No. 08-861

IN THE
Supreme Court of the United States

FREE ENTERPRISE FUND *ET AL.*
Petitioners,
v.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD *ET AL.*
Respondents.

On a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF *AMICI CURIAE* LAW PROFESSORS IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI CURIAE* [1]

Amici are scholars at American law schools whose research and teaching focus on federal securities regulation and the governance of public corporations. *Amici* have no financial stake in the outcome of this litigation but are interested in ensuring an accurate interpretation of Title I of the Sarbanes-Oxley Act of 2002 (the "Act"), which established the Public Company Accounting Oversight Board ("Board" or "PCAOB").[2]

As law professors who have studied and written about the massive accounting and corporate governance scandals that prompted the passage of the Act, we applauded Congress's decision to establish a new independent regulator to oversee the conduct of the auditors of public companies. We have been concerned, however, that the particular design chosen by Congress accorded the PCAOB substantial discretion and autonomy without imposing constitutionally sufficient accountability. The current economic crisis in the financial markets has raised for us another concern: that Congress may use the design of the PCAOB in creating additional independent financial regulators. Ultimately, we

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[1] This brief was not authored, in whole or in part, by counsel for either party, and no person other than *amici*, counsel, and counsel's academic institution contributed monetarily to the preparation or submission of this brief. The parties have consented to the filing of this brief and copies of their letters of consent have been filed with the Clerk of the Court.

[2] A full list of *amici*, who joined this brief as individuals and not representatives of any institutions with which they are affiliated, is set forth in the Appendix to this brief.

hope that a decision by this Court will prompt Congress to restructure the PCAOB as a regulator that is more accountable and transparent.

SUMMARY OF ARGUMENT

In Title I of the Act, 15 U.S.C. §§ 7211-7219, Congress placed public company accounting under the oversight of an independent private-sector board that, while not itself "an agency or establishment of the United States Government," *id.* § 7211(b), is subject to oversight by the Securities and Exchange Commission ("Commission" or "SEC"). The statutory text creating the PCAOB further specified that: "No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service." *Id.*

Petitioners' constitutional challenge to the PCAOB presents a statutory conundrum because the PCAOB *is* part of the Federal Government, and the Board's five members *are* federal officers, notwithstanding Congress's claim to the contrary. As this Court has held explicitly, "it is not for Congress to make the final determination of [an entity's] status as a Government entity for purposes of determining the constitutional rights of citizens affected by its actions." *Lebron* v. *National R.R. Passenger Corp.*, 513 U.S. 374, 392 (1995). Respondents have conceded that, under *Lebron*, the PCAOB is a federal entity for purposes of the Constitution. *See* Petitioner's Appendix (Pet. App.) 112a. Accordingly, the court below correctly rejected the statutory text and

struggled to situate the PCAOB within an organizational chart of the federal government.

The members of the three-judge panel constructed very different versions of this organizational chart. Pet. App. 3a-104a, reported at 537 F.3d 667. The panel majority depicted the PCAOB as a "specialized" and "heavily controlled component" of the SEC (Pet. App. 19a, 29a-30a), with the Board's exercise of its statutory duties "subject to check by the Commission at every significant step." Pet. App. 13a. In sharp contrast, the dissenting judge regarded the PCAOB as "an independent agency appointed by and removable for cause by another independent agency." Pet. App. 65a.

As this brief seeks to show, the panel majority's view of the PCAOB as a "heavily controlled component" of the SEC cannot be squared with the Act's statutory text or legislative history. Nor can that view be reconciled with the securities industry's self-regulatory (SRO) model on which the PCAOB was patterned.[3] Mindful of the constitutional limitations placed on congressional delegations of government power to private entities, Congress provided for SEC oversight of the PCAOB in certain well-delineated areas, including recordkeeping, rulemaking, and disciplinary actions. *See* 15 U.S.C. § 7217. But the text of the statute situates the

[3] *See* U.S. Brief in Opp. 2-3 ("Congress patterned the Board on the so-called self-regulatory organizations (SROs), such as the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE), that have regulated the securities markets under close government supervision for more than half a century.")(citation omitted).

PCAOB outside of the SEC, not within it, *id.* § 7211(b), and the text provides the PCAOB with substantial discretion and autonomy, particularly with respect to PCAOB inspections, investigations, and enforcement determinations. Congress's decision to establish a powerful accounting industry regulator that was separate and apart from the SEC was a considered one, and the legislative history confirms that Congress focused on making the PCAOB independent. *See* 148 Cong. Rec. 12,116 (2002) (statement of Sen. Sarbanes) (stating that the board was established by "statute in order to provide an extra guarantee of its independence and its plenary authority to deal with this important situation").

To be sure, Congress could have created the PCAOB as a mere "component" of the SEC, along the lines constructed by the court of appeals. And by situating the Board as a "component" within the SEC, Congress could have ensured that the PCAOB was, as the court below found, subject to check by the SEC "at every significant step." But Congress did not do so, and this Court should not try to amend the Sarbanes-Oxley Act to enact an alternative that Congress specifically considered and rejected.

Instead, this Court should scrutinize the Board that was actually established by the legislation passed by Congress and signed by the President. That legislation created the PCAOB as a corporation whose members are appointed by the SEC for fixed terms, 15 U.S.C. § 7211(e)(4)(A), and removable only by the SEC and only "for good cause shown," *id.* § 7211(e)(6); *see also id.* § 7217(d)(3) (restricting grounds for removal for "good cause"). The PCAOB was thus designed to be an independent entity —

independent from the accounting industry it was established to regulate; independent from "partisan forces" (Pet. App. 34a), and independent from both the SEC and the President.

