

Division of Research
Graduate School of Business Administration
The University of Michigan

May 1983

RULE 2(e) AND CORPORATE OFFICERS

Working Paper No. 330

by George J. Siedel

The University of Michigan

FOR DISCUSSION PURPOSES ONLY

None of this material is to be quoted or
reproduced without the expressed permission
of the Division of Research.

RULE 2(e) AND CORPORATE OFFICERS

by

George J. Siedel*

The Securities and Exchange Commission (SEC or Commission) has used rule 2(e), the possible successor to rule 10b-5 as the cause celebre in securities law,¹ against corporate officers since 1975. Beyond its impact on individual officers named as defendants, the use of rule 2(e) against management has important implications with respect to corporate governance. Despite their importance, however, rule 2(e) proceedings against officers have gone virtually unnoticed by legal commentators² and even by counsel for the SEC. In the argument of the leading rule 2(e) case, *Touche Ross & Co. v. SEC*,³ Judge Gurfein asked the SEC counsel: "What about a treasurer of a company; suppose he does something wrong? Does the SEC, without the intervention of the Court, have the power to tell him never to file again before the Commission? It doesn't seem right to me." The counsel responded: "I don't think it does under any of its rules."⁴ By October, 1978, when this colloquy took place, the Commission had, apparently unknown to its counsel, asserted this power in thirteen cases against corporate officers.

The purpose of this article is to discuss the general operation of the rule (Part I), the nature of rule 2(e) proceedings involving corporate officers (Part II), legal and policy reasons why corporate officers should not be subject to rule 2(e) proceedings (Part III), and the appropriate management response to the proceedings (Part IV).

I. OPERATION OF RULE 2(e)

A. Rule 2(e) Provisions

Rule 2(e) was promulgated in 1935 by the newly-formed Commission.⁵ Under the original version of the rule the Commission assumed the responsibility for admitting lawyers

*Associate Professor of Business Law, The University of Michigan

to a specialized bar but this role was abandoned when the rule was amended in 1938.⁶ The rule was further amended in 1970⁷ and 1971.⁸ Rule 2(e), as amended, is reprinted in the Appendix.

The Commission uses three different procedures in enforcing rule 2(e). First, rule 2(e)(1) provides that the Commission may deny the privilege of appearing and practicing before it after instituting an original proceeding which includes notice of and opportunity for a hearing. Original 2(e) proceedings may be instituted against any person who (1) does not possess the qualifications to represent others; (2) lacks character or integrity, or has engaged in unethical or improper professional conduct; or (3) has willfully violated, or willfully aided and abetted violation of federal securities laws.

Second, Rule 2(e)(2) provides that the Commission may automatically suspend (1) an attorney who has been suspended or disbarred by a court; (2) any person whose state license to practice has been revoked or suspended; or (3) any person convicted of a felony, or a misdemeanor involving moral turpitude.

Third, Rule 2(e)(3) allows the Commission to suspend temporarily attorneys, accountants and other professionals who have, in an SEC action, been permanently enjoined from violating or aiding and abetting the violation of federal securities laws. Under this provision temporary suspension may also be used when a court of competent jurisdiction, in an SEC action, determines that a professional has violated or aided and abetted the violation of federal securities laws,⁹ unless the violation was not willful. The temporary suspension under rule 2(e)(3) becomes permanent unless the person suspended, within thirty days after service of the suspension order, petitions the Commission to lift the suspension. If a petition is filed, the Commission must either lift the suspension or schedule a hearing.

B. Incidence of Rule 2(e) Proceedings

Legal research relating to rule 2(e) is challenging in that section (7) of the rule provides that all hearings "shall be nonpublic" unless the Commission directs otherwise. The Commission has rarely directed that proceedings be made public; in fact, the first time the Commission ordered a public hearing was in Touche Ross in 1976.¹⁰ Private proceedings are justified on the grounds that if the charges are dismissed, which they often are, the professional's reputation is left intact.¹¹ There is also some question as to whether, when the hearings result in sanctions, the decisions have been published. While the Commission

indicated in 1971 that it is "our practice" to publish decisions,¹² in a 1975 release the Commission noted that "hereafter" it would publish orders of administrative law judges finding a basis for sanctions,¹³ implying that it may not have done so in the past.

To further complicate rule 2(e) research, the SEC does not have a complete list of 2(e) proceedings¹⁴ and there is no other comprehensive index of proceedings. Another problem is that 2(e) decisions are difficult to locate using traditional methods of legal research because the orders are often buried within injunctive actions.

In an attempt to surmount these difficulties, the following methodology was used to create the 2(e) database described below. Marsh, in his leading article which surveys the use of rule 2(e) over forty-five years (1935-1979),¹⁵ used a list of sixty-three rule 2(e) cases supplied by the Commission, the most complete list available of proceedings involving both attorneys and accountants. My request to the SEC in 1982 produced the same list of cases used by Marsh. In providing the list the Commission emphasized that the list was only a partial list of public proceedings put together by the staff for its own use and did not purport to be an complete list of rule 2(e) proceedings.¹⁶

With this core list of proceedings in hand, a LEXIS search was then conducted.¹⁷ The use of LEXIS for this type of research has certain drawbacks in that the LEXIS federal securities library does not contain all SEC administrative decisions and releases and, additionally, it is difficult to devise a suitably narrow program.¹⁸ Despite these problems, the LEXIS search produced an additional seventy-nine cases over the forty-five year period covered in the Marsh survey.¹⁹

A review of all SEC Accounting Series Releases for the same period resulted in twenty more 2(e) proceedings and, finally, thirty-three proceedings were discovered through a review of rule 2(e) literature. Although they are limited to rule 2(e) proceedings against attorneys, the Kelleher²⁰ and Klein²¹ articles were especially useful.

The end result of the computerized and traditional searches is that the initial SEC list used by Marsh has been expanded from sixty-three to one hundred and ninety-five proceedings. A breakdown of these proceedings over time and by type of respondent reveals the following distribution.²²

	<u>Attorneys</u>	<u>Accountants</u>	<u>Total</u>	<u>(SEC List)</u>
1935-39			0	
1940-49	1	7	8	(0)
1950-59	4	4	8	(5)
1960-69	12	10	22	(12)
1970-74	27	13	40	(9)
1975-79	60	57	117	(37)
	<u>104</u>	<u>91</u>	<u>195</u>	<u>(63)</u>

This list compares favorably with 1979 estimates of the total number of 2(e) proceedings by former Chairman Williams, who stated that the Commission had brought over 100 proceedings against attorneys and 80 proceedings against accountants,²³ and former Commissioner Karmel, who noted that over 85 cases have been instituted against attorneys since 1970.²⁴ And although there are significant differences between this list and the SEC list,²⁵ there is one striking similarity in that sixty percent of the cases occurred in the last five years of the period surveyed.²⁶

II. RULE 2(e) PROCEEDINGS INVOLVING CORPORATE OFFICERS

During the activist years of 1975-79, the SEC not only increased its use of rule 2(e) but also, for the first time, brought rule 2(e) proceedings against corporate officers who happened to be attorneys or accountants. This development was first observed by Marsh, who discovered three cases on the SEC list which involve corporate officers.²⁷ An analysis of the more complete list of 195 rule 2(e) cases reveals a total of fourteen such proceedings²⁸ which have the following characteristics.

