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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ARTHUR ANDERSEN & CO., Plaintiff, SECURITIES AND EXCHANGE COMMISSION, Defendant.	Civil Action No. 76 C 2832 (Judge Marshall)

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION
IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT OR,
ALTERNATIVELY, TO DISMISS

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Exhibit A - Accounting Series Release No. 150

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Exhibit E - Accounting Series Release No 193

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ARTHUR ANDERSEN & CO. Plaintiff, v. SECURITIES AND EXCHANGE COMMISSION Defendant.	Civil Action No. 76-C-2832 (Judge Marshall)

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT OR, ALTERNATIVELY, TO DISMISS.

Preliminary Statement

The defendant, Securities and Exchange Commission, submits this memorandum in support of its motion for summary judgment or, alternatively, to dismiss.

The complaint in this action seeks a declaratory judgment that two pronouncements of the Commission relating to accounting — Commission Accounting Series Release No. 150 ("ASR 150") 1/ and Revised Instruction H(f) to Form 10-Q ("Instruction H(f)) announced in Commission Accounting Series Release No. 177 ("ASR 177") 2/ -- are unlawful. Plaintiff, Arthur Andersen & Co. ("Andersen"), had also sought to enjoin the Commission, pendente lite, from enforcing compliance with ASR 150 and Instruction H(f), but Andersen's motion for a temporary restraining order was denied on August 13, 1976, and, on September 3, 1976, this Court denied Andersen's motion for a preliminary injunction.

1/ ASR 150 is attached as Exhibit A to this memorandum. That release is also found in 5 CCH Fed. Sec. L. Rep. ¶72,172.

2/ ASR 177 is attached as Exhibit B to this memorandum. The text of Instruction H(f) is found on pages 19-20 of that release and noted by marginal emphasis. The discussion of Instruction H(f) is found on page 10 of that release and also noted by marginal emphasis. ASR 177 is also found in 5 CCH Fed. Sec. L. Rep. ¶72,199.

ASR 150, although characterized by Andersen as a substantive rule, is no more than a reaffirmation of a long standing administrative policy of the Commission of looking to generally accepted accounting principles established in the private sector as a frame of reference in connection with the Commission's staff's informal review of registration statements and reports filed with the Commission. The Commission first advised the public of that policy in 1938 with the issuance of Accounting Series Release No. 4 ("ASR 4"), 3/ and the policy has been reaffirmed over the years. Following the establishment of the first full time professionally staffed accounting standard setting body in the private sector -- the Financial Accounting Standards Board ("FASB") -- the Commission, in ASR 150 issued in 1973, reaffirmed that historic policy. In that release, the Commission recognized that the newly-formed FASB was the entity established by the private sector to adopt accounting principles for the accounting profession. But, as a statement of policy, ASR 150 does not impose any legal obligations or requirements upon accountants or any other persons.

Instruction H(f) is a substantive rule promulgated in full compliance with the letter and spirit of the Administrative Procedure Act ("APA"). The rule implicitly recognizes the potential for abuse and the lack of consistency engendered by accounting changes. The Commission believes, and generally accepted accounting principles provide, that consistency in the application of accounting principles is to be favored unless a change is to an alternative acceptable principle which is preferable under the circumstances; that is, that the change provides for better financial reporting. Instruction H(f) requires that

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3/ ASR 4 is attached as Exhibit C to this memorandum. It also appears in 5 CCH Fed. Sec. L. Rep. ¶72,005.

when there has been a change in accounting principles, the registrant must furnish a letter from its independent public accountant stating whether or not the change was, in his opinion, to an alternative principle that was preferable under the circumstances.

The rule is not some whimsically-conceived bureaucratic decree, as Andersen seems to argue. To the contrary its antecedents are found in literature emanating from, and views espoused by, an accounting profession which itself has imposed requirements of consistency in accounting treatment. Instruction H(f) is the logical evolution of such requirements. The Commission's concern that changes in accounting principles be made only when they lead to improved financial reporting are long standing. Instruction H(f) is a reflection of the Commission's exercise of its broad authority in accounting matters in an area in which the historic policy of reliance on the principles developed in the private sector did not work as well as the Commission had hoped.

Andersen's complaint attempts to link ASR 150 to Instruction H(f), suggesting that the fatal flaws in ASR 150 did not fully manifest themselves until Instruction H(f) was adopted. There is no meaningful relevant common thread between the two. They represent divergent approaches by the Commission, with few common denominators except for the fact that they both concern accounting principles and they were both properly issued pursuant to the broad authority conferred upon the Commission by Congress. In all other respects, ASR 150 and Instruction H(f) are of different substance and effect and should be considered by this Court as the distinct entities that they are. 4/

4/ This memorandum deals separately with the arguments regarding ASR 150 and Instruction H(f) as if each was the subject of a separate count in the complaint. But they are not. The complaint alleges a single integrated count regarding both. Perhaps the complaint should be judged by what it alleges. If that is so, and if this court finds any material part of the integrated single count to be without merit, then the entire complaint should fail. At any rate, irrespective of the manner in which this Court treats Andersen's complaint, there is no merit to Andersen's arguments concerning ASR 150 or Instruction H(f).

This motion for summary judgment or alternatively, for dismissal, is an appropriate vehicle for the resolution of this case. We agree with counsel for Andersen, who has conceded that there are no genuine issues of fact in this case and that the issues raised by its complaint are legal issues (see, Arthur Andersen & Co. v. Securities and Exchange Commission, N.D. Ill No. C-76-2832, transcript of proceedings dated August 12, 1976, p. 4. ("Tr. ___ p. __").

The principal legal issue concerning ASR 150 which Andersen seeks to engender is whether that release, which does not create any new obligations or duties for accountants or registrants, is a substantive rule or merely a statement of policy. But ASR 150 is simply a statement of policy, not a rule. If this Court concurs, then the remainder of Andersen's arguments concerning ASR 150 must fall. For those remaining arguments are premised on an assumption that ASR 150 is a substantive rule which creates new obligations and requirements, a conditional imperative which establishes a binding norm for the staff's review of financial statements.

The legal inquiries relating to Instruction H(f) which Andersen seeks to raise are whether that rule is within the Commission's broad authority to prescribe accounting methods, and whether the rule, which is founded upon well recognized accounting principles and policies, is arbitrary or capricious. The remaining issues — essentially make-weights, and as will be seen, entirely specious -- concern the allegedly impermissible incorporation by Instruction H(f) of Accounting Principles Board opinions 20 and 28, the asserted "amendment" of Instruction H(f) by a letter from the Commission and, whether the rule violates due process of law by creating a supposed impermissible class of persons.

There are no genuine issues of material fact in this case. For the purposes of a summary judgment motion, "[a]n issue of fact is not 'genuine' within the meaning of Rule 56(c) unless it has legal probative force as to controlling

issues." O'Brien v. McDonald's Corporation, 48 F.R.D. 370, 374, (N.D. Ill., E.D., 1970); see also, Andersen v. Schulman, 337 F. Supp. 177, 181 (N.D. Ill., E.D., 1971). And the Court of Appeals for the Seventh Circuit has remarked that, while courts "should not look the other way to ignore the existence of genuine issues of material fact, on the other hand, we do not deem it necessarily in the best interest of judicial administration to strain to find the existence of such genuine issues where none exist." Kirk v. Home Indemnity Company, 431 F. 2d 554, 560 (C.A. 7, 1970). See also Mintz v. Mathers Fund, Inc., 463 F. 2d 495, 498 (C.A. 7, 1972).

The resolution of the above legal issues necessarily will result in the final disposition of this action before this Court. The Commission believes that it is entitled to summary judgment. In any event, this Court should dismiss this action, since Andersen lacks standing to maintain this action, and no justiciable case or controversey is presented here.

* * *

We will refer in this memorandum to the attached affidavits of (1) Dr. John C. Burton, 5/ (2) A. Clarence Sampson 6/ and (3) Professors Henry R. Jaenicke and Lee J. Seidler (jointly). 7/ From June, 1972, until September 15, 1976, when he assumed the position of Deputy Mayor for Finance of the City of New York, Dr. Burton was the Commission's Chief Accountant. As such, he has personal knowledge of the facts and circumstances which led to the issuance of ASR 150 and ASR 177 as well as the development of a number of the accounting principles, practices and policies which will be discussed in this memorandum; he has additional knowledge, based upon his review of the relevant literature, of still other matters which will be discussed in this memorandum. Mr. Sampson

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5/ Attached as Appendix I to this memorandum.

6/ Attached as Appendix II to this memorandum.

7/ Attached as Appendix III to this memorandum.

has been on the Commission's staff since 1959, and he has been Associate Chief Accountant of the Commission since 1969. Since Dr. Burton's departure, he has been serving as the Acting Chief Accountant of the Commission. Mr. Sampson has personal knowledge of certain of the matters which will be discussed in this memorandum. Professors Jaenicke and Seidler, academians and certified public accountants, have studied and are familiar with the development of certain of the accounting concepts which will be discussed in this memorandum.

ARGUMENT

Point I

ASR 150 IS NOT A SUBSTANTIVE RULE BUT IS MERELY A STATEMENT OF THE COMMISSION'S POLICY. AS SUCH IT DOES NOT CONSTITUTE ANY DELEGATION OF COMMISSION AUTHORITY, TO ANY PERSON AND WAS PROPERLY ISSUED

A. The Background of the Commission's Accounting Policy.

The keystone of the Securities Act of 1933 8/ ("Securities Act") was its substitution of the requirement of full and fair disclosure for a policy of *caveat emptor*. The Securities Act closed the "channels of . . . commerce to securities issues unless and until a full disclosure of the character of such securities" had been made in the form of a registration statement filed with the Commission. 9/ In considering the manner in which such disclosure could be ensured, Congress considered, among other alternatives, a corps of federal auditors to conduct examinations of companies which sought to obtain money for the public. In response to testimony from the accounting profession, 10/ however, Congress opted for reliance on the certification of an *independent* public or certified accountant. 11/

While the Federal Trade Commission (the first administrator of the Securities Act) was not required to conduct audits of corporations which filed financial statements with that agency, it was, nonetheless, given broad authority to define accounting terms and to prescribe the form and details by which financial

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8/ 15 U.S.C. 77a *et seq*.

