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# In the Supreme Court of the United States

FREE ENTERPRISE FUND *ET AL.*, PETITIONERS

*v.*

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD,
RESPONDENT

*ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT*

## BRIEF FOR THE CATO INSTITUTE AND PROFESSORS LARRY RIBSTEIN AND HENRY BUTLER AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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## QUESTION PRESENTED

Whether the Constitution requires that the Public Company Accounting Oversight Board—which enjoys a broad mandate to regulate the accounting industry, and the full panoply of taxing, spending, rulemaking, and criminal enforcement powers needed to carry out that mandate—be accountable to the President.

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## INTRODUCTION[*]

The separation of powers lies "at the heart" of the governmental structure created by the Constitution. *Buckley* v. *Valeo*, 424 U.S. 1, 119 (1976). And in separating the powers of the federal government's three branches, "[t]he Founders * * * consciously decide[ed] to vest Executive authority in one person rather than several." *Clinton* v. *Jones*, 520 U.S. 681, 712 (1997) (Breyer, J., concurring in judgment).

This constitutional design was not only a part of the Framers' original understanding; it was a wise way to facilitate both coordinated law enforcement and government that is accountable and responsive to the people. "The Framers recognized * * * [that] structural protections against abuse of power [are] critical to preserving liberty." *Bowsher* v. *Synar*, 478 U.S. 714, 730 (1986). And presidential control over the use of executive power by federal agencies is indispensable to the good government that is liberty's everyday safeguard. In short, "[w]hen structure fails, liberty is always in peril." *Public Citizen* v. *U.S. Dep't of Justice*, 491 U.S. 440, 468 (1989) (Kennedy, J., concurring in judgment). It has failed here.

Indeed, the Public Company Accounting Oversight Board ("PCAOB" or "Board") of the Sarbanes-Oxley Act of 2002—passed with little scrutiny amidst a panic—is a story of government failure on two levels:

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[*] The parties have consented to the filing of this brief, and their letters of consent are on file with the Clerk. In accordance with Rule 37.6, *amici* state that no counsel for any party has authored this brief in whole or in part, and no person or entity, other than the *amici*, has made a monetary contribution to the preparation or submission of this brief.

*First*, the Board's structure creates unusually dangerous incentives virtually certain to make it dysfunctional. Indeed, the Board's unprecedented power, together with its novel insulation from presidential control, encourage institutional aggrandizement more than in any previous agency. Historically, the power to remove an official "for cause" was seen as "an impediment to, not an effective grant of, Presidential control." *Morrison* v. *Olson*, 487 U.S. 654, 706 (1988) (Scalia, J., dissenting). But at least traditional independent agencies are subject to this control. That much is settled. Here, the Board is protected from Presidential control by *two* layers of "for cause" removal statutes—rendering removal effectively impossible. Truly, "[t]his wolf comes as a wolf." *Id.* at 699.

*Second*, and inevitably, these failures in institutional design have generated failed policy results. In particular, the Board's lack of connection to the "nerve center" of law enforcement—the Executive—has caused the Board to regulate without coordinating with other agencies. This clumsiness, in turn, has caused the Board to trigger threats of retaliatory regulation by foreign countries—creating just the kind of confusion Congress could have avoided by placing the Board under the President, who speaks with one voice for the United States in foreign affairs. Likewise, the Board's lack of coordination with other agencies is subjecting regulated parties to a host of duplicative regulations—here again, a result wholly unnecessary given the Constitution's sensible requirement of accountability to the Executive.

## INTEREST OF THE *AMICI CURIAE*

The Cato Institute believes that sound public policy requires, as the Framers understood, a limited

federal government composed of properly divided branches. Cato was established in 1977 as a nonpartisan public policy research foundation dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Constitutional Studies was established in 1989 to help restore the principles of limited constitutional government that are the foundation of liberty. Toward those ends, the Cato Institute publishes books and studies, conducts conferences, publishes the annual Cato Supreme Court Review, and files *amicus* briefs with the courts. This case is of central concern to Cato because it implicates the core constitutional structure—the separation of powers—that secures our liberty.

Professors Larry Ribstein and Henry Butler have devoted a substantial part of their professional careers to studying the federal securities laws, including how those laws should be drafted, interpreted, and enforced to ensure protection of investors and promotion of efficiency, competition, and capital formation. Professor Ribstein, an author of multiple treatises on corporate law, holds the Mildred Van Voorhis Jones Chair in Law at the University of Illinois College of Law. Professor Butler, a noted law-and-economics scholar, is a Senior Lecturer at Northwestern University Law School and Executive Director of the Searle Center on Law, Regulation, and Economic Growth.

## STATEMENT OF THE CASE

Sarbanes-Oxley was passed in record time under massive public pressure. With the accounting scandals of Enron and WorldCom just behind and midterm elections just ahead, considered opposition to

the bill all but disappeared. "House GOP Opposition to Senate's Accounting Bill Vanishes," *Congress Daily* declared. See Pamela Barnett, 2002 WLNR 11741925 (July 18, 2002). Even in this environment, it is striking that the House's name-sponsor of Sarbanes-Oxley, House Financial Affairs Committee Chairman Michael Oxley, would declare, just twelve days before Sarbanes-Oxley was signed into law, that the "governmental powers" being given to the Board would be "extraordinary *and maybe even beyond constitutional*." *Ibid.* (emphasis added).

