

Putting Power Back Into Separation of Powers Analysis: Why the SEC-PCAOB Structure is Constitutional

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Separation-of-powers analysis of administrative structures does not, and should not, take place in a legal vacuum that ignores the reasons Congress designs agencies in particular ways and the institutional context in which these agencies actually function. This is particularly true in the exceptionally complicated domain of financial regulation. That arena has long been characterized by a unique set of institutional structures and relationships unlike any other area of federal administration. Thus, my aims in this Essay are twofold: to explain the historical context and reasons that led Congress to design the administrative structure at issue in *Free Enterprise Fund*,¹ and to provide a realistic account of how that structure actually functions in practice. You can consider this Essay, then, a kind of "Brandeis brief." The Supreme Court needs to approach this case, in my view, with a rich understanding of the unique, long-established structures of financial regulation and an appreciation for how the administrative structures at issue in *Free Enterprise Fund* actually work. With a clear understanding of these elements in mind, the Court should find that the Sarbanes-Oxley Act is constitutional.

In creating the Public Company Accounting Oversight Board ("PCAOB" or "Board"), Congress built on seven decades of experience concerning financial regulation. As advised by experienced regulators and other experts, Congress designed the PCAOB to be independent of the accounting profession, but under the complete control and authority of the Securities and Exchange Commission ("SEC"). The SEC-PCAOB structure is a logical outgrowth of unique public-private regulatory partnerships that have long characterized financial regulation. Since the 1930s, the SEC has exercised power over an integrated regulatory system that includes private-sector, self-regulatory organizations ("SROs"), such as the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers ("NASD," now the Financial Industry Regulatory Authority, ("FINRA")), and the Municipal Securities Rulemaking Board. In creating the PCAOB, Congress built upon this longstanding structure but gave the SEC even more pervasive powers over the Board. Congress did so precisely to ensure the unified, coherent

1. *Free Enter. Fund v. PCAOB*, 129 S. Ct. 2378 (2009) (granting cert).

administration of financial regulation that can come only from comprehensive SEC control.

Moreover, the SEC's complete power over the Board is not just a matter of legal authority, but of fact. In the seven years since Sarbanes-Oxley was enacted, the SEC has used its arsenal of powers vigorously and continuously to ensure that PCAOB rules and practices conform to SEC policies. The SEC's authority has spawned close, ongoing coordination between the two bodies. The pervasive powers Congress gave the SEC have thus translated in practice into comprehensive SEC control and oversight of the Board's actions.

Viewed in this proper context, the constitutional challenges to the PCAOB should be rejected. Whatever the nature of its authority to remove PCAOB members, the SEC's comprehensive power over the Board, in law as well as fact, enables the SEC to direct the Board's every action and effectively to preclude any Board member from defying the Commission's policy choices. Contrary to the rhetoric of the Board's opponents, this case presents no question of an independent agency inside an independent agency, or, as the dissenting judge on the D.C. Circuit put it, of "*Humphrey's Executor* squared."² The Board is not an independent agency. Congress designed the Board to be independent of the accounting profession, but completely subordinate to the SEC—and that objective has been realized in practice. As long as the SEC itself is constitutional, the SEC-Board structure is constitutional.

I. THE SEC-PCAOB STRUCTURE WAS DESIGNED TO MAKE REGULATION INDEPENDENT OF THE ACCOUNTING PROFESSION BUT SUBJECT TO PLENARY SEC CONTROL

Based on testimony and information from experienced regulators, Congress designed the SEC-Board structure with several aims: to secure independence of the Board from the accounting profession; to ensure efficient, unified, and coherent regulation by putting the Board under the plenary authority of the SEC; to facilitate competent administration by enabling the Board to pay competitive salaries; to guarantee sustained focus and commitment to the Board's mission by giving it a dedicated source of funding; and to realize fair, impartial administration by limiting potential congressional

2. *Free Enter. Fund v. PCAOB*, 537 F.3d 667, 686 (D.C. Cir. 2008) (Kavanaugh, J., dissenting).

interference with the Board. All these aims are important and legitimate. None is at odds with the separation of powers.

In creating the SEC-Board relationship, Congress also did not draft on a blank slate. The Board's design was a logical outgrowth of decades of public-private regulatory partnerships that uniquely characterize national regulation of the financial markets. The industry's SROs, such as the NYSE—private, quasi-governmental bodies responsible for standard-setting and discipline, subject to SEC plenary control—provided the regulatory framework within which the former Chairmen testified and Congress acted in designing the PCAOB. In creating the Board, Congress built upon decades of experience with these structures. To the extent Sarbanes-Oxley departs from that experience, it consistently does so to *increase* the SEC's control over the Board even beyond that which the SEC has over the SROs.

