the Commission, and, therefore, may not pose a future threat to the Commission's processes sufficient to require Commission action under Rule 102(e)(1)(ii)."

In determining what conduct will be actionable under the rule, the critical question is whether the conduct is so egregious that the accountant poses a future threat to the Commission's processes. Under the Commission's own guidance, therefore, an honest, even if negligent, mistake should not give rise to an enforcement action. In many cases, a hotly contested question is whether a professional's conduct, even if negligent and even if in violation of some professional standard, is sanctionable under the rule.

The line between non-actionable and actionable conduct by attorneys may be even less clear. The 1998 amendment addressed only the definition of "improper professional conduct" as it applies to accountants, and subsequent cases have not shed much new light on the state of mind required for sanctioning other professionals under the rule. In *Altman*, the D.C. Circuit sidestepped a challenge to the rule as it applies to attorneys: "The Commission found Altman had engaged in 'egregious' intentional improper professional conduct, specifically that he was seeking a severance package for his client in exchange for untruthful testimony in Commission proceedings or evasion of its process by his client. Whatever ambiguities may exist as to lesser mental states that might implicate Rule 102(e), intentional, improper conduct in the nature of 'extreme departures,' such as Altman's sanctioned conduct, falls within the rule's ambit."[46]

Violating or Aiding and Abetting Violation of Securities Laws

The third basis for suspension or disbarment after notice and opportunity for hearing within Rule 102(e)(1) is that the respondent "willfully violated" a provision of the federal securities laws.[47] The Commission has taken the position that "willful" means only that the respondent intentionally committed the act that was found to violate federal securities laws.[48] The Commission only occasionally has relied on this third provision, as it typically seeks a temporary suspension without a hearing pursuant to Rule 102(e)(3) if there has been a prior finding of a federal securities law violation by a court or the SEC.[49] When the Commission has relied on this part of the rule, it often has done so in conjunction with, and in addition to, a claim of improper professional conduct. For example, in the recent matter of *Ponce*, the Division of Enforcement commenced Rule 102(e) proceedings against an auditor on grounds that he had violated federal securities laws and that he had engaged in improper professional conduct.[50] While the administrative law judge ("ALJ") initially ruled that he had not violated either ground, the Division of Enforcement appealed and the Commission reversed the ALJ, finding that he had "willfully aided, abetted, and caused" the audited company's securities law violations and had failed to "comply with at least three of the 10 general standards of GAAS: he did not act with due professional care, he falsely stated that his audit was conducted in accordance with GAAS, and he was not independent."[51] The Ninth Circuit affirmed, noting that a ban from practicing before the Commission was a reasonable sanction, as it was "rational for the SEC to conclude that Ponce could persist in violating federal securities laws, perhaps no longer in his duties for AAC, but possibly on behalf of another company."[52]

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[44] *Marrie*, 374 F.3d at 1203 (quoting Rel. No. 33-7593 (1998)).

[45] Rel. No. 33-7593 (1998).

[46] *Altman v SEC*, 666 F.3d 1322, 1328 (D.C. Cir. 2011) (citations and footnotes omitted).

[47] 17 C.F.R. § 201.102(e)(1)(iii).

[48] *See, e.g.*, *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976).

[49] *See, e.g.*, *In re Blazar*, Rel. No. 34-26848 (1989).

[50] *Ponce v. SEC*, 345 F.3d 722, 726 (9th Cir. 2003).

[51] *In re Ponce*, Rel. No. 34-43235 (2000).

[52] *Ponce*, 345 3d at 741.

Procedures in Matters Requiring Notice and a Hearing

Hearings pursuant to Rule 102(e) are conducted pursuant to the SEC's administrative procedures. Following issuance of an order instituting proceedings, the ALJ typically must hold the evidentiary hearing and issue an initial decision on the matter as soon as 120 days, but no later than 300 days from the date of its service.[53] As observed in *Dearlove*, while respondents may request a postponement or continuance of their hearing, the ALJ and the Commission, "like a trial judge, enjoy[] broad discretion in deciding when to grant a continuance" and they have a "policy of strongly disfavoring . . . requests for postponement."[54] The Division of Enforcement is required to turn over its investigative files within seven days after service of the order commencing the administrative proceeding.[55] While the Division of Enforcement may have taken months or years compiling its investigative file prior to initiating proceedings, and may have collected voluminous documents and sworn testimony from numerous witnesses, respondents may receive an enormous volume of materials with scant time to review it.[56] With limited exceptions, little discovery is permitted.[57] Hearings are conducted in a manner similar to bench trials. Traditional evidence rules may be significantly relaxed. While ALJs are required to exclude all evidence that is "irrelevant, immaterial, or unduly repetitious," they are also required to admit all evidence which "can conceivably throw any light upon the controversy."[58] If there is any doubt as to admissibility, they are expected to admit the evidence.[59] Hearsay is generally admissible.[60] Following the hearing and any post-hearing briefing, the ALJ issues a written initial decision.[61]