1. Corporate position. The defendants in these proceedings held a variety of positions within the corporation,²⁹ including chairman of the board (3), president (3), vice-president (8), and treasurer (5); and in several cases the officers also served as directors.³⁰ Although all of the defendants were professionals (twelve accountants and four attorneys³¹), in most of the proceedings they were charged as a result of their conduct as corporate officers. Several orders make specific reference to the defendant's improper conduct as a corporate officer. In one case, for instance, the Commission took into consideration the following statement in deciding to accept the defendant's settlement offer: "The activities charged by the Commission did not involve a report filed by Ingis as a CPA."³² In commenting on this statement the Commission noted that: "Ingis was, however, the chief financial officer at Allied and the chief executive officer at Kalvex."³³

2. Nature of the proceedings. Not one of the fourteen proceedings resulted in a formal hearing. Six of the proceedings were settled when the defendants agreed to sanctions in lieu of a formal proceeding and in four of the cases the defendants consented to a 2(e) order. In the remaining four cases, temporary suspension became permanent under 2(e)(3) as a result of the failure of the defendant to file a petition within thirty days. The fact that in every proceeding the defendant either consented or failed to petition the Commission is understandable in that, in most of the cases, the defendants had previously or concurrently with the 2(e) matter consented to an injunction. Given such consent injunctions, formal 2(e) hearings would be futile.³⁴

3. Defendants' conduct. In the rule 2(e) proceedings, corporate officers have been charged with three types of improper conduct. First, in some cases the SEC has charged that the officer made false statements in filings or failed to file reports as required by federal securities law.³⁵ Second, it has been alleged that certain corporate officers, typically the vice president for finance with responsibility for SEC filings, has violated rule 2(e) by failing to meet certain standards of conduct expected of such officers by the Commission, even though the officer did not act fraudulently and did not intentionally violate the law.³⁶ Third, several cases involve fraudulent conduct not directly related to filings with the SEC.³⁷ Several proceedings involve combinations of these three types of conduct.³⁸

For those officers with filing responsibilities, typically certified public accountants, suspension under rule 2(e) has a Catch 22 impact. As a result of the order the defendant is not qualified to continue serving as a financial officer because of the inability to sign SEC filings. But it is difficult for the defendant to obtain employment elsewhere because the order would prevent the officer from accepting employment with a public accounting firm.³⁹

III. PROPRIETY OF RULE 2(e) PROCEEDINGS AGAINST CORPORATE OFFICERS

Rule 2(e) is subject to two major lines of attack in proceedings against corporate officers. First the argument can be made that rule 2(e) is invalid in any type of proceeding--regardless of whether the defendant is an attorney, accountant, geologist or corporate officer. The second argument is that, even if 2(e) is valid when used in proceedings against attorneys and accountants, it should not be used when these professionals are acting as corporate officers. The starting point for a discussion of both

arguments is Touche Ross, the first court decision to uphold the Commission's authority to use rule 2(e) against accountants.⁴⁰

A. The Touche Ross Decision

On September 1, 1976, the SEC entered an order⁴¹ providing for a public administrative proceeding against Touche Ross & Co. and three of its former partners. The proceeding was instituted to determine whether the firm and the individual partners had engaged in unethical, unprofessional or fraudulent conduct in auditing the financial statements of Giant Stores Corporation and Ampex Corporation.⁴² The SEC decided that it would be in the public interest to institute a public proceeding in light of the firm's nationwide accounting practice.⁴³

Touche Ross commenced an action against the SEC on October 12, 1976 in the Southern District of New York seeking a permanent injunction against the proceeding and a declaratory judgment that there is no statutory authority for rule 2(e). The district court granted the SEC's motion to dismiss the complaint on the grounds that Touche Ross had not exhausted its administrative remedies.⁴⁴

On appeal the Second Circuit affirmed the district court's dismissal of the action. The court initially held that, with regard to the question whether the Commission has the authority to promulgate rule 2(e), Touche Ross did not need to exhaust administrative remedies because there was no need for further agency action to enable the court to decide the issue. The court then addressed the 2(e) issue.

Because the SEC conceded that it had no express authority to promulgate rule 2(e),⁴⁵ the court's analysis focused on whether the Commission's authority was implied. Touche Ross argued that any implied authority was negated by a provision in the 1934 Act which states that the district courts "shall have exclusive jurisdiction of violations of this chapter."⁴⁶ It was argued that this provision and others,⁴⁷ which authorize the SEC to commence proceedings in district courts to enjoin violations of securities law, indicate that Congress intended that only the courts, and not the SEC, should adjudicate such violations.

The court rejected this argument. The court noted that the SEC was not attempting to usurp the jurisdiction of the courts but, instead, was merely using rule 2(e) to preserve the integrity of its own procedures. According to the court, the "Commission has made it clear that its intent in promulgating Rule 2(e) was not to utilize the rule as an additional weapon in its enforcement arsenal, but rather to determine whether a person's professional qualifications,

including his character and integrity, are such that he is fit to appear and practice before the Commission."

The court further observed that rule 2(e) is not inconsistent with the Commission's statutory authority. Citing the Supreme Court in *Mourning v. Family Publications Services, Inc.*,⁴⁸ the court stated that the test to be applied is whether agency rules and regulations are reasonably related to the statutory purposes. Under Section 23(a) (1) of the 1934 Act⁴⁹ and similar provisions in other statutes,⁵⁰ Congress has given the Commission broad authority to carry out its functions. These functions relate to the purpose of the 1933 Act, which is to provide investors with full disclosure.⁵¹ Full disclosure is provided in part by means of a registration statement filed with the Commission.⁵² However, the Commission, with a small staff and limited resources, cannot examine with close scrutiny every financial statement that is filed and therefore, the court reasoned, must rely heavily on the accounting and legal professions: "The role of the accounting and legal professions in implementing the objectives of the disclosure policy has increased in importance as the number and complexity of securities transactions has increased."⁵³

Because of this important role, the court continued, the SEC must be allowed to use rule 2(e) to protect the integrity of its own processes, for the disclosure process would be impaired if incompetent or unethical accountants were permitted to certify financial statements.⁵⁴ As the Second Circuit noted in an earlier, oft-quoted opinion: "In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting loss more potent than the chisel or the crowbar."⁵⁵

In support of its decision, the court noted that other courts have rejected challenges to the authority of agencies to discipline attorneys practicing before them. In *Goldsmith v. Board of Tax Appeals*,⁵⁶ for example, the Supreme Court held that the Board of Tax Appeals could adopt rules of practice for professionals appearing before it despite the lack of explicit statutory authority. The court observed that, although the argument could be made that cases such as *Goldsmith* involve agencies acting in a judicial function and that the SEC was merely an enforcement agency, in fact "it is uniformly accepted that many agencies properly combine the functions of prosecutor, judge and jury."⁵⁷

B. General Validity of Rule 2(e)

In order to determine whether rule 2(e) should be used against corporate officers, the general validity of the rule must first be examined. The court in *Touche Ross* reached

the following conclusions in upholding the rule: (1) Rule 2(e) does not conflict with the jurisdiction of the federal district courts because it is not an additional enforcement weapon and is reasonably related, under the Mourning test, to statutory purposes; (2) Section 23(a)(1) of the 1934 Act and similar provisions elsewhere give the Commission broad authority to carry out its functions; (3) In other cases, such as Goldsmith, courts have rejected challenges to agency authority to discipline attorneys; and (4) Rule 2(e) applies to attorneys as well as accountants. For the reasons summarized below, it appears that the court's analysis is flawed and that the rule is invalid.