A. Congress Designed the PCAOB within the System of Public-Private Regulatory Structures That Have Uniquely Characterized Financial Market Regulation since the 1930s

Since its creation in the wake of the 1929 market crash, the SEC has regulated the U.S. capital markets through a unique “partnership between government and private enterprise.”³ A central pillar of this unique regulatory regime, with no counterpart in other areas of national regulation, is the principle of industry self-regulation, under which “the industry regulates itself through various self-regulatory organizations [SROs] overseen by the SEC.”⁴ SROs include securities exchanges such as the NYSE, as well as FINRA (formerly the NASD), which regulate the over-the-counter securities market.⁵

Self-regulatory organizations long predate the creation of the SEC—the NYSE, for example, was formed in 1792—and “have enjoyed congressionally delegated quasi-governmental powers to discipline their members for nearly 70 years.”⁶ In various statutes beginning with the Securities Exchange Act of 1934 (“Exchange Act”), Congress “

3. *Silver v. N.Y. Stock Exch.*, 373 U.S. 341, 366 (1963).

4. *Accounting Reform and Investor Protection Issues Raised by Enron and Other Public Companies: Hearings Before the S. Comm. on Banking, Hous., and Urban Affairs*, 107th Cong. 552 (2002) [hereinafter *Accounting Reform Hearings*] (statement of Comptroller General David M. Walker).

5. *Id.*

6. *NASD v. SEC*, 431 F.3d 803, 807 (D.C. Cir. 2005).

'delegated government power' to SROs . . . 'to enforce . . . compliance by members of the industry with both the legal requirements laid down in the Exchange Act and ethical standards going beyond those requirements.'⁷ SROs' wide-ranging responsibilities include rulemaking, examining member firms for compliance with those rules, and taking disciplinary action against members that fail to comply, as well as professional activities such as testing, training, and licensing, dispute resolution, investor education, and market monitoring.⁸

SROs, though private entities, act pursuant to SEC oversight and control.⁹ The SROs have "no authority to regulate independently of the SEC's control."¹⁰ SROs must obtain the Commission's approval before enacting or amending any rule,¹¹ and the Commission may amend or abrogate the rules of any SRO.¹² The Commission also "closely supervises and approves" SRO disciplinary processes and may "fully revisit[] the issue of liability, and can completely reject or modify" SRO disciplinary decisions.¹³ Thus, the legal authority of the SROs "ultimately belongs to the SEC."¹⁴

In light of the SEC's numerous powers of control and oversight, the SEC has long been understood to have "plenary power" over the SROs.¹⁵ Indicative of that authority, the SEC's role in approving and regulating SRO actions and rules has been held to immunize some regulated SRO practices from antitrust liability.¹⁶ Similarly, the Commission's role in reviewing and approving SRO rules means that such rules may preempt conflicting state law.¹⁷ Regulation of the financial markets has thus long entailed a unique set of public-private

7. *Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1128 (9th Cir. 2005) (quoting S. Rep. No. 94-75, at 23 (1975)).

8. See *Accounting Reform Hearings*, *supra* note 4, at 570 (statement of NASD Chairman Robert Glauber).

9. See *Gordon v. N.Y. Stock Exch.*, 422 U.S. 659, 667 (1975).

10. S. Rep. No. 94-75, at 23 (1975); see also 15 U.S.C. § 78s (2006) (delineating SEC oversight of SROs).

11. 15 U.S.C. § 78s(b) (2006).

12. *Id.* § 78s(c); see also *Bus. Roundtable v. SEC*, 905 F.2d 406, 408-09 (D.C. Cir. 1990).

13. *NASD v. SEC*, 431 F.3d 803, 806 (D.C. Cir. 2005); see also 15 U.S.C. §§ 78s(d), (e) (2006); *Schultz v. SEC*, 614 F.2d 561, 568 (7th Cir. 1980).

14. *NASD*, 431 F.3d at 806.

15. *Bus. Roundtable*, 905 F.2d at 409; see also *Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119, 1130 (9th Cir. 2005).