Appeals from initial decisions are to the Commission itself.[62] The Commission reviews initial decisions under *de novo* review standard and can affirm, reverse, modify, set aside, or remand for further proceedings.[63] Both the respondent and the Division of Enforcement staff may appeal.[64] Once a final order has been entered by the Commission, either party may appeal that decision to either the United States Court of Appeals for the District of Columbia or the circuit in which the appealing party resides or has its principal place of business.[65] The court must treat the Commission's findings of fact as conclusive if supported by substantial evidence.[66] It also must affirm the Commission's legal conclusions unless they are, among other things, "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law."[67]

One factor impacting respondents' consideration of settlement prior to the issuance of an order instituting proceedings is that the Division of Enforcement has a high win rate in the administrative proceedings that proceed to decision after a contested hearing. Recently, the division won all but one of the 23 proceedings that

[53] 17 C.F.R. § 201.141(a)(1) & (2); *see also* 17 C.F.R. § 201.200 ("Whenever an order instituting proceedings is issued by the Commission, appropriate notice thereof shall be given to each party to the proceeding by the Secretary or another duly designated officer of the Commission [and e]ach party shall be given notice of any hearing within a time reasonable in light of the circumstances, in advance of the hearing.").

[54] *Dearlove*, at 807.

[55] 17 C.F.R. § 201.230(d).

[56] 17 C.F.R. §§ 201.220(b) & (f), 201.155(a), 201.221(f), and 201.310; see *Dearlove*, at 807 (rejecting argument that four months to review a "massive record – compiled by the SEC over several years of investigation – and to prepare for the hearing" constituted a violation of due process as the ALJ and Commission have broad discretion in ordering the conduct of proceedings).

[57] Depositions may be permitted only when necessary to preserve testimony of witness unlikely to be able to attend the hearing. *See* 17 C.F.R. § 201.233.

[58] 17 C.F.R. § 201.320; *In re Rosenblum*, 47 SEC 1065, 1072 (1984).

[59] *See City of Anaheim,* 54 S.E.C 452, 454 & n.7 (1999).

[60] *In re Arouh,* Rel. No. 34-62898 (2010) ("We have repeatedly held . . . that hearsay is admissible in administrative proceedings . . . .").

[61] 17 C.F.R. § 201.360 (b).

[62] 15 U.S.C. § 78d(a).

[63] 17 C.F.R. § 201.411(a).

[64] *See, e.g., In re Altman*, Rel. No. 34-63306 (2010) (increasing sanction from nine-month suspension to permanent ban); *In re Bartko*, Rel. No. 34-71666 (2014) (expanding scope of ban to include industries originally exempted by ALJ).

[65] 15 U.S.C. § 78y(a)(1).

[66] 15 U.S.C. § 78y(a)(4).

[67] 5 U.S.C. § 706(2)(A).

went to a decision between September 2012 and September 2014.[68]

Survey of Recent Rule 102(e)(1) Proceedings

From January 1, 2014 to June 1, 2015, the SEC issued 48 releases concerning 39 different matters involving 64 respondents that related to alleged violations of Rule 102(e)(1). The respondents settled in 33 of the 39 matters. Of the remaining six matters, the Division of Enforcement has prevailed on one after an appeal to the Commission,[69] and the others are still pending before an ALJ or on appeal.