The PCAOB's independence from the SEC and the President may well contribute to its effectiveness as a regulator, but the particular design chosen by Congress clashes directly with constitutional principles of separation of powers and the text of the Appointments Clause. The PCAOB's design violates the doctrine of separation of powers because the President has no authority to appoint or remove any member of the PCAOB, nor does an "alter ego" of the President have such authority. By lodging the power to appoint and remove PCAOB officials in the SEC, an independent agency that is itself insulated from direct control by the President, Congress has exceeded the boundaries established by this Court in *Humphrey's Ex'r* v. *United States*, 295 U.S. 602 (1935) and *Morrison* v. *Olson*, 487 U.S. 654 (1988). The PCAOB's design violates the Appointment Clause because only "inferior" officers may be appointed by Heads of Departments, and under *Edmond* v. *United States*, 520 U.S. 651, 662 (1997), PCAOB members are not "inferior" officers. As *Edmond* made clear, an "inferior" officer must have a "superior" who directs and supervises the inferior's work. *See id.* at 662-63. Because the PCAOB establishes its own regulatory initiatives and priorities, and because PCAOB members cannot be removed by the SEC at will, the SEC's Commissioners cannot properly be viewed as the "superiors" of the PCAOB. Thus, the PCAOB's members are "principal" officers who, pursuant to the Appoint-

ments Clause, must be appointed by the President with advice and consent from the Senate.

In upholding the constitutionality of the congressionally created and governmentally appointed PCAOB, the court of appeals has opened the door for Congress to establish a multitude of additional independent regulators, answerable in only limited respects to other independent regulators. Congress's pursuit of policy through this double layer of independence is particularly worrisome, for it places elected officials in a position where they will benefit regardless of the actual outcome of those policies. Through the use of such doubly-insulated regulators, "Congress and the President can claim credit for the ingenuity that resulted in regulatory successes and they can avoid blame for the private regulator's unpopular decisions or unwise policies."[4]

This Court has provided Congress much latitude in the creation of independent regulatory agencies. But a double-decker independent regulatory entity like the PCAOB stretches the constitutional text and this Court's precedents too far. This Court should declare the PCAOB unconstitutional. Congress could then restructure the PCAOB either as a unit within the SEC with members who are SEC employees, or as an independent regulator with members appointed by the President with the advice and consent of the Senate, and removable for cause by the President.

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[4] Donna M. Nagy, *Playing Peekaboo With Constitutional Law: The PCAOB and its Public/Private Status*, 80 Notre Dame Law Rev. 975, 1065 (2005).

ARGUMENT

I. ALTHOUGH SUBJECT TO SEC OVERSIGHT AND ENFORCEMENT, THE PCAOB IS INDEPENDENT FROM THE SEC

A. Congress's Creation of the PCAOB as a Private Nonprofit Corporation Belies the Court Below's *Ex Post* Characterization of the PCAOB as a "Component" of the SEC

In establishing the PCAOB "to oversee the audit of public companies," 15 U.S.C. § 7211(a), Congress recognized that it was creating a "strange kind of entity." 148 Cong. Rec. 12,122 (2002) (statement of Sen. Gramm). As Senator Phil Gramm explained: "We want it to be private, but we want it to have governmental powers. We have tried to structure it in ways to try to accommodate this." *Id.*

There is no dispute that Congress vested the PCAOB with broad governmental powers and responsibilities. These powers and responsibilities encompass substantial rulemaking, enforcement, and adjudicative functions, and include the authority to: register accounting firms that audit public companies, 15 U.S.C. § 7212; enact rules setting standards for auditing, quality control, ethics, and independence, *id.* § 7213; inspect on a yearly basis the nation's largest accounting firms and inspect other firms at least once every three years, *id.* § 7214; investigate accounting firms and their associated persons for possible violations of PCAOB

rules or the federal securities laws, *id.* § 7215; and impose discipline for established violations through a range of sanctions including censures, temporary suspensions, permanent bars, and substantial monetary fines, *id.*

The statutory text also makes clear Congress's intention to vest these broad governmental powers in a private, nonprofit corporation. In a subsection captioned "status," Congress provided that:

> The Board shall not be an agency or establishment of the United States Government and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

Id. § 7211(b). This private-sector corporation was to be headed by five members appointed by the SEC for fixed terms "after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury," with vacancies filled "in the same manner." *Id.* § 7211(e)(4). PCAOB members could be removed from office by the SEC only for "good cause shown," *id.* § 7211(e)(6). Congress further provided that the SEC "shall have oversight and enforcement over the Board, as provided in this Act," *id.* §7217(a).

