

IN THE UNITED STATES DISTRICT COURT BY M. L. G.
FOR THE DISTRICT OF COLUMBIA

DATE RECD 4/73

FILE REF. _____

FOLLOW-UP _____
DATE _____

ARTHUR ANDERSEN & CO.,
69 West Washington Street,
Chicago, Illinois 60602,
(312) 346-6262,

Plaintiff,

v.

Civil Action No. _____

SECURITIES AND EXCHANGE COMMISSION
500 North Capitol Street
Washington, D. C.,

Defendant.

COMPLAINT

(Injunctive and Declaratory Relief)

Jurisdiction

1. The relief sought by this Complaint is a declaratory judgment under 28 U.S.C. § 2201, and an injunction pendente lite under Rule 65, Fed. R. Civ. P. Jurisdiction of this action is founded upon 28 U.S.C. § 1331, upon Sections 10(a) and (b) of the Administrative Procedure Act, 5 U.S.C. §§ 702 and 703, upon § 22 of the Securities Act of 1933, 15 U.S.C. § 77v and § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa. The wrong complained of herein against defendant Securities and Exchange Commission ("SEC") consists of a violation of the rule-making provisions of the Administrative Procedure Act, 5 U.S.C. § 553 and of the SEC's own rule-making regulations, 17 C.F.R. § 202.6, and of the Constitution of the United States.

The Parties

2. Plaintiff Arthur Andersen & Co. (hereinafter "Arthur Andersen") is a general partnership organized and existing under the laws of the State of Illinois, with its principal office located at 69 West Washington Street, Chicago, Illinois. Arthur Andersen is a firm of independent public accountants. The firm's business consists principally of providing accounting and auditing services to corporations, including the examining and reporting upon the financial statements of such corporations. Many of Arthur Andersen's audit clients are subject to the jurisdiction of defendant SEC and are required to file with the SEC financial statements, together with the audit reports thereon of Arthur Andersen, under the various Acts administered by the SEC, including, but not limited to, registration statements filed pursuant to the Securities Act of 1933, 15 U.S.C. § 77 et seq., and periodic reports and proxy statements filed pursuant to the Securities Exchange Act of 1934, 15 U.S.C. § 78 et seq. In all such filings, Arthur Andersen is required to observe the rules and regulations promulgated by the SEC which govern the form and content of financial statements and the audit reports of independent public accountants in respect thereof. In particular, Arthur Andersen is required to observe the SEC's Regulation S-X governing accounting presentations in filings with the SEC (17 C.F.R. § 210.1-01 et seq.).

Accounting Series Release No. 4 issued by the SEC on April 25, 1938, reads as follows:

In cases where financial statements filed with this Commission pursuant to its rules and regula-

tions under the Securities Act of 1933 or the Securities Exchange Act of 1934 are prepared in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be presumed to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material. In cases where there is a difference of opinion between the Commission and the registrant as to the proper principles of accounting to be followed, disclosure will be accepted in lieu of correction of the financial statements themselves only if the points involved are such that there is substantial authoritative support for the practices followed by the registrant and the position of the Commission has not previously been expressed in rules, regulations or other official releases of the Commission, including the published opinions of its Chief Accountant. [Emphasis added.]

Under SEC General Rule 2(e), Arthur Andersen is permitted to practice before the SEC only so long as its conduct and practice comport with SEC rules and regulations.

3. Defendant SEC is an agency of the United States established by Congress in 1934 by 15 U.S.C. § 78(d). The SEC has statutory power to administer the various federal securities laws. The SEC has been delegated by Congress the power to make rules and regulations implementing and enforcing the laws which it administers (15 U.S.C. §§ 77(s), 78(w)).

Existence of Justiciable Controversy
and Grounds for Declaratory Judgment
and Other Relief

4. On August 24, 1973, the SEC promulgated its Accounting Series Release 146 ("ASR 146") under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940, a copy of which is annexed hereto as Exhibit 1. ASR 146, if allowed to stand, will constitute an effective adoption by the SEC of a definitive, substantive rule of general applic-

ability for the accounting of business combinations either as a "pooling of interests" or as a "purchase".