9/ H. Rep. 85, 73d Cong. 1st Sess. 3 (1933).

10/ Hearings on S. 875, Before the Senate Committee on Banking and Currency, 73d Cong., 1st Sess. 55-63 (1933)("Senate Hearings on S. 875")

11/ 15 U.S.C. 77aa (25), (26) and (27).

information was to be presented. 12/ The draftsmen of the Securities Act recognized that conferring "broad powers of regulation" upon the administrator of the Act was preferable to detailed enumeration of regulatory requirements, since an agency with such powers "would be in a better position to determine, after practical experience, what information is needed. . . . " 13/

A year later, with the enactment of the Securities Exchange Act of 1934, administration of the Securities Act was transfered to the newly created Securities and Exchange Commission and again the role of the independent accountant was recognized. 14/ In addition, the Commission's authority to define accounting terms 15/ and to prescribe the forms, details, and the methods to be followed in the presentation of financial statements was expanded. 16/ Companies that sought public funds from the sale of their securities and companies whose securities were held by significant numbers of public investors were required to make full disclosure of their financial and operating condition, in such form, in such manner, and at such intervals as the Commission determined to require.

The Commission was "given complete discretion . . . to require in corporate reports only such information as it deems necessary or appropriate in the public interest or to protect investors." (Emphasis added). 17/

Significantly, however, this broad grant of authority was entirely permissive. The determination to invoke that authority was left entirely up to the Commission.

12/ 15 U.S.C. 77s(a)

13/ Senate Hearings on S. 875 at 250.

14/ 15 U.S.C. 78m(a)

15/ 15 U.S.C. 78c(b)

16/ 15 U.S.C. 78m(b)

17/ S. Rep. 792, 73d Cong. 2d Sess. 10 (1934).

How to conform the federal securities laws' policy of full and fair disclosure to varying accounting policies was the subject of early Commission debates. The Commission wrestled with the problem of whether it should establish accounting principles and a uniform system of accounts, or whether a more flexible approach, allowing for evolution of accounting principles in the private sector, should prevail. On April 1, 1937, the Commission issued Accounting Series Release No. 1 18/ in which it "announced a program for the publication from time to time, of opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions." The drift was clearly to the latter, more flexible approach.

The question was finally settled with the issuance of ASR 4 in 1938. ASR 4 was an expression of the Commission's administrative policy. It stated that the Commission would presume that financial statements which were prepared in accordance with accounting principles for which there was no substantial authoritative support were misleading notwithstanding disclosure of those principles. If there was a difference of view with the Commission, the Commission would accept disclosure in lieu of a change in the financial statements only when there was substantial authoritative support for the proposed accounting principle and the Commission had not expressed a contrary view in an official release. Thus, rather than exercise its extensive authority to adopt specific accounting principles and methods, the Commission elected, in large part, to accept, in the first instance, principles which already had substantial precedent — accounting principles which were generally accepted in the private sector.

18/ 5 CCH Fed. Sec. L. Rep. ¶72,002.

In 1940, the Commission adopted Regulation S-X 19/ which contained the rules and requirements as to the form, content and detail of financial statements and schedules filed under the Securities Act and the Securities Exchange Act. Regulation S-X did not purport to establish accounting principles; it was limited to securing consistency in the form and structure of financial statements. Accounting principles continued to evolve in the private sector and as a result of the Commission's procedure of having its staff informally review registration statements before they became effective.

In 1950, the Commission, following extensive public comment, adopted a comprehensive amendment to Regulation S-X. In its release announcing adoption of the revised regulation, the Commission stated:

> "The amendment makes it clear also that the several requirements previously expressed in published opinions continue to reflect considered Commission policy. This has been accomplished, to a large extent, by amending Rule 1-01, which now reads, in part, as follows:
>
> > 'Rule 1-01 (a). This regulation (together with the Accounting Series Releases) states the requirements applicable to the form and content of all financial statements required to be filed . . ." 20/

The amendment to Rule 1-01(a) was intended to call registrants' attention to the Commission's Accounting Series Releases, many of which provided guidance and interpretation of the requirements of Regulations S-X. This did not constitute an adoption of all prior and future accounting series releases as rules of the Commission, however. In fact, many accounting series releases cover matters totally removed from Regulation S-X. 21/

19/ 17 C.F.R. Part 210.

20/ Accounting Series Release No. 70, December 20, 1950 (5 CCH Fed. Sec. L. Rep. ¶72,089).

21/ See, e.g., ASR 123, 5 CCH Fed. Sec. L. Rep. ¶72,145 (urging the creation of audit committees of outside directors); ASR 158, 5 CCH Fed. Sec. L. Rep. ¶72,180 (order accepting undertaking by an accountant not to practice before the Commission.)

The Commission's policy -- of accepting, in the first instance, the accounting principles established in the private sector -- was unchanged by this release and remained the governing policy of the Commission.

In Accounting Series Release No. 96 ("ASR 96") 22/, issued in 1963, the Commission reaffirmed that policy. The relevant portion of the release stated:

> "In Accounting Series Release No. 1, published April 1, 1937, the Commission announced a program for the purpose of contributing to the development of uniform standards and practices in major accounting questions. Accounting Series Release No. 4 recognizes that there may be sincere differences of opinion between the Commission and the registrant as to the proper principles of accounting to be followed in a given situation and indicates that, as a matter of policy, disclosure in the accountant's certificate and footnote will be accepted in lieu of conformance to the Commission's views only if such disclosure is adequate and the points involved are such that there is substantial authoritative support for the practice followed by the registrant, and then only if the position of the Commission has not been expressed previously in rules, regulations, or other official releases of the Commission, including the published opinion of its Chief Accountant. This policy is intended to support the development of accounting principles and methods of presentation by the profession but to leave the Commission free to obtain the information and disclosure contemplated by the securities laws and conformance with accounting principles which have gained general acceptance."(Emphasis added).

Over the years, the accounting profession has designated a number of standard-setting bodies to establish and improve accounting principles. In 1939, the American Institute of Certified Public Accountants ("AICPA") organized the Committee on Accounting Procedure ("CAP") and authorized it to issue pronouncements on accounting. Between 1939 and 1959 the CAP issued 51 Accounting Research Bulletins on accounting principles and practices which were designed to be guides to the profession. (See, Statement of Position of the Financial Accounting Foundation and Financial Accounting Standards Board, Exhibit 2 to the Affidavit of John C. Burton, at A-1)("FASB Statement of Position"). In 1959, the Accounting Principles Board of the AICPA ("APB") replaced the CAP as the body designated by the profession to establish and improve accounting

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22/ 5 CCH Fed. Sec. L. Rep. ¶72,118

principles. The members of the APB served on a part-time basis and without compensation, and the board had no research staff of its own. Instead, it relied for staff support on other divisions of the AICPA. From 1959 to 1973, when the FASB was established, the APB issued 31 Opinions and four Statements on financial accounting and reporting matters. (FASB Statement of Position, at A-1).

The FASB was the first independent, full-time body designated by the profession to formulate and issue accounting principles. It has seven full-time salaried members who have no other business affiliations. It is assisted in its work by a full-time technical and research staff. (FASB Statement of Position, at A-3, A-8). It also has a full-time professional and administrative staff of approximately 81 persons (FASB Statement of Position, at A-7). Through August, 1976, the FASB has issued twelve "Statements of Financial Standards," the title given to its pronouncements (Affidavit of Henry R. Jaenicke and Lee J. Seidler, ¶4)("Jaenicke & Seidler Affidavit").

Before the FASB issues a Statement of Financial Accounting Standard or Interpretations of those Statements or of Accounting Research Bulletins or Accounting Principles Board Opinions, an elaborate procedure involving notice to the public and an opportunity for comment must be met. First a discussion memorandum is prepared and circulated to approximately 25,000 persons. The FASB then holds public hearings to receive suggested solutions to the problems raised in the discussion memorandum. After consideration of the oral and written comments, an exposure draft setting forth the proposed financial and reporting standards is issued for broad public comment. After consideration of the comments received, the FASB deliberates further and prepares a final statement for issuance. (FASB Statement of Position, at A-3 through A-5).

With the establishment of the FASB, which it had supported, the Commission believed that it was appropriate to reaffirm publicly its policy of relying

on the private sector to establish generally accepted accounting principles. On December 20, 1973, the Commission issued ASR 150 in which it reaffirmed its policy of relying, in the first instance, on the private sector for the establishment of accounting principles, and recognized that the FASB was the entity designated by the private sector to have that responsibility. That release stated in part:

> "For purposes of this policy, principles, standards and practices promulgated by the FASB in its Statements and Interpretations 1/ will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered (footnote omitted) to have no such support.
>
> 1/ Accounting Research Bulletins of the Committee on Accounting Procedure of the American Institute of Certified Public Accountants and effective opinions of the Accounting Principles Board of the Institute should be considered as continuing in force with the same degree of authority except to the extent altered, amended, supplemented, revoked or superseded by one or more Statements of Financial Accounting Standards issued by the FASB."

The Commission emphasized, in that release, however, that it still had the "responsibility to assure that investors are provided with adequate information." Accordingly, the Commission noted that, if it was necessary to depart from statements of the FASB or its predecessors as those presumed to have substantial authoritative support in order to prevent misleading financial statements, other principles would be acceptable or might even be required by the Commission. In this regard, the release stated:

> "It should be noted that Rule 203 of the Rules of Conduct of the Code of Ethics of the AICPA provides that it is necessary to depart from accounting principles promulgated by the body designated by the Council of the AICPA if, due to unusual circumstances, failure to do so would result in misleading financial statements. In such a case, the use of other principles may be accepted or required by the Commission."