This Court rebuffed a legislative attempt to do an end run around the Constitution in *Lebron* v. *National R.R. Passenger Corp.*, 513 U.S. 374 (1995), in which it held that Amtrak's actions were subject to constitutional constraints, notwithstanding Congress's determination that Amtrak "'will not be an agency or establishment of the United States Government.'" *Id.* at 391 (quoting 45 U.S.C. § 541). This Court rejected Congress's legerdemain because where "the Government creates a corporation by special law, for the furtherance of governmental objectives, and retains for itself permanent authority to appoint a majority of the directors of that corporation, the corporation is part of the Government for purposes of [the Constitution]." *Lebron*, 513 U.S. at 400.[5]

Given this Court's holding in *Lebron*, Congress's determination that the PCAOB is not part of the Federal Government must be rejected, at least for purposes of constitutional law. As Respondents have conceded, the PCAOB's structure must adhere

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[5] As this Court has recognized, congressionally created corporations are "not a unique, or indeed even a particularly unusual, phenomenon." *Lebron*, 513 U.S. at 386. The PCAOB, however, is unique. Never before has Congress created a "private" corporation with the sheer scope of the PCAOB's rulemaking, enforcement, and adjudicative authority. *See* Nagy, *supra* note 4, at 1026-29. Claims that the PCAOB is unexceptional because it was "patterned" on the NYSE and the NASD (now the Financial Industry Regulatory Authority ("FINRA")) are unconvincing. Neither the NYSE nor NASD/FINRA was created by Congress, and the government does not appoint the officials that head those SROs. *See infra* at 23-24.

to the doctrine of separation of powers and the Appointments Clause. It does not.

The statutory text nonetheless establishes the PCAOB as a corporation outside of the SEC. As this Court recognized in *Lebron,* Congress's decision to situate an entity in the private sector "is assuredly dispositive of" that entity's status "for purposes of matters that are within Congress's control – for example, whether it is subject to statutes that impose obligations or confer powers upon Government entities, such as the Administrative Procedure Act, the Federal Advisory Committee Act, and the laws governing Government procurement." *Lebron* 513 U.S. at 392 (statutory citations omitted). Congress's decision to situate the PCAOB in the private sector should also be dispositive as to whether the PCAOB is a "component" of the SEC. The statutory text makes clear that the PCAOB stands separate and apart from the SEC and, for purposes of the Constitution, is thus an independent regulatory agency subject to oversight and enforcement by another independent regulatory agency.

B. Before Settling on the PCAOB's Design, Congress Rejected Structural Alternatives That Would Have Made the PCAOB a Component of the SEC

The court below's decision to reconstruct the PCAOB as a "component" of the SEC was particularly inappropriate because Congress specifically considered that alternative and rejected it in favor of the structure ultimately selected. Indeed, in creating

the PCAOB as an independent regulator in the private sector, Congress acted contrary to the specific advice provided by the Comptroller General of the United States.

In the Senate hearings that preceded the enactment of the Act, U.S. Comptroller General David Walker testified that there were "several alternative structures" from which Congress could choose in establishing a new regulator for the accounting industry, including the creation of:

> (1) a new unit within the SEC; (2) an independent government entity within the SEC; (3) an independent government agency outside the SEC; or (4) a nongovernmental private-sector body overseen by the SEC.[6]

Although he recognized that all four alternatives had strengths and weaknesses, the Comptroller General believed that alternatives one and four had lesser likelihoods of success. He specifically noted that "under alternatives one and four, the new body would have less direct accountability to the Congress and the public than a body with board members who are PASs [president appointed confirmed by the Senate]."[7]

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[6] *See Oversight Hearings on Accounting Reform and Investor Protection Issues Raised by Enron and Other Public Companies Before the Senate Banking, Housing, and Urban Affairs Comm.*, 107th Cong. 661 (2002) (Letter from David Walker, U.S. Comptroller Gen., to Sen. Paul Sarbanes).

[7] *Id.*

The legislative history further reveals that the House of Representatives had initially favored an alternative altogether different from the four suggested by the Comptroller General. Under the proposed "Corporate and Auditing Accountability, Responsibility, and Transparency Act" (CAARTA), H.R. 3763, 107th Cong. § 2(b) (2002), a bill sponsored by Representative Michael Oxley, Congress would have established explicit criteria for "public regulatory organizations," but Congress itself would not have created any such entity. Rather, the bill required the SEC to promulgate rules reflecting and supplementing the congressional criteria, and authorized the SEC to "recognize" entities that applied to the SEC pursuant to its rules. *Id.* § 2(a). As such, this section of the CAARTA bore a close resemblance to provisions in the Maloney Act of 1938, Pub. L. No. 75-719, 52 Stat. 1070 (1938) (codified as amended at 15 U.S.C. § 78o-3), which authorized the SEC to "recognize" national securities associations, such as the NASD. Although CAARTA passed the House by a vote of 334 to 90, 148 Cong. Rec. 5548 (2002), its "public regulatory organization" alternative was subsequently abandoned in favor of an accounting oversight board that was congressionally created.

The text of the statute leaves no doubt that Congress ultimately chose the fourth alternative outlined in the Comptroller General's Senate testimony -- the creation of "a nongovernmental private-sector entity overseen by the SEC."[8] Thus,

[8] Both a former Chairman of the PCAOB and one of the Board's initial members have noted that concerns about competitive compensation influenced Congress's decision to situate the

in depicting the PCAOB as a "component" of the SEC to salvage its constitutionality, the court of appeals essentially turned back the clock and selected for Congress the Comptroller General's first alternative that Congress had rejected – "a unit within the SEC." Because the choice of a constitutional structure for the PCAOB is one that belongs to Congress, this Court should not affirm that error.