16. See *Gordon v. N.Y. Stock Exch.*, 422 U.S. 659 (1975) (holding fixed commission rate practices immune); *United States v. Nat'l Ass'n of Secs. Dealers, Inc.*, 422 U.S. 694 (1975) (holding securities dealers' pricing practices in secondary mutual funds markets immune).

17. See, e.g., *Credit Suisse*, 400 F.3d at 1128, 1132.

regulatory partnerships, with the SEC at the top of this system to ensure its overall effectiveness, efficiency, and coherence.

B. By the Time of Sarbanes-Oxley, Regulation of Accounting and Auditing Had Become Compromised by Dependence on the Accounting Profession

Before Sarbanes-Oxley, the principle of self-regulation similarly shaped SEC regulation of financial reporting and auditing. The Commission relied on and deferred to the private sector to set and enforce financial reporting and auditing standards.¹⁸

Even before the collapse of Enron, however, experts within and outside the accounting industry concluded that this system of self-regulation of auditing and accounting practices had become inadequate. In numerous hearings leading up to enactment of Sarbanes-Oxley, Congress heard extensive testimony on the existing system's failure to prevent financial misstatements and fraud. The consensus view of witnesses and members of Congress was that these failings were due to the accounting industry's capture and domination of the regulatory regime. As Senator Kohl summarized the testimony before Congress, "the current system of self-regulation . . . has been the root of many of the frauds being revealed today."¹⁹

Congress was advised repeatedly to create a "truly independent" overseer that would not be hostage to the regulated industry.²⁰ Part of the problem was that existing entities, like the Public Oversight Board ("POB"), relied on peer review to oversee auditing practices. As former SEC Chairman Roderick M. Hills testified, "the almost universal view is that peer review of accounting firms is not providing sufficient quality control."²¹ Chairman Pitt agreed that "the current system of peer review is not working. You have firm-on-firm review. It doesn't provide the kind of discipline that

18. See *Accounting Reform Hearings*, *supra* note 4, at 552 (statement of Comptroller General Walker).

19. 148 Cong. Rec. S6758 (daily ed. July 15, 2002); see also 148 Cong. Rec. S6330 (daily ed. July 8, 2002) (statement of Sen. Sarbanes); *Accounting Reform Hearings*, *supra* note 4, at 71-72 (statement of former SEC Chairman Ruder); *id.* at 897 (testimony of POB Chairman Bowsher).

20. *Accounting Reform Hearings*, *supra* note 4, at 21-22, 24-25, 898.

21. H.R. 3763, *the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002: Hearings Before the H. Comm. On Fin. Servs.*, 107th Cong. 257 ("CAARTA Hearings").

we need.”²² Former SEC Chairman Harold Williams, under whose chairmanship the POB had been created, also agreed that “events over the intervening years have demonstrated that [the POB] does not meet the needs and is not adequate.”²³ He reported that “as the Big 8 has become the Big 5,” peer review had become “too incestuous”; since the POB’s creation in 1977, no firm had ever given another firm a negative review.²⁴

In addition, experts testified that the self-regulating entity for accounting was compromised by its dependence on the accounting profession for funding. Without adequate dedicated funding, this entity was “beholden for its funding to the very people it [was] supposed to oversee.”²⁵ Congress learned, for example, that the industry had decided to cut off funding for reviews of the major accounting firms that one such entity was conducting at the Commission’s request.²⁶

Apart from the need for a body independent of the accounting profession, Congress heard testimony that this new entity must be subject to complete SEC control. Thus, SEC Chairman Pitt advised that:

[c]ritical regulatory functions, including quality control and discipline, should be moved from the profession to an independent regulatory body that is completely or substantially free from influence or funding by the profession, and is subject to comprehensive and vigorous SEC oversight.²⁷

C. Congress Designed the Board to Be Both Independent of the Accounting Profession and Subject to Pervasive SEC Control

In light of these concerns, Congress designed the new oversight board with the overriding goal of ensuring its independence from the accounting profession. As Senator Sarbanes explained, the failings of self-regulation in the accounting area was “obviously one of the reasons we are moving, in this legislation, to an independent public company accounting oversight board.”²⁸ Senator Levin agreed that designing the oversight board to be “free of domination by either

22. *The Enron Collapse: Implications to Investors and the Capital Markets, Part 2: Hearings Before the Subcomm. on Capital Markets, Insurance, and Gov’t Sponsored Enterprises of the H. Comm. on Fin. Servs.*, 107th Cong. 48 (2002) [hereinafter *Enron Collapse Hearing*].