From the foregoing it can be seen that the only effect of ASR 150 was its explicit announcement of a rebuttable presumption which the Commission's staff was employing to facilitate its review of registration statements and reports

filed with the Comission. No legally binding norm was created. If the application of principles for which there is substantial authoritative support produces misleading financial statements, deviation from those principles is permitted; indeed the Commission indicated that it might require deviation if it believed that to do otherwise would result in misleading financial statements.

For members of the AICPA, such as partners of Andersen, ASR 150 should have no effect on their evaluation of generally accepted accounting principles. Rule 203 of the revised Code of Professional Ethics, adopted by the AICPA in early 1973, (and referred to in ASR 150), requires AICPA members to follow FASB pronouncements or to demonstrate that departures from such principles are in conformity with generally accepted accounting principles. While failure to conform to the conduct required by Rule 203 might subject an AICPA member to possible sanctions by that organization, 23/ the use of principles for which there was no substantial authoritative support could not subject an accountant or registrant to any liability under ASR 150. (See discussion of liability, *infra*, pp. 17-18).

B. ASR 150 is a General Statement of the Commission's Policy.

Andersen does not directly challenge the merits of the Commission policy embodied in ASR 150. Its arguments are concerned, instead, with alleged defects of essentially a procedural nature. Thus, Andersen argues that the release was not issued in accordance with the rulemaking requirements of the Administrative Procedure Act, 5 U.S.C. 551, *et seq.*, and that the release unlawfully delegates authority to the FASB.

Andersen's claims are based upon a fundamental misconception of the nature of ASR 150. That release is not, as Andersen states, a substantive rule of the Commission. At most, ASR 150 is a general statement of the Commission's policy regarding accounting principles.

23/ A member of the AICPA may be expelled from the AICPA or have his membership suspended if he infringes any provision of its Code of Professional Ethics. See, By-laws of the AICPA, Section 740, 2 CCH AICPA Professional Standards, Section 740.

The term "rule" is defined in the APA to include:

> "the whole or part of an agency statement of general or particular applicability, and future effect designed to implement, interpret, or prescribe law or policy or practice requirements of an agency . . . ." 5 U.S.C. 551(4).

When an administrative agency seeks to promulgate a substantive rule the APA requires that, generally, notice of the proposed rulemaking proceeding must first be published in the Federal Register, interested persons must be given an opportunity to comment on the proposed rule, and the rule must be published at least 30 days before it is to become effective, 5 U.S.C. 553. The draftsmen of the Act recognized, however, that the sweeping definition of "rule" and the detailed and possibly time consuming rulemaking proceedings might discourage agencies from issuing pronouncements in the nature of "interpretative rules" and "general statements of policy." Accordingly, these types of agency pronouncements were expressly exempted from the APA's notice and publication requirements. 24/ 5 U.S.C. 553(b)(A) and (d)(2).

Thus, even if this Court were to conclude that ASR 150 is a rule, that is not the end of the inquiry, as Andersen suggests, but is only the beginning. The crucial determination for purposes of this case is whether ASR 150

24/ See, S. Doc. No. 248, 79th Cong., 2d Sess. 18 (1946).

In addition, because the contents and occasions for the issuance of such pronouncements widely differed, the legislators felt that the agency should decide when notice and publication were appropriate. Finally, the legislators recognized that irrespective of whether the agency decided to publish such pronouncements for comment, private parties could secure a reconsideration of the pronouncement by the agency through the provisions of the APA which provided a method for persons to petition the agency "for the issuance, amendment, or repeal of a rule (which includes statements of policy within its definition)." 5 U.S.C. 553(e). This last reason is germane to this case because, here, Andersen has done just that -- petitioned the Commission to revoke ASR 150, and Instruction H(f). The Commission rejected Andersen's petition insofar as it requested that the substantive portion of Instruction H(f) be revoked. As to ASR 150, however, the Comission is presently seeking public comments on a number of questions which relate to the concerns raised by Andersen's petition regarding that release. See, Accounting Series Release No. 193, Exhibit E to this memorandum, and also found in 5 CCH Fed. Sec. L. Rep. ¶ 72,215. A number of comments have been received, including the FASB's, which is attached as Exhibit 2 to the affidavit of John C. Burton ("Burton Affidavit"). Andersen has advised the Commission that it is declining to comment because of this pending action.

is merely a general statement of policy and therefore exempt from the notice and publication requirements of the APA. We submit that it is.

In an early attempt to define "general statement of policy," the Attorney General's Manual on the Administrative Procedure Act, page 30 n. 3 (1947) characterized such issuances as "statements issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power." That is precisely what exists here. ASR 150 merely advises "the public prospectively" of the frame of reference which the staff will utilize in its informal review of registration statements.

Similarly, ASR 150 comes well within the definition accorded statements of policy by those courts which have dealt with the issue. In one of the more complete expositions on the subject, the Court of Appeals for the District of Columbia Circuit defined a general statement of policy as "an informational device . . . by which an agency can express its views." Pacific Gas and Electric Company v. Federal Power Commission, 506 F.2d 33, 38 (C.A. D.C. 1974). Unlike a substantive rule "which has the force of law . . . ,"a statement of policy "does not establish a 'binding norm'. It is not finally determinative of the issues or rights to which it is addressed." Id.

In many respects ASR 150 is like the agency pronouncement held to be a a general statement of policy in Pacific Gas & Electric Co. v. Federal Power Commission, supra. In view of the possibility of natural gas shortages, the Federal Power Commission ("FPC"), in an earlier pronouncement, had directed gas pipeline companies to establish plans for the curtailment of their distribution of natural gas, to be implemented in times of natural gas shortages. The FPC found that the plans which had been submitted to it for its final approval employed widely different approaches. Accordingly, the FPC issued the pronouncement in question, which set forth that agency's preference for

the priorities to be assigned by gas pipeline companies in establishing curtailment plans. The pronouncement, in effect, informed the public that curtailment plans which followed the FPC's preferred priorities would receive tentative FPC approval. The pronouncement offered no assurance, however, that compliance with those priorities would result in final FPC approval. The court of appeals found that the FPC's pronouncement had "no final, inflexible impact upon" the party challenging its validity. Pacific Gas & Electric Co. v. Federal Power Commission, supra, 506 F. 2d at 41. Companies were not precluded from proposing other priorities, and the FPC was free to adopt variations.

In much the same manner, ASR 150 announces the Commission's preference for principles adopted by the FASB as a source of authoritative support. A registrant or accountant may urge the use of some other principle, however, if it would be appropriate under the circumstances, and in such instances the Commission may permit or require the use of the other principle.

Concededly, the failure to follow generally accepted accounting principles might alert the Commission to the fact that such financial statements might be misleading. But no action would lie under ASR 150 itself to seek redress. The Commission, or a private plaintiff instituting suit, would have to rely on a cause of action founded upon some other provision of the securities laws, such as those which prohibit misleading statements. 25/ Such suit, moreover, could not succeed merely on a demonstration that generally accepted accounting principles had not been followed, but would require proof that the financial statements in question were materially misleading. 26/ The Commission "cannot apply or rely upon" ASR 150 as law because it "only announces what the [Commission] . . . seeks to establish as policy." Pacific Gas & Electric Co. v. Federal

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25/ See, e.g., 15 U.S.C. 77k and 77q, 15 U.S.C. 78j(b), 17 C.F.R. 240.10b-5.

26/ See, e.g., TSC Industries Inc. v. Northway Inc., 96 S. Ct. 2126 (1976).

Power Commission, supra 506 F. 2d at 38. Thus, if the Commission seeks to apply "the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued." Id. 27/

Of course, should the Commission determine that the policies adopted in the private sector do not adequately protect the interests of investors it can always exercise its authority and adopt accounting principles by promulgating substantive rules. 28/ Hence, ASR 150 — one of the informative devices through which the Commission has made public its preferences for accounting principles — is not a substantive rule, but is a general statement of the Commission's policy.

The same conclusion is reached under the widely embraced "substantial impact" test. See, Noel v. Chapman, 508 F.2d 1023 (C.A. 2, 1975); Pickus v. United States Board of Parole, 507 F.2d 1107 (C.A. D.C., 1974); Lewis-Mota v. Secretary of Labor, 469 F.2d 478 (C.A. 2, 1972); Texaco, Inc. v. Federal Power Commission, 412 F.2d 740 (C.A. 3, 1969); Airport Commission of Forsyth County v. Civil Aeronautics Board, 300 F.2d 185 (C.A. 4, 1962). That inquiry examines whether the agency pronouncement has "'a substantial impact on those regulated' . . . that is, ordinarily rules that change 'existing rights and obligations . . . .'" Noel v. Chapman, supra, 508 F.2d at 1030.

The effect of ASR 150 falls considerably short of the substantial impact on existing rights and obligations which the regulations had in the cases cited by

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27/ The Pacific Gas case also suggests that an agency's own characterization of a pronouncement may provide an indication of the nature of the announcement. Pacific Gas & Electric Co. v. Federal Power Commission, supra, 506 F. 2d at 39. ASR 150 is repeatedly referred to in its caption and text as a statement of the Commission policy. While that label is not conclusive, it is entitled to appropriate deference by this Court in the absence of any showing of bad faith.

28/ See, e.g., ASR 96 (5 CCH Fed. Sec. L. Rep. ¶72,118), which rejected the conclusion of APB Opinion No. 2 that there was only one acceptable acounting method for the treatment of investment/credit. ASR 130 (5 CCH Fed. Sec. L. Rep. ¶72,1523) flatly contradicted Interpretation No. 21 of APB Opinion No. 16 concerning the requirements for a "pooling of interests."

Andersen in its papers previously filed in support of its motion for a preliminary injunction. 29/ The only reasonable effect of the release is found in the comfort it offers to registrants by affording some assurance that conformity with

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29/ The agency directives which the court in Columbia Broadcasting System, Inc. v. United States, 316 U.S. 407 (1942), concluded were reviewable orders, seriously disrupted the plaintiff's business by causing wholesale cancellations of the contracts which plaintiffs had with its affiliated broadcasting stations. The regulations, which were expressed in mandatory terms, provided that the Federal Communications Commission would not grant a broadcast license to any stations which had contracts containing the types of provisions which were characteristic of plaintiffs' contracts with its affiliates.