C. The Act's Text and Legislative History Establish that the PCAOB Operates with Substantial Discretion and Autonomy

The court of appeals erred not only in its finding that the PCAOB was a "component" of the SEC; it was also incorrect in its assessment that the Act's provision for SEC oversight and enforcement constitutes "extraordinary" direction and supervision

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PCAOB in the private sector. *See* William J. McDonough, *The Fourth Annual A.A. Sommer, Jr. Lecture on Corporate, Securities & Financial Law*, 9 Fordham J. Corp. & Fin. L. 583, 599 (2004) ("We were created as a not-for-profit corporation largely so the PCAOB could pay better than the government."); Robert H. Colson, *Maintaining Public Credibility: An Interview with Charles D. Niemeier*, CPA J., Apr. 1, 2003 at 18, 19-20 (quoting statement) ("'Congress had a stroke of genius when it chose to organize the board as an independent not-for-profit organization rather than as a unit of government. The board will be able to offer a compensation structure that will attract highly qualified individuals and offer them a career path that simply is not possible for people in the government.'"). A finding that the PCAOB's structure is unconstitutional would not preclude Congress from once again pursuing the CAARTA's alternative of congressionally-authorized private sector regulation under SEC oversight.

(Pet. App. 7a), with the PCAOB's powers subject to "a vast degree of Commission control at every significant step." Pet. App. 36a. Both the Act's text and legislative history confirm Congress's deliberate intention to structure the PCAOB as an entity that would operate with a substantial degree of discretion and autonomy.

Several aspects of the statutory text evidence the PCAOB's structural independence from the SEC. First and foremost are the Act's provisions for appointment and removal of the PCAOB's five members. PCAOB members are appointed by the SEC for staggered five-year terms, 15 U.S.C. § 7211(e)(4), and are removable by the SEC only for "good cause shown," *id.* § 7211(e)(6). As the court of appeals recognized, the decision to place the PCAOB appointment and removal power with the SEC, rather than with the President, "reflects Congress's intention to insulate the Board from partisan forces." Pet. App. 34a. But the limitations placed on the SEC's power to remove PCAOB members provide insulation from "partisan forces" to the point of negating all democratic influence. Specifically, a PCAOB member may only be removed if the SEC finds, after notice and opportunity for a hearing, that such member has willfully violated the Act, the federal securities laws, or PCAOB rules; has willfully abused his or her authority; or, without reasonable justification or excuse, has failed to enforce any registered public accounting firm's or any associated person's compliance with any such provision or rule. 15 U.S.C. § 7217(d)(3). These same provisions limit the circumstances in which the SEC can censure PCAOB members to the same findings of malfea-

sance. *Id.* The SEC's power to remove (or even censure) a member of the PCAOB is thus highly circumscribed by the Act. Critically, the SEC cannot remove PCAOB members for disagreements on matters of policy, such as prioritizing the PCAOB's rulemaking, investigative, or enforcement efforts.

The PCAOB's substantial discretion and autonomy is furthered evidenced by the limited role assigned to the SEC in connection with Board oversight. To be sure, the Act provides for comprehensive SEC oversight in connection with the PCAOB's recordkeeping, rulemaking, and disciplinary actions. *Id.* §§ 7217(a)-(c). The Act also requires the PCAOB to notify the SEC about any pending investigations involving potential violations of the federal securities laws, so that the PCAOB and the SEC's Division of Enforcement may coordinate their work. *Id.* § 7215(b)(4)(A). Yet the Act does not require SEC notification when an investigation relates to possible violations of the PCAOB's own rules. And the Act provides no role for the SEC in all of the many steps leading up to its review of the PCAOB's final rules and disciplinary sanctions.

Although the court of appeals did not dispute the statute's failure to assign the SEC any specific role in the PCAOB's inspections, investigations, and enforcement determinations (beyond the SEC's own rulemaking and its general responsibility to review and approve all PCAOB rules), the court regarded the PCAOB's substantial discretion and autonomy in these areas as trumped by the statute's grant of authority "for the Commission to limit and to remove Board authority altogether." Pet. App. 30a. Specifically, the Act provides that the SEC, by rule, "may

relieve the Board of any responsibility to enforce compliance with any provision of [the] Act, the federal securities laws, the rules of the Board, or professional standards." 15 U.S.C. § 7217(d)(1). In addition, the Act permits the SEC, by order, to "censure or impose limitations on the activities, functions, and operations of the Board" upon a finding that the Board has either violated, or is unable to comply with, the Act, the federal securities laws, or PCAOB rules or, "without reasonable justification or excuse, has failed to enforce" compliance with such provisions. *Id.* § 7217(d)(2)(B). Thus, in the view of the court of appeals, Congress essentially granted the SEC "at-will removal power over Board functions if not Board members[.]" Pet. App. 35a. [9]

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[9] The PCAOB's design as a purportedly private board exercising governmental power sheds significant light on the following paradox raised by the court below: "why would Congress deny the Commission at-will removal authority on the one hand and then provide the Commission with the authority to abolish Board powers on the other, essentially granting at-will removal power over Board functions if not Board members?" Pet. App. 35a. The validity of the court's supposition that "Commission authority over the Board" was intended to "preserve the means of Executive control" (Pet. App. 35a), is undercut by the fact that Congress was under the mistaken impression that PCAOB members would be private sector officials. S*ee supra* at 7-8. In all likelihood, Congress did not consider itself obligated to preserve a means of Executive control over the PCAOB; nor did Congress consider itself restrained by the Appointments Clause. *Cf.* Walter Dellinger, *The Constitutional Separation of Powers Between the President and Congress,* 63 Law & Contemp. Probs. 513, 535 (2000) (memorandum stating that "[t]he Appointments Clause simply is not implicated when significant authority is devolved upon non-federal actors"). Congress, however, was undoubtedly aware of the constitu-