Chairman Oxley was right. And as we explain below, the constitutional failures in his bill have produced predictably bad policy results. To understand why this is so, however, it is helpful to understand the process that led to the Board's creation and the nature of the authority conferred on the Board.

### A. The Board's origin in a panicked legislative environment

Although the accounting profession had not previously been subject to day-to-day federal regulation, Congress abruptly changed course in 2002.[1] It created a new agency with sweeping federal power to

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[1] See Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and Its Public/Private Status*, 80 NOTRE DAME L. REV. 975, 983-95 (2005) (describing tradition of self-regulation). Although the SEC had formal power to regulate accounting methods used to prepare and audit financial statements included in reports mandated by that agency, the SEC had for nearly a century adopted a "policy of looking to the private sector for leadership in establishing and approving accounting principles." *Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards*, 39 Fed. Reg. 1260 (Jan. 7, 1974).

"audit the auditors," and it required all accounting firms that prepare or issue audit reports on American public companies to register with the Board. 15 U.S.C. § 7212(a).[2] Yet this fundamental shift in regulation of the accounting industry was as hasty as it was significant. Indeed, as many scholars have observed,[3] it was "an exemplar of low-quality legislative decisionmaking." Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1544 (2005).[4]

Sarbanes-Oxley was enacted as a piece of emergency legislation prompted by a feeling of crisis. As the long bull market of the 1990s began to decline, Enron's spectacular and well-publicized demise shocked the stock market. A drumbeat of revelations involving fraud at other corporations soon followed, and all of this accompanied a stock market crash fu-

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[2] As of July 23, 2009, 2,083 firms had registered. See *Registered Public Accounting Firms As of July 23, 2009* (available at: http://www.pcaob.org/Registration/Registered_Firms.pdf).

[3] See, *e.g.*, Larry E. Ribstein, *Sarbox: The Road to Nirvana*, 2004 MICH. ST. L. REV. 279 (2004); Robert Charles Clark, *Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too*, 22 GA. ST. U. L. REV. 251 (2005); HENRY N. BUTLER & LARRY E. RIBSTEIN, THE SARBANES-OXLEY DEBACLE: WHAT WE'VE LEARNED; HOW TO FIX IT (2006).

[4] Sarbanes-Oxley also fundamentally altered the regulation of internal corporate governance—nationalizing a swath of regulation that had long been the province of state law. Corporate activity that was previously regulated by the state-law duty of care (and the business judgment rule) became subject to requirements enforced by the Board, such as those involving internal controls reporting. See Romano, *Quack Corporate Governance*, at 1523.

eled by investor panic. See Romano, *Quack Corporate Governance*, at 1544-1549.

The panicked atmosphere on Wall Street caused a similar panic in the halls of Congress, with overwhelming pressure to do something—anything—to "restore investor confidence." The process in Congress was notable for the speed with which it occurred—and for the attendant lack of careful deliberation. In both houses, the legislation was considered within an unusually narrow time frame. The House took only one day, for example, to consider the Financial Services Committee's bill; and the Senate debate, which lasted only a week, occurred under a cloture motion, which restricted the time for legislative consideration and amendment. See *id.* at 1549.

In a rush to act as quickly as possible, members of Congress reached for off-the-shelf policy proposals. And the interest group best positioned with such proposals ready at hand was a group of "policy entrepreneurs," composed mainly of former government officials and led by former SEC Chairman Arthur Levitt. *Id.* at 1549, 1568-1571. Levitt had failed to enact his policy agenda less than two years earlier, due to bipartisan congressional opposition. *Id.* at 1549-1550. But this time, government officials associated with the SEC—some of whom would later be positioned to influence the PCAOB's priorities—dominated the process. See *id.* at 1569 (showing that current and former government officials, usually associated with the SEC, testified more often during committee hearings than any other group).

Although legislators listened to many of these government officials, what they most glaringly did not consult was the overwhelming body of empirical re-

search that contradicted what was being proposed. As Professor Roberta Romano has documented in her review of nearly fifty empirical studies in the corporate finance and accounting literature, the studies were virtually unanimous in their findings that many of Sarbanes-Oxley's substantive corporate governance mandates would not benefit investors. See *id.* at 1529-1543.

### B. The Board's unprecedented insulation from presidential oversight

In a rushed legislative atmosphere heedless of empirical evidence and dominated by government officials, it is hardly surprising that one result of this process was a perch for more government officials. More surprising, however, is the unprecedented nature of the Board that Congress hastily created.

The Board's powers are sweeping. Its duties include establishing professional audit standards, inspecting the engagements of registered accounting firms, and, as necessary, investigating and bringing enforcement actions against those firms 15 U.S.C. §§ 7211(c), 7214(a), 7215(c)(4). The Board also has a broad mandate to make law, including whatever rules and standards "may be necessary or appropriate in the public interest or for the protection of investors." *Id.* § 7213(a)(1). Violations are punishable as crimes (*id.* §§ 78ff(a), 7202(b)), and the Board has power to impose sanctions "as it determines appropriate" (*id.* §§ 7215(b)(1), (c)(4)). The Board also has power to levy its own taxes on publicly traded companies and to appropriate that money however it wishes by setting its own budget. *Id.* § 7219(b)-(d).