In Pickus v. United States Board of Parole, supra, 507 F.2d at 1107, the parole board regulations in question "define[d] parole selection criteria" and were "calculated to have a substantial effect on ultimate parole decisions." Id. at 1112-1113. The regulations did not merely provide a framework for the exercise of an informal discretionary function, but were "controls over the manner and circumstances in which the agency . . . [would] exercise its plenary power." Id. at 1113.

Similarly, in Texaco, Inc. v. Federal Power Commission, supra, 412 F.2d 740, the agency regulation required gas companies to pay a compound interest on refunds ordered by the agency. And, the language of the regulation itself stated that the requirements were "substantive amendments" under the APA. Id. at 742.

Pharmaceutical Manufacturers Association v. Finch, 307 F. Supp. 858, 859 (D. Del., 1970), involved regulations which "promulgated new standards of evidence necessary to demonstrate the effectiveness of drug products." In addition, the newly pronounced standards were applied retroactively, and so jeopardized the continued sale of thousands of drug products for which the Food and Drug Administration had previously approved applications permitting their sale.

The regulations in Seaboard World Airlines, Inc. v. Gronouski, 230 F. Supp. 44 (D. D.C., 1964). had the effect of substantially depriving plaintiff of all of its revenues as an airmail carrier by requiring, in effect, that jet planes, and not the turbine-powered aircraft which plaintiffs used, carry the mails.

Lewis-Mota v. Secretary of Labor, supra, 469 F. 2d 478, also relied on by Andersen, involved an administrative regulation which changed existing rights and obligations by requiring the submission of certain proofs, which had not previously been required, before aliens could obtain visas to reside as permanent residents in the United States.

Similarly, the regulation in National Motor Freight Traffic Association v. United States, 268 F. Supp. 90 (D. D.C., 1967), aff'd, 393 U.S. 18 (1968), gave notice that the Interstate Commerce Commission had created a new administrative right of action under a newly enacted statute.

generally accepted accounting principles will facilitate the review and filing of reports with the Commission. No one is, or could be, subject to criminal sanctions for violation of the release: the Commission could not institute an injunctive action to compel compliance with ASR 150, and an accountant could not be suspended or barred from practice under Rule 2(e) of the Commission's Rules of Practice, 17 C.F.R. 201.2(e), solely with reference to ASR 150 (See, Burton Affidavit, ¶22)

In the final analysis, ASR 150 is, in effect, "'directed primarily at the staff'" of the Commission and describes how the staff "'will conduct agency discretionary functions . . . .'" Noel v. Chapman, supra, 508 F. 2d at 1030. The policy allows for a presumption for the purpose of facilitating the staff's review of registration statements. But, ASR 150 is not substantive, nor a rule: it is not a conditional imperative to which the staff is conclusively bound in its informal review of registration statements.

C. ASR 150 Does Not Delegate Rulemaking Authority To The FASB

It follows from the determination that ASR 150 is not substantive nor a rule, that ASR 150 does not delegate any authority to the FASB. The release is not even an exercise of the Commission's own substantive rulemaking authority, much less a delegation of that authority to the FASB. In fact, ASR 150 represents a Commission decision not to exercise its broad rulemaking authority. FASB pronouncements are of no more substantive force and effect after the issuance of ASR 150 than they were before it was issued.

In sum, ASR 150 could not constitute an unlawful delegation of Commission authority since it does not delegate any authority. 30/

30/ Andersen's reliance on Carter v. Carter Coal Co., 298 U.S. 238 (1936) in its memorandum in support of its motion for a preliminary injunction is misplaced because the present case involves no delegation at all. In any event, this case is not at all like Carter, where a federal statute conferred authority on a majority of coal producers and miners "to regulate the affairs of an unwilling minority . . ." id. at 311, by setting minimum wages and hours which would bind the minority.

Andersen improperly relies on United States v. Mazurie, 487 F. 2d 14 (C.A. 10, 1973), which it erroneously cites as having been reversed on other grounds by the Supreme Court when in fact the Court of Appeals decision was reversed on the precise grounds for which Andersen cites it. 419 U.S. 544 (1975)

As the AICPA demonstrates in its amicus brief, moreover, even if ASR 150 constituted a delegation of authority, it would be a permissible delegation. Memorandum of Points and Authorities of American Institute of Certified Public Accountants as Amicus Curiae pp. 35-41.

Point II

INSTRUCTION H(f) TO FORM 10-Q IS A PROPER EXERCISE OF THE COMMISSION'S BROAD AUTHORITY TO ADOPT ACCOUNTING RULES, IS NOT ARBITRARY OR CAPRICIOUS, AND WAS ADOPTED IN ACCORDANCE WITH THE ADMINISTRATIVE PROCEDURE ACT

In contrast with its claims against ASR 150, which were procedural in nature, Andersen's claims regarding Instruction H(f) are addressed both to alleged procedural infirmities in the adoption of the rule, and to alleged substantive improprieties in the rule. All of the following issues are exclusively legal issues, susceptible to resolution on this motion for summary judgment. None of them has any merit. Andersen alleges that (1) the Commission exceeded its authority in adopting Instruction H(f), (2) the rule is arbitrary and capricious and an abuse of the Commission's discretion, (3) the rule was not adopted in accordance with the notice and publication requirements of the Administrative Procedure Act because of (a) its incorporation of APB opinions 20 and 28 and (b) its "amendment" by a letter of the Commission to Kenneth P. Johnson on April 30, 1976, and (4) the rule creates an impermissible classification of persons in violation of due process of law.

A. The Antecedents Of Instruction H(f)

Instruction H(f) is one example of an instance in which the Commission has exercised its "complete discretion" 31/ to adopt acounting principles for the protection of investors. Instruction H(f) is a substantive rule, a mandate of the Commission. But its directive is addressed to entities which register securities with the Commission, not their accountants.

31/ See n. 17 supra.

Instruction H(f) to Form 10-Q requires, when there is a change in accounting principle, that

> "in the first Form 10-Q filed subsequent to the date of an accounting change, a letter from the registrant's independent accountants shall be filed as an exhibit indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances . . . ." (Emphasis added).

The instruction imposes no obligation on accountants, however, and no penalty flows from the rule to an accountant when he declines to furnish a client with a letter regarding preferability.

Andersen's attack on Instruction H(f) depends upon the isolation of that rule from its background. Andersen seeks to segregate Instruction H(f) from the fundamental accounting principles to which it relates, and upon which it bears, and on that basis argues that the rule is without foundation, "a mere whim" (memorandum of Andersen in support of its motion for a preliminary injunction at 10) issuing from the mind of some bureaucrat writing on a blank slate. Andersen's bald assertions could not be more incorrect.

The rule is the result of a logical evolution from well-established requirements that accountants exercise judgment in the selection of accounting principles and that there be consistency in the employment of accounting principles. As such, the antecedents of the rule go back many years. Not only does the rule have its roots in the past, but it is entirely consistent with other actions by the Commission based on its belief that accounting changes should be made only when they will result in more meaningful financial reporting.

In the early years following enactment of the Securities Act, its review of registration statements demonstrated to the Commission that there was a wide diversity of views on accounting principles. And, as recognized in ASR 4, more than one accounting principle may have substantial authorative

support. The Commission has generally sought, however, to encourage registrants to present financial data in the manner most meaningful to users of financial statements. In its sixth annual report to Congress, the Commission described its practice in the accounting area as follows:

> "While the Commission's formal opinions, rules, regulations, and accounting series releases have been influential in lifting the level of accounting standards, it is believed that even greater benefits have been derived from the Commission's day-to-day activities with respect to accounting matters under the securities Acts. Those cases in which accounting practices are clearly unsound are generally settled or corrected in conference between the staff and the registrant, its counsel, and accountants. For every formal opinion involving an accounting point, there have been a score of cases in which accounting problems were adjusted in conference. Moreover, presentation in such conferences of what may be termed the most preferable method frequently leads to its adoption in lieu of a method which, while recognized as acceptable, is generally considered not to be the most preferable" (emphasis added) Securities and Exchange Commission, Sixth Annual Report, at 174 (1940).

The Commission's concern with preferability as a predicate to change in accounting principles was again discussed in the Commission's twenty-fourth annual report to Congress:

> "Another characteristic of the past year has been the number of cases coming to the attention of our accountants in which a change in accounting policy has been adopted or desired. Where a change has appeared to be motivated by a desire to improve current earnings . . . we have objected unless it could be shown that the new method was clearly in the interest of improved financial reporting in the long run." Securities and Exchange Commission, Twenty-fourth Annual Report, at 120 (1958)(emphasis added).

The latter part of the 1960's, sometimes referred to as the "go-go years," saw increased stress on the rate of growth shown by companies. Earnings per share became the magic figure. Investors were concerned with performance — performance as measured by the percentage growth in earnings per share from period to period — and, unfortunately, the pressure for performance placed great stress on accountants. For many companies, the goal was no longer how best to portray the economic

realities of the company, but how to increase earnings per share. One commentator noted:

> "The one trend that is discernible from these data is an increase in changes in accounting which tend to increase reported net income. 1968 and 1969 were years of economic uncertainty, inflation, and the surtax. In such an economic environment, the data suggest that many firms, in order to minimize declines in reported net income, or to minimize declines in annual growth rate of income, resorted to changes in accounting methods. That they were able to do so casts some doubt on the adherence to 'generally accepted accounting principles.'" Frishkoff, "Some Recent Trends in Accounting Changes," Journal of Accounting Research, Vol. 8, No. 1 [Spring 1970], at 141-44.