23. *Accounting Reform Hearings*, *supra* note 4, at 24–25.

24. *Id.*

25. *Id.* (testimony of former SEC Chairman Williams).

26. *Id.* at 897 (testimony of POB Chairman Bowsher).

27. *CAARTA Hearings*, *supra* note 21, at 307.

28. 148 Cong. Rec. S6330 (daily ed. July 8, 2002).

accounting or corporate interests” and liberating the standard-setting process from the “direct control of the accounting industry” was “one of the most important changes” the new legislation would make.²⁹

To achieve these objectives, Congress borrowed from the financial system’s existing regulatory institutions and long tradition of public-private partnership, while adding even greater safeguards to make the new board more independent from the profession than existing SROs were with respect to the elements of the securities industry they oversaw.³⁰ Like existing SROs, the new board would have authority to propose rules and standards, examine firms for compliance, and propose sanctions for noncompliant firms. Thus, the PCAOB was essentially an extension of the SRO model that had structured securities regulation for 70 years (and continues to do so in many areas today).

To ensure the Board’s independence, Congress accepted the recommendations of experienced regulators that the Board have a guaranteed source of funding not dependent on voluntary industry contributions.³¹ Instead, Congress adopted an industry-funded dedicated fee structure similar to those long used in other contexts, such as for the Municipal Securities Rulemaking Board, which also functions under SEC control.³² As former SEC Chairman Hills put it, the new overseer “should not need to ‘pass the hat.’”³³ Congress also recognized that dedicated funding would allow the Board to compensate employees at competitive levels high enough to attract a “strong, well-trained, and experienced staff, of sufficient size to carry out [the Board’s] responsibilities.”³⁴

29. 148 Cong. Rec. S6566 (daily ed. July 10, 2002).

30. See, e.g., *Accounting Reform Hearings*, supra note 4, at 1091–92; *id.* at 1099–1100; *id.* at 21 (testimony of former SEC Chairman Ruder) (urging the creation of a “new, separate audit supervisory board . . . modeled on the private sector [FASB] and perhaps on the self-regulatory system of the NASD”); *id.* at 527–30, 571–73 (testimony of NASD Chairman Robert R. Glauber) (suggesting new private-sector regulator modeled on NASD). The PCAOB’s statutory designation as a private, nonprofit corporation, see 15 U.S.C. §§ 7211(a), (b) (2006), thus reflects the Board’s roots in the SRO tradition. The SROs were private-sector organizations, and many experts urged Congress to borrow from that model in order to achieve the comparative resource, staffing, and infrastructure advantages that private organizations enjoyed over government entities. See *Accounting Reform Hearings*, supra note 4, at 532–33, 579 (testimony and statement of Prof. Joel Seligman); *id.* at 583–84 (statement of Prof. John C. Coffee, Jr.); *id.* at 527–30, 571–73 (testimony and statement of NASD Chairman Glauber).

31. See 15 U.S.C. § 7219 (2006).

32. *Id.* § 780-4(b)(2)(J).

33. *CAARTA Hearings*, supra note 21, at 264.

34. S. Rep. No. 107-205, at 7 (2002).

Congress similarly adopted other structural features to enhance the Board's independence from the accounting profession. Congress imposed, for example, strict limits on Board member ties to industry.³⁵ While ensuring the Board's independence, Congress also built on the SEC's relationships with the SROs to guarantee that the Board would function under the full authority and complete control of the SEC. Thus, many statutory oversight rules governing SROs generally were applied to the PCAOB in Sarbanes-Oxley.³⁶

But Congress also subjected the Board to even greater SEC authority than the Commission had over the SROs. Thus, unlike SROs, PCAOB members are appointed by the SEC, after consultation with the Secretary of the Treasury and the Chairman of the Federal Reserve's Board of Governors.³⁷ Unlike SROs, the PCAOB's budget is subject to SEC approval.³⁸ And while the PCAOB, unlike the SROs, has the power to compel production of documents and testimony, it can do so only by seeking issuance of a subpoena by the SEC.³⁹ Thus, as even one of the academic amici supporting the challenge to the Act has put it in prior academic writing, the Board "is squarely under the thumb of the SEC's oversight and control."⁴⁰

