**UNITED STATES OF AMERICA**
**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

Administrative Proceeding
File No. 3-15012

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| In the Matter of | : | |
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| | : | **DIVISION OF ENFORCEMENT'S** |
| Scott W. Hatfield, CPA, and | : | **PETITION FOR REVIEW** |
| S. W. Hatfield, CPA | : | |
| | : | |
| Respondents. | : | |
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Pursuant to Rule 410 of the Commission's Rules of Practice, the Division of Enforcement petitions the Commission for review of the Initial Decision rendered in this matter by Administrative Law Judge Carol Fox Foelak on September 10, 2013. The Initial Decision granted summary disposition in favor of the Respondents and dismissed this proceeding.[1]

## FACTUAL BACKGROUND[2]

Respondent Scott W. Hatfield, CPA ("Hatfield"), of Dallas, Texas, is the sole proprietor of Respondent S.W. Hatfield, CPA ("SWH"), a Texas accounting firm originally licensed through the Texas State Board of Public Accountancy in 1994. Hatfield renewed SWH's license annually through January 1, 2009. But from January 31, 2010 through May 19, 2011, SWH's firm license was expired and had not been renewed. Specifically, SWH's license had expired due to non-payment of required fees and a failure to complete required peer reviews. The Texas

[1] In a separate proceeding, the Public Company Accounting Oversight Board (PCAOB) permanently revoked SWH's PCAOB registration and barred Hatfield from association with a registered public accounting firm. The Commission sustained the PCAOB's findings and sanctions. Exchange Act Release No. 69930 (July 3, 2013).

[2] This factual background is taken from the findings included within the Initial Decision and the record evidence.

Public Accountancy Act requires a firm to hold a valid license in order to provide attest services, including audits. Because its license was expired, SWH was not in good standing in Texas and was, therefore, not recognized as an accountant by the Commission during that period. The Texas State Board of Accountancy told Hatfield that he could be sanctioned if he issued audit reports without a valid license.

Nevertheless, knowing that SWH's license was expired, Hatfield and SWH issued 38 audit reports for 21 public company issuers. The Respondents issued the audit reports while SWH lacked a license and was therefore not in good standing, and the reports were included in the public filings of SWH's issuer clients. Hatfield signed the audit reports and knowingly authorized them to be included in the issuers' public filings. Respondents charged $187,222 as fees for audits conducted or completed while SWH's license was expired.

THE ORDER INSTITUTING PROCEEDINGS AND INITIAL DECISION

The Order Instituting Proceedings alleged that, as a result of their actions, the Respondents willfully violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5(b) thereunder. The OIP further alleged that, as a result of their conduct, Respondents do not possess the requisite qualifications to represent others, pursuant to Section 4C(a)(1) and Rule 102(e)(1)(i) of the Commission's Rules of Practice. Finally, the OIP alleged that, as a result of their actions, Respondents willfully violated the federal securities laws, pursuant to Section 4C(a)(3) of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

In ruling on a motion for summary disposition filed by the Division, ALJ Foelak, without specifically addressing the Division's various arguments, stated simply that "there is no allegation that the audit reports or the financial statements that were the subject of the audit reports contained misrepresentations, much less that Respondents were in any way liable for

misrepresentations in the reports and financial statements.[3] Accordingly, the allegation that Respondents violated Exchange Act Section 10(b) and Rule 10b-5 is unproven." [OIP at 4-5].[4]

ALJ Foelak further concluded that, because the allegation that Respondents had violated Section 10(b) and Rule 10b-5 of the Exchange Act had not been proven, there was no basis for sanctioning them pursuant to Rule 102(3)(1)(iii). [OIP at 4].

Finally, ALJ Foelak concluded there was no basis for sanctioning the Respondents under Rule 102(e)(1)(i). Specifically, ALJ Foelak based that conclusion on her understanding that Rule 102(e)(1)(i) has been referenced in litigated cases only in association with a Rule 102(e)(1)(iii) sanction and a finding that a respondent willfully violated the federal securities laws. [OIP at 5]. In other words, according to the Initial Decision, because "there is no litigated case in which a respondent was sanctioned pursuant to Rule 102(e)(1)(i) alone," the Respondents could not be sanctioned under it here.

As discussed below, the Division objects to and takes exception to each of the findings and conclusions noted above.

## THE DIVISION'S OBJECTIONS AND EXCEPTIONS TO THE INITITIAL DECISION

### A. The Initial Decision's overly narrow interpretation of culpability ignored established precedent and resulted in the wrong conclusion that Respondents could not be held liable under Section 10(b) and Rule 10b-5 of the Exchange Act.