But unlike the Act's oversight provisions, which obligate the SEC to review the PCAOB's final rules and disciplinary actions, the SEC's enforcement authority over the PCAOB, including its authority to displace or limit Board functions, is merely an SEC power to sanction the PCAOB for transgressions. In fact, the very caption of that subsection of the Act terms this authority a "sanction." 15 U.S.C. § 7217(d) ("Censure of the Board; Other Sanctions"). The SEC likewise possesses specific statutory authority to sanction registered broker-dealers and investment advisers for their transgressions, *see* Exchange Act § 15(b)(4), 15 U.S.C. § 78o(b)(4); Investment Advisers Act § 209, 15 U.S.C. § 80b-9, yet it would be absurd to claim that the SEC's power to sanction broker-dealers or investment advisers begets a corresponding power to "direct and control" these registered entities, thus stripping away their independence and autonomy.

The legislative history of the Act reinforces the text's design of the PCAOB as an independent

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tional restraints placed on its delegations of governmental power to private regulators. *Cf. Sunshine Anthracite Coal Co.* v. *Adkins*, 310 U.S. 381, 398-400 (1940) (upholding congressional delegation of power to private boards because the boards' rulemaking was subject to effective governmental oversight).

Thus, the paradoxical design of the PCAOB is better explained by a concern on the part of Congress that its delegation of vast power and discretion to a private nonprofit corporation not run afoul of the so-called private delegation doctrine. *See* 148 Cong. Rec. 12,120 (2002) (statement of Sen. Gramm) (observing that "[our proposed board] is a little more independent of the SEC; though in the end, *to meet the constitutional test*, the SEC has to have authority over it") (emphasis added).

regulatory entity free from "extraordinary" control by the SEC. The Senate Report explains that the Act "creates a strong, independent board to oversee the conduct of the auditors of public companies" S. Rep. No. 107-205, at 2 (2002), and emphasizes the Board's "plenary" rulemaking, *id.* at 8, and its "broad authority to investigate" possible violations of PCAOB rules, the Act, or the federal securities laws, *id.* at 10. The congressional record is also replete with references to the PCAOB as a "strong, independent . . . board with significant authority." *See, e.g.,* 148 Cong. Rec. 12,955 (2002) (statement of Sen. Dodd); *supra* at 4 (statement of Sen. Sarbanes). And the record reflects at least one Senator's view of the Board as an entity with "massive power, unchecked power, by design." 148 Cong. Rec. 12,119 (2002) (statement of Sen. Gramm).[10]

There is no doubt that Congress feared political interference with the PCAOB's ambitious

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[10] Respondents have suggested that Senator Gramm's candid assessment of the PCAOB should be discounted because "he opposed the bill for much of the process." Board Br. in Opp. at 11 n.1. Yet a careful study of the legislative record reveals that Senator Gramm was actually a strong proponent of a powerful, independent accounting oversight board and, together with Senator Michael Enzi, had proposed an alternative structure that would have made the board "a little more independent of the SEC," by providing for presidential appointment of the board's chairman and direct appeals of board rulemaking and disciplinary sanctions to a federal district court. *See* 148 Cong. Rec. 12,120, 12,122 (2002) (statement of Sen. Gramm). Senator Gramm went so far as to acknowledge that the "board that Senator Enzi and I set up in our bill has massive unchecked power as well. I mean, that is the nature of what we are trying to do here." *Id.* at 12,119.

mission of preventing future Enron and WorldCom-type scandals, and designed the Board accordingly. As Senator Sarbanes recounted during a hearing, several witnesses had advised Congress that "if we can structure the board well enough, it might actually have more independence from political influence than the SEC would have." *See Oversight Hearings*, *supra* note 6, at 1027. The PCAOB's double insularity enabled Congress to achieve its objective in depoliticizing the PCAOB. But that structure fatally clashes with the democratic accountability demanded by the Constitution.

II. THE PCAOB'S STRUCTURE VIOLATES THE DOCTRINE OF SEPARATION OF POWERS AND THE APPOINTMENTS CLAUSE

As the foregoing analysis reveals, in creating the PCAOB as the accounting industry's overseer, Congress wanted it all. It wanted a strong, independent, private sector regulator with governmental powers, free from partisan forces and political influence. Yet Congress was unwilling to allow the accounting industry, working with the SEC, to establish its own regulator. Nor was Congress willing to allow the private sector to select the new regulator's leadership.

Under our Constitution, Congress cannot have it all. As "the Government itself," the PCAOB is subject to constitutional checks and balances. And as currently structured, the PCAOB violates both the doctrine of separation of powers and the Appointments Clause.