Finally, Congress rejected other possible alternative structures for the Board for sound, legitimate reasons. For example, Congress was advised that an entirely new, stand-alone agency would likely spawn jurisdictional battles, create redundant regulation, or make it hard to ensure regulatory coherence. Former Chairman Breeden warned, for example, that creating a new entity with an overlapping portfolio, but outside the Commission's control, would lead to turf wars and inefficiency and would "lose the benefit of nearly 70 years" of SEC regulatory experience.⁴¹ Only by putting the Board under effective SEC oversight and control could Congress ensure an efficient and unified regulatory regime. Subjecting the Board to SEC review would "assure that the Board's policies are consistent with the administration of the federal securities laws,"⁴² and alleviate the

35. See 15 U.S.C. §§ 7211(e)(2), (3) (2006).

36. Compare, e.g., 15 U.S.C. §§ 78q(b)(1), 78s(c) (2006), with *id.* § 7217(a), (b)(5); see also S. Rep. No. 107-205, at 12 ("The rules for SEC oversight of the Board are generally the same as those that apply to SEC oversight of the [NASD].").

37. See 15 U.S.C. § 7211(e)(4) (2006); see also S. Rep. No. 107-205, at 6-7.

38. See 15 U.S.C. § 7219(b) (2006).

39. *Id.* § 7215(b)(2)(D).

40. A.C. Pritchard, *The Irrational Auditor and Irrational Liability*, 10 LEWIS & CLARK L. REV. 19, 35 (2006).

41. CAARTA Hearings, *supra* note 21, at 158-59.

42. S. Rep. No. 107-205, at 12.

possibility that the PCAOB might duplicate SEC enforcement efforts.⁴³

At another possibility, Congress considered requiring the SEC itself to carry out the expanded standard-setting and disciplinary functions contemplated by Sarbanes-Oxley. But this suggestion quickly foundered on the fact, as many testified, that the SEC lacked sufficient staff and resources to take on these new responsibilities without diluting its other priorities.⁴⁴ Moreover, simply increasing the SEC's funding would not have achieved the long-recognized benefits of the SRO structure. The ability to attract and retain experienced professionals focused on specific policy priorities and able to provide their own expert advice to the SEC is the essential and unique benefit of the PCAOB, as of the SROs. That ability would be compromised were the Board's functions simply located inside the SEC. Relatedly, merely increasing the SEC's budget would not have assured that the funds were spent on the accounting problems Congress sought to remedy, given competing, and potentially shifting, SEC priorities. Congress sought to establish an entity with a sustained, focused commitment to the problem at hand and, thus, created a source of funding dedicated directly to that entity.

Thus, in fashioning the PCAOB, Congress designed the Board as an extension of the SRO model that had structured securities regulation for 70 years (and continues to do so today). Congress built upon and modified that design to create a regulatory system that would be free from capture by the regulated profession and subject to comprehensive oversight by the SEC.

II. THE SEC EXERCISES VIGOROUS AND PERVASIVE CONTROL OVER THE BOARD IN PRACTICE

For constitutional purposes, it suffices that the SEC has comprehensive *de jure* authority over the Board. Any doubt on that score, however, should be removed by the fact that, not only does the SEC possess these powers in principle, but the SEC exercises them vigorously in practice. The profound power the SEC possesses and

43. See 148 Cong. Rec. H4479 (daily ed. July 10, 2002) (statement of Rep. LaFalce).

44. See *Accounting Reform Hearings*, *supra* note 4, at 38 (testimony of former SEC Chairman Levitt) ("[T]he SEC is pretty stretched right now in terms of resources."); *id.* at 119 (testimony of Paul Volcker, former Chairman of the Federal Reserve Board) (SEC was insufficiently funded and lacked "sufficient staff to do the review process that it needs to do"); *id.* at 223 (testimony of former SEC Chief Accountant Turner) ("Obviously, the SEC does not have the resources or the talent right now" to serve as an "uber-auditor").

exercises makes clear that (1) Board members are inferior officers and (2) Board members are completely subordinate to the SEC, regardless of the structure of the SEC's removal power.

A. The SEC's Authority to Inspect the PCAOB, Approve its Budget, and Censure the Board or Remove its Members Gives the SEC Further Control

The SEC has an arsenal of general powers over the Board. It has the power to inspect the Board's activities, to approve and therefore control the Board's budget, to relieve the Board of particular functions, and to censure and remove Board members. In the few years of the Board's existence, the SEC has already used many of these weapons to ensure that the Board is carrying out SEC policy. As even one of the challenger's *amici* acknowledges, "[t]he bottom line is that if the SEC believes that the PCAOB is not regulating in a sufficiently vigorous fashion, the SEC has all the power it needs to correct that deficiency."⁴⁵

1. The SEC Uses its Authority to Inspect the PCAOB to Advance the SEC's Policies and Priorities

Under the 1934 Exchange Act and subsequent amendments, the SEC may examine the records of self-regulatory organizations any time the Commission deems it necessary or appropriate.⁴⁶ Sarbanes-Oxley made these provisions applicable to the PCAOB,⁴⁷ thereby giving the Commission authority to examine the Board's records and otherwise inspect the Board's implementation of its statutory authority.