The ALJ's conclusion that Respondents did not violate Exchange Act Section 10(b) and Rule 10b-5 is based on a misreading of the OIP and the Division's allegations and on a

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[3] The Respondents did not file a motion for summary disposition.

[4] ALJ Foelak noted that the issuers who included the audit reports with their filings violated the reporting provisions of the Exchange Act and the Securities Act of 1933 and that the Respondents were secondarily liable for the violations. She noted, however, the OIP did not charge Respondents will violating the reporting provisions. [OIP at 5].

misapplication of well-settled law. In fact, especially in light of the truncated nature of the opinion, the Initial Decision creates significant risk that it will be used to further improperly narrow the scope of liability to which professionals such as auditors of public companies may be subjected. Therefore, the Division seeks review of the ALJ's findings and conclusions related to that issue.

First, the Initial Decision misconstrues the allegations of the OIP and the Division's arguments. Specifically, ALJ Foelak ignored the allegations, both within the OIP and in the Division's briefing, that Hatfield and SWH's audit reports were themselves false and misleading. Indeed, the OIP rests on the core allegation that the Respondents are liable for the false claim implicit in the audit reports that the audit reports are prepared by properly licensed accountants recognized as such by the Commission. [See, e.g. OIP at paragraphs 2, 7-11]. And the Division argued in its motion for summary disposition that "[i]mplicit in each of SWH's audit reports issued between January 31, 2010 and May 19, 2011 was the representation to each issuer that SWH was recognized as a CPA under the federal securities and qualified and permitted to issue audit reports on its clients' financial statements." [See Division's Motion for Summary Disposition at p. 13]. As the Division alleged – and indeed, as the undisputed evidence showed – this representation was flatly untrue, since Respondents were unquestionably not qualified as accountants for SEC reporting purposes during the relevant period. The Division further alleged and proved that Hatfield knowingly signed those audit reports and intentionally consented to their inclusion in periodic filings disseminated to the public. In short, contrary to the ALJ's conclusion, the Division did specifically allege that Respondents' audit reports themselves were false and misleading, and presented evidence directly on this point.

ALJ Foelak also suggested that the Division had not alleged that the Respondents were liable for any misrepresentations in the audit reports or the financial statements. [OIP at p. 5].

Again, this finding contradicts the OIP's allegations and the Division's arguments in its motion for summary disposition. For example, the Division alleged and argued that Respondents were solely responsible for the content of their audit reports, and controlled the dissemination of those reports to the public through the consents they intentionally signed to allow issuers to include the reports in their public filings. [See, e.g, OIP at paragraph7-9, Motion for Summary Disposition at p. 14-15]. The Division provided ALJ Foelak with extensive citation to Commission and other precedent establishing that publicly filed audit reports prepared someone not recognized as an accountant are material misstatements in violation of the antifraud provisions. [See, e.g., Motion for Summary Disposition at p. 12-13].[5] The Division further alleged, and argued at length, that the Respondents were liable for the materially false audit reports included in the issuers' public filings because, for example, the statements made in the reports were explicitly attributed to the Respondents. [See, e.g., Motion for Summary Disposition at p. 15 and n.5., *citing, inter alia SEC v. KPMG LLP*, 412 F.Supp. 2d 349, 372-374 (S.D.N.Y. 2006) (holding audit engagement partners directly liable for false audit opinion included in issuers' filings because they had the ultimate authority of whether to issue the firm's audit opinion) and Division of Enforcement's Reply Brief in Support of Motion for Summary Disposition at 8-15]. The ALJ's evident disregard for the Division's explicit allegations on this point also warrant Commission review of the Initial Decision.

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[5] ALJ Foelak apparently disregarded any prior Commission order that arose from a settlement, citing to case law indicating that settlements are not precedent. [See Initial Decision at 5, n.7]. It is unclear whether ALJ Foelak applied this view to the Division's arguments related to the fraud allegations or only to the question discussed below of whether Rule 102(e)(1)(i) provides an independent basis to sanction Respondents.

In any event, this sweeping disregard for Commission Orders is not warranted. As documents approved by the Commission, Orders in administrative proceedings provide relevant, even if not always dispositive, explanations of the Commission's view of the legal principles at issue. Moreover, such settlements are routinely cited by the Commission and courts as authority. Finally, the Division also cited federal court actions to support its arguments, including *SEC v. CoElco, Ltd*, et al, Civil Action No. 86-7892 (C.D. Cal.) (October 25, 1988).