The most remarkable feature of the Act, however, is the lack of accountability to accompany the Board's

breathtaking authority. The President does not oversee the Board in any respect—whether through removal or otherwise. To the contrary, the Board is deliberately insulated from his control by a double "for cause" removal structure whereby the Board (itself an independent agency) is answerable only to *another* independent agency, the SEC. The SEC's commissioners can remove the PCAOB's board members, but only for "cause," narrowly defined. *Id.* §§ 7211(e)(6) & 7212(d)(3). And the SEC's commissioners, in turn, are likewise appointed for fixed terms and removable only for cause. 15 U.S.C. § 78d(a); Pet. App. 5a.

By layering one "for cause" removal requirement upon another, Congress made the presidential power of removal exponentially more limited for the Board than for an ordinary independent agency. For the President to remove a PCAOB official, he would need not only cause to remove the official, but also cause to remove the SEC commissioners for refusing to remove the official. In practice, this is no power at all.

It is therefore unsurprising that the Board would describe itself as a "*private-sector*, non-profit corporation."[5] Indeed, in its degree of insulation from presidential oversight and control, the Board is alone among all other agencies, past or present. Pet. App. 42a, 43a (Kavanaugh, J., dissenting) (noting the "world of difference between the legion of [independ-

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[5] See www.pcaob.org ("[t]he PCAOB is a private-sector, nonprofit corporation") (PCAOB homepage) (visited July 30, 2009) (emphasis added); 15 U.S.C. § 7211(a), (b) ("the Board shall be a body corporate"; "the Board shall not be an agency or establishment of the United States government"). The parties have agreed, however, that the Board is a governmental entity for constitutional purposes. Pet. App. 112A; Pet. 7 n.1.

ent] agencies and the PCAOB" and describing the latter as a structure seen "never before in American history"). Congress's decision to strip the President of all appointment and removal power was quite deliberate: It aimed to give the Board "unchecked power, by design." 148 Cong. Rec. S6327-06, S6334 (daily ed. July 8, 2002) (statement of Sen. Gramm). For regulated accountants, the Board amounts to nearly a whole government in microcosm—an agency that is at once the lawmaker, the tax collector, the inspector, the sheriff, the prosecutor, the judge, and the jury—yet without the political accountability that normally constrains even independent agencies.

## SUMMARY OF ARGUMENT

In its haste to enact Sarbanes-Oxley, Congress created a regulatory institution never before seen in American history: the PCAOB, an independent agency shielded beneath another independent agency—and thus entirely unaccountable to the President, who is constitutionally charged to "take Care that the Laws be faithfully executed." U.S. Const. art. II, § 3. At the same time, Congress matched this unprecedented unaccountability with an equally unprecedented amount of power: a new mandate to regulate the accounting industry, and a full panoply of taxing, spending, rulemaking, and criminal enforcement powers with which to carry out that mandate.

Not only is the resulting agency unconstitutional, but, as demonstrated below, it is also a policy failure. There is no tension here between good government and constitutional government. Not coincidentally, the Board threatens both.

As we explain in Part I, the Board's uniquely unaccountable structure creates incentives that are inherently inconsistent with good government. Because the President has no power to oversee the Board's budget, hold it accountable to the public, or coordinate its actions with other executive branch activities, the Board is a policy failure in design.

Inevitably, and as we explain in Part II, that failure in design has caused failures in practice. The Board's built-in incentives are beginning to create significant policy problems that cannot be remedied by the President. Although it is imperative that the Nation speak with one voice—the President's voice—in foreign affairs, the Board imposes American accounting standards abroad. These actions, which have bloated the Board's budget, have caused numerous international complications and invited retaliation by foreign regulators. Additionally, on the home front, the Board has imposed massive costs on American businesses—many owing to a lack of coordination with other Executive Branch agencies that is quite expected from an agency not subject to the faintest hint of control by the President.

## ARGUMENT

As Judge Kavanaugh noted in his dissent below, "even assuming that the [PCAOB] is an effective means to regulate the accounting industry, that a given law or procedure is efficient, convenient, and useful * * * will not save it if it is contrary to the Constitution." Pet. App. 103a (Kavanaugh, J., dissenting) (citation omitted). Unfortunately, the Board is *not* an efficient, convenient, or ultimately useful means of regulating the accounting industry. Good government requires that institutions with the right

incentives wield power responsibly and in a manner that serves the public interest. And the Board's unprecedented degree of power, together with its near-total exemption from presidential oversight, not only renders it unconstitutional, but creates incentives that cannot yield sound policy results.

## I. The President's Inability To Control The Board Creates Incentives Virtually Certain To Aggrandize Parochial Interests At The Expense Of The Public Interest.

The Board's uniquely unaccountable structure is not simply a formal or technical violation of the Constitution's required separation of powers. Rather, the Board's structure makes it highly likely to be a policy failure. This conclusion is confirmed by lessons drawn from the established political science and public choice literature on institutional design. Despite good intentions in its creation, the Board suffers from incentives that inevitably impede good government. The trouble is twofold.