In practice, this inspection authority has provided the SEC with an important means of supervising the Board's activities. The Commission has used its inspection authority, for example, as one tool to set long-range goals for the Board and to examine whether the Board is fulfilling those expectations. As then-SEC Chairman William Donaldson described to Congress in 2005:

[T]he Commission and the Board have forged a close working relationship. In addition to coordinating with us on major projects related to auditing matters, the PCAOB has agreed to prepare a long-range strategic plan for its operations and budget as well as a self-assessment of the internal controls for its operations and budget. In addition, the

45. Pritchard, *supra* note 40, at 34.

46. See 15 U.S.C. § 78q(b)(1) (2006); see also *id.* § 78q(a)(1).

47. *Id.* § 7217(a).

Commission is preparing to conduct its initial examination of the PCAOB, as contemplated by Section 107(a) of the Act. We anticipate receiving the strategic plan and self-assessment and commencing our initial examination of the PCAOB prior to our review of the PCAOB's 2006 budget, in accordance with our statutory responsibility to oversee the PCAOB.⁴⁸

The following year, Chairman Donaldson's successor agreed that the SEC's inspection authority had been "an important aspect of the Commission's general oversight" of the Board.⁴⁹

SEC oversight of the PCAOB's implementation of internal control audits under section 404 of the Sarbanes-Oxley Act illustrates this process. Before the adoption of the PCAOB's Auditing Standard No. 5, the SEC used its statutory authority to examine the PCAOB's process of inspecting registered accounting firms in order to gather information about implementation of section 404. Chairman Cox thus informed Congress in 2006 that the Commission intended to "focus[] [its] next inspection of the PCAOB on its largest program area—inspections of registered public accounting firms under Sarbanes-Oxley 404 and [the existing PCAOB Auditing Standard]" with the goal of "achiev[ing] greater compliance with the Commission's and the PCAOB's own guidance that [internal control] audits be risk-based and cost-effective."⁵⁰ Chairman Cox elaborated that the purpose of the SEC's inspection would be "to make sure that they are doing what we think they are doing."⁵¹

After the PCAOB adopted and the SEC approved the new standard for implementing section 404, the SEC again invoked its inspection authority to monitor whether the PCAOB's inspections were conducted in a manner consistent with the SEC's expectations under the new rules.⁵² As stated in its order adopting the new standard, the Commission would continue to use its inspection authority to "carefully monitor[]" the implementation of the new standard, including "examin[ing] whether the PCAOB inspections of registered accounting firms have been effective" in achieving the Commission's expectations.⁵³

48. *The Impact of the Sarbanes-Oxley Act: Hearings Before the H. Comm. on Financial Services*, 109th Cong. 48 (2005).

49. *Sarbanes-Oxley at Four: Hearing Before the H. Comm. on Financial Servs.* 109th Cong. 63 (2006) (statement of then-Chairman Cox).

50. *Id.*

51. *Id.* at 24–25.

52. See Video of SEC Chairman Christopher Cox's statement on the PCAOB auditing standard and definition of "Significant Deficiency" at the SEC's Open Meeting (July 25, 2007), available at <http://www.sec.gov/news/press/2007/2007-144.htm>.

53. Order Approving Proposed Auditing Standard No. 5, SEC Release No. 34-56152 (July 27, 2007).

2. The SEC Uses its Authority to Review and Approve the PCAOB's Budget to Direct and Supervise Board Activities

The SEC's complete control over the Board's budget provides the SEC with one of its most potent tools to control all the Board's actions. The SEC must approve the PCAOB's annual budgets, as well as the user fees established each year to fund the Board.⁵⁴ As with the Board's rulemaking and enforcement, the SEC's approval authority has translated in practice into substantial control at all stages of the Board's budgeting process. In particular, the SEC has closely coordinated with the PCAOB in developing the Board's annual budgets, even establishing a formal review process for doing so. Moreover, the SEC has used that authority to influence the Board's conduct of its other statutory responsibilities. As Christopher Cox, SEC Chairman from 2005 to 2009, has explained, the SEC and the PCAOB "discuss things in development" so that "before the SEC would have to take formal action after the fact to try and influence or adjust or reverse some action, these things are well understood and worked out to start with."⁵⁵