Equally troubling is the Initial Decision's implication that, as a matter of law, an auditor may not be held liable under Section 10(b) and Rule 10b-5 for material misrepresentations in an audit report, that are included in an issuer's public filings with the auditor's knowing consent. [OIP at 5 "the allegation that Respondents violated Exchange Act Section 10(b) and Rule 10b-5 is unproven"]. For example, the Initial Decision recognizes that issuers who included SWH's audit reports may have violated the reporting provisions of the Exchange Act and the Securities Act, and that Respondents could be secondarily liable for those violations. [Initial Decision p. 5].[6] But the decision suggests that the Respondents could only be held secondarily liable for those reporting violations, and could not be held primarily liable for fraud. [Id.]

The Commission should review and correct this implication. As discussed above, the Commission and courts have long held that an auditor may be held primarily liable for fraud if his audit opinion is false and misleading and he acts with the requisite state of mind. Specifically to this case, an auditor violates the antifraud provisions when he issues an audit opinion without being properly licensed and qualified as an accountant. [See generally Division's Motion for Summary Disposition at pp. 12-14, discussing *In the Matter of Ronald Effren, et al.*, 1996 SEC LEXIS 69 (January 16, 1996) (settled administrative proceeding); *In the Matter of Alan S. Goldstein*, 1994 SEC LEXIS 2787 (SEC 1994) (settled administrative proceeding); and *SEC v. CoElco, Ltd.*, Civil Action No. 86-7892 (C.D. Cal.) (October 25, 1988); 1988 SEC LEXIS 2184 (October 31, 1988)].

Unless the Commission corrects this error, the Initial Decision could be read to improperly limit the scope of liability that can, and should, attach to auditors who intentionally or recklessly issue materially false and misleading audit reports, that the auditor knows will be

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[6] The Division does not disagree with that conclusion. But it disagrees, as discussed above, that the Respondent's actions only support to reporting violations.

included in public filings. The Division also asks that the Commission issue an order finding that each Respondent violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

### B. The Initial Decision incorrectly holds that the Respondents cannot be sanctioned under Section 4C of the Exchange Act and Rule 102(e)(1)(i) unless they are also found to have willfully violated the federal securities laws.

Rule of Practice 102(e) is the Commission's primary tool to preserve the integrity of its processes and to ensure the competence of the professionals who appear and practice before it. *See, e.g., Marrie v. SEC*, 374 F.3d 1196, 1200 (D.C. Cir. 2004). The Initial Decision, however, without any citation, applies an excessively narrow interpretation of that Rule. First, the Initial Decision incorrectly holds that Exchange Act Section 4C(a)(1) and SEC Rule of Practice 102(e)(1)(i) do not provide an independent basis to sanction an accountant, but instead only applies if the Division alleges and proves that the accountant also willfully violated the federal securities laws. This holding misconstrues the plain reading of Rule 102(e) and well-established precedent.

Rule 102(e)(1) provides that the Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission:

i. "[n]ot to possess the requisite qualifications to represent others; or

ii. "[t]o be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or

iii. To have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

Rule 102(e)(1)(i), (ii), and (iii) (emphasis added).[7]

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[7] As the Initial Decision noted, Section 4C and Rule 102(e) are, in essence, identical. [OIP at n. 1]. Therefore, like the Initial Decision, the Division here only explicitly discussed Rule 102(e), but the same analysis, and objections, apply to its claims under Section 4C.

Contrary to the Initial Decision's conclusion, Rule 102(e)(1)(i) provides an independent basis to sanction Respondents. Rule 102(e) "...set[s] forth three independent bases on which the Commission may discipline a person..." including when the attorney (or person) lacks the requisite qualification to represent others. *In the Matter of Steven Altman, Esq.*, Rel. No. 63306 (November 10, 2010), *aff'd* by DC Circuit (2011). As the Commission explained:

> "Altman argues that this proceeding should be dismissed for a variety of reasons. His first reason is that he was not charged with violating the federal securities laws. A federal securities law violation, however, is not a prerequisite to the initiation of a disciplinary proceeding under Rule 102(e) and Exchange Act Section 4C. Those provisions set forth three independent bases on which the Commission may discipline a person licensed to practice as an attorney: first, when the attorney lacks the "requisite qualifications to represent others"; second, when the attorney lacks "character or integrity" or engages in "unethical or improper professional conduct"; or third, when the attorney willfully violates, or willful aids and abets a violation of, the federal securities laws."