*First*, as scholars have amply demonstrated, agencies have a natural tendency to aggrandize their own institutional interests—and thus to stray from the broader public interest. Most commonly, this tendency manifests itself in an agency's inherent incentive to maximize its own budget. See generally WILLIAM A. NISKANEN, BUREAUCRACY AND REPRESENTATIVE GOVERNMENT (1971). Because agencies aim to enlarge their expected discretionary budgets while minimizing their responsibilities—to be paid more for doing less—the result is systematic inefficiency: The "budget of a bureau is too large, the output * * * is generally too small and that inefficiency in production is generally the normal condition." William A.

Niskanen, *Bureaucracy*, in THE ELGAR COMPANION TO PUBLIC CHOICE 264 (2001). Countless empirical studies have confirmed this phenomenon. See DENNIS C. MUELLER, PUBLIC CHOICE III 373-379 (2003) (reviewing fifty-six studies finding inefficiency in comparison with private firms engaging in similar activities).

Even the best government agencies indulge some inefficiency, of course, but they are typically constrained by important limits on their revenues and spending. Ordinarily, an agency must persuade appropriators to grant funding increases. Thus, the costs of such persuasion are a natural and routine brake on inefficiency and agency growth.

Not so with the Board. It enjoys both the power to set its own budget and the power to raise revenue by levying taxes—a quintessential legislative power. See U.S. Const. art. I, § 8 ("Congress shall have Power To lay and collect Taxes"). Congress thus effectively granted the board a monopoly, relieving it of the need to persuade appropriators and compete for funds with other agencies. Yet, having created an agency with the ability to generate out-of-control costs, Congress also eliminated the principal check on those costs: presidential oversight. The Board is overseen only by another agency with similar inherent budget-expanding incentives. The President has no meaningful ability to use his appointment and removal power to demand efficiency or to rein in the costs of executing the law.

*Second*, and even more fundamentally, Congress's creation of an agency immune from presidential control strengthens its own power relative to that of the President. But as a formidable body of literature confirms, these conditions are the very opposite of those

needed for good government. The perils of unchecked legislative control are well-known: what the Framers called "factions," and what public choice scholars call "interest group" dominance. See generally MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1965). Because Congress "is made up of hundreds of coequal individuals, each concerned with bringing home the bacon," legislative power is particularly vulnerable to the influence of interest groups that do not represent the public as a whole. Terry M. Moe & Scott A. Wilson, *Presidents and the Politics of Structure*, 57 L. & CONTEMP. PROBS. 1, 15 (1994). And because Congress exerts control over agencies by creating the procedures and authority under which they operate, interest group dominance of the legislature can translate into dominance of the agencies. See Mathew D. McCubbins, *et al.*, *Administrative Procedures as Instruments of Political Control*, 3 J.L. ECON. & ORG. 243 (1987).

Indeed, the threat to good government from legislative aggrandizement is particularly acute when it comes to designing the structure of new regulatory agencies. Propelled by narrow interest groups, legislators have a powerful incentive to create agencies immune from presidential oversight. Such oversight can threaten those interest groups' ability to maintain control over the agencies down the road.[6] See

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[6] The effect of this powerful incentive for interest groups to dominate agency design is compounded by the fact that ordinary citizens have little interest and expertise in issues involving agency structure. And where broad constituency influences are largely absent, "legislators' political antennae are fully sensitive to the demands of organized interest groups, who do care about structure, pressure for what they want, and know how to use their political resources to shape the popularity and electoral prospects of legislators." Moe & Wilson, *Presidents*, at 8.

Moe & Wilson, *Presidents*, at 6 (explaining how today's winners "fashion structures to insulate them from ongoing democratic control, exercising most of their control *ex ante*, via structural design, rather than *ex post*"). In other words, "[a]gencies are insulated precisely because those who create them do not want them held accountable by tomorrow's authorities." *Ibid.*

The principal source of tomorrow's accountability—and thus the chief bulwark against interest group dominance of agencies—is the President. With respect to their institutional incentives, "presidents are dramatically different from legislators." *Id.* at 12. They "pursue interests that are often incompatible with, and indeed threatening to, the interests of most of the other major players." *Id.* at 11. Representing a heterogeneous national constituency, presidents (of whatever party) are more likely than Congress to resist parochial agendas and to concern themselves more broadly with the public interest. And critically, "[u]nlike legislators, presidents are held responsible by the public for virtually every aspect of national performance." *Ibid.* Because they are more likely to take the blame, presidents are more likely to be responsive to agency and regulatory failures. As a result, "they are the only players * * * who are motivated to seek a unified, coordinated, centrally directed bureaucratic system." *Ibid.*