1. Conflict with district court jurisdiction. Despite the court's conclusion, rule 2(e) does conflict with district court jurisdiction in cases where proceedings are based upon the same conduct (for example, a willful violation of securities laws) that could be reached through enforcement proceedings in court. In fact, in many cases violation of federal securities law results in both rule 2(e) proceedings and district court injunctive actions.⁵⁸ Furthermore, the Commission's argument that rule 2(e) is not an additional enforcement weapon⁵⁹ is not in accord with statements by SEC Commissioners.⁶⁰

The court's questionable conclusion that rule 2(e) does not conflict with district court jurisdiction is compounded by its application of the Mourning test (that is, whether agency rules and regulations are reasonably related to statutory purposes⁶¹) to determine the validity of rule 2(e). In its analysis, the court overlooked the fact that the Supreme Court has held that rules are not reasonably related when they conflict with the statutory scheme.⁶² Given the conflict between rule 2(e) proceedings and district court actions, rule 2(e) should be invalidated when the proper test is applied.⁶³

2. Section 23(a)(1). The court's reliance on section 23(a)(1) of the 1934 Act is not justified for a number of reasons. First, the argument can be made that because Congress gave the SEC explicit power over certain groups, it is implied that the Commission lacks power over other groups.⁶⁴ For example, the SEC can suspend the registration of a member of an exchange,⁶⁵ and can bring administrative proceedings against broker-dealers⁶⁶ and investment advisers.⁶⁷ The securities laws do not give the SEC similar authority to deal with attorneys and accountants. In fact, when the 1933 Act was originally drafted, a proposal providing for administrative certification and approval of accountants was rejected because it was felt that "this would put a discretion in the hands of the Commission that might be dangerous and would certainly be criticized."⁶⁸ The combination of the express provisions for proceedings

against other groups and the legislative history would appear to negate SEC authority over attorneys and accountants.⁶⁹

Furthermore, it appears that the court in Touche Ross misconstrued the purpose of Section 23 in deciding that this provision granted the Commission the power to discipline accountants. A review of both House and Senate reports accompanying the 1934 Act indicates that Congress intended that the SEC use its authority under Section 23 to oversee the stock exchanges more effectively.⁷⁰ Thus the legislative history does not support the Second Circuit's reliance on Section 23 as authority for rule 2(e).

Finally, even if the securities laws contained no express provisions relating to other groups and the legislative history supported the Second Circuit's conclusion, it is questionable whether rule 2(e) is "necessary" as required by Section 23. Accountants and attorneys who violate securities law are subject to civil injunctive actions⁷¹ and criminal proceedings;⁷² in practice, "all but a handful" of cases involve injunctive actions.⁷³ Even when professional conduct falls short of violating securities law, the SEC has a number of other remedies available.⁷⁴ Furthermore, rule 2(e) is not necessary because state licensing boards and professional organizations protect the public by policing the conduct of professionals.⁷⁵

3. The Goldsmith Decision. Cases such as Goldsmith do not provide the support for rule 2(e) indicated by the Second Circuit. Goldsmith and other cases cited by the court⁷⁶ involve quasi-judicial tribunals with authority to admit attorneys to practice and to disbar them.⁷⁷ While the SEC often acts in an adjudicative capacity, it has never used rule 2(e) to discipline attorneys in quasi-judicial proceedings,⁷⁸ and, indeed, has adopted another rule directed specifically toward such proceedings.⁷⁹ Thus cases like Goldsmith do not authorize the SEC to monitor "activities conducted in the privacy of an attorney's or accountant's office."⁸⁰

4. Application of rule 2(e) to attorneys. Former SEC Commissioner Karmel has noted that it "can be argued" that rule 2(e) is necessary to discipline accountants because the Commission has express statutory power⁸¹ to define accounting terms and to require certification of financial statements.⁸² However, she has also observed that, because the use of rule 2(e) against accountants can be distinguished from proceedings against attorneys, the dictum in Touche Ross upholding the validity of the rule as to attorneys is suspect.⁸³ One reason for this conclusion is that Congress has not given the Commission statutory powers over attorneys similar to those relating to accountants.⁸⁴

Another, and perhaps more significant, reason is the potential for corruption of justice when an administrative

agency such as the SEC is given the power to sanction an adversary representing a client. Although the Second Circuit dismissed a similar argument as "facetious" in Touche Ross,⁸⁵ it appears that the Commission's use of rule 2(e) against attorneys may interfere with a client's right to counsel, which is protected by the common law, the Administrative Procedure Act⁸⁶ and the Sixth Amendment to the Constitution.⁸⁷ Indeed, as a policy matter, even the use of rule 2(e) against accountants interferes with the accountant-client relationship in a way "which may chill professionalism, innovation and independence."⁸⁸

C. Validity of Rule 2(e) Against Corporate Officers

Even if it is assumed that Touche Ross was correctly decided and that rule 2(e) is valid generally, the use of the rule against corporate officers is improper for two reasons. First, in many cases corporate officers have been named as defendants in rule 2(e) proceedings on the basis of activities which do not directly relate to SEC processes. Second, rule 2(e) represents an attempt to federalize the law of corporate governance, which has traditionally been the domain of state government.

1. Corporate officers and SEC processes. Throughout the Touche Ross opinion the Second Circuit stressed that rule 2(e) is necessary in order for the Commission "to preserve the integrity of its own procedures, by assuring the fitness of those professionals who represent others before the Commission."⁸⁹ Thus, according to the court, rule 2(e) "represents an attempt by the SEC to protect the integrity of its own processes," which would be undermined if incompetent or unethical accountants were permitted to certify financial statements.⁹⁰ Cases cited by the court in support of its decision, such as Goldsmith,⁹¹ deal with judicial process and procedures. The court's interpretation of the scope of rule 2(e) appears to be in accord with the purpose of the Rules of Practice, which are applicable to proceedings before the Commission, "particularly those which involve a hearing or opportunity for a hearing."⁹²

As noted above,⁹³ there are three types of 2(e) cases involving corporate officers. One of these--the situation where an officer files false reports or fails to file reports--relates directly to SEC processes and procedures. The other two types of cases--where the corporate officer is engaged in fraudulent conduct or in non-fraudulent conduct which does not meet the Commission's expectations--are only indirectly related to SEC processes. Under the authority of Touche Ross it would appear that the first type of case should fall within the ambit of rule 2(e). But to include other cases would mean that virtually all corporate

activities would be subject to scrutiny under rule 2(e) because they relate indirectly to SEC filings. The end result would be that rule 2(e) would become the law of corporations.

Despite the corporate officer cases which have surfaced recently, the SEC does not publicly advocate this result. In Touche Ross, the Commission "made it clear that its interest in promulgating Rule 2(e) was ... to determine whether a person's professional qualifications, including his character and integrity, are such that he is fit to practice before the Commission."⁹⁴ As noted above,⁹⁵ in arguing the Touche Ross case, counsel for the SEC stated that the SEC does not have the power to tell the treasurer of a company who does something wrong that he cannot file again before the Commission. Former Chairman Williams apparently agreed with this result in his concurring opinion in a 2(e) proceeding: "I agree with Commissioner Karmel that Rule 2(e) should not be utilized as an enforcement tool against those who violate the federal securities laws and happen coincidentally also to be lawyers or accountants."⁹⁶ Similar views have been expressed elsewhere by the SEC General Counsel.⁹⁷ In light of these statements, and given the first forty years of rule 2(e) enforcement (1935-1974) in which no corporate officers were named as defendants,⁹⁸ it seems clear that rule 2(e) is necessary, if at all, only when officers are directly involved in SEC processes.

2. Federalization of corporate law. As previously observed,⁹⁹ in one type of 2(e) proceeding, the Commission has alleged that the defendant corporate officer has violated the rule by failing to meet certain standards of conduct expected of such officers by the Commission. In the Matter of Paul N. Conner,¹⁰⁰ for example, the Commission concluded that a corporate vice president and treasurer has a duty as a corporate officer and a certified public accountant to (1) take independent steps to satisfy himself that judgments made by senior management are reasonable; and (2) to make objections to certain practices¹⁰¹ known to senior management, directors, and independent auditors. The Commission determined that these objections must be made known even when senior management is aware of much of the information and even though the transactions in question are disclosed to independent auditors, who concur in the practices and disclosure.