Only 17 of the 43 respondents who settled or were found to have violated Rule 102(e)(1) received censure as their only sanction. Only one of these respondents was an individual, while the rest were accounting firms.[70] Eight of those accounting firms were the independent auditors of broker-dealers and had been censured for having assisted those broker-dealers in the drafting of their financial statements, despite this having long been the practice in the industry.[71] Five of them were Chinese accounting firms that had refused to produce documents to U.S. regulators on the grounds that it would violate Chinese secrecy laws.[72] Three of the other accounting firms were censured for independence-related violations, such as auditing a company that had invested in an entity related to the accounting firm,[73] providing non-audit services to three audit clients,[74] and having a lobbying subsidiary that had tried to influence the votes of congressional staff on bills that would directly impact two of the accounting firm's audit clients.[75]

More severe sanctions were issued in cases with findings of obvious fraud or gross recklessness. For example, the five respondents who received permanent bans included an individual who ran a Ponzi scheme,[76] an investment advisor who defrauded his clients,[77] an accountant who had no audit training and conducted audits of two public companies based on a checklist he downloaded from the internet,[78] an accounting firm that performed no audit procedures at all before issuing an unqualified audit opinion,[79] and an auditor who signed audit opinions for dozens of companies despite the fact that he knew that his accounting firm's license had lapsed several years before due to failure to comply with peer review requirements.[80] The seven respondents who received five- to 10-year bans included a CEO and a CFO who knowingly made false statements to fraudulently inflate revenues,[81] a CFO who knowingly made false statements to increase access to financing from a credit facility,[82] a CFO who solicited investors using offering documents that he knew or should have known contained misrepresentations,[83] a CFO who knew or should have known that revenues had been falsely inflated by approximately $240 million,[84] an attorney who misled investors by issuing deficient and baseless opinion letters to aid a fraudulent stock lending scheme,[85] and an attorney who defrauded clients as an unregistered investment advisor.[86]

Temporary bans ranging from two to three years were issued to 10 respondents. Generally, these sanctions involved cases with findings of negligence. This included auditors who had failed to properly perform procedures for related party transactions,[87] auditors who

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[68] Jean Eaglesham, *SEC is Steering More Trials to Judges It Appoints*, WALL ST. J., Oct. 21, 2014.

[69] *In re Hatfield*, Rel. No. 34-73763 (2014).

[70] *In re Yafeh*, Rel. No. 34-73770 (2014).

[71] *In re BKD*, Rel. No. 34-73768 (2014); *In re Boros & Farrington Accounting Corp.*, Rel. No. 34-73773 (2014); *In re Brace*, Rel. No. 34-73772 (2014); *In re Cooper*, Rel. No. 34-73769 (2014); *In re EFP Rotenberg LLP*, Rel. No. 34-72503 (2014); *In re Lally,* Rel. No. 34-73771 (2014); *In re Lerner & Sipkin CPAs LLP*, Rel No. 34-73775 (2014); *In re Oum & Co.*, Rel No. 34-73774 (2014).

[72] *In re BDO China Dahua CPA, Co.*, Rel. No. 34-74217 (2015).

[73] *In re Mayer Hoffman McCann, P.C.*, Rel. No. 34-75028 (2015).

[74] *In re KPMG*, Rel. No. 34-71389 (2014).

[75] *In re Ernst & Young LLP*, Rel. No. 34-72602 (2014).

[76] *In re Berkman*, Rel. No. 34-71667 (2014).

[77] *In re Acri*, Rel. No. 33-72370 (2014).

[78] *In re Egeberg*, Rel. No. 34-72976 (2014).

[79] *In re Child, Van Wagoner & Bradshaw, PLLC*, Rel. No. 34-74262 (2015).

[80] *In re Hatfield*, Rel. No. 34-73763 (2014).

[81] *In re Airtouch Communications,* Rel. No. 34-74691 (2015); *In re Airtouch Communications,* Rel. No. 34-74183 (2015).

[82] *In re Cummings*, Rel. No. 34-72722 (2014).

[83] *In re Lana*, Rel. No. 34-73852 (2014).

[84] *In re Marshall*, Rel. No. 34-71688 (2014).

[85] *In re Patterson*, Rel. No. 34-74421 (2015).

[86] *In re Asbell*, Rel. No. 34-73206 (2014).

[87] *In re Baker Tilly*, Rel. No. 34-73862 (2015); *In re Lesser*, Rel. No. 34-74827 (2015).

had improperly relied on and failed to supervise audit teams in China,[88] an auditor who had failed to obtain a concurring reviewer for his audits,[89] an auditor who had accrued gambling debts at a casino to which he had served as the auditor,[90] and a COO who executed an improper related-party loan benefiting the company's founder.[91]

Four respondents received bans of one year, including an attorney found to have aided and abetted misrepresentations made by the company's principal,[92] an auditor found to have knowingly allowed a non-qualified individual to sign an audit opinion,[93] a controller found to have made improper accounting adjustments,[94] and a concurring review partner found to have failed to act with due professional care.[95]