Good government thus cautions against permitting Congress to overpower the President by insulating an agency from presidential control. Because the Framers understood this well, it is no coincidence that the Constitution requires what good government recommends. As this Court observed in *Printz* v. *United States*, 521 U.S. 898, 922 (1997), the "insis-

tence of the Framers upon unity in the Federal Executive" was "to ensure both vigor and accountability." See also STEPHEN BREYER, ACTIVE LIBERTY 16 (2007) (observing the Constitution's purpose to design institutions in a manner "capable of translating the people's will into sound policies"); Moe & Wilson, *Presidents*, at 14, 18 (explaining how the President's formal constitutional powers—such as appointment—are "of enormous consequence" because they enable the President "to make many important structural choices on [his] own, without going through the legislative process"); *Chadha* v. *INS*, 634 F.2d 408, 423 (9th Cir. 1980) (Kennedy, J.) (wherever "'the right both of making and enforcing the laws, is vested in one and the same man,'" "'there can be no public liberty'" (quoting WILLIAM BLACKSTONE, 1 COMMENTARIES *146-147)), *aff'd*, 462 U.S. 919 (1983). This is especially so where an agency is granted criminal law enforcement authority, which "is manifestly and quintessentially executive power." *United States* v. *Lara*, 541 U.S. 193, 216 (2004) (Thomas, J., concurring); accord, *e.g.*, *United States* v. *Nixon*, 418 U.S. 683, 693 (1974) ("[T]he Executive Branch has exclusive authority and absolute discretion to decide whether to prosecute a case"); *Heckler* v. *Chaney*, 470 U.S. 821, 832 (1985) (criminal prosecutorial decisions have "long been regarded as the special province of the Executive Branch").

Plainly, Congress too has a vital democratic role to play, but an agency designed by Congress to be entirely immune from presidential oversight lacks the many checks that only a President can bring: coordination with other executive functions, prominent and undivided public accountability, and the incentives necessary to resist narrow interest group pressures.

Unlike other "independent" agencies, the Board here is not "insulate[d] * * * , *to a degree*, from 'the exercise of political oversight,'" *FCC* v. *Fox Television Stations, Inc*., 129 S. Ct. 1800, 1815 (2009) (Breyer, J., dissenting) (quoting *Freytag* v. *Comm'r*, 501 U.S. 868, 884 (1991) (Scalia, J., concurring in part and concurring in the judgment) (emphasis added)); it is insulated from such oversight *entirely*. If one were to analogize government agencies to a sound system, it might be said that traditional independent agencies *muffle* the democratic signal. The Board, by contrast, does not merely muffle the signal, it *mutes* it. Completely cut off from the citizenry by any political accountability, the Board is both a broken "microphone" (it cannot "pick up" signals from the public) and a muted "speaker" (having failed to pick up the public's signals, it cannot transmit them).

The Board's subservience to the SEC does not remedy this problem; it exacerbates it. As Judge Kavanaugh explained in his dissent below, "it is undisputed that the SEC as an independent agency is not the President's alter ego." Pet. App. 43a. Its own members are removable only for "cause." Thus, the SEC's role as an intermediary between the President and the Board is the "world of difference between the legion of *Humphrey's Executor*-style agencies and the PCAOB." *Id*. at 42a. Layering the SEC over the Board creates a "double for-cause removal structure" (*id*. at 73a) that amounts to "*Humphrey's Executor* squared" (*id*. at 42a). Unlike an ordinary independent agency, the Board is insulated (by the SEC) from all practical presidential oversight.

As discussed below, the Board's lack of these structural checks has led to the aggrandizement of its power, even internationally, and to uncoordinated

law enforcement efforts on the domestic front—*i.e.*, to bad policy.

## II. The Board's Defective Structure Has Resulted In Widespread Policy Failures.

Not surprisingly, the Board's constitutionally faulty structure has led to bad results in practice. By definition, of course, the less a "democratic" government is accountable to the political process, the less it is effective. But the problem is deeper than that. "When structure fails, liberty is always in peril." *Public Citizen*, 491 U.S. at 468 (Kennedy, J., concurring in judgment). Because the Board is utterly disconnected from its constitutionally prescribed Executive command center, the Board consistently *fails to coordinate* with other agencies—leading to confusion among regulated parties, especially abroad, and to the worst forms of duplicative and burdensome regulation at home.

### A. The Board's lack of coordination with the Executive Branch in regulating foreign firms has created confusion abroad and undercut the President's ability to speak with one voice in foreign affairs.

The Board's track record confirms that granting vast power to an unaccountable agency leads to further aggrandizement of the agency's power and works against coordinated problem-solving. One of the most powerful illustrations of this problem is the Board's involvement in the regulation of foreign accounting firms—an issue that implicates not only the President's executive power generally, but his specific charge to speak for the United States in the field of foreign affairs. As this Court recognized in *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304,

320 (1936), the "power of the President" in foreign affairs is "very delicate, plenary and exclusive": He is "the sole organ of the federal government in the field of international relations—[and this is] a power which does not require as a basis for its exercise an act of Congress, but which, of course, like every other governmental power, must be exercised in subordination to the applicable provisions of the Constitution." See also *Republic of Iraq* v. *Beaty*, 129 S. Ct. 2183, 2191 (2009); *Pasquantino* v. *United States*, 544 U.S. 349, 368-370 (2005). The Board's lack of accountability, and the manner in which it has exercised its unreviewable authority, contravene this principle.

1. Under the Sarbanes-Oxley Act, the Board is charged with regulating international accounting firms that audit American companies. See 15 U.S.C. § 7216. This is a vast mandate. Indeed, the Board has recently announced that it will begin inspections in just a few months in the following countries:

- Argentina
- Australia
- Brazil
- Canada
- Chile
- China
- Finland
- France
- Germany
- Greece
- Hong Kong
- Indonesia
- Ireland
- Israel
- Kazakhstan
- Korea
- Mexico
- Netherlands
- New Zealand
- Norway
- Philippines
- Portugal
- Russia
- Singapore
- Sweden
- Switzerland
- United Kingdom

See *PCAOB Plans International Inspections* (available at www.webcpa.com/news/31255-1.html) (Apr. 8, 2009).