The Accounting Principles Board (APB), the predecessor of the FASB, considered the problem of accounting changes. It issued two exposure drafts before finally issuing its Opinion No. 20 in July of 1971. As was the custom, the members of the APB were in close contact with the Chief Accountant of the Commission concerning the proposed opinion. Pre-exposure drafts were discussed with the Chief Accountant, and a meeting was held between the Chief Accountant, members of his staff, and representives of the APB to discuss a draft dated December 29, 1969. As a result of that meeting, and at the request of the APB, the draft opinion was discussed by the Chief Accountant with the members of the Commission. In a letter dated January 20, 1970, furnished to all members of the APB, the Commission's Chief Accountant wrote:

> "As you requested . . . I have brought the draft opinion as subsequently edited, to the Commission's attention. In doing so, I have stressed that it is the purpose of this opinion to encourage accounting changes which would reflect the best of the alternative practices now permitted in several areas under generally accepted accounting principles and to prohibit such changes which do not reflect improvements in financial reporting. We understand that paragraph 10 of the opinion is intended to emphasize this purpose. If the opinion is ultimately adopted substantially as drafted, we would expect that the staff would be furnished with written supplemental justification by both the registrant and its certifying accountants for any proposed accounting changes." (Emphasis added).

Thus, so far as the Commission was concerned, the accounting profession was to have a joint responsibility with the registrant in determining that the change represented an improvement in financial reporting (See, Affidavit of A. Clarence Sampson, ¶6) ("Sampson Affidavit"). The December 29, 1969, draft opinion shown to the Commission was issued as an exposure draft on February 16, 1970. Paragraph 10, of that draft referred to by the Commission in its January 20, 1970 letter read:

> "There is a presumption that an accounting principle or method, once adopted, will not be changed as long as the pertinent events or transactions continue. The presumption that accounting changes will not be made may be overcome only when it is demonstrable that the change proposed is to a method which is generally accepted and which will provide more useful results than those furnished by the method previously followed, considering the varying interests of parties using the financial statements. Issuance of an Opinion by the Accounting Principles Board expressing a preference for a certain method or proscribing a previously accepted method is sufficient support for an accounting change. In the absence of such an Opinion, the burden of demonstrating that a change is appropriate rests with the business enterprise making the change."

The exposure draft of February 16, 1970, was superseded by an exposure draft dated January 20, 1971. The new draft provided that the "presumption that an entity should not change an accounting principle may be overcome only if the enterprise demonstrates that an alternative accounting principle that is generally accepted will provide more useful financial information."

Among those commenting on the exposure draft was Arthur Andersen & Co., which submitted a printed "Brief and Argument" dated April 28, 1971. The Andersen brief recommended that :

> "The issuer of the financial statements and the independent auditor should assume more responsibility for justifying and documenting a change in accounting principle as a significant improvement in the presentation of the facts to investors. Otherwise, a change should not be made." Arthur Andersen & Co., Brief and Argument, at 11 (April 28, 1971) (emphasis added).

The APB issued Opinion No. 20 in July of 1971. In relevant part it states:

"15. The Board concludes that in the preparation of financial statements there is a presumption that an accounting principle once adopted should not be changed in accounting for events and transactions of a similar type. Consistent use of accounting principles from one accounting period to another enhances the utility of financial statements to users by facilitating analysis and understanding of comparative accounting data."

"16. The presumption that an entity should not change an accounting principle may be overcome only if the enterprise justifies the use of an alternative acceptable accounting principle on the basis that it is preferable . . . " (emphasis added).

APB No. 20 is clear statement that consistency in accounting treatment is to be favored — a position with which the Commission agrees. It also clearly states the logical corollary of the consistency requirement, the requirement that a change in accounting principles be to a preferable principle before the presumption of consistency could be overcome.

The requirement of consistency is fundamental to the profession of accounting. There can be no meaningful presentation of an entity's continuing financial picture unless the measurements used are applied in a consistent fashion. Thus, APB No. 20 appropriately required that deviations from consistency should be acquiesced in by independent auditors only when the change in accounting principle was a preferable change. Moreover, the Commission had no reason to believe that the responsibility for the preferability determination would be anything less than a joint responsibility of the accountant and its client. While business judgments were entrusted to the client, the accountant was, nevertheless the person with the independent and professional expertise to objectively determine whether changes were preferable as a matter of accounting judgment. If the accountant could not make such a determination then the change was not to receive the implicit or explicit acquiescence of the independent auditor. To ask that the accountants assume responsibility was not unreasonable. As one text points out:

"an auditor is sure to have been involved in the consideration of a proposed change, at least in helping to draft the explan note and more likely in suggesting a change to a preferable method in the first place." Monntgomery's Auditing, 769 (9th ed., 1975) (Emphasis added).

In November of 1972, however, a committee of the American Institute of Certified Public Accountants, the Committee on Auditing Procedure, issued Statement on Auditing Procedure No. 53 ("SAP 53") (later incorporated in Statement on Auditing Standard No. 1)("SAS 1"). The statement was intended to provide guidance for members of the accounting profession on how to report when accounting changes have occurred. Paragraph 27 of that statement provided:

"The auditor should evaluate a change in accounting principle to satisfy himself that (a) the newly adopted accounting principle is a generally accepted accounting principle, (b) the method of accounting for the effect of the change is in conformity with generally accepted accounting principles and (c) management's justification 12/ for the change is reasonable.

12/ Accounting Principle Board Opinion No. 20, paragraph 16, states: 'The presumption that an entity should not change an accounting principle may be overcome only if the enterprise justifies the use of an alternative acceptable accounting principle on the basis that it is preferable.' The requirement for justification is applicable to years beginning after July 31, 1971."

As noted, the Commission and its staff believed that APB No. 20 required the independent accountant to satisfy himself that any accounting change was to a preferable method. Particularly since SAP 53, in its footnote number 12, referred back to the APB No. 20 standard, the Commission and its staff believed, at first, that SAP 53 represented no change, but merely provided guidance for auditors. It soon became apparent, however, that many accountants believed that the auditing standard changed their obligation under APB No. 20 -- and that, as a result, their only obligation was to satisfy themselves that management's justification was "reasonable," a lesser requirement than reaching an independent judgment as to the "preferability" of the new accounting principle in the particular factual circumstances.

Thus, despite the fact that the accountant usually recommended "a change to a preferable method in the first place," the profession had sought to place responsibility for such determination with the client (See Sampson Affidavit, ¶8).

Because the Commission believed that generally accepted accounting principles required that the independent accountant be satisfied that any change be to a preferable method, in December 1974 it proposed Instruction H(f) in conjunction with various proposed change in interim reporting.

In the release proposing the changes, the Commission explained its reasoning:

> "This letter is required since Accounting Principles Board Opinion No. 20 dealing with accounting changes provides that such changes may be made only 'if the enterprise justifies the use of an alternative acceptable accounting principle on the basis that it is preferable.' The Commission believes that the management of the enterprise has sustained this burden of justification only if it has convinced its independent public accountant that the change will result in improved reporting, and hence in the judgment of the independent accountant the new principle is preferable under the circumstances." Securities Act Release No. 5549 (Dec. 19, 1974). 32/

The Commission received in excess of 700 letters of comment on its various proposals relating to interim reporting. It conducted public hearings and heard the oral presentations of 14 persons. Andersen commented on these proposals, including Instruction H(f). After giving full consideration to the various comments that had been made, and having made modifications of certain of its proposals, the Commission adopted its proposals, including Instruction H(f), on September 10, 1975 (Burton Affidavit, ¶37). Its reasons for adopting

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32/ Securities Act Release No. 5549 is attached as Exhibit F to this memorandum, the portions of the release wich concern Instruction H(f) are noted with marginal emphasis.

that proposed rule remain the same -- generally accepted accounting principles mandate consistency in reporting unless the change represents a change that is, under the circumstances, preferable.

Following the adoption of the rule, the staff offered its interpretative advice regarding compliance with the rule. In Staff Accounting Bulletin No. 6 (Exhibit 3 to Andersen's Complaint) the staff stated:

"Question 1

> If one client of an independent accountant firm changes its method of accounting and the accountant submits the required letter stating his view of the preferability of the principle in the circumstances, does this mean that all clients of that firm are constrained from making the converse change in accounting (e.g., if one client changes from Fifo to Lifo, can no other client change from Lifo to Fifo)?

Interpretive Response:

> Where the factual circumstances surrounding the accounting changes are similar, the staff would not expect an accounting firm to accept accounting changes in both directions by different clients. In unusual cases, however, substantially different factual circumstances may exist in different client situations which would make it possible for the accountant to conclude that switches in opposite directions may each be preferable under all the particular circumstances. Registrants and accountants may expect the staff to request that it be furnished with the details supporting acceptance of apparently inconsistent positions by the accounting firm." 33/

33/ As noted in Accounting Series Release No. 180 (Nov. 4, 1975) (Attached as Exhibit G):

> "[T]he statements in the [Staff Accounting] Bulletin are not rules or interpretations of the Commission nor are they published as bearing the Commission's official approval; they represent interpretations and practices followed by the Division [of Corporation Finance] and the Chief Accountant in administering the disclosure requirements of the federal securities laws."

ASR 180 also appears in 5 CCH Fed. Sec. L. Rep. ¶ 72,202.

The staff reiterated the obvious -- that the determination of preferability should be made on a case-by-case basis. If the circumstances are similar it follows that the same accounting principles should be employed. But should there be some reason for the employment of divergent accounting principles, even when the circumstances are similar, nothing in the rule or in what the staff has said would prohibit that. In such a situation, the staff only indicated that it would request "that it be furnished with the details supporting acceptance of apparently inconsistent positions."