Cases such as Conner, coupled with the Commission's use of the rule against a defendant who was not an attorney or accountant,¹⁰² open the door to rule 2(e) actions against MBAs and even individuals without professional degrees who are serving as corporate officers. Professor Kripke has observed that this, in turn, could lead to the use of the rule "to put pressure on the thinking and decision-making

processes of corporate directors in the tender offer and other fields. We would then have a reasonable facsimile of the preemption of state corporate law in the enforcement of the Commission's managerialist program."¹⁰³ This development would be contrary to *Santa Fe Industries, Inc. v. Greene*, where the Supreme Court indicated that it would not extend federal corporate law to cover the "corporate universe" unless Congress clearly so intended.¹⁰⁴ Apart from specific provisions relating to proxy solicitations and tender offers, Congress has not stated an intention to give the SEC power over corporate governance.¹⁰⁵

IV. MANAGEMENT RESPONSE TO RULE 2(e) PROCEEDINGS

A. Rule 2(e) in an Deregulatory Environment

In a deregulatory environment, management might easily become complacent with respect to the threat of rule 2(e) proceedings, for conventional wisdom suggests that the net result of a deregulatory philosophy, new personnel and a tight budget will be a Commission that is supportive of industry rather than adversarial. Chairman John Shad, for example, is said to consider the SEC as being less like an independent agency and more like "the Agriculture Department, whose job is to promote the interests of farmers."¹⁰⁶

Any complacency resulting from perceptions that the SEC will be lax in enforcement actions is both unjustified and dangerous. John Fedders, the director of the Division of Enforcement, has made it clear that he feels that Touche Ross represents the law and that the SEC will remain active in bringing 2(e) actions.¹⁰⁷ More significant than this statement, however, are three factors that impact on rule 2(e) enforcement. First, as a result of the Commission's tight budget and shrinking work force,¹⁰⁸ it is likely that the use of rule 2(e) will expand. Even before budgetary reductions, the Commission's resources had become inadequate in recent years as a result of its expanded legal responsibilities, the quantitative increase and diversity in securities offerings, increasing variety in trading markets and practices, and general problems in applying securities law in an increasingly complex economy.¹⁰⁹

The court in Touche Ross observed the importance of the accounting and legal profession in the face of increasing complexity in securities transactions and limited Commission resources. Because the Commission must rely heavily on both professions, the court concluded, rule 2(e) is important in protecting the integrity of its processes.¹¹⁰ In a deregulatory environment, there is every reason to believe that the

Commission will place even greater reliance on the professions and on attorneys and accountants acting as corporate officers. This will lead to increasing use of rule 2(e) to regulate these professionals.

A second factor that will result in continuing use of rule 2(e) is that the Commission has concluded that rule 2(e) proceedings are appropriate even when other remedies are unavailable. The Supreme Court, in Ernst and Ernst v. Hochfelder,¹¹¹ decided that proof of scienter (defined as "a mental state embracing intent to deceive, manipulate, or defraud"¹¹²) is required in private damage actions under rule 10b-5. The Supreme Court later held that the SEC must establish scienter as an element in civil enforcement actions to enjoin violations of § 17(a)(1) of the 1933 Act and § 10(b) and rule 10b-5 of the 1934 Act.¹¹³

However, the SEC has traditionally held that proof of scienter is not required in rule 2(e) proceedings¹¹⁴ and the Commission has made it clear that, even after Hochfelder, simple negligence will be sufficient to support a rule 2(e) order. As the Commission's General Counsel stated in a memorandum to the SEC chairman, after Hochfelder "it may be appropriate for the Commission to place greater reliance upon Rule 2(e) in the future as a means of preventing a recurrence of unethical or improper conduct."¹¹⁵ In a later memorandum to the chairman, the General Counsel stated that rule 2(e) might be appropriate even where "as a consequence of Hochfelder, negligent conduct by an accountant or attorney which injured investors may not constitute a violation of Section 10(b) and Rule 10b-5, nor otherwise violate the securities laws...."¹¹⁶ As if to reinforce this statement, five days after this memorandum was written the SEC ordered the public proceeding against Touche Ross; in the order, the Commission did not allege that Touche Ross had engaged in any misconduct which would meet the scienter requirement.¹¹⁷

The third factor which will cause continuing SEC reliance on rule 2(e) is the willingness of defendants to consent to settlements. As noted earlier,¹¹⁸ not one of the proceedings against corporate officers resulted in a formal hearing. The willingness of defendants to settle is understandable in that the publicity of an open proceeding is avoided.¹¹⁹ Furthermore, settlement might be a preferable option to a hearing before an agency which combines the functions of prosecutor, judge and jury.¹²⁰ In the words of Professor Fiftis, "the word 'consent' in 'consent decree' can be likened most to the 'I do' in a 'shotgun wedding.'"¹²¹ Even Touche Ross, once the Second Circuit decided not to enjoin the proceeding, consented to a settlement.¹²²

B. Management Response

Rule 2(e) proceedings represent a danger both to management generally, in the form of increasing federalization of the corporate governance process, and to individual corporate officers who, as a result of rule 2(e) orders, are unable to function in their corporate positions and are limited in their ability to work for professional firms. Given the continued vitality of the rule in a deregulatory environment, there are two responses individual officers should make when charged under rule 2(e). First, management should challenge the validity of the rule. It is questionable whether the rule itself is valid, and even more doubtful whether its use against corporate officers is justified. And if the rule passes these hurdles corporate officers who are charged on the basis of activities undertaken in good faith should challenge the Commission's failure to apply the scienter requirement in rule 2(e) proceedings.

Second, even if the rule is valid, corporate officers should exercise caution in consenting to injunctions. The effect of such consents is devastating because, under rule 2(e)(3), the Commission may use the injunction as the basis for temporary suspension, which becomes permanent after thirty days. A petition for a hearing filed by a defendant within the thirty-day period will in most cases be a futile effort because the rule provides that even a defendant who does not admit the facts when consenting to the injunction is presumed to have committed the misconduct alleged in the complaint. Thus, at a minimum, corporate officers should negotiate any rule 2(e) consequences when settling injunctive actions.¹²³

In addition to its effect on individual officers, settlement has a deleterious impact upon the law of corporate governance. Although consent decrees do not establish legal precedent, in practice they are used to develop the law.¹²⁴ The failure of accountants to challenge the rule before Touche Ross played a role in the decision, for the court noted that, despite the long history of rule 2(e), "it is noteworthy that no court has ever held that the Rule is invalid."¹²⁵ By failing to challenge the rule, corporate officers are establishing a similar record which may influence a court years from now.

Beyond individual challenges to rule 2(e), corporate management has a rare opportunity to make its views about rule 2(e) known to Congress, which is considering the substantial reform of securities law embodied in the proposed Federal Securities Code. Early drafts of the code contained a section granting the Commission the right to suspend attorneys and other professionals from practice before the Commission, and the definition of professionals did not include officers and directors.¹²⁶ The final draft

deleted this section, thus "neither enlarging nor diminishing whatever explicit authority the Commission has."¹²⁷ Any impetus to add this section back to the code during the legislative process must come from management. Action by management--both collectively during the legislative process and individually in 2(e) proceedings--at this juncture in history is important to the future of corporate governance, for without such action the SEC will be allowed by default to continue using rule 2(e) to influence and shape the management process.

APPENDIX

Rule 2(e), 17 C.F.R. § 201.2(e) (1982)

(e) Suspension and disbarment. (1) The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice of and opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws (15 U.S.C. 77a to 80b-20), or the rules and regulations thereunder.