This massive initiative is placing a strain on the Board's already considerable budget, which is growing by 9% this year in large part to pay for foreign auditors. "In addition to the time and travel demands, PCAOB officials say foreign inspections drain the resources of the [Board's] Office of International Affairs, which is responsible for maintaining relationships with the Board's non-U.S. counterparts." Ken Rankin, Board Approves PCAOB Budget (avail. at: www.webcpa.com/ato_issues/2009_1/30103-.html) (Jan. 5, 2009). And according to one member, even 9% growth is not enough; "he would press to divert funds from other areas to finance overseas inspections." *Ibid*.

Exploding budget demands, however, are likely the least troubling aspect of the Board's global reach—and not only because the Board can levy taxes to meet whatever budget it sets for itself. The bigger problem is that imposing American accounting standards has triggered "strenuous objections abroad," Roberta S. Karmel & Claire R. Kelly, *The Hardening of Soft Law in Securities Regulation*, 34 BROOKLYN J. INT'L L. 883, 909 (2009), including threats of retaliation. According to the internal markets commissioner for the European Union, "The PCAOB's approach may lead to mounting pressure to require U.S. audit firms to register in the EU." Jim Peterson, *Balance Sheet: Accounting Rules as Melodrama*, NEW YORK TIMES (May 10, 2003).

Not only are foreign firms loath to face two sets of *regulators* (one from their own country, the other the

PCAOB), they are loath to face two sets of *regulations*. "French law, for example, makes it a crime punishable by prison for an auditor to disclose its clients' secrets. Yet to comply with [the PCAOB's regulations] a firm is obliged to produce, on request, both its working papers and the testimony of its personnel." *Ibid*. Nor is France alone. "[H]ow is a German auditor," for her part, "to reconcile the U.S. requirement for testimony with the German constitutional protection against self-incrimination?" *Ibid*. In short, from the perspective of our trading partners, "non-U.S. firms are under legal burdens they cannot waive, and the [PCAOB] cannot inflict its unilateral will, however noble it may deem its purpose." *Ibid*; see generally BUTLER & RIBSTEIN, THE SARBANES-OXLEY DEBACLE, at 71-74.

But "inflict[ing] its unilateral will" is the PCOAB's very reason for existence. As one Senator put it during floor debate, attempting to offer the Board a compliment:

> This Board is going to have massive power, unchecked power, by design. * * * We are setting up a board with massive power that is going to make decisions that affect all accountants and everybody they work for, which directly or indirectly is every breathing person in the country. They are going to have massive unchecked powers.

148 Cong. Rec. S6334 (daily ed. July 8, 2002) (statement of Sen. Gramm). This statement approaches the truth: The Senator failed only to note that the Board's "massive unchecked power" would extend "by design" to "every breathing person" on the *planet*.

2. Granting this kind of unchecked power to an agency whose leadership cannot be removed by the

President flies in the face of the constitutional design. It is one thing for a department head such as the Secretary of State to exercise authority in foreign affairs; she serves at the pleasure of the President. It is another for one of the traditional independent agencies such as the SEC to create regulations that may apply abroad. But it is a different matter entirely for an agency that cannot be controlled in any sense by the President to have "massive unchecked powers" in foreign affairs.

Indeed, the problem posed by the Board's unchecked power in foreign affairs dates back to the Articles of Confederation, under which the Continental Congress was impotent to prevent States, which were not answerable to the President, from conducting their own foreign policy. See John Jay, *In An Address to the People of the State of New York on the Subject of the Constitution*, in PAMPHLETS ON THE CONSTITUTION OF THE UNITED STATES 69, 72 (Paul Ford ed., 1971). Consequently, States were regularly causing foreign policy embarrassments. The turmoil created by these multifarious foreign policies was "a major drive wheel in the movement for constitutional reform." FREDERICK W. MARKS, III, INDEPENDENCE ON TRIAL: FOREIGN AFFAIRS AND THE MAKING OF THE CONSTITUTION 50 (1973). "Nothing contributed more directly to the calling of the 1787 Constitutional Convention than did the spreading belief that under the Articles of Confederation Congress could not effectively and safely conduct foreign policy." Walter LeFeber, *The Constitution and United States Foreign Policy: An Interpretation*, 74 J. AM. HIST. 695, 697 (1987).

Since the Founding, therefore, this Court has consistently shown its "concern for uniformity in this

country's dealings with foreign nations." *Banco Nacional de Cuba* v. *Sabbatino*, 376 U.S. 398, 427 n.25 (1964). In *Crosby* v. *National Foreign Trade Council*, 530 U.S. 363 (2000), for example, the Court invalidated a Massachusetts statute that interjected the Commonwealth into a foreign policy matter—in that case, by imposing economic sanctions on companies doing business with Burma. While the Court ultimately rested its decision on federal preemption, the Court strongly condemned Massachusetts' interference with foreign policy negotiations: "It is not merely that the differences between the state and federal Acts * * * threaten to complicate discussions; they compromise the very capacity of the President to speak for the Nation with one voice in dealing with other governments." *Id*. at 381. This in turn would deprive the President of "economic and diplomatic leverage" in negotiations. *Id*. at 377. The Court concluded that "the President's maximum power to persuade rests on his capacity to bargain for the benefits of access to the entire national economy, without exception for enclaves fenced off willy-nilly by inconsistent political tactics." *Id*. at 381; see also THE FEDERALIST NO. 44, at 299 (James Madison) (J. Cooke ed., 1961) (emphasizing "the advantage of uniformity in all points which relate to foreign powers").