5. Prior to the promulgation by the SEC of ASR 146, the SEC had not adopted a definitive, substantive rule of general applicability in respect of the accounting for business combinations as a "pooling of interests" or as a "purchase". Whether a particular business combination was to be accounted for as a "pooling of interests" or as a "purchase" depended upon which accounting treatment conformed with the then generally accepted principles of accounting.

6. The SEC failed to comply with the notice and public rule-making procedures prescribed by § 4 of the Administrative Procedures Act, 5 U.S.C. § 553, or SEC Rule 20².6, 17 C.F.R. § 20².6, in promulgating ASR 146. ASR 146 was promulgated in contravention of the express requirements of the Administrative Procedure Act and is null and void ab initio. Section 4 of the Administrative Procedures Act provides, in part, as follows:

"(b) General notice of proposed rule-making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include --

(1) a statement of the time, place, and nature of public rule-making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

* * * * *

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection."

7. The SEC has designated ASR 146 "an interpretation" of Opinion No. 16 of the Accounting Principles Board of the American Institute of Certified Public Accountants referred to in Paragraph 8 hereof, and presumably has thereby sought to avoid compliance with the above-quoted provisions of the Administrative Procedure Act because of an exception in § 4 of said Act in respect of "interpretative rules". The SEC has no statutory authority to issue interpretations of opinions of such privately constituted organizations and may not adopt such opinions as rules of its own without following the public rule-making proceedings alleged in Paragraph 6 hereof. But even assuming the SEC has the statutory authority to interpret opinions of such an unofficial board, which opinions the SEC has not therefore adopted pursuant to notice and public participation as alleged in Paragraph 6 hereof, ASR 146 is not an interpretation. ASR 146 prescribed for the first time a definitive, substantive rule of general applicability for the accounting of business combinations either as a "pooling of interests" or as a "purchase" in contravention of the Administrative Procedure Act. The SEC has by

ASR 146 materially altered the standards that have theretofore been generally accepted by the accounting profession in determining appropriate accounting treatment of business combinations. Unless Arthur Andersen and independent accountants generally abide by the terms of the rule, as so adopted and limited by the SEC, registration statements under the Securities Act of 1933 will not be permitted by the SEC to become effective, proxy statements and other filings with the SEC under the Securities Exchange Act of 1934 will be unacceptable to the SEC, and comparable problems will arise under the other acts referred to above.

Setting in Which ASR 146 Was
Promulgated by SEC and Consequences of Such Action

8. The American Institute of Certified Public Accountants ("AICPA") is a professional society. The Congress of the United States has not conferred upon it any regulatory powers over accounting principles or over practicing accountants. It is not necessary for an independent accountant to be a member of the AICPA in order to practice his profession, including practice before the SEC. In August, 1970, the Accounting Principles Board ("APB"), a creature of the AICPA, issued its Opinion Nos. 16 and 17 relating to the accounting for business combinations either as a "pooling of interests" or as a "purchase", and, if the latter, requiring among other things that any goodwill arising from the acquisition be capitalized and amortized against income over a period not exceeding 40 years. Paragraph 47d of APB Opinion No. 16 provided that "pooling of interests" accounting would not be invalidated for a business combination if treasury shares were acquired --

(a) for "stock option and compensation plans, and

(b) for other recurring distributions", provided "a systematic pattern of reacquisitions is established at least two years before the plan of combination is initiated" or coincident "with the adoption of a new stock option or compensation plan". [Emphasis added.] Copies of these Opinions are annexed hereto as Exhibits 2 and 3, respectively.