As in other areas, the SEC works closely and informally with the PCAOB before the Board submits a proposed budget. For example, SEC and PCAOB staff began meeting in August 2005 to develop the Board's proposed 2006 budget and ensure that the PCAOB supplied all information necessary for the Commission to review and approve the budget.⁵⁶ Likewise, the PCAOB's 2007 budget was the result of "many months of close-knit teamwork and coordination between" the Board and the Commission.⁵⁷ As one SEC Commissioner explained:

Our budget dialogue with the PCAOB... included countless briefings and communications between our relative staffs [and] engaged all of the Commissioners' offices

The total package... positively reflects many months of feedback, review, and communication between the PCAOB and the SEC on issues ranging from the purely administrative . . . to strategic decisions that have wide-spread policy and programmatic implications in core substantive areas like inspections, enforcement, and the Office of the Chief Auditor.⁵⁸

54. See 15 U.S.C. §§ 7219(b), (d)(1) (2006).

55. *Sarbanes-Oxley at Four*, *supra* note 49, at 24–25 (statement of then-Chairman Cox).

56. See Order Approving Public Company Accounting Oversight Board Budget and Annual Accounting Support Fee for Calendar Year 2006, SEC Release No. 8676 (Apr. 13, 2006).

57. Speech by SEC Commissioner: Remarks Before the SEC Open Meeting on the 2007 PCAOB Budget by Commissioner Roel C. Campos (Dec. 4, 2006).

58. *Id.*

Where the PCAOB has failed to seek the SEC's views and incorporate them into the budget ahead of time, the Commission has forced the PCAOB to reconsider its position.⁵⁹

The SEC has used this budgeting authority as a vehicle for influencing and supervising the Board's rulemaking and inspection activity. For example, in approving the PCAOB's 2009 budget, the SEC required the Board to consult with the Commission about implementing recommendations from a Treasury Department advisory committee. The SEC directed the Board, in particular, to submit a project plan to the Commission and to provide an opportunity for the Commission to give its views.⁶⁰ Similarly, the SEC directed the PCAOB to include in its quarterly reports to the Commission "information on the PCAOB's fulfillment of its 2009 budgeted inspection plan," including statistics on the number and type of firms expected to be inspected in 2009 and updates on the PCAOB's efforts to cooperate with non-U.S. regulators regarding the inspection of foreign accounting firms.⁶¹ In practice, then, the SEC's statutory authority to review and approve the Board's budgets has provided the Commission with opportunities not only to heavily influence—if not dictate—the Board's annual budgets, but also to control the PCAOB's actions and policies.

3. The SEC's Power to Censure the Board or Remove its Members Provides a Further Meaningful Instrument of Control

Apart from these other means of oversight and control, the SEC may also take the ultimate step of forcing the removal of a Board member, censuring the Board or its members, or limiting or rescinding the Board's authority altogether.⁶² Though the SEC has not yet been compelled to invoke those powers, the Commission's experience imposing punitive measures against the SROs in other contexts demonstrates how powerful tools like these can be, including the mere threat of their use.

The SEC's powers to censure SROs, remove their directors and officers for cause, or strip them of authority have enabled the SEC to force changes in SRO management, along with other major reforms.

59. See Order Approving Public Company Accounting Oversight Board Revised Budget and Annual Accounting Support Fee for Calendar Year 2005 (Mar. 3, 2005).

60. See Order Approving Public Company Accounting Oversight Board Budget and Annual Accounting Support Fee for Calendar Year 2009, at 4 (Dec. 17, 2008).

61. See *id.* at 3–4.

62. 15 U.S.C. § 7217(d) (2006).