Similarly, the Court in *American Insurance Association* v. *Garamendi*, 539 U.S. 396 (2003), struck down a California law that required foreign insurers doing business in the State to disclose information concerning Holocaust-era insurance policies issued overseas. Because the Executive Branch had negotiated various executive agreements with foreign nations that took a different approach to the same issue, the Court held that California's policy was preempted

by the Executive's authority over foreign affairs. In so holding, the Court emphatically reaffirmed "the President's 'vast share of responsibility for the conduct of our foreign relations.'" *Id.* at 414 (quoting *Youngstown Sheet & Tube Co.* v. *Sawyer*, 343 U.S. 579, 610-611 (1952) (Frankfurter, J., concurring)). He "has 'the lead role * * * in foreign policy'" and "can 'act in external affairs without congressional authority.'" *Id.* at 414, 415 (citations omitted).

To be sure, the statute here is a federal law, and the Board is not a State. But like Massachusetts in *Crosby* and California in *Garamendi*, the Board is nonetheless operating as its own impermissible foreign policy enclave. Lacking any oversight by the President or need to cooperate with agencies under his oversight, the Board is a free-wheeling, self-funded quasi-state, negotiating with foreign nations in the name of the United States, but ultimately only for itself. This is a recipe for just the kind of embarrassments created under the Articles of Confederation—the kind of embarrassments avoided by the uniformity called for in *Banco National de Cuba*, *Crosby*, and *Garamendi*.

This Court has recognized "the Framers' overriding concern that 'the Federal Government must speak with one voice when regulating commercial relations with foreign governments.'" *Japan Line, Ltd.* v. *Los Angeles County*, 441 U.S. 434, 449 (1979) (quotation omitted). And as James Madison put it in *Federalist No. 42*, "[i]f we are to be one nation in any respect, it clearly ought to be in respect to other nations." *Id.* at 279. As a federal agency that is wholly unaccountable to the President yet engaged in foreign commercial regulation, the Board starkly violates these principles.

### B. The Board's lack of coordination with other agencies has created duplicative and overly burdensome regulation.

Nor does the burden of submitting to the Board extend only to foreign firms. American companies—and the American economy—are likewise laboring under its weight. As with foreign firms, the challenge for American companies is not merely that of new regulations and investigations, but of new regulations and investigations piled on top of existing ones—two sets of regulations that frequently conflict.

1. In its first year alone, the Board imposed more than $35 billion in direct costs on American businesses. HANS BADER & JOHN BERLAU, THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD: AN UNCONSTITUTIONAL ASSAULT ON GOVERNMENT ACCOUNTABILITY 3 (2005). But this number, while staggering, is dwarfed by the net loss to the American economy posed by Sarbanes-Oxley at large. According to the best available evidence, Sarbanes-Oxley "has imposed a net loss on the American economy of $1.4 trillion." BUTLER & RIBSTEIN, THE SARBANES-OXLEY DEBACLE, at 5 (citation omitted). Firms spent a total of $6 billion complying with Sarbanes-Oxley in 2006. *Ibid.* "Large firms' financial officers, surveyed in 2007, said their companies spent an average of $1.7 million each to comply with [Sarbanes-Oxley]." Larry E. Ribstein & Henry N. Butler, *Where Was SOX*?, FORBES (Dec. 22, 2008) at 28.

This regulatory burden is due in significant part to the fact that the Board duplicates requirements already imposed by other agencies. Perhaps the most glaring example of this piling-on is in the banking industry. As name-sponsor of Sarbanes-Oxley, former-

House Financial Services Committee Chairman Michael Oxley, has explained, Sarbanes-Oxley requires the Board to regulate "internal controls" of publicly traded companies—a provision that "was two paragraphs long, but by the time the PCAOB was done, it was 330 pages of regulations. It was far too prescriptive and [more] expensive than anyone anticipated." Stephen Taub, *Oxley: I'm Not Happy With Sarbox*, CFO.com (Apr. 6, 2007). But this was not the worst of it. Those 330 pages were *on top of* like regulations already imposed on the banking industry.

The "internal controls" requirement, Oxley explained, "was really taken from a banking statute. * * * *So banks ended up with the worst of all worlds—existing banking regulations and [Sarbanes-Oxley]*." *Ibid*. (emphasis added). "For banks," Oxley continued, "it is an unnecessary regulatory burden [in addition to those] they are already complying with." *Ibid*. "[Banks] should have been exempted." *Ibid*.