(2) Any attorney who has been suspended or disbarred by a Court of the United States or in any State Territory, District, Commonwealth, or Possession, or any person whose license to practice as an accountant, engineer or other expert has been revoked or suspended in any State, Territory, District, Commonwealth, or Possession, or any person who has been convicted of a felony, or of a misdemeanor involving moral turpitude, shall be forthwith suspended from appearing or practicing before the Commission. A disbarment, suspension, revocation or conviction within the meaning of this paragraph (e)(2) shall be deemed to have occurred when the disbaring, suspending, revoking, or convicting agency or tribunal enters its judgment or order, regardless of whether appeal is pending or could be taken, and includes a judgment or order on a plea of nolo contendere.

(3)(i) The Commission, with due regard to the public interest and without preliminary hearing, may by order temporarily suspend from appearing or practicing before it any attorney, accountant, engineer, or other professional or expert who, on or after July 1, 1971, has been by name:

(a) Permanently enjoined by any court of competent jurisdiction by reason of his misconduct in an action brought by the Commission from violation or aiding and abetting the violation of any provision of the Federal securities laws (15 U.S.C. 77a to 80b-20) or of the rules and regulations thereunder; or

(b) Found by any court of competent jurisdiction in an action brought by the Commission to which he is a party or found by this Commission in any administrative proceeding to which he is a party to have violated or aided and abetted the violation of any provision of the Federal securities

laws (15 U.S.C. 77a to 80b-20) or the rules and regulations thereunder (unless the violation was found not to have been willful).

An order of temporary suspension shall become effective when served by certified or registered mail directed to the last known business or residence address of the person involved. No order of temporary suspension shall be entered by the Commission pursuant to this paragraph (e)(3)(i) more than three months after the final judgment or order entered in a judicial or administrative proceeding described in (a) or (b) of this paragraph (e)(3)(i) has become effective upon completion of review or appeal procedures or because further review or appeal procedures are no longer available.

(ii) Any person temporarily suspended from appearing and practicing before the Commission in accordance with paragraph (e)(3)(i) may, within thirty days after service upon him of the order of temporary suspension, petition the Commission to lift the temporary suspension. If no petition has been received by the Commission within 30 days after service of the order by mail the suspension shall become permanent.

(iii) Within 30 days after the filing of a petition in accordance with paragraph (e)(3)(i), the Commission shall either lift the temporary suspension or set the matter down for hearing at a time and place to be designated by the Commission or both, and after opportunity for hearing, may censure the petitioner or may disqualify the petitioner from appearing or practicing before the Commission for a period of time or permanently. In every case in which the temporary suspension has not been lifted, every hearing held and other action taken pursuant to this paragraph (e)(3) shall be expedited in every way consistent with the Commission's other responsibilities.

(iv) In any hearing held on a petition filed in accordance with paragraph (e)(3)(ii), the staff of the Commission shall show either that the petitioner has been enjoined as described in paragraph (e)(3)(i)(a) of this section or that the petitioner has been found to have committed or aided and abetted violations as described in (e)(3)(i)(b) of this section and that showing, without more, may be the basis for censure or disqualification; that showing having been made, the burden shall be upon the petitioner to show cause why he should not be censured or temporarily or permanently disqualified from appearing and practicing before the Commission. In any such hearing the petitioner shall not be heard to contest any findings made against him or facts admitted by him in the judicial or administrative proceeding upon which the proceeding under this paragraph (e)(3) is predicated, as provided in paragraph (e)(3)(i) of this section. A person who has consented to the entry of a permanent injunction as described in paragraph (e)(3)(i)(a)

without admitting the facts set forth in the complaint shall be presumed for all purposes under this paragraph (e)(3) to have been enjoined by reason of the misconduct alleged in the complaint.

(4)(i) An application for reinstatement of a person permanently suspended or disqualified under paragraph (e) (1) or (3) of this section may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown.

(ii) Any person suspended under paragraph (e)(2) shall be reinstated by the Commission upon appropriate application, if all the grounds for application of the provisions of that subparagraph are subsequently removed by a reversal of the conviction or termination of the suspension, disbarment or revocation. An application for reinstatement on any other grounds by any person suspended under paragraph (e)(2) may be filed at any time and the applicant shall be accorded an opportunity for a hearing in the matter; however, such suspension shall continue unless and until the applicant has been reinstated by order of the Commission for good cause shown.

(5) Any person appearing or practicing before the Commission who has been the subject of an order, judgment, decree, or finding as set forth above shall promptly file with the Secretary of the Commission a copy thereof (together with any related opinion or statement of the agency or tribunal involved). Failure to file any such paper shall not impair the operation of any other provision of this paragraph (e).

(6) Any proceeding brought under any of the above subparagraphs shall not preclude a proceeding under any other paragraph.

(7) All hearings held under this paragraph (e) shall be nonpublic unless the Commission on its own motion or the request of a party otherwise directs.

FOOTNOTES

1. Marsh, Rule 2(e) Proceedings, 35 BUS. LAW. 987 (1980).
2. Apart from Marsh, who first discovered that the SEC was using rule 2(e) against corporate officers (*id.* at 992-993), the only commentary of any length on this development is found in Kripke, The SEC, Corporate Governance, and the Real Issues, 36 BUS. LAW. 173, 202-205 (1981).
3. 609 F.2d 570 (2d Cir. 1979).
4. Touche Ross & Co. v. SEC, U. S. Court of Appeals for the Second Circuit, Docket No. 78-6095, Transcript of Oral Argument, at 36, reprinted in Marsh, supra note 1, at 992.
5. See Klein, The SEC and The Legal Profession: Material Adverse Developments, 9 ELEVENTH ANNUAL INSTITUTE ON SECURITIES REGULATION 604 (Practicing Law Inst. No. 319, 1979); Note, Reassessing the Validity of SEC Rule 2(e) Discipline of Accountants, 59 B. U. L. REV. 968 (1979).
6. Touche Ross & Co. v. SEC, 609 F.2d 570, 578 n.13. (2d Cir. 1979). The Commission was prescient in abandoning this role, for Congress, in a 1965 amendment to the Administrative Procedure Act, 5 U.S.C. § 500(b), prohibited federal agencies from establishing admission requirements. See Klein, supra note 5, at 604.
7. The 1970 Amendment added rules 2(e)(i)(iii) and 2(e)(2). See Securities Act Release No. 588, [1970] FED. SEC. L. REP. (CCH) ¶77,913; Note, Regulation of The Accounting Profession Through Rule 2(e) of the SEC's Rules of Practice: Valid or Invalid Exercise of Power?, 46 BROOKLYN L. REV. 1159, 1172 n.69 (1980).
8. The 1971 amendment provides for the supervision of practitioners who have been enjoined from the violation of federal securities laws. See Securities Act Release No. 5147 [1971] FED. SEC. L. REP. (CCH) ¶78,064; Note, supra note 7, at 1172 n.69.
9. See SEC v. National Student Marketing Corp., 457 F.Supp. 682 (D.C.D.C. 1978) for the type of violation which would be covered by this provision. In National Student Marketing, the court found that the attorneys had violated the federal securities laws but did not issue an injunction. See Marsh, supra note 1, at 1001.

