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IN THE

Supreme Court of the United States

FREE ENTERPRISE FUND
AND BECKSTEAD AND WATTS, LLP,
Petitioners,

v.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD
AND UNITED STATES OF AMERICA,
Respondents.

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

BRIEF FOR AMICI CURIAE FORMER CHAIRMEN OF THE SECURITIES AND EXCHANGE COMMISSION IN SUPPORT OF RESPONDENTS

CHRISTOPHER J. MEADE
WILMER CUTLER PICKERING
HALE AND DORR LLP
399 Park Avenue
New York, N.Y. 10022
(212) 230-8800

RICHARD H. PILDES
Counsel of Record
Vanderbilt Hall Room 507
40 Washington Square South
New York, N.Y. 10012
(212) 998-6377

CATHERINE M.A. CARROLL
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 663-6000

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INTEREST OF AMICI CURIAE[1]

Amici curiae are seven former Chairmen of the SEC, who reflect four decades of SEC leadership under Presidents of both political parties: G. Bradford Cook (1973), Roderick M. Hills (1975-1977), Harold M. Williams (1977-1981), David S. Ruder (1987-1989), Arthur Levitt, Jr. (1993-2001), Harvey L. Pitt (2001-2003), and William Donaldson (2003-2005). Former Chairmen Hills and Ruder served on the Advisory Council to the PCAOB from 2004 to 2009 and now serve as emeritus members. Collectively, amici represent decades of experience in the administration of the federal securities laws. Five (Chairmen Hills, Williams, Ruder, Levitt, and Pitt) testified during hearings that led to the adoption of the Sarbanes-Oxley Act of 2002, and Congress cited their testimony frequently to support and explain the Act's structure. Two (Chairmen Pitt and Donaldson) were directly responsible for the Act's initial implementation, including creating and staffing the PCAOB. Amici filed briefs before the District Court and Court of Appeals to support the United States' defense of the Act.

The former Chairmen address two areas in which they believe their experience and expertise can provide important context to the constitutional issues before the Court: (1) the significance of the SEC-Board relationship within the overall regime of financial regula-

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[1] The parties have consented to the filing of this brief. Pursuant to Rule 37.3(a), written consents to the filing of this brief have been placed on file with the Clerk of the Court. No counsel for a party authored this brief in whole or in part, and no person, other than amici or their counsel, made a monetary contribution to the preparation or submission of this brief.

tion, and (2) the extent to which the SEC has actively overseen, supervised, and directed the Board's activities in the more than seven years since the Act's adoption. Given the importance of the Act and the SEC-PCAOB structure to the integrity of U.S. capital markets, the former SEC Chairmen respectfully submit this brief.

SUMMARY OF ARGUMENT

Congress designed the PCAOB to be wholly independent of the accounting profession, but under the complete oversight and control of the SEC. As advised by experienced financial regulators and other experts, Congress built on the unique system of public-private regulatory partnerships that have characterized financial regulation in the United States for seven decades. 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 Nasdaq Stock Exchange, the National Association of Securities Dealers (NASD, now the Financial Industry Regulatory Authority, (FINRA)), and the Municipal Securities Rulemaking Board. The SEC-PCAOB structure was a logical outgrowth of this longstanding SRO system. But Congress gave the SEC even more pervasive powers over the Board than it has over the SROs, precisely in order to ensure the unified, coherent administration of financial regulation that is possible only through 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 thus have translated in practice into comprehensive SEC control and oversight of the Board's actions.

Viewed in this proper context, petitioners' 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 of "*Humphrey's Executor* squared." 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.

ARGUMENT

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 ensure the Board's independence from the accounting profession; to ensure efficient and coherent financial regulation by putting the Board under the plenary authority of the SEC; to ensure competent and sophisticated supervision of the

accounting profession by enabling the Board to pay salaries competitive with the private sector; to ensure sustained focus and commitment to the Board's mission by giving it a dedicated and independent source of funding; and to ensure fair, impartial administration by limiting potential congressional interference with the Board.