Subsequently, on April 30, 1976, the Commission provided further interpretative assistance in a letter to Kenneth P. Johnson, the Chairman of the Auditing Standards Executive Committee of the AICPA ("AudSec letter") (Exhibit D to this Memorandum), in which the Commission advised Mr. Johnson that it had declined to amend Instruction H(f) as recommended by Mr. Johnson's committee. The Commission reemphasized that the accountant was only expected to exercise his professional accounting judgment under the specific circumstances of each case. Thus, the letter stated in part:

> "The accountant's judgments as to preferability should not be based solely upon an abstract preference among principles . . . but rather must reflect professional appraisal of the specific circumstances that exist in the case of a particular registrant. . . . In addition, there may be elements of business judgment and business planning which enter into a registrant's determination that an alternative accounting principle is preferable and the accountant is not expected to either ignore such elements or to substitute his judgment with respect to them (within reasonable limits) for that of the registrant. Rather he is expected to apply his professional accounting judgment to a determination as to whether an alternative accounting principle is preferable in the light of all the relevant factors in the particular case. In his letter with respect to the preferability of the change, an accountant may refer to his reliance on the registrant's judgment with respect to such elements.

> The Commission therefore believes that it is only requiring registrants to meet the requirements of generally accepted accounting principles in requiring that registrants provide a justification sufficient to convince their independent accountants that the accounting change is to a preferable method in the circumstances. If the accounting profession has been interpreting the words of SAS 1 to lead to a different conclusion, the Commission believes that the profession has amended an accounting standard in an inappropriate way. If in fact there is no professional basis for concluding that one accounting principle is preferable to another, as AudSec suggests, then APB Opinion 20 makes it clear that no change can be made which is in conformity with generally accepted accounting principles."

As the Commission indicated, the accountant generally need not enmesh itself in the business judgements of management, nor should an accountant reach an opinion regarding preferability when there is no professional basis for that conclusion. Rather, the accountant might rely on the registrant's business judgments so long as they are reasonable. And, where there is no professional basis for concluding that one principle is preferable to another, consistency must prevail, and APB Opinion 20 states that no change should be made.

B. Instruction H(f) Is A Reasonable And Proper Exercise Of The Commission's Authority To Adopt Accounting Rules

As we noted earlier, the federal securities laws conferred broad authority upon the Commission to adopt accounting principles, and invested the Commission with "complete discretion" to decide when to exercise that authority. See pp. 7-8, supra. Andersen contends (Complaint ¶25 B. 3.) that the Commission exceeded its authority when it adopted Instruction H(f). There is nothing in the legislative history of the securities acts, or in the language of the relevant provisions of those acts which would suggest that the Commission's authority in this area is anything less than complete.

Nor has Andersen or any of the amici who have participated in the proceedings to date cited to any limitation upon that authority.

The Commission's action in adopting Instruction H(f) must be presumed valid unless Andersen can affirmatively demonstrate that the purposes of the rule are not consonant with the statutory aims, that there is no relation between the action taken and its purposes, or that the factual bases underlying the Commission's determination to adopt the rule do not exist. 34/

Andersen does not begin to meet this demonstration. Instead, it suggests, for instance, that it is not within the professional competence of accountants to make professional judgments regarding the preferability of alternative accounting principles under the circumstances of each particular case. But the accounting profession and Andersen have, for years, made just such determinations. (See, e.g., Jaenicke & Seidler Affidavit, ¶¶11, 14-15)

More importantly, since the adoption of Instruction H(f) in September 1975, accounting firms, including Andersen, have furnished clients with letters regarding preferability. 35/ (See Sampson Affidavit, ¶12). Unless Andersen is suggesting that these letters have been submitted in bad faith, the letters demonstrate that the judgment called for by Instruction H(f) is within the professional competence of the accounting profession.

Unlike Andersen, which claims that the rule never can be complied with, the AICPA is more selective in expressing its concerns. The AICPA noted in its memorandum as amicus curiae (p. 47) that there are three situations in which

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34/ Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968); Interstate Commerce Commission v. City of Jersey City, 322 U.S. 503, 512-513 (1944); Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944).

35/ Andersen has furnished its letters "under protest."

changes in accounting principles occur. In the first two situations, there is no problem with the accountant expressing an opinion as to preferability. In the first situation, changes in accounting principles occur because a new authoritative pronouncement may express a preference for a particular accounting principle or reject a principle which was previously acceptable. In the second situation, specific criteria may exist by which an accountant might test alternative accounting principles and determine which is preferable in a particular circumstances. It is the third situation with which the AICPA is concerned. There, according to the AICPA, alternative acceptable principles exist for which there is no authoritative guidance for an accountant to determine which of two or more is preferable.

This supposed conundrum raised by the third situation ignores the relationship of Instruction H(f) to its sister principle, consistency. If an accountant cannot determine that one principle is preferable to another under the circumstances, then generally accepted accounting principles dictate that consistency prevails. The Commission simply stated the obvious when it observed in the AudSec letter (See, pp. 31-32, <u>supra</u>) that:

> "If in fact there is no professional basis for concluding that one accounting principle is preferable to another, as AudSec suggests, then APB Opinion 20 makes it clear that no change can be made which is in conformity with generally accepted accounting principles."

If the accountant believes that the available body of accounting literature as applied to a discrete set of facts does not permit him, conscientiously and in good faith, to give his professional opinion that a change is to an accounting method which is preferable under the circumstances, he cannot

explicitly approve the change. The presumption of consistency has not been overcome.

It is argued by the AICPA, however, that business judgments will often enter into the determination of preferability and that accountants should not be placed in the position of making such judgments. This assertion reflects a misconception by the AICPA of the manner in which the rule operates. The accountant does not have to make such determinations. In the AudSec letter the Commission offered the following interpretative advice:

> "there may be elements of business judgment and business planning which enter into a registrant's determination that an alternative accounting principle is preferable and the accountant is not expected to either ignore such elements or to substitute his judgment with respect to them (within reasonable limits) for that of the registrant. Rather he is expected to apply his professional accounting judgment to a determination as to whether an alternative accounting principle is preferable in the light of all the relevant factors in the particular case. In his letter with respect to the preferability of the change, an accountant may refer to his reliance on the registrant's judgment with respect to such elements."

As we have seen, the businessman may have incentives to change the company's method of accounting so as to show earnings in the most favorable light. SAP 53 placed the businessman in the position of making an accounting judgment. If the businessman, presumably less skilled in the policies and practices of the accounting profession, is capable of making such a determination, certainly the independent accountant can. If, however, the accountant believes that there exists no basis for reaching a professional judgment regarding preferability, and therefore he cannot formulate an opinion, the businessman certainly should not be able to either.

1. Instruction H(f) Is Neither Arbitrary Nor Capricious

Andersen correctly embraces the so-called "arbitrary and capricious test" of Section 10(e)(2)(A) of the APA, 5 U.S.C. §706(2)(A) as the standard of review in this action. That standard of review, however, "is a narrow one. The court is not empowered to substitute its judgment for that of the

agency." Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 416 (1971) 36/ "'[A]dministrative action may be regarded as arbitrary and capricious only where it is not supportable on any rational basis.'" Carlisle Paper Box Co. v. N.L.R.B., 398 F. 2d 1, 6 (C.A. 3, 1968). 37/

The basis for Instruction H(f) is not only rational, but it is a basis which, as we have seen, was essentially formulated by the accounting profession itself, including Andersen. The Commission adopted Instruction H(f) as a means of ensuring that the requirement of consistency in accounting treatment would be met. The rule implicitly recognizes that, if the registrant is capable of determining whether a change in accounting principle is preferable, in the accounting sense of the word, then so too must the accountant.

Andersen's challenge to the rule is really a challenge to the propriety of the rule. The Commission believes that the rule is in the best interest, of the investing public and we believe we have demonstrated its wisdom. But considerations of the wisdom or unwisdom of the rule fall outside the scope of this Court's review.

The limited scope of that review was explained in National Broadcasting Co. Inc. v. United States, 319 U.S. 190, 224 (1943):

> "The Regulations are assailed as 'arbitrary and capricious.' If this contention means that the Regulations are unwise, that they are not likely to succeed in accomplishing what the Commission intended, we can say only that the appellants have selected the wrong forum for such a plea. What was said in Board of Trade v. United States, 314 U.S. 534, 548, is relevant here: 'We certainly have neither the technical competence nor legal authority to pronounce upon the wisdom of the course taken by the Commission'. . . It is not for us to say that the 'public interest' will be furthered or retarded by the . . . Regulations."

36/ See also, Secretary of Labor v. Farino, 490 F. 2d 885 (C.A. 7, 1973).

37/ Cited with approval in First National Bank of Fayetteville v. Smith, 508 F. 2d 1371, 1376 (C.A. 8, 1974) certiorari denied , 421 U.S. 930 (1975).

2. Instruction H(F) Does Not Violate Due Process of Law

(a) Andersen and the amici that have challenged Instruction H(f) as a violation of due process of law for reason of its alleged vagueness, have all chosen to ignore the fact that the term "preferability" did not spring anew with Instruction H(f), but is a term which the accounting profession itself has conceived. The requirements of due process are satisfied where the word challenged as vague is "of fixed meaning in itself . . . or by the context or other legitimate aid to its construction," Connally v. General Construction Co., 269 U.S. 385, 395 (1926), "notwithstanding an element of degree in the definition as to which estimates might differ . . . ." Id. at 391. Here, the requirements of due process are satisfied since the term preferability is a term used by the profession itself in APB No. 20, and Instruction H(f) has done nothing to alter the meaning of that term. 38/

(b) To the extent that Andersen argues that Instruction H(f) violates due process because it, in effect, requires an accountant to express an opinion that a change is to a preferable method of accounting when he cannot in fact render such an opinion, the short and complete answer is that H(f) requires no such conduct. Rather, H(f) requires the client to obtain a letter from its, independent accountant "indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances . . ." (emphasis added). If an independent accountant, for whatever reason, is unable in good faith to form a professional judgment that the change "is preferable under the circumstances", he need only state that. In that event, however, the client should not make the change because

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38/ See Arnett v. Kennedy, 416 U.S. 134 (1974); Colton v. Kentucky, 407 U.S. 104 (1972); See also, Parker v. Levy, 417 U.S. 733 (1971); Civil Service Commission v. National Association of Letter Carriers, 413 U.S. 548 (1973); Clarke v. Weeks, 414 F. Supp. 703 (N.D.Ill., E.D., 1976).

the presumption accorded to consistency has not been overcome. Insuring that the change in such a circumstances is not made is the purpose of the rule; the accountant merely states his opinion to his client.