10. Brief for Plaintiffs--Appellants, Touche Ross & Co. v. SEC, Docket No. 78-6095, (2d Cir. 1979) at 7, noted in Marsh, supra note 1, at 1002-1003. See also Note, supra note 5, at 971 n.29.
11. See Sommer, Emerging Responsibilities of the Securities Lawyer, N.Y.L.J., January 30, 1974, at 4, col. 7, noted in Note, supra note 7, at 1172 n.69.
12. In the Matter of Murray A. Kivitz, Securities Act Release No. 5163 at 11 n.19 (June 29, 1971).
13. Securities Act Release No. 5572, Exchange Act Release No. 11274 (Mar. 4, 1975). See Marsh, supra note 1, at 988.
14. Telephone conversation with Linda D. Fienberg, SEC Associate General Counsel, on June 7, 1982. See also Klein, supra note 5, at 608 n.2.
15. Marsh, supra note 1.
16. Letter from Linda D. Fienberg, SEC Associate General Counsel, dated June 11, 1982.
17. Three files in the Federal Securities library (FEDSEC), Courts, Releases and No-action Letters, were searched. The Literature file in the Accounting Information library was also searched.
18. See Kelleher, Scourging the Moneylenders from the Temple: The SEC, Rule 2(e) and the Lawyers, 17 SAN DIEGO L. REV. 801, 827 (1980). For instance, a "2(e)" search of several LEXIS files, supra note 17, produced 648 cases with a possible bearing on rule 2(e).
19. A single proceeding with multiple defendants was counted as one proceeding. Two or more proceedings arising out of one incident were counted separately unless the defendants were identical in each proceeding.
20. Kelleher, supra note 18. Kelleher included, in addition to rule 2(e) proceedings, "nonproceedings involving consent withdrawal from practice before the Commission, injunctive actions in which a lawyer's right to practice before the Commission apparently was on the bargaining table and criminal cases where a lawyer-defendant sustained a conviction involving securities related crime." Id. at 828. His list includes several

cases involving criminal convictions or disbarment where the release does not state the disposition; rule 2(e)(2) provides for mandatory suspension in such cases. Id.

21. Klein, supra note 5.
22. In preparing this distribution, two proceedings were counted twice because an attorney and an accountant were named as defendants, SEC v. Emersons Ltd., 9 SEC DOCKET 667 (1976), or one defendant was both an accountant and an attorney, In the Matter of C. Wayne Litchfield, 12 SEC DOCKET 1016 (1977). Two proceedings were excluded from the tabulation. In In the Matter of Robert M. Topol, Exchange Act Release No. 14385 (Jan. 17, 1978), the order does not state whether the defendant was an accountant or an attorney, while in In the Matter of Robert W. McDowell, Jr., Securities Act Release No. 5903 (Feb. 2, 1978), the defendant was a geologist and engineer. Marsh, supra note 1, at 993, was both inaccurate and perceptive in stating that rule 2(e) has only been applied to attorneys and accountants but "it is conceivable that it might be invoked in the future against an engineer or geologist."
23. In the Matter of Keating, Muething & Klecamp, Exchange Act Release No. 15982, FED. SEC. L. REP. (CCH) ¶82,124 at 81,990 (July 2, 1979) [concurring opinion].
24. Id. at 81,994 [dissenting opinion].
25. For example, 83% of the proceedings in the SEC list were against attorneys; in the more complete list this drops to 53%. Marsh, supra note 1, at 989, surmised that the disproportion in the SEC list "appears to be due in large measure to the fact that more proceedings against accountants were kept secret."
26. The use of rule 2(e) parallels to some extent the Commission's enforcement of section 10(b) of the Securities and Exchange Act, which was virtually ignored for several years after its enactment. See Kempin, The Use and Misuse of Inside Information by Corporate Managers and Other Insiders, 14 AM. BUS. L. J. 139, 140 (1976).
27. Marsh, supra note 1, at 992-993.

28. In the Matter of Robert L. Ingis, CPA, 8 SEC DOCKET 695 (1975); SEC v. Emersons Ltd., 9 SEC DOCKET 667 (1976); In the Matter of Phillip Shelby Merkatz, Exchange Act Release No. 13005 (Nov. 2, 1976); In the Matter of Walter E. Parker, Gerald H. Lowther, Hubert E. Lay, 11 SEC DOCKET 1761 (1977); In the Matter of Marvin F. Rosenbaum, Exchange Act Release No. 13495 (May 2, 1977); SEC v. American Commonwealth Financial Corp. et al., 12 SEC DOCKET 421 (1977); In the Matter of Ernest C. Neuman, Exchange Act Release No. 13677 (June 24, 1977); In the Matter of Allen M. Lindenberg, Exchange Act Release No. 13759 (July 18, 1977); In the Matter of Bruce Flamm, Accounting Series Release No. 230 (Oct. 28, 1977); In the Matter of Harvey Fein, Accounting Series Release No. 231 (Oct. 28, 1977); In the Matter of Stephen Kneapler, Accounting Series Release No. 232 (Oct. 28, 1977); In the Matter of Paul N. Conner, 13 SEC DOCKET 1397 (1978); In the Matter of Gerald J. Flannelly, Exchange Act Release No. 15181, FED. SEC. L. REP. (CCH) ¶72,277 (Sept. 22, 1978); In the Matter of Martin E. Davis, FED. SEC. L. REP. (CCH) ¶72,289 (July 2, 1979).

Another six proceedings could, arguably, be added to the list. In the Matter of Keating, Muething & Klekamp, Exchange Act Release No. 15982, FED. SEC. L. REP. (CCH) ¶82,124 (July 2, 1979), the order concluded that a law firm had knowledge of certain transactions by virtue of, among other things, the fact that individual partners of the firm participated on the Board of Directors of two subsidiaries. Id. at 81,988. Commissioner Karmel dissented because, among other reasons, "it is not very clear whether the wrongdoing of these lawyers was in their conduct as professionals or as directors of client companies. The Commission does not have general administrative authority to sanction directors." Id. at 81,997.

In two proceedings it appears that the defendants' positions as corporate officers were only incidental to the proceedings. In the Matter of Francois D. V. De Labarre, Exchange Act Release No. 12721 (August 19, 1976); SEC v. Sharon Steel Corp., et al., 13 SEC DOCKET 178 (1977). In the Matter of Robert M. Topol, Exchange Act Release No. 14385 (Jan. 17, 1978), although the defendant was a vice-president and director of Harris Upham, it is doubtful whether rule 2(e) was used (even though the case appears on the SEC list). Finally, the Topical Index to rule 2(e) proceedings in the Commission's Accounting and Auditing Enforcement Release No. 1 includes, under the heading "Accountants

as Members of Management" In the Matter of John W. Hosford, Accounting Series Release No. 216 (May 16, 1977) and In the Matter of Wilbert S. Fox, Accounting Series Release No. 217 (May 16, 1977). These releases, however, do not state that the defendants were corporate officers.

29. The number of positions is greater than the number of proceedings because several defendants held multiple positions. For example, in In the Matter of Marvin F. Rosenbaum, Exchange Act Release No. 13495 (May 2, 1977), the complaint alleged that the defendant "as vice-president, secretary, treasurer and a director" was responsible for non-disclosure of material facts.
30. See id.; In the Matter of Harvey Fein, Accounting Series Release No. 231 (October 28, 1977); In the Matter of Walter E. Parker, Gerald H. Lowther, Hubert E. Lay, 11 SEC DOCKET 1761 (1977).
31. The number of professionals exceeds the number of proceedings because two attorneys were named as defendants in one proceeding, In the Matter of Walter E. Parker, Gerald H. Lowther, Hubert E. Lay, 11 SEC DOCKET 1761 (1977), while in another proceeding one defendant was an attorney and the other was an accountant. SEC v. Emersons Ltd., 9 SEC DOCKET 667 (1976).
32. In the Matter of Robert L. Ingis, CPA, 8 SEC DOCKET 695, 697 (1975).
33. Id. at 698 n. 10.
34. See note 123 infra and accompanying text.
35. See, e.g., In the Matter of Ernest C. Neuman, Exchange Act Release No. 13677 (June 24, 1977), where the Commission alleged that the defendant, as vice-president and treasurer, played a significant role in a corporation's filing of false statements with the Commission and failure to file reports.
36. See, e.g., In the Matter of Paul N. Conner, 13 SEC DOCKET 1397 (1978) discussed at note 100 infra.
37. See, e.g., In the Matter of Robert L. Ingis, CPA, 8 SEC DOCKET 695 (1975).