A. The PCAOB is Not Subject to Constitutionally Sufficient Control by the President

Congress's unconstitutional interference with the President's executive powers is most evident in the Act's provision for five-year fixed terms with explicit limitations on the removal of PCAOB members. This Court has long recognized that Congress may create entities that exercise significant executive power, notwithstanding the fact that the officials who head those entities are insulated from presidential control by their fixed terms and limited removal. *Humphrey's Ex'r* v. *United States*, 295 U.S. 602 (1935); *Morrison* v. *Olson*, 487 U.S. 654 (1988). But the officials who head such independent entities must be removable by the President for cause, *Humphrey's Executor*, 487 U.S. at 625-26, or must be removable by an alter ego of the President for cause. *See Morrison,* 487 U.S. at 692 (stating that "because the independent counsel may be terminated for 'good cause,' the Executive, through the Attorney General, retains ample authority to assure that the counsel is completely performing his or her statutory responsibilities in a manner that comports with the provisions of the Act."). As an independent regulatory agency whose commissioners serve for fixed terms, the SEC is itself insulated from presidential control to a substantial degree, and thus does not function as an "alter ego" of the President. *See Humphrey's Executor*, 295 U.S. at 628 (independent agencies "cannot in any proper sense be characterized as an arm or an eye of the executive"). Accordingly, the statute's provision for SEC-only

removal of PCAOB members contravenes both *Humphrey's Executor* and *Morrison* and provides "no means for the President to ensure the 'faithful execution' of the laws." *Morrison*, 487 U.S. at 692.

Like the Act's provision for SEC removal of PCAOB officials, Congress's decision to lodge the appointment power in the SEC further attenuates the President's control over the PCAOB, and thus further compromises the separation of powers. The SEC's power to appoint PCAOB officials deprives the President of the ability to choose like-minded members who share his policy goals and preferences. As the current Solicitor General recognized in a 2001 article, "[a]s a practical matter, successful insulation of administration from the President—even if accomplished in the name of 'independence'—will tend to enhance Congress's own authority over the insulated activity."[11] Accordingly, while the Act's provisions for the appointment and removal of PCAOB members do not constitute direct congressional aggrandizement of power, these provisions nonetheless produce that effect.

Under *Humphrey's Executor* and *Morrison*, the Constitution does not prohibit Congress from enhancing its power through the creation of independent regulatory agencies like the SEC. However, this Court should not extend those decisions to allow Congress to accumulate even more power through the creation of a regulator like the PCAOB that is two steps removed from Presidential control.

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[11] Elena Kagan, *Presidential Administration*, 114 Harv. L. Rev. 2245, 2271 n. 93 (2001).

B. PCAOB Members are Not Inferior Officers

The Act's provision for SEC appointment of the PCAOB's five members also contravenes the text of the Appointments Clause because the members of the PCAOB do not qualify as "inferior" officers who may be appointed by the Head of a Department. As this Court held in *Edmond* v. *United States*, 520 U.S. 651, 662 (1997), "[w]hether one is an 'inferior' officer depends on whether he has a superior" other than the President. SEC Commissioners who cannot remove PCAOB members in connection with even substantial disagreements about matters of policy can hardly qualify as the PCAOB's "superiors."

This Court has further clarified that inferior officers "are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate." *Id.* at 663 (1997). Yet by channeling the SEC's oversight role toward PCAOB recordkeeping, rulemaking, and disciplinary actions, Congress ensured that the PCAOB would remain free to pursue its own policy initiatives and priorities.

Moreover, the Commission's ultimate authority "to limit and to remove Board authority altogether" (Pet. App. 30a) does not transform the SEC Commissioners into the PCAOB's supervisors. Congress possesses an analogous power "to limit and to remove [SEC] authority altogether" through amendments to the Exchange Act and the other securities laws, or by withholding appropriations.

Yet Congress's ultimate authority to limit the functions of the SEC, or to abolish the agency entirely, does not make Congress the "supervisors" of the SEC's five Commissioners. Nor does Congress's "at-will removal power over [SEC] functions" provide Congress with direction and control over the execution of the law. If it did, then the SEC, and all of the other independent regulatory agencies subject to congressional oversight and appropriation, would be unconstitutional under *Bowsher* v. *Synar*, 478 U.S. 714, 722 (1986) ("The Constitution does not contemplate an active role for Congress in the supervision of officers charged with the execution of the law it enacts."). Accordingly, the SEC's "at-will removal power over Board functions" cannot constitute constitutionally sufficient direction and control for purposes of the Appointments Clause.

III. THE SRO MODEL ON WHICH THE PCAOB WAS PATTERNED FURTHER DEMONSTRATES THAT SEC OVERSIGHT AND ENFORCEMENT AUTHORITY IS NOT SYNONYMOUS WITH DIRECTION AND CONTROL

Congress patterned the PCAOB on the securities industry's self-regulatory model, which has been in place for more than 70 years. *See supra* note 3. Although this model has sparked unsuccessful constitutional challenges under the nondelegation doctrine,[12] the model has not triggered the other

[12] *See, e.g., R.H. Johnson & Co.* v. *SEC*, 198 F.2d 690 (2d Cir. 1965) (concluding that Exchange Act Section 15A did not constitute an unconstitutional delegation of power to the NASD

types of constitutional challenges raised in the case at bar because SROs, like the NASD (now FINRA) and the NYSE, are not created by the government, nor are their officials appointed by the government. Accordingly, the NYSE and FINRA, unlike the PCAOB, are not part of the "Government itself" under *Lebron* v. *National R.R. Passenger Corp.*, 513 U.S. 374, 400 (1995), and NYSE and FINRA officials are not federal officers or employees for purposes of the Appointments Clause.[13] The SRO model is nonetheless useful in analyzing the constitutionality of the PCAOB because, as explained below, the statutory provisions granting the SEC oversight and enforcement authority over the PCAOB are virtually

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because of the SEC's authority to disapprove NASD rules and review NASD disciplinary actions).