(c) Andersen attempts to portray Instruction H(f) as raising a constitutional dilemma, and suggests that this dilemma is aggravated by SAB 6, which, it claims, has the effect of making determinations that a change is preferable with respect to one client "binding on all of [Andersen's] clients" (memorandum of Andersen in support of its motion for a preliminary injunction at 9). As we noted earlier, (<u>supra</u> pp. 30-31) in SAB 6 the staff was simply emphasizing that the determination to be made is based on the circumstances of each case, and thus "where the factual circumstances surrounding the accounting changes are similar, the staff would not expect an accounting firm to accept changes in both directions by different clients." In any event, the positions expressed by SAB 6 are interpretive views of the staff, not the Commission.

3. <u>Instruction H(f) Was Adopted in Accordance With The Letter And Spirit Of The APA</u>.

Instruction H(f) was published for comment on December, 1974 in conjunction with various proposed changes in interim reporting. The proposed rule read:

> "The financial statements to be included in this report shall be prepared in conformity with the standards of accounting measurement set forth in Accounting Principles Board Opinion No. 28 and any amendments thereto adopted by the Financial Accounting Standards Board. In addition to meeting the reporting requirements for accounting changes specified therein, the registrant shall state the date of any change and the reasons for making it. In addition, a letter from the registrant's independent accountants shall be filed as an exhibit indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances; except that no letter from the accountant need be filed when the change is made in response to a standard adopted by the Financial Accounting Standards Board which requires such change."

The Commission received comments and heard the oral presentations of various persons. After giving full consideration to the comments, the Commission adopted Instruction H(f) on September 10, 1975.

Andersen claims that Instruction H(f) incorporates APB Opinion 28, which incorporates APB Opinion 20, and, accordingly, that the rule is invalid since neither of these provisions were adopted in accordance with the APA notice and publication requirements. But this claim ignores the obvious -- that the rule as proposed expressly referred to APB opinion 28, which incorporates APB opinion 20. Therefore, to the extent that Instruction H(f) incorporates either of those opinions, it is proper, since the public had notice of that fact and an opportunity to comment when the rule was proposed.

Similarly, Andersen claims that another aspect of the rule -- the supposed amendment of the rule by the AudSec letter -- also was adopted in violation of the APA's notice and publication requirements. That letter is nothing more than an interpretative position of the Commission regarding the operation of Instruction H(f). As such, even if it may be viewed as a rule under the APA's sweeping definition, it is exempt from the notice and publication requirements of the APA as an interpretative rule. See , United States v. 353 Cases etc., 247 F. 2d 473, 480 (C.A. 8, 1957); Gibson Wine Co. Inc. v. Snyder, 194 F. 2d 329, 331 (C.A.D.C., 1952).

4. Instruction H(f) Does Not Discriminate Against Any Registrants.

Andersen claims that Instruction H(f) creates an impermissible classification of persons. It argues that if an accountant determines that accounting principle Y is preferable to principle X, when, for instance, a registrant changes from X to Y, if another registrant-client of that accountant who is employing principle X decides to continue using that principle he is stigmatized by the accountant's prior determination that principle X is "a nonpreferred principle," and since the registrant has no opportunity

to be heard, this stigmatization allegedly violates due process. (Complaint ¶ 25 B. 2)

This analysis ignores the manner in which the rule operates. The opinion of the accountant under Instruction H(f) is based upon the circumstances of each case. Thus, if under the circumstances, an accountant is satisfied that a change from principle X to principle Y, for example, is a change to a preferable accounting method, that does not have the effect of establishing principle X as a nonpreferred principle. That opinion only reflects that, under those particular circumstances, principle Y is preferable. Where the circumstances differ, as they frequently do, principle X or some other principle may be preferable.

Point III

THIS ACTION SHOULD BE DISMISSED SINCE ANDERSEN HAS NO STANDING TO PURSUE THE ISSUES RAISED.

The questions presented to this Court by Andersen's law suit are interesting and important. Moreover, the releases that Andersen challenges are related to accounting matters and those accountants whose clients are required to file documents with the Commission have a genuine interest in the problems dealt with in those releases.

> "But a mere 'interest in a problem' no matter how longstanding the interest and no matter how qualified the organization is in evaluating the problem, is not sufficient by itself to render the organization 'adversely affected' or 'aggrieved' within the meaning of the APA." Sierra Club v. Morton, 405 U.S. 727, 739 (1972)

Indeed, accountants may reasonably differ as to the wisdom of the policies of the Commission, for example, to look to the private accounting sector for the establishing of accounting principles, but that does not warrant the reconciliation of such differences by a federal judge in an adjudicatory proceeding. The Supreme Court has, for that reason, refused

> "to construe the APA to authorize judicial review at the behest of organizations or individuals who seek to do no more than vindicate their own value preferences through the judicial process." Id. at 740. 39/

A threshold issue in every federal case, therefore, is whether the plaintiff has standing, an issue raised by the constitutional limitation on the courts' ability to exercise power only in an actual "case or controversy" under Article III of the Constitution. Perhaps in realization of its difficulty in

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39/ In United States v. SCRAP, 412 U.S. 669, 687 (1973), the Court, referring to its decision in Sierra Club, again emphasized that the requirement of standing

> "prevents the judicial process from becoming no more than a vehicle for the vindication of the value interests of concerned bystanders."

articulating any sound theory of its standing to sue here, Andersen has been constantly shifting its theories of injury and standing. Initially, in its complaint, Andersen alleged speculative injury to itself simply because there exist provisions imposing criminal and civil sanctions for violation of the securities laws and Commission rules. 40/ It also alleged that hypothetical "burdensome lawsuits" might be instituted against it and its clients. 41/ Subsequently, in its papers in support of its motions for a temporary restaining order and preliminary injunction, Andersen alleged possible injury to its clients. 42/

Andersen further shifted its ground during argument on its application for a TRO to some vaguely-articulated interference with the accountant-client relationship. 43/ In its Reply Memorandum to the Commission's Memorandum in Opposition to a Preliminary Injunction, Andersen argued an injury to its own economic interest in terms of possible loss of clients and fees 44/ and cited its non-economic interest in the "stature of the profession" and the "public interest." 45/

40/ Complaint ¶¶ 16, 17.

41/ Id. ¶23.

42/ Andersen alleged that Instruction H(f) created "unconstitutional classifications" of some of its clients and that one or more clients may have received or will receive deficiency letters from the Commission. Andersen Memorandum on Preliminary Injunction at 3-4, 10-12; Catlett Affidavit ¶12. Of course, the mere fact of the receipt of a deficiency letter is not, in itself, any injury. The letter invites a response, and often the problems are worked out. A description of the function of the deficiency letter, one of the informal procedures used in the processing of filings, is found at 17 C.F.R. 202.3 (1976).

43/ Tr., 8/12-13/76, pp. 13, 22.

44/ Andersen Reply Memo, pp. 2, 4, 6. It pointed to no instance where it lost a client or a fee.

45/ Id. at 3, 5, 7.

Andersen appears not to be comfortable with any of its theories of injury or standing. All of its arguments, as is shown below, fail to demonstrate one critical factor: that Andersen itself has suffered and will continue to suffer direct and demonstrable injury in fact sufficient to warrant a finding of standing.

A. Andersen Has Not Demonstrated That It Is Or Will Be Injured In Fact By The Matters Challenged, And Thus Fails To Present A Case Or Controversy

The constitutional limitation of federal court jurisdiction to actual cases or controversies requires that there by an injury in fact to the person or persons seeking to prosecute their claims before standing to maintain such claims will lie. The complaint in this action, and Andersen's embellishments of its complaint in the memoranda it has filed in support of its requests for interim relief, fail to establish that Andersen has been or will be injured in a manner which is cognizable by a federal court.

1. Andersen is not injured by a hypothetical possibility that sanctions may be imposed on it. Here, in any event, even that possibility does not exist.

Andersen's claim of possible Commission disciplinary or enforcement actions against it are, at best, completely speculative, as we have shown in our memoranda in opposition to both the motions for a TRO 46/ and a preliminary injunction. 47/ In fact, as we have already pointed out, no such liability on accountants could stem from either ASR 150 or Instruction H(f), since the former pronouncement is not a substantive rule, and the latter pronouncement imposes no obligation on accountants.

46/ Memorandum in Opposition to TRO at 7.

47/ Memorandum in Opposition to Preliminary Inuunction at 8.

While standing in some circumstances may be predicated upon the threat of sanctions, Steffel v. Thompsen, 415 U.S. 452, 459 (1974), allegations of threats of sanctions cannot be "imaginary or speculative," Younger v. Harris, 401 U.S. 37, 42 (1971), nor "chimercial," but must be "grounded in a realistic fear of prosecution." Poe v. Ullman, 367 U.S. 497, 508 (1961).

The Commission has threatened no sanctions against Andersen. Nor has Andersen alleged any facts which would indicate that fear of sanctions by the Commission is any more than "imaginary or speculative." The "mere existence" of sanctions, absent a "real threat of enforcement," is insufficient to grant a litigant standing. Id. at 507. Here, moreover, the "mere existence" of sanctions is not even present.

2. Andersen Has No Standing To Raise Supposed Injuries To Its Clients. And, Even Those Injuries Alleged Are Highly Remote.

Andersen has not shown any injury in fact to any of its clients 48/ nor has it alleged that it has lost any clients or that any clients have threatened to terminate their relationship with Andersen. In any event, Andersen cannot assert the rights of persons who are not parties to this action. The Supreme Court has recently reaffirmed, that

> "the plaintiff generally must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties." Warth v. Seldin, 422 U.S. 490, 499 (1975), citing Tileston v. Ullman, 318 U.S. 44 (1943).

And, the type of speculative injury which Andersen claims will befall its business relationships is insufficient to confer standing. Reading the Tileston case together with Griswold v. Connecticut, 381 U.S. 479 (1965), is instructive in this regard.