9. In September, 1971, the AICPA issued its Accounting Interpretation No. 20 ("AICPA 20"), a copy of which is annexed hereto as Exhibit 4, which related to and had the effect of substantively modifying Paragraph 47d of APB Opinion No. 16. The principal substantive modification were:

(1) to provide expressly that acquisitions of treasury shares will not invalidate "pooling of interests" accounting for a business combination if such acquisitions are made for specific purposes not related to a particular business combination which is planned to be accounted for by the "pooling of interests" method and such shares are specifically reserved for such other purposes, and

(2) to set forth the specific purposes for which shares may be reacquired prior to a "pooling of interests" to include acquisitions:

(i) for stock option or compensation plans;

(ii) for stock dividends declared;

(iii) for a specific "purchase", and

(iv) for an existing contingent share agreement from a prior business combination.

Thus, the conditions of Paragraph 47d of APB Opinion No. 16 were in effect changed to add shares acquired for the specific purposes set forth above, whether or not acquired in a "systematic pattern", subject only to the requirement that they be specifically reserved for such purposes. Any requirement of a "systematic pattern of reacquisitions" would clearly have been incompatible with added purposes (iii) and (iv), and AICPA 20 made no distinction between any of the four purposes in this regard. The issuance of interpretations of APB Opinions was authorized under procedures established by the AICPA; and in the case of AICPA 20, the interpretation was considered prior to its issuance by the APB at a regular meeting and was approved by the Chairman of the APB without objection by the APB.

10. Prior to the promulgation by the SEC of ASR 146, substantial authoritative support had developed in the accounting profession for the changes made in the conditions of Paragraph 47d of APB Opinion No. 16 in respect of the acquisition of treasury shares as alleged in Paragraph 9 hereof, and for the addition of the following specific purposes to those for which treasury shares could be acquired without invalidating the use of "pooling of interests" accounting:

- (1) for conversions of outstanding convertible securities, and
- (2) for exercises of outstanding warrants, provided only that such shares were reserved for such a purpose and a reasonable expectation existed that such a purpose would be realized.

11. The SEC had knowledge of the changes in

generally accepted accounting principles in respect of the acquisition of treasury shares as related to accounting for business combinations as they evolved as alleged in Paragraphs 8, 9 and 10 hereof, and had accepted up until August 24, 1973, financial statements included in registration statements, proxy statements, annual reports and other documents filed with it which reflected accounting for business combinations as a "pooling of interests" rather than a "purchase" in the circumstances set forth in Paragraphs 9 and 10 hereof.

12. It was in this setting and at this juncture that the SEC promulgated ASR 146. The SEC has no statutory power to issue interpretations of APB Opinions or of AICPA interpretations of such Opinions. Moreover, ASR 146 was not limited to interpretation. The effect of the SEC's ASR 146 was to prescribe and adopt as a definitive substantive rule of accounting APB Opinion No. 16, but also to restate and amend substantively that Opinion in respect of the provisions applicable to the acquisition of treasury shares. Such changes with respect to APB Opinion No. 16 consisted principally of the following:

(a) It extended the specifically prescribed time periods in Paragraphs 47c and 47d during which the acquisition of treasury shares might "taint" or invalidate a pooling of interests from "within two years before the plan of combination is initiated or between the dates the combination is initiated and consummated" to include an indefinite period of time subsequent to the consummation of the business combination.

(b) It added to the specific purposes for which treasury shares might be acquired without in-

validating a "pooling", as follows:

- (i) for warrants;
- (ii) for convertible securities;
- (iii) for stock purchase or bonus plans;
- (iv) for stock dividends;
- (v) for a specific "purchase", and
- (vi) for an existing contingent share

agreement from a prior business combination.

(c) It added, as a condition to avoid invalidating a "pooling of interests", the requirement that there exist a reasonable expectation that the treasury shares reacquired will be issued for such purposes, and set forth the following tests as generally applicable:

"(1) As to stock option plans, warrants or convertible securities, the quoted price of the common shares is not less than 75 percent of the exercise or conversion price.

(2) As to stock purchase or bonus plans or stock dividends, either (a) shares are reacquired to fulfill existing commitments or dividends declared or (b) based on a pattern of issuing shares for such purposes in the prior two years, the shares are reacquired to fulfill anticipated requirements in the succeeding year."