[13] *See* Nagy, *supra* note 4, at 1022-25 (observing that both the NYSE and the Investment Bankers Association of America (a trade group that later restructured to become the NASD) "were formed at the initiative of securities brokers and firms long before Congress enveloped them in a regulatory scheme" and emphasizing that neither the NYSE nor FINRA have a governmentally appointed board). As a governmentally created SRO, the Municipal Securities Rulemaking Board (MSRB) stands out as an exception. In 1975, Congress authorized the SEC to create the MSRB, and the SEC was charged with appointing the MSRB's initial Board. *See* Exchange Act §15B, 15 U.S.C. § 78o-4(b). However, although the PCAOB and the MSRB share a similar congressional origin, the MSRB's discretion is nowhere near as vast as the PCAOB's: the MSRB's statutory responsibilities extend only to rulemaking subject to SEC review and approval, and do not involve any investigative or enforcement authority. *Id.* Accordingly, assuming the MSRB is the Government itself under *Lebron*, its rulemaking responsibilities do not raise the same constitutional concerns as the PCAOB.

identical to the statutory provisions providing for SEC oversight and enforcement authority over the NYSE and FINRA.

The similarities between the PCAOB and the NYSE and FINRA are striking. As with the PCAOB, Congress has delegated substantial rulemaking, enforcement, and adjudicatory powers to these private self-regulators, with each SRO's recordkeeping, rulemaking, and disciplinary actions subject to SEC oversight. *See* Exchange Act §§ 17(a) and (b), 15 U.S.C. §§ 78q(a) and (b); Exchange Act §§ 19(b) and (d), 15 U.S.C. §§ 78s(b) and (d). Moreover, as with the PCAOB, the SEC has enforcement authority over the SROs. Specifically, the SEC may, by order, suspend or revoke the registration of an SRO, or "censure or impose limitations on the activities, functions, and operations" of an SRO, upon a finding that the SRO has either violated, or is unable to comply with the law or, "without reasonable justification or excuse, has failed to enforce" any member firm's or any associated person's compliance with any such provision or rule. Exchange Act, §19(h)(1), 15 U.S.C. § 78s(h)(1). The SEC may also remove any SRO officer or director for willful violations of law or abuses of authority. Exchange Act § 19(h)(4), 15 U.S.C. § 78s(h)(4). Finally, as with the PCAOB, the SEC may, by rule, "relieve" an SRO of any of its enforcement responsibilities under the Exchange Act. Exchange Act § 19(g)(2), 15 U.S.C. §78s(g)(2).[14]

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[14] To the extent that there are differences between the PCAOB and the NYSE and FINRA beyond the critical distinction of the PCAOB's governmental creation and appointment of members, these differences are principally designed to make the PCAOB

The SRO model thus provides for SEC oversight and enforcement over the private self-regulators in the securities industry, but that oversight and enforcement authority does not even come close to the type of SEC direction and supervision that would be necessary for the PCAOB's structure to comply with the doctrine of separation of powers and the Appointments Clause. As former SEC chairman, Justice William O. Douglas once explained, the SRO model in the securities industry lets "the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use, but with the hope it would never have to be used." William O. Douglas, *Democracy and Finance* 82 (James Allen ed., 1940) (cited in *Silver* v. *New York Stock Exchange*, 373 U.S. 292, 352 (1963)). Although Congress revised the statutory scheme in 1975 to provide for additional SEC oversight and enforcement authority over the SROs (as reflected in the provisions discussed above), the fundamental

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an even more powerful regulator than the SROs. These differences include: the PCAOB's guaranteed source of funding through statutorily mandated accounting support fees paid by public companies, *id.* §7219(d)(1); a means for the PCAOB to subpoena testimony and documents (from persons other than registered accounting firms and their employees) through requests to the SEC, *id.* §7215(b)(2)(D); immunity for PCAOB officials "to the same extent as an employee of the Federal Government in similar circumstances," *id.,* §7215(b)(6); and a statutory privilege from third party discovery of PCAOB materials. *Id.* §7215(b)(5).

framework recognized by Justice Douglas has remained unchanged.[15]

Title I of the Sarbanes-Oxley Act reflects a similar congressional intention to assign leadership over the accounting industry to the PCAOB, with the SEC playing the "residual role." The statutory design ensured that the PCAOB would take leadership, in particular, with respect to key executive functions involving inspections and investigations of, and the initiation of disciplinary proceedings against, auditors of public companies. The fact that the SEC can theoretically pick up a well-oiled "shotgun" sometime in the future does not make the SEC the superiors of the PCAOB for the present while that shotgun remains behind the door. As leaders acting separately and apart from the SEC, the PCAOB members are "principal officers" who must be appointed by the President with advice and consent by the Senate, and must be removable by the President for cause.

To be sure, this Court has described the SEC's "supervisory authority" over the SROs as "extensive" and "pervasive." *United States* v. *National Association of Securities Dealers, Inc.*, 422 U.S. 694, 732-33 (1975). This Court, however, was considering the specific context of SRO rulemaking and the SEC's

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[15] *See* Fair Administration and Governance of Self-Regulatory Organizations, Exchange Act Release No. 50699, 69 Fed. Reg. 71,126, at 71,128 (Dec. 8, 2004) (stating that while "the Commission has ultimate responsibility for oversight of the U.S. securities markets and their participants, the SROs continue to have 'front-line' responsibility for overseeing trading on their markets and their members' compliance with applicable statutory and regulatory provisions").

statutory responsibility to review and approve an SRO's rules.