In pursuing those objectives, Congress 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 regulation of the financial markets. The industry's SROs—private, quasi-governmental bodies responsible for standard-setting and discipline, subject to SEC plenary control—provided the regulatory framework within which Congress designed the PCAOB. Congress built upon decades of experience with these structures in an effort to maintain the distinct advantages that flow from the SROs' public-private nature while providing needed independence from the regulated profession. To the extent Sarbanes-Oxley departs from the SRO experience, it consistently does so to *increase* the SEC's control over the Board even beyond that which the SEC has over the pre-existing 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." *Silver* v. *New York Stock Exchange*, 373 U.S. 341, 366 (1963); *see also Gordon* v. *New York Stock Exchange, Inc.*, 422 U.S. 659, 663-667

(1975). A central pillar of this unique regulatory regime has long been the principle of industry self-regulation, under which "the industry regulates itself through various self-regulatory organizations … overseen by the SEC." *Accounting Reform and Investor Protection: Hearings Before the S. Comm. on Banking, Hous., and Urban Affairs*, 107th Cong. 552 (2002) ("*Accounting Reform Hearings*") (statement of Comptroller General David M. Walker). SROs include securities exchanges such as the NYSE, as well as the NASD (now FINRA), which regulates the over-the-counter securities market. *Id.* As the Commission observed decades ago:

> There are, no doubt, many other instances in which the policy of entrusting a degree of social control to "private" groups has been adopted, but securities regulation is unique in featuring self-regulation as an essential and officially sanctioned part of the regulatory pattern.

SEC, Report of Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 88-95, pt. 4, at 501 (1963).

Self-regulatory organizations long predated 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." *National Ass'n of Secs. Dealers, Inc.* v. *SEC*, 431 F.3d 803, 807 (D.C. Cir. 2005) ("*NASD*"). In the federal securities laws, beginning with the Securities Exchange Act of 1934 ("Exchange Act"), Congress "'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.'" *Credit Suisse First Boston Corp.* v. *Grunwald*, 400 F.3d 1119, 1128 (9th Cir. 2005) (quoting S. Rep. No. 94-75, at 23 (1975)) (second alteration in original). SROs' wide-ranging responsibilities include rulemaking, examining members 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. *See, e.g.*, *Accounting Reform Hearings*, at 570 (statement of NASD Chairman Robert Glauber).

SROs, though private entities, act pursuant to SEC oversight, *see Gordon*, 422 U.S. at 667, and have "no authority to regulate independently of the SEC's control," S. Rep. No. 94-75, at 23; *see also* 15 U.S.C. § 78s (delineating SEC oversight of SROs). SROs must obtain the Commission's approval to enact or amend any rule, *id.* § 78s(b), and the Commission may amend or abrogate the rules of any SRO, *id.* § 78s(c). 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. *NASD*, 431 F.3d at 806; *see also* 15 U.S.C. § 78s(d), (e); *Schultz* v. *SEC*, 614 F.2d 561, 568 (7th Cir. 1980). Thus, the legal authority of the SROs "ultimately belongs to the SEC." *NASD*, 431 F.3d at 806.

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. *See, e.g.*, *NASD*, 431 F.3d at 806-808; *Credit Suisse*, 400 F.3d at 1130. Indicative of that authority, the SEC's broad authority to approve or disapprove SRO rules and other actions may immunize regulated SRO practices from antitrust liability. *See Gordon*, 422 U.S. 659 (immunity for fixed

commission rates); *United States* v. *National Ass'n of Secs. Dealers, Inc.*, 422 U.S. 694 (1975) (immunity for securities dealers' pricing practices in secondary mutual funds markets). Similarly, the Commission's role in reviewing and approving SRO rules means that such rules may preempt conflicting state law. *See, e.g.*, *Credit Suisse*, 400 F.3d at 1128, 1132. Regulation of the financial markets has thus long entailed a unique set of public-private 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, Auditing Oversight 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 looked to the private sector, in the first instance, to establish Generally Accepted Accounting Principles and to set ethical standards. *See Accounting Reform Hearings*, at 552 (statement of Comptroller General Walker). Regulation of the accounting profession occurred largely under the auspices of the American Institute of Certified Public Accountants (AICPA), the profession's trade association, which set professional standards. Accounting standards were first set inside AICPA, then, when that proved inadequate, by an outside body, the Financial Accounting Standards Board (FASB). Though reserving the right to object, the SEC generally deferred to FASB's standards. *See* SEC, Statement of Policy on Establishment and Improvement of Accounting Principles and Standards, 39 Fed. Reg. 1260 (Jan. 7, 1974); *Accounting Reform Hearings*, at 552 (statement of Comptroller General Walker).

Financial scandals in the mid-1970s led the AICPA and SEC to create the Public Oversight Board (POB), a private-sector body charged with conducting quality assurance reviews of public accounting firms, particularly in connection with their auditing activities. *See Accounting Reform Hearings*, at 552 (statement of Comptroller General Walker); *see also id.* at 555-557. Despite efforts to imbue the POB with independence, the POB's financing depended on AICPA and the major accounting firms; ultimately their ability to threaten or actually withhold funding from the POB made it clear—even before the collapse of Enron—that self-regulation of auditing was inadequate. By 1999, the SEC reported to Congress that it no longer considered the POB system effective. *See* SEC Annual Report 1999, at 92; *see also Accounting Reform Hearings*, at 246-247 (testimony of former SEC Chief Accountant Lynn Turner).