38. See, e.g., In the Matter of Phillip Shelby Merkatz, Exchange Act Release No. 13005 (Nov. 24, 1976); In the Matter of Allen M. Lindenberg, Exchange Act Release No. 13759 (July 18, 1977). In these cases, the defendants were charged with selling unregistered stock and with making untrue statements in connection with the sales.
39. See Marsh, *supra* note 1, at 992. For example, in In The Matter of Paul N. Conner, 13 SEC DOCKET 1397, 1400 (1978) the defendant was suspended from practicing before the Commission both as an accountant and as an employee of a public company. However, the defendant in In the Matter of Martin E. Davis, FED. SEC. L. REP. (CCH) ¶72,289 (July 2, 1979) apparently avoided the dual penalty by accepting a position in the management consulting division of a public accounting firm.
40. See Note, *supra* note 5, at 970. In *In re Carter*, Exchange Act Release No. 17,597, FED. SEC. L. REP. (CCH) ¶82,847 at 84,147 and n.5 (Feb. 28, 1981), the Commission cited several cases on its authority to adopt rule 2(e): SEC v. Csapo, 533 F.2d 7 (D.C. Cir. 1976); Fields v. SEC, 495 F.2d 1075 (D.C. Cir. 1974); Kivitz v. SEC, 475 F.2d 956 (D.C. Cir. 1973); Schwebel v. Orrick, 251 F.2d 919 (D.C. Cir.), cert. denied 336 U.S. 927 (1958); and SEC v. Ezrine, [1972-1973 Transfer Binder] CCH FED. SEC. L. REP. ¶93,594 (S.D.N.Y. 1972). In these cases, however, the Commission's authority was not discussed or, if discussed, the language was dictum. See Dolin, SEC Rule 2(e) After Carter-Johnson: Toward a Reconciliation of Purpose and Scope, 9 SEC. REG. L.J. 331, 336-337 n. 17.
41. In the Matter of Touche Ross & Company, et. al., Securities and Exchange Commission Proceeding No. 3-5075.
42. For example, with regard to Giant Store financial statements, the order alleged that Touche Ross "permitted the use of accounting principles not generally accepted, placed excessive reliance on the representations of Giant Store's management and that its report on Giant Store's financial statements was 'materially false and misleading.'" 609 F.2d at 573 n.3.
43. The court noted that there are 525 partners and principals, and approximately 4500 other professional employees in the firm, which has offices in 37 states. 609 F.2d at 573 n.6.

44. [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,415 (S.D.N.Y. April 24, 1978).
45. [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,415, at 93,500, noted in Note, supra 5, at 972 n.32. On appeal, the court made it appear that the concession concerning express authority was made by the appellant, Touche Ross: "Appellants concede there is no express statutory prohibition against promulgation of the Rule." 609 F.2d at 579.
46. 15 U.S.C. § 78aa (1976).
47. See 15 U.S.C. § 78u(e) (1976), and 15 U.S.C. § 77t(b) (1976).
48. 411 U.S. 356 (1973). The court also cited Trans Alaska Pipeline Rate Cases, 436 U.S. 631 (1978).
49. 15 U.S.C. § 78w(a)(1) (1976).
50. See 15 U.S.C. § 77s (1976); 15 U.S.C. § 79t (1976); 15 U.S.C. § 77sss (1976); 15 U.S.C. § 80a-37 (1976); and 15 U.S.C. § 80b-11 (1976).
51. See Ernst and Ernst v. Hochfelder, 425 U.S. 185, 195 (1976), where the Supreme Court noted that the chief purpose of the 1933 Act is to "provide investors with full disclosure of material information concerning public offerings of securities in commerce."
52. See SEC v. Arthur Young & Co., 584 F.2d 1018, 1025 n. 51 (D.C. Cir. 1978), cert. denied, 439 U.S. 1071 (1979).
53. 609 F.2d at 580.
54. Id. at 581.
55. United States v. Benjamin, 328 F.2d 854 (2d Cir. 1964), cert. denied 377 U.S. 953 (1964).
56. 270 U.S. 117 (1926).
57. 609 F.2d at 581.
58. See Note, SEC Disciplinary Proceedings Against Attorneys Under Rule 2(e), 79 MICH. L. REV. 1270, 1286-1287; Klein, supra note 5, at 635.
59. 609 F.2d at 579.

60. See Note, supra note 58, at 1287. See also Speech by Chairman Garrett, New Directions in Professional Responsibility, National Institute of the American Bar Association (October 11, 1973), reprinted in J. WIESEN, REGULATING TRANSACTIONS IN SECURITIES 296 (1975): "Our tools in this context, aside from informal comment and criticism, are enforcement weapons--suspension or disbarment from practicing before the Commission under Rule 2(e) of our Rules of Practice, and an action for an injunction...."
61. See note 48 supra and accompanying text.
62. FCC v. Midwest Video Corp., 440 U.S. 689 (1979). See Note, supra note 58, at 1281.
63. See Note, supra note 58, at 1285.
64. See Note, supra note 5, at 977.
65. 15 U.S.C. § 78s (1976). See Note, supra note 7, at 1180.
66. 15 U.S.C. § 78o(b)(4), (6) (1976).
67. Id. § 80b-3(e). See Note, supra note 5, at 977.
68. Hearings on S. 875 before the Senate Comm. on Banking and Currency, 73d Cong., 1st Sess. 248 (1933) reprinted in Note, supra note 5, at 979.
69. See SEC v. Sloan, 436 U.S. 103 (1978); Wallach v. SEC, 202 F.2d 462 (D.C. Cir. 1953). See also Note, supra note 7, at 1178-1179.
70. See Note, supra note 7, at 1177.
71. 15 U.S.C. §§ 77t(b), 78u(d) (1976).
72. 15 U.S.C. § 77x (1976); id. § 78ff (Supp. I 1977). See Note, supra note 5, at 976-977.
73. Klein, supra note 5, at 634-635.
74. For example, the Commission may suspend the effectiveness of a registration statement, 15 U.S.C. §§ 77h(d), 78l(j) (1976), and may require the correction of financial statements, id. § 77h(d). See Note, supra note 5, at 977.

75. See Note, supra note 5, at 989; Klein, supra note 5, at 640.
76. Herman v. Dulles, 205 F.2d 715 (D.C. Cir. 1953); Koden v. United States Department of Justice, 564 F.2d 228 (7th Cir. 1977).
77. See Note, supra note 58, at 1280.
78. Klein, supra note 5, at 632.
79. 17 C.F.R. § 201.2(f) (1982). See Marsh supra note 1, at 1005.
80. Marsh, supra note 1, at 1005.
81. 15 U.S.C. § 77s(a) and § 77aa (Schedule A).
82. In the Matter of Keating, Muething & Klekamp, Exchange Act Release No. 15982, FED. SEC. L. REP. (CCH) ¶82,124 at 81,993 (July 2, 1979) [dissenting opinion].
83. Id.
84. Id.
85. 609 F.2d 570, 581.
86. 5 U.S.C. § 555(b).
87. See KARMEL, REGULATION BY PROSECUTION 178-180 (1982).
88. In the Matter of Keating, Muething & Klekamp, Exchange Act Release No. 15982, FED. SEC. L. REP. (CCH) ¶82,124 at 81,996 n.31 (July 2, 1979) [dissenting opinion].
89. 609 F.2d 570, 579.
90. 609 F.2d at 581.
91. 270 U.S. 117 (1926).
92. 17 C.F.R. § 201.1 (1982). See Hazen, Administrative Enforcement: An Evaluation of the Securities and Exchange Commission's Use of Injunctions and Other Enforcement Methods, 31 HASTINGS L. J. 427, 441 (1979).
93. See note 35-37 supra and accompanying text.
94. 609 F.2d at 579.