(d) It prescribed that the "systematic pattern of reacquisitions" test would not apply to shares acquired -

(i) for issuance in a specific "purchase" business combination, or

(ii) to resolve an existing contingent share agreement from a prior business combination.

ASR 146 also changed AICPA 20 and the accounting principles which had gained substantial authoritative support subsequent thereto in the respects alleged in subparagraph (a) and in clauses (1) and (2) of subparagraph (c) of this Paragraph 12, and further it reimposed the condition that the acquisitions of treasury shares be in a "systematic pattern of reacquisitions established at least two years before the plan of combination is initiated (or coincidentally with the adoption of a new stock option or compensation plan)" for all recurring distributions, which include all of the specific purposes referred to either in Paragraph 47d of APB Opinion No. 16, in AICPA 20 or in ASR 146 except only -

(x) treasury shares acquired for issuance in a specific "purchase" business combination, or

(y) to resolve an existing contingent share agreement from a prior business organization.

Because ASR 146 creates substantive rules of accounting required to be followed in financial statements filed with the SEC, it was promulgated in contravention of the provisions of the Administrative Procedure Act and is null and void ab initio.

13. ASR 146 concludes with the following sentence:

"The interpretation set forth herein should be applied to all subsequent business combinations even though shares issued in these combinations may have been reacquired prior to the date of this release."

and thus constitutes ex post facto legislative rule-making in violation of Section 9 of Article I of the Constitution of the United States. It purports to preclude a company from acquiring another business and accounting for it as a "pooling

of interests" --

- (i) if either of the combining companies had acquired shares within a two-year period prior to the initiation or consummation of the combination or within an unspecified period thereafter, and
- (ii) if such acquisitions of treasury shares had not conformed with the subsequently imposed requirements of ASR 146

even though such treasury shares were acquired in good faith prior to the promulgation of ASR 146, in conformity with then existing generally accepted accounting principles, and after obtaining an opinion of an independent public accountant to the effect that the acquisition of such treasury shares would not invalidate accounting for a subsequent business combination as a "pooling of interests" in conformity with generally accepted accounting principles. A number of audit clients of Arthur Andersen have acquired treasury shares in such circumstances and after obtaining written or oral opinions of Arthur Andersen to that effect. Furthermore, the SEC by its ASR 146 purports to preclude such a company from accounting for such an acquisition made subsequent to August 24, 1973, as a "pooling of interests" even though such acquisition was included in a proxy statement or registration statement which had been cleared with, or made effective by, the SEC prior to August 24, 1973, and which had presented the pro forma financial statements of the combined businesses on a "pooling of interests" basis. A sale of shares to "cure" the "taint" imposed retroactively by the SEC's ASR 146 would in many

1970; that he participated in the deliberations of the APB in respect of APB Opinion No. 16 and in the voting on the adoption thereof; that in September, 1971, the AICPA issued its accounting interpretation No. 20 ("AICPA 20"); that the allegations of fact and of accounting opinion set forth in Paragraphs 2, 4, 5, 8, 9, 10, 11, 12, 13 and 15 of the complaint in the above case are true and correct; and that it is his opinion as an expert on accounting principles (1) that Accounting Series Release 146 ("ASR 146") promulgated by the Securities and Exchange Commission on August 24, 1973, constituted a substantive change in the then prevailing generally accepted principles of accounting as reflected in practice, and was not merely an interpretation of what then constituted generally accepted principles of accounting, and (2) that ASR 146 by its terms applies retroactively as set forth in Paragraph 13 of the complaint in the above case.

Executed at Chicago, Illinois, this 11th day of September, 1973.

George R. Catlett
George R. Catlett

Subscribed and sworn to before me, a notary public, in and for the State and County aforesaid, this 11th day of September, 1973.

Deana Robinson
Notary Public

My commission expires

8/7/77