In the mid-1990s, for example, when problems emerged in the Nasdaq over-the-counter market, the SEC investigated the NASD's regulatory efforts, concluded the NASD had failed to carry out its disciplinary responsibilities, and successfully insisted on new management for the NASD and the Nasdaq.⁶³ At the same time, the SEC reached a settlement with the NASD censuring it for failing to comply with its statutory obligations and ordering it to undertake numerous reforms—including adopting new rules and altering management and staffing structures. In announcing that settlement, the SEC noted several other occasions on which it had censured other SROs and ordered them to undertake reforms or pay substantial fines.⁶⁴

As noted above, the SEC has even more power over the Board than the SROs. Yet as just illustrated, the SEC has been able to force dramatic management changes even in the SRO context. Thus, any notion that the SEC, which appoints the Board, controls its budget, and can completely neuter it, cannot force management changes at the Board blinks reality. The former Chairmen I represent in this litigation have no doubt, and have stated in our *amici curiae* brief, that the SEC can readily dictate Board management, should the SEC choose to do so.

In addition to all of these general powers, the SEC has specific powers of control and oversight, and has exercised them aggressively over every one of the Board's central functions: rulemaking, registration and inspection activities, and investigation and disciplining of firms. I cannot document those facts here. But as one brief example, no PCAOB rule may become effective without the SEC's approval,⁶⁵ and the SEC can abrogate, delete, or add to existing Board rules.⁶⁶ As a result, the SEC has enormous leverage over Board rulemaking. That leverage translates in practice into substantial involvement in the development of PCAOB rules from their earliest stages. Thus, well before a rule or standard is ever submitted to the SEC for approval, SEC staff consult and coordinate closely with the PCAOB during the development of rules and auditing standards the

63. See Joel Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance* 698–702 (3d ed. 2003).

64. See Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and Nasdaq Market (Aug. 1996); see also SEC Release No. 34-51163 (Feb. 9, 2005) (requiring NASD to undertake remedial measures in light of failures SEC investigation identified).

65. 15 U.S.C. § 7217(b)(2) (2006).

66. *Id.* § 7217(b)(5).

PCAOB intends to propose.⁶⁷ Even after submitting an initial proposal, the Board often continues to refine proposed rules in accordance with SEC staff recommendations in order to secure the Commission's approval.⁶⁸ The Commission also influences PCAOB rulemaking by issuing its own interpretive releases when it approves the Board's rules.⁶⁹ Doing so permits the Commission to put its own stamp on how the Board's new rule should be applied and to ensure that PCAOB and SEC rules are appropriately aligned. The SEC has similar, comprehensive, specific powers over all the other functions of the Board.

III. CONCLUSION

The heart of this case, constitutionally, is whether Board members are principal officers. Because the SEC exercises pervasive authority, control, and oversight over Board members, they are not. Congress designed the SEC-PCAOB structure to ensure effective, unified, efficient, and sustained regulation of the accounting profession, with the SEC possessing plenary power over this arena of financial regulation, as all others.

As inferior officers, Board members need no more be removable at the will of the President than any other inferior officers. And the

67. For example, as then-SEC Chairman Cox has explained, the Board's need for SEC approval requires a high level of coordination between the SEC and the PCAOB. If a standard were approved by the Board and not by the Commission, not only could it never take effect but valuable time would be lost when the entire effort would have to begin anew. Unofficial Transcript of Meeting of Commissioners (Apr. 4, 2007). Unless otherwise noted, all cited SEC documents, orders, statements, and other materials are publicly available on the Commission's website, at www.sec.gov. Similarly, all cited PCAOB materials are publicly available online at www.pcaobus.org.

68. For example, the Board has changed previously submitted proposed rules in response to SEC staff concerns that a rule might have unintended consequences for the interpretation of other securities laws. See, e.g., Audio Webcast: PCAOB Open Meeting (Nov. 22, 2005); Board Approves 2006 Budget, Amendments to Tax Rules (Nov. 22, 2005); SEC Release No. 34-53677 (Apr. 19, 2006).

69. For example, when approving the PCAOB's Auditing Standard No. 1 in 2004, the Commission simultaneously issued its own interpretive release to address implementation of the newly approved standard and clarify its impact on other rules and regulations. See Order Approving Proposed Auditing Standard No. 1, SEC Release No. 34-49707 (May 14, 2004); Commission Guidance Regarding the Public Company Accounting Oversight Board's Auditing and Related Practice Standard No. 1, SEC Release No. 33-8422 (May 14, 2004). Similarly, when it approved the PCAOB's Auditing Standard No. 4 and related Board rules, the SEC provided its own guidance in the approval order on issues the new standard raised. See *Sarbanes-Oxley at Four*, *supra* note 49, at 63 (statement of SEC Chairman Cox); see also Order Approving Proposed Auditing Standard No. 4, SEC Release No. 34-53227 (Feb. 6, 2006).