The same duplication problems plague in-house controllers and accountants. "The SEC and PCAOB have issued two sets of guidance rules to perform the same assessment task," the Institute of Management Accountants ("IMA") explains, "resulting in unnecessary confusion and complexity for management." Press Release, *IMA Responds to SEC and PCAOB Exposure Drafts on SOX: Much More is Needed to Get It Right* (Feb. 27, 2007). "Without major changes," IMA emphasized, "PCAOB's new audit standard will" be the "costly de facto standard." *Ibid*. These problems of duplication also necessarily arise in the context of investigations into allegations of misconduct in public companies, as accounting firms find themselves responding to simultaneous and

overlapping requests for information by the SEC and the Board.

If the President could control the Board, he could lift this "unnecessary regulatory burden," prevent the "unintended confusion and complexity," and ultimately adjust this "costly de facto standard." But Congress did not afford the President any power to control the Board—even the power of "for cause" removal of the Board's members.

2. To make matters worse, the Board not only fails to coordinate with other agencies on shared responsibilities; it is unresponsive to the public on matters in which it has *sole* responsibility. This should come as little surprise for an agency that is both uncontrolled and self-funded: The Board has no meaningful institutional incentive to recognize or remedy its mistakes.

For example, the Board publishes on its website oblique reports about its investigations of accounting firms. See Sarah Johnson, *Why the Big Four Are Still A Big Mystery*, CFO.com (Jan. 26, 2007). But these reports are stripped of critical contextual information, such as how many total audits the firm performed (and thus whether the audit was fairly representative of the firm's work), and how long ago the inspections were performed. *Ibid*. As one leading academic commentator put it, "I wonder about the effectiveness of this process if the 2005 reports are just getting posted in January 2007." *Ibid*. Moreover, the reports are not intended to discuss a firm's strengths, but instead are based on inspections targeted at higher-risk audits. *Ibid*. There is therefore a built-in selection bias towards finding and documenting weaknesses.

None of this, of course, is to say the Board should not conduct such inspections. Nor is it to say that the Board should not (as the Board puts it) conduct a "dialogue" with regulated firms. *Ibid*. It is, however, to note the oddity of the Board publishing this manifestly confusing "dialogue" on the Internet. And more importantly, it is to observe that an entity accountable to the President would have both a greater *sense* of responsibility (through the democratic process) and *actual* responsibility (because of its accountability to the President) to confront this seeming excess.

For the same reason, the Board also has little institutional reason to consider the effect of its regulations on the American economy. And the Board's actions have imposed real costs.

As we have already noted, Sarbanes-Oxley imposes direct economic costs of $1.4 trillion annually—a significant portion of which has been imposed by the Board. What this number fails to show, however, are the unstated costs to the economy of companies that refuse to go public, decide to go public overseas, or simply de-list—all because Sarbanes-Oxley and the PCAOB have so raised the cost of doing business. In the mid-1990s, "the median market cap[italization] of a company going public was $52 million"; [t]oday it has shot up to $227 million. John Berlau, *The Downside of Sarbox: Bad News for Stock Investors*, STOCKS, FUTURES & OPTIONS MAGAZINE (Apr. 2007). In other words, "average investors are now often shut out of the company's growth to the $200 million mark." *Ibid*.

Why? "[T]he consensus is that," compared to the period before Sarbanes-Oxley, "it is roughly four times as expensive to go public today." *Ibid*. Thus, it

is unsurprising that "[b]ankers in the City of London * * * would like to erect a solid gold statue in honor of the legislators who sponsored [Sarbanes-Oxley], for their efforts * * * certainly resulted in shifting a massive proportion of the mergers and acquisitions boom to Britain." CLAIRE BERLINSKI, THERE IS NO ALTERNATIVE: WHY MARGARET THATCHER MATTERS 148-49 (2008).

We are not suggesting that independent agencies have no role to play in regulation of the economy. The Federal Reserve and the SEC, to cite just two examples, are longstanding testimonies to Congress's judgment that depoliticizing market regulation will preserve confidence among market participants that government decisionmakers will act impartially. But even in these sensitive contexts, the Constitution requires *some* measure of democratic and political accountability. In recognition of this, traditional independent agencies are at least run by persons appointed by the President and subject to the President's "for cause" removal power. Here, however, the balance between integrity and democratic politics is lopsided: There is *no* political control.

* * * * *

In creating the Board, Congress created an agency that is uniquely unaccountable to the President and, ultimately, to the people. The Board has no meaningful institutional incentive to limit its reach, to coordinate with other federal agencies (whether traditional or independent), or to avoid duplicative and burdensome regulation.

Not surprisingly, the Board has exercised its unreviewable authority in a manner that reflects these failures in constitutional design. It has aggrandized

its authority both domestically and internationally; it has engaged in extensive extraterritorial regulation, creating foreign policy difficulties; and it has heavily burdened the economy by imposing a second set of overlapping, sometimes conflicting rules on American firms, driving many of them abroad. Of course, if the Board were a resounding policy success, that would not eliminate the constitutional defects in its design. But it is not a success, and its failures stem directly from its constitutional deficiencies.

This case thus powerfully illustrates the principle that "[w]hen structure fails, liberty is always in peril." *Public Citizen*, 491 U.S. at 468 (Kennedy, J., concurring in judgment). As the Framers recognized, presidential control over the use of executive power by federal agencies is indispensable to good government and, ultimately, liberty.

## CONCLUSION

For the foregoing reasons, the judgment below should be reversed.

Respectfully submitted.

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