SUSPENSION OR DISBARMENT WITHOUT NOTICE OR HEARING

In certain circumstances, Rule 102(e) authorizes the Commission to suspend or disbar professionals without notice or an opportunity for hearing. Specifically, Rule 102(e)(2) authorizes the Commission to suspend professionals without notice or opportunity for hearing who have had professional licenses revoked or suspended, or have been convicted by a court of a felony or misdemeanor involving moral turpitude.[96] In addition, the Commission is authorized by Rule 102(e)(3) to temporarily suspend any professional without notice or hearing if they have been found by any court to have violated, or aided and abetted a violation of the federal securities laws.[97]

Criminal Conviction

Unlike Rule 102(e)(1), Rule 102(e)(2) provides that the Commission can suspend an individual from practicing before the Commission without notice or hearing. Under the rule, an accountant or attorney may be subject to an automatic suspension or disbarment if his license to practice has been revoked in any state, or if he has been convicted of a felony or misdemeanor involving moral turpitude.[98] Despite the Commission's authority to issue sanctions without need for notice or a hearing under this provision, there is precedent for the Commission accepting an offer of settlement from a prospective respondent for a Rule 102(e)(2) claim.[99]

Injunction or Finding of Federal Securities Violation

Rule 102(e)(3) also authorizes the Commission to temporarily suspend individuals from practicing before it without notice and opportunity for hearing if they have been permanently enjoined from future violations of federal securities laws by a court in an action brought by the SEC or upon a court or Commission "finding" that they had violated the federal securities laws.[100] In order to institute a temporary suspension under Rule 102(e)(3), the Commission must act within 90 days from the date when final appeal procedures are exhausted or are no longer available with respect to the injunction or finding of a violation of federal securities laws.

In the event that the Commission issues a temporary suspension under Rule 102(e)(3), the burden is on the respondent to have it lifted.[101] The respondent has 30 days from the date of the Commission's suspension order to file a petition seeking to lift the suspension or the suspension becomes permanent. If a petition is filed, the Commission must, within 30 days, either lift the suspension without a hearing, or provide for a hearing. All hearings are public unless the Commission otherwise dictates.[102]

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[88] *In re Child, Van Wagoner & Bradshaw, PLLC*, Rel. No. 34-74262 (2015); *In re EFP Rotenberg LLP*, Rel. No. 34-72503 (2014); *In re Walker,* Rel. No. 34-72199 (2014).

[89] *In re Kan*, Rel. No. 34-71585 (2014).

[90] *In re Adams*, Rel. No. 34-72198 (2014).

[91] *In re Jenson*, Rel. No. 34-73294 (2014).

[92] *In re Alpha Titans, LLC*, Rel. No. 34-74828 (2015).

[93] *In re Berman & Co.*, Rel. No. 34-73427 (2014).

[94] *In re Daniels*, Rel. No. 34-71896 (2014).

[95] *In re Walker,* Rel. No. 34-72199 (2014).

[96] 17 C.F.R. § 201.102(e)(2).

[97] *Id*. § 201.102(e)(3).

[98] *Id*. § 201.102(e)(2).

[99] *See*, *e.g.*, *In re Loglisci*, Rel. No. 34-71677 (2014); *In re Miller*, Rel. No. 34-72516 (2014); *In re Morris*, Rel. No. 34-71676 (2014); *In re Hipwell*, Rel. No. 34-59303 (2009).

[100] 17 C.F.R. §§ 201.102(e)(3). Note that 102(e)(3)(i)(B) potentially allows the Commission to issue a temporary suspension or disbarment even where a court did not believe such an injunction necessary. *See*, *e.g.*, *SEC v. Nat'l Stud. Mktg. Corp*., 457 F. Supp. 682 (D.D.C. 1978).

[101] 17 C.F.R. § 201.102(e)(3)(iv).

[102] Rel. No. 33-6783 (1988).

CONCLUSION

There have been relatively few administrative proceedings that have been litigated up to the federal courts. The Commission settled or prevailed in all of the administrative proceedings completed over the last 18 months pursuant to Rule 102(e)(1) – obtaining censure for 17 respondents, temporary suspensions ranging from one to 10 years for 21 respondents, and permanent bans for five respondents. If the Commission continues to ramp up enforcement efforts under Rule 102(e), it is likely that more judicial decisions interpreting Rule 102(a) and its proper application will be forthcoming. ■