95. See note 4 supra and accompanying text.
96. In the Matter of Keating, Muething & Klekamp, Exchange Act Release No. 15982, FED. SEC. L. REP. (CCH) ¶82,124 at 81,991 (July 2, 1979) [concurring opinion]. See also the dissent of Commissioner Karmel, id. at 81,997.
97. See Ferrara, Administrative Disciplinary Proceedings Under Rule 2(e), 36 BUS. LAW. 1807, 1810 (1981): "We then consider whether the misconduct may, in some way, be connected to the Commission's own processes. This litmus test, I believe, keeps the Commission out of the business of regulating the office practice of attorneys and into the business of protecting its own processes. This is what I like to call the 'nexus issue.'" See also the remarks of SEC General Counsel Edward F. Greene to the New York County Lawyers' Association, 14 B.N.A. Securities Regulation & Law Report, January 20, 1982.
98. See In the Matter of Keating, Muething & Klekamp, Exchange Act Release No. 15982, FED. SEC. L. REP. (CCH) ¶82,124 at 81,994 (July 2, 1979) [dissenting opinion].
99. See note 36 supra and accompanying text.
100. 13 SEC DOCKET 1397 (1978).
101. The order noted, for example, the manner in which the company used equity kickers in calculating its reserve. Id. at 1399.
102. In the Matter of Robert W. McDowell, Jr., Securities Act Release No. 5903 (Feb. 2, 1978). Rule 2(e) states that it applies to "any person."
103. Kripke, supra note 2, at 203-204.
104. 430 U.S. 462, 479-80. See Note, supra note 58, at 1277.
105. The Conference Report, H.R. Rep. No. 1838, 73d Cong., 2d Sess., 35 (1934) noted that the Securities Exchange Act of 1934 should not be construed as authorizing the Commission to interfere with management. See Kripke, supra note 2, at 174 n.2. But see the discussion of the role of the Commission in enforcing the Foreign Corrupt Practices Act, S. Rep. No. 95-114, 95th Cong., 1st Sess. 12 n.6 (1977). The report noted that rule

2(e) "authorizes the Commission to censure, suspend, or bar professionals, such as accountants and lawyers, from practicing before the Commission." The Touche Ross court concluded that this report indicates implicit Congressional approval of rule 2(e). 609 F.2d at 580. However, Congressional intent should not necessarily be presumed because it is doubtful whether Congress was fully aware of the Commission's extensive use of rule 2(e). See Note, supra note 58, at 1288-1289.

106. Welles, John Shad's Biggest Deal, INSTITUTIONAL INVESTOR, April, 1982, at 58. See also Hudson, The Changing Face of the SEC, Wall Street Journal, Dec. 27, 1982, at 8, col. 3.
107. 610 BNA Securities Regulation & Law Report A-2, July 1, 1981.
108. See Wall Street Journal, Oct. 20, 1982, at 6, col. 1.
109. See SEC REPORT OF THE ADVISORY COMMITTEE ON ENFORCEMENT POLICIES AND PRACTICES 4-5 (June 1, 1972), reprinted in Comment, SEC Disiplinary Rules and the Federal Securities Laws: The Regulation, Role and Responsibilities of the Attorney, 1972 DUKE L. J. 969, 1021.
110. 609 F.2d at 580-581.
111. 425 U.S. 185 (1976).
112. Id. at 193-194 n.12.
113. Aaron v. SEC, 446 U.S. 680 (1980).
114. In In re Haskins & Sells, Accounting Series Release No. 73 (1952), CCH FED. SEC. L. REP. 72,088, at 62,197, the Commission held:

We accept respondents' assertion that they acted in good faith and accordingly do not find any willfulness in the sense referred to by them. However, in a disciplinary action under Rule II(e) we are not required to make such a finding. We are of the opinion that respondents' accounting work in connection with the Thomascolor registration statement was so deficient in the respects set forth above, as a result of their failure to give this professional undertaking the degree of care and inquiry it demanded under the circumstances, that disciplinary action is required.

115. Memorandum to Chairman Hills, June 8, 1976, Staff Study, Senate Subcomm. on Reports, Accounting and Management, Appendix I, at 1472 n.2 (1976).
116. SEC Office Memorandum, August 27, 1976, Staff Study, Senate Subcomm. on Reports, Accounting and Management, Appendix I at 1508 (1976). See Miller, The Distortion and Misuse of Rule 2(e), 7 SEC. REG. L. J. 54, 63-64 (1979).

It appears that the Commission has waived with regard to the scienter issue. Under its traditional approach, the SEC looked only for proof that a respondent had intentionally committed the act which constitutes the violation, even though the actor was unaware that the act violated the law. Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965). "In other words, he did not do what he did while sleepwalking." Marsh, supra note 1, at 997. However, in In re Carter, Exchange Act Release No. 17,597, FED. SEC. L. REP. (CCH) ¶82,847 (1981), the Commission's discussion of state of mind resembled the Hochfelder test. See Gruenbaum, The SEC's Use of Rule 2(e) to Discipline Accountants and Other Professionals, 56 NOTRE DAME LAWYER 820, 834-835 (1981).

See also Ferrara, supra note 97, at 1812: "...I think a good argument can be made that the Tager test of willfulness can lie comfortably alongside of Aaron. But, having said that, again I cannot think of a case that I have recommended to the Commission where there has not been at least knowledge plus some added ingredient of culpability...."

117. See Note, supra note 5, at 979. Another reason for the Commission's use of rule 2(e) when other remedies are inappropriate is that courts will not issue injunctions where there is no likelihood that the activity will continue in the future. SEC v. National Student Marketing Corp., 457 F. Supp. 682 (D.C.D.C. 1978). See Downing and Miller, The Distortion and Misuse of Rule 2(e), 54 NOTRE DAME LAWYER 774, 793 n.82 (1979).
118. See text accompanying note 34 supra.
119. One SEC chairman has observed that "if the proceeding is disposed of at the very time it is begun, there normally will be only one round of adverse publicity. Otherwise, there may be two--or more. Lawyers should think about such things." Address to Southwestern

Legal Foundation by Garrett, A Look at the SEC's Administrative Practice (August 25, 1974), reprinted in Downing and Miller, supra note 117, at 784 n.44.

120. 609 F.2d 570, 581.
121. Fiflis, Views on Legal and Ethical Responsibilities of Accountants, 30 BUS. LAW. 186, 187 (1975). See also H. JAENICKE, THE EFFECT OF LITIGATION ON INDEPENDENT AUDITORS 50 (1977).
122. Accounting Series Release No. 153A, FED. SEC. L. REP. (CCH) ¶72,175A (June 27, 1979). One of the former partners named as a defendant did not consent to the settlement and the proceeding against him was dismissed. Order Dismissing Proceeding In the Matter of James M. Lynch, Accounting Series Release No. 266 (June 27, 1979).
123. See Gonson, Disciplinary Proceedings and Other Remedies Available to the SEC, 30 BUS. LAW. 191, 199 (1975); D. CAUSEY, DUTIES AND LIABILITIES OF PUBLIC ACCOUNTANTS 52 (1979).
124. Kripke, supra note 2, at 196.
125. 609 F.2d at 518.
126. ALI FED. SEC. CODE § 1502(a)(5) (Tent. Draft Nos. 1-3, 1974).
127. ALI FED. SEC. CODE § 1804. Explanatory Note 2 (Proposed Official Draft, 1978). See Hazen, supra note 92, at 464-465; Downing and Miller, supra note 17, at 793 n.82.