*Id.* (emphasis added). Because the Initial Decision erroneously states that Rule 102(e)(1)(i) only applies when the Respondent has also been found to have willfully violated the federal securities laws under Rule 102(e)(1)(iii), Commission review is warranted.

Indeed, by holding that Rule 102(e)(1)(i) can apply only if Rule 102(e)(1)(iii) is also triggered, the Initial Decision effectively renders Rule 102(e)(1)(i) a nullity. This violates fundamental rules of statutory and regulatory interpretation. The three subsections of Rule 102(e)(1) are written disjunctively, as evident by the recurrence of the word "or" between each subsection. This means that they each supply an independent ground for barring a professional from appearing or practicing before the Commission. There is nothing in the Rule to support a conclusion that subsections (i) and (iii) are somehow dependent upon one another or otherwise linked. Had the Commission intended Rule 102(e)(1)(i) to apply only if Rule 102(e)(1)(iii) also applied, it could easily have included conjunctive language to make that condition apparent. Or it could have eliminated subsection (i) altogether. But it did neither of these things and, accordingly, ALJ Foelak's application of these provisions is in error.

In short, because Respondents issued audit reports without holding proper licenses and without SWH being recognized as an accountant by the Commission, Rule 102(e)(1)(i) applies here. *See, e.g., In the Matter of Alan S. Goldstein, CPA,* Exchange Act Release No. 34641 (Sept. 6, 1994) ("As an accountant whose license to practice as a CPA had lapsed, Goldstein did not possess the requisite qualifications to represent others within the meaning of Rule 2(e)(1)(i) of the Commission's Rules of Practice."); *In the Matter of Elliot Stumacher*, Exchange Act Release No. 3924 (Sept. 24, 1997) ("Stumacher is not duly registered and in good standing as a CPA. . . [t]hus, [he] does not possess the requisite qualifications to represent others as a certified public accountant before the Commission."). Accordingly, the Division asks the Commission to review the Initial Decision's ruling on this issue and permanently bar Respondents form appearing or practicing before the Commission pursuant to Exchange Act Section 4C and Rule 102(e)(1)(i).

### C. The Initial Decision improperly determined that the Respondents should not be sanctioned under Exchange Act Section 4C(a)(1) and Rule 102(e)(1)(iii).

Second, the Initial Decision wrongly dismissed the OIP's claims under Rule 102(e)(1)(iii). As discussed above, the Respondents willfully violated the antifraud provisions of the Exchange Act. For that reason, Respondents should be sanctioned under Rule 102(e)(1)(iii). The Division asks the Commission to review the Initial Decision's findings and conclusion that Respondents could not be sanctioned under Section 4C of the Exchange Act and Rule 102(e)(1)(iii) and permanently bar Respondents form appearing or practicing before the Commission pursuant to that provision.

### D. The Respondents should have been subjected to further appropriate sanctions.

Finally, the Division takes exception to the ALJ's refusal to impose other appropriate sanctions against Respondents, including entering a cease-and-desist order, ordering disgorgement, plus prejudgment interest, and civil monetary penalties. As explained in the

Division's briefing, the Respondents conduct more than warranted the imposition of such remedies. Accordingly, the Division asks that the Commission issue a cease-and-desist order, order the Respondents to pay, on a joint and several liability basis, disgorgement of at least $187,222, plus prejudgment interest, and order each Respondent to pay a second tier civil penalty.

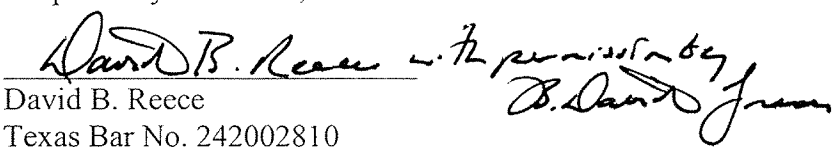
## CONCLUSION

In sum, the Commission should review the Initial Decision in this matter and: (1) find that Respondents violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; (2) order Respondents to cease and desist from future violations; (4) order Respondents to pay disgorgement, on a joint and several liability basis, of $187,222, plus prejudgment interest pursuant to Rule 600 of the Commission's Rules of Practice, (5) order each Respondent to pay an appropriate second-tier civil penalty; and (6) permanently bar Respondents from appearing or practicing before the Commission pursuant to either, or both of, Rule of Practice 102(e)(1)(i) and 102(e)(1)(iii).[8]

[8] As noted above, for the same reasons, Respondents should be sanctioned under Section 4C of the Exchange Act.

Dated: October 1, 2013

Respectfully submitted,



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