48/ The Commission believes that there is no legal injury visited upon Andersen's clients as a result of either ASR 150 or Instruction H(f).

Tileston was a declaratory judgment action to review a statute making it a crime to give birth control services or information. Dr. Tileston was a physician who claimed (1) that the statute prevented his giving professional advice regarding the use of contraceptives to three patients whose conditions of health was such that their lives would be endangered by child-bearing, and (2) that Ullman, who was State's Attorney for Connecticut, intended to prosecute any offence against the statute and "claim or may claim" that the advice which Dr. Tileston proposed to give would constitute such an offence. The Supreme Court of Connecticut had ruled that the statute indeed prohibited the giving of the advice which Dr. Tileston proposed to give his three patients. Tileston, supra, 318 U.S. at 45-46. In the Griswold case, the executive director of the Planned Parenthood League of Connecticut and a regional director in the League had already been convicted under a statute similar to that in the Tileston case, for giving birth control advice to married persons.

The Supreme Court in Tileston rejected as a basis for standing the contention that the statute interfered with the professional doctor-patient relationship and denied the plaintiff standing to challenge the statute. In Griswold, the Court concluded that the plaintiff had standing to challenge a statute under which he had been convicted. In distinguishing, but preserving, its prior ruling in Tileston, the Court noted that in Tileston only a declaratory judgment had been sought and in such cases, "the requirements of standing should be strict, lest the standards of 'case or controversy'

in Article III of the Constitution become blurred." Griswold v. Connecticut, supra, 381 U.S. at 481. 49/

In the present case, Andersen also seeks a declaratory judgment, but like the plaintiff in Tileston, Andersen is not charged with anything, nor is it compelled to do anything as a result of either ASR 150 or Instruction H(f). Indeed, Andersen could not be charged with violating either Instruction H(f) or ASR 150 and its protestations of possible harm to its clients fall far short of the risk of death of Dr. Tileston's patients, which the Supreme Court found not sufficient to confer standing on the plaintiff.

Even assuming the presence of injury to its clients, Andersen could not establish that the rights of its clients are so fundamental as to afford Andersen standing to assert such rights on their behalf. Andersen argues, for instance, that its clients are being denied their right to change accounting

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49/ A limited exception to the proposition reaffirmed in Warth v. Seldin, supra, -- that the plaintiff must assert his own interests and not those of others — has developed. But, even under this exception, before standing will lie to challenge a statute which runs to persons other than the plaintiff, the plaintiff must demonstrate: first, a direct and substantial injury to itself; and, secondly, that the statute challenged impinges upon some fundamental right of the third party to whom it runs. See, Barrows v. Jackson, 346 U.S. 249 (1953) (racial discrimination); Pierce v. Society of Sisters, 268 U.S. 510 (1925) (freedom of religion); and Truas v. Raich, 239 U.S. 33 (1915) (discrimination against aliens).

Andersen fails on both counts. The hypothetical belief that its client relationships may be disturbed as a result of Instruction H(f) is, as we noted, insufficient under Tileston to establish standing. And, the physician/patient relationship, which was rejected as a basis for standing in Tileston, enjoys a greater degree of legal protection from interference than that of independent accountant and client. See e.g., Baylor v. Mading-Dugan Drug Co., 57 F.R.D. 509, 512 (N.D. Ill. E.D. 1972), where the Court in denying a motion to quash a subpoena duces tecum on the ground that an Illinois statute provided for an accountant-client privilege, stated:

> ". . . it is clear that the Supreme Court has announced the policy that the Accountant-Client relationship is not to be considered privileged in federal district courts."
>
> "Thus it is the opinion of this court that the Illinois accountant privilege is not applicable in federal question cases."

methods without first seeking an opinion of preferability from an independent accountant. To our knowledge such a "right" has never been recognized as fundamental by the federal courts. Certainly, Andersen is not suggesting a return to the "go-go" years of the late Sixties when manipulation of accounting methods was sometimes used as a means of enhancing earnings without regard to economic reality.

The vitality of Tileston continues. Only recently the Supreme Court stated, in Singleton v. Wulff, 96 S. Ct. 2868 (1976), that standing will lie only if "the relationship between the litigant and the third party . . . [is] such that the former is fully, or very nearly, as effective a proponent of the right as the latter . . . ." (id. at 2874) and "there is some genuine obstacle preventing the third party from asserting his own rights. Id. at 2875. Even if, as we seriously doubt, Andersen could establish injury to a client, there is no reason why the client could not sue to vindicate its own rights.

B. There Is No Other Basis Upon Which Andersen May Base Standing

Andersen has no standing to represent either the accounting profession or the public interest. And, while we have shown a failure on Andersen's part to demonstrate injury in fact, even assuming some injury could be shown, such could not be legally attributable to the Commission pronouncements which Andersen challenges.

1. Andersen has no standing to litigate on behalf of the accounting profession or as a private attorney general "in the public interest."

While standing to sue may be based upon certain kinds of non-economic injury, e.g., United States v. SCRAP, 412 U.S. 669, 686-687 (1973); Sierra Club v. Morton, 405 U.S. 727, 738 (1972), no case has ever recognized standing

based upon an alleged injury to one's ethical values which might be caused by following a law or rule asserted to be illegal. The Supreme Court has never retreated from its firm rule that "[a]bstract injury is not enough." O'Shea v. Littleton, 414 U.S. 488, 494 (1974). And the Court has expressly noted that "claimed nonobservance . . . [of a constitutional provision by a branch of government], would adversely affect only the generalized interest of all citizens in constitutional governance, and that is an abstract injury." Schlesinger v. Reservists To Stop the War, 418 U.S. 208, 217 (1974).

That Andersen seeks to base its "non-economic injury" on its specialized interest in "'the stature of the profession and its ability to serve the public'" 50/ and not just its general interest in lawful government, does not provide it with standing. In Sierra Club v. Morton, supra 405 U.S. at 739, the Court ruled that "a mere 'interest in a problem,' no matter how longstanding the interest and no matter how qualified the organization is in evaluating the problem, is not sufficient by itself to render the organization 'adversely affected' or 'aggrieved' within the meaning of the APA."

Nor may Andersen argue the public interest as a means of obtaining standing. Since "the fact of economic injury is what gives a person standing to seek judicial review under" the APA, and it is only after "review is properly invoked, that [a] person may argue the public interest in support of his claim . . . ." Id. at 737. Nor do we concede that Andersen's position is in the public interest. To the contrary, the public interest in this

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50/ Plaintiff's Reply to Memorandum in Opposition to Plaintiff's Motion for Preliminary Injunction, at 3.

case -- the protection of investors by inducing full and fair disclosure -- is represented by the Commission, not by Andersen. And to the extent that Andersen perceives itself as a private attorney general of sorts for the accounting profession at large, 51/ members of that profession have disavowed such representation in amicus curiae briefs filed with this Court.

2. Andersen's Allegedly Threatened Injuries Are Not Legally Attributable To The Pronouncements It Challenges

Andersen's allegation of injury to its business relations are based upon its hypothetical concern that its voluntary refusal to provide a letter regarding preferability will result in its loss of clients. Even if such injury has occurred or is imminent, "the 'case or controversy' limitation of Art. III still requires that a federal court act only to redress injury that fairly can be traced to the challenged action of the defendant, and not injury that results from the independent action of some third party not before the court." Simon v. Eastern Ky. Welfare Rights Org., 96 S. Ct. 1917, 1926 (1976).

51/ Insofar as the issues raised by Andersen concern the public interest and the accounting profession, the action before this Court is inappropriate for their resolution. In fact, Andersen had petitioned the Commission on June 15, 1976, requesting it to reconsider its position in regard to ASR 150 and Instruction H(f) (Complaint ¶ 27). The Commission responded on July 27, 1976, with a letter to Andersen's counsel (Complaint ¶ 27, and exhibit 6) and a public release (Exhibit E to this memorandum).

The release announced the receipt and content of Andersen's June 15 petition and recited the background of both ASR 150 and Instruction H(f). While the Commission noted that Andersen's contentions in regard to Instruction H(f) had been recently considered in depth and that Andersen had not raised any new objections, the Commission did solicit public comment on the policy underlying ASR 150. The comment period closed on September 15, 1976, and the Commission is currently evaluating comments received.

Having initiated this review by the Commission of its policy, it would seem appropriate for Andersen to await its outcome.

Although, economic injury has long been held sufficient to meet the injury in fact test, see, e.g., Association of Data Processing Service v. Camp, 397 U.S. 150, 152 (1970), injury in fact, alone, does not satisfy fully the test for standing. That injury must somehow be legally attributable to the challenged actions of defendants. See, Simon v. Eastern Ky. Welfare Rights Org., supra, 96 S. Ct. at 1927.

Here, the Commission has not caused the hypothetical quandry of which Andersen complains. Instruction H(f) and ASR 150 impose no requirements on Andersen. The Commission has no more authority to compel Andersen to assist a registrant client in complying with Instruction H(f) than to require that Andersen certify a particular client's financial statements. Any injury to Andersen is self inflicted. It asserts that as a matter of policy it will not provide "preferability" letters under any circumstances. Andersen's contentions that it may be economically injured by its steadfast objection to the rule is not sufficient to confer standing to a challenge of Instruction H(f), since that rule could not be the legal cause of any injury which may or may not occur to Andersen.

Andersen has not alleged any facts which would establish otherwise. Its bald assertion that "[t]he direct cause of Andersen's injury is the SEC's promulgation of ASR 150 and Instruction H(f)" (Reply Memo at 5) does not establish the requisite "nexus" between the claimed injury and the challenged actions of the Commission. Particularly when alleging the "nexus" between the claimed injury and the challenged actions, "pleadings must be something more than an ingenious academic exercise in the conceivable." United States v. SCRAP, supra, 412 U.S. at 688.

CONCLUSION

For the foregoing reasons, this Court should grant the Commission summary judgment or, in the alternative, dismiss this action.

Dated: Washington, D.C.
October 4, 1976

Respectfully submitted,

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