The SEC's extensive role as "reviewer" of an SRO's final rules, like its extensive role as "reviewer" of SRO disciplinary sanctions, does not alter the fact that SROs operate with substantial discretion and autonomy in all of the many steps leading up to those rules and disciplinary sanctions. Although SROs are required under the Exchange Act "to provide a fair procedure for the disciplining of members," Exchange Act § 15A(b)(8), 15 U.S.C. §78o-3(b)(8), SROs typically conduct their investigations, enforcement determinations, and adjudications free from dictates by the SEC.[16] Indeed, for purposes of constitutional protections such as the Fifth Amendment's privilege against self-incrimination, the SEC and courts have consistently refused to regard SRO action as "state action" precisely because SRO investigations and disciplinary proceedings are *not* conducted under the direction and control of the SEC.[17]

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[16] *See* Alan Lawhead, *Useful Limits to the Fifth Amendment: Examining the Benefits that Flow From A Private Regulator's Ability to Demand Answers to its Questions During an Investigation*, 2009 Colum. Bus. L. Rev. 211, 250 (stating that "[t]he initiative for typical cases is entirely FINRAs. FINRA investigates, files a complaint, and litigates the case, all without any government approval or pressure to do so.").

[17] *See id.* at 223-65 (discussing this Court's "state actions" tests and their applicability to FINRA). *But see* Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies?,* 14 Stan. J.L. Bus. & Fin. 151, 171-78 (2008) (observing that judicial decisions regarding SRO immunity are very difficult to reconcile with constitutional decisions concluding that SROs are not state actors).

With respect to SRO disciplinary proceedings, both the SEC and federal courts have routinely depicted the SEC's role as a limited one. As the SEC has explained,

> SRO proceedings are not initiated by a government agency, nor does their initiation require our approval. We do not participate in the disciplinary proceeding before the SRO, and we do not control when the SRO begins or concludes its determination. Our sole responsibility in this context arises when an SRO imposes a final disciplinary sanction on a person who seeks review of the SRO's determination from this Commission.[18]

Lower courts have likewise described the SEC's role in SRO disciplinary proceedings as involving "adjudication."[19]

SROs are also typically found to be acting free from the SEC's direction and control in the course of SRO investigations, including investigations for

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[18] *In the Matter of Larry Ira Klein*, Release No. 34-37835, 52 S.E.C. Docket 1030, 1039 (Oct. 17, 1996) (ruling that NASD disciplinary proceedings need not conform to 28 U.S.C. § 2462's five year statute of limitations generally applicable in government proceedings where a sanction is sought).

[19] *See, e.g., Jones* v. *SEC*, 115 F.3d 1173, 1181 (4th Cir. 1997) (holding that neither the Fifth Amendment's Double Jeopardy clause nor collateral estoppel prevented the SEC from instituting its own enforcement action, because "as reviewer" of an NASD disciplinary proceeding, "the SEC does not become a party; its review role is an adjudicatory one").

possible violations of the federal securities laws.[20] SRO investigations are thus only rarely deemed state action, and only on some of the infrequent occasions in which the SRO engages in "joint action" with the SEC or the Department of Justice.[21]

Once again, Congress cannot have it both ways: If the SRO model is one that provides for SEC oversight and enforcement, but nonetheless permits the SROs to operate with substantial discretion and autonomy, then under that model, the SROs, and by extension the PCAOB, cannot be said to be operating under the SEC's "extraordinary" direction and

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[20] *See, e.g., D.L. Cromwell Inv., Inc.* v. *NASD Regulation, Inc.* 279 F.3d 155, 161 (2d Cir. 2002) (stating that the Fifth Amendment "will constrain a private entity only insofar as its actions are found to be 'fairly attributable' to the government" (citing *Lugar* v. *Edmondson Oil Co.*, 457 U.S. 922, 937 (1982)); *United States* v. *Solomon*, 509 F.2d 863 (2d Cir. 1975) (finding no violation of the Fifth Amendment where the government relied on testimony that was compelled in an NYSE investigation); *Shultz v. SEC*, 614 F.2d 561, 569 (7th Cir. 1980) (Chicago Board Options Exchange is "not an authority of the Government" and thus not governed by the Administrative Procedure Act).

[21] *See. e.g., In the Matter of Frank Quattrone,* Release No. 53547, 87 S.E.C. Docket 1847, 2165 (Mar. 24, 2006) (emphasizing that "cooperation between the Commission and the NASD will rarely render NASD a state actor, and the mere fact of such collaboration is generally insufficient, standing alone, to demonstrate state action," but holding that respondent "proffered enough evidence concerning the Joint Investigation to earn an evidentiary hearing"). *See generally* Lawhead, *supra* note 16, at 256-58 (citing cases and concluding that the "uniform result reached by lower federal courts and the SEC has been that FINRA, NASD, and the New York Stock Exchange are private actors").

control. If, however, the SRO model is one that provides for "a vast degree of Commission control at every significant step" (Pet. App. 36a), then SROs are essentially alter egos of the SEC, and most of their actions constitute "state action" that is subject to the Constitution and a host of federal statutes.

CONCLUSION

For these reasons, *amici* respectfully urge this Honorable Court to reverse the ruling of the United States Court of Appeals for the District of Columbia.

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APPENDIX

APPENDIX

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