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.[2] Harvey Pitt, the sitting Chairman of the SEC, and five former Chairmen, along with other experts, detailed weaknesses of the existing self-regulatory regime and advocated creation of a new auditing oversight board. *See, e.g.*, *Accounting Reform*

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[2] Contrary to petitioners' amici's characterization (*see, e.g.*, Cato Br. 1, 3-4, 6), Sarbanes-Oxley was the product of extensive deliberation. From late-2000 to mid-2001, Congress held dozens of hearings, considered over 30 versions of proposed legislation, and heard testimony from representatives of government, industry, academia, and consumer groups. *See* Nagy, *Playing Peekaboo With Constitutional Law: The PCAOB and its Public/Private Status*, 80 Notre Dame L. Rev. 975, 996-997 (2004-2005); *see also, e.g.*, *Accounting Reform Hearings*, at iii-ix.

Hearings, at 21-22, 71-72 (testimony and statement of former SEC Chairman David S. Ruder); *see also id.* at 23 (testimony of former SEC Chairman Harold M. Williams). Charles Bowsher, then chairman of the POB and previously U.S. Comptroller General, testified "that the voluntary, self-regulatory program needs to be replaced because it has failed to keep pace with the challenges faced by the profession." *Id.* at 897. And Paul Volcker, former Chairman of the Federal Reserve System, concluded that oversight of auditing by the accounting profession had proved "very unsatisfactory." *Id.* at 106.

The consensus view of witnesses and members of Congress was that these failings were due to the accounting profession's capture and domination of the private-sector regulatory regime. As Senator Kohl concluded, "the current system of self-regulation … has been the root of many of the frauds being revealed today." 148 Cong. Rec. S6757, S6758 (daily ed. July 15, 2002).[3] Congress was thus advised repeatedly to create a "truly independent" overseer that would not be hostage to those being regulated. *Accounting Reform Hearings*, at 21-22 (testimony of former SEC Chairman Ruder); *see also id.* at 24-25 (testimony of former SEC Chairman Williams); *id.* at 898 (testimony of POB Chairman Bowsher) ("to be effective," oversight "must be totally independent of the accounting profession").[4]

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[3] *See also* 148 Cong. Rec. S6327, S6330 (daily ed. July 8, 2002) (statement of Sen. Sarbanes); *Accounting Reform Hearings*, at 71-72 (statement of former SEC Chairman Ruder); *id.* at 897 (testimony of POB Chairman Bowsher).

[4] *See also H.R. 3763, The Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002: Hearings*

Part of the problem was that entities like the 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." *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*"). 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 we need." *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) ("*Enron Collapse Hearings*"). Former SEC Chairman Harold Williams, during whose chairmanship the POB had been created, agreed that "events over the intervening years have demonstrated that [the POB] does not meet the needs and is not adequate." *Accounting Reform Hearings*, at 24-25. 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. *Id.*

In addition, experts testified that the POB was compromised by its dependence on the accounting profession for funding. Without adequate dedicated funding, the POB was "beholden for its funding to the very

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Before the H. Comm. on Fin. Servs., 107th Cong. 200 (statement of Barry Melancon, AICPA President and CEO) (advocating "a robust private sector regulatory body, independent of the accounting profession"); *id.* at 50 (testimony of Barbara Roper, Director of Investor Protection, Consumer Federation of America) (same).

people it [was] supposed to oversee." *Accounting Reform Hearings*, at 24-25 (testimony of former SEC Chairman Williams). Congress learned, for example, that the industry had decided to cut off funding for reviews of the major accounting firms that POB was conducting at the Commission's request. *Id.* at 897 (testimony of POB Chairman Bowsher).

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:

> Critical 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.

CAARTA Hearings, at 307; *see also Accounting Reform Hearings*, at 1106. Indeed, the SEC had already proposed the creation of a new private-sector regulatory body, *CAARTA Hearings*, at 71, 82, 309-310 (testimony of then-Chairman Pitt), that would be structured to provide needed independence from industry and be subject to the Commission's "rigorous oversight," *Enron Collapse Hearings*, at 30 (testimony of then-Chairman Pitt); *see also id.* at 48 (testimony of then-Chairman Pitt) (describing SEC proposal); 67 Fed. Reg. 44,964 (July 5, 2002) (notice of proposed rulemaking).

C. Congress Designed The Board To Be Independent Of The Accounting Profession But 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 failing 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." 148 Cong. Rec. at S6330. Senator Levin agreed that designing the oversight board to be "free of domination by either 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. 148 Cong. Rec. S6561, S6566 (daily ed. July 10, 2002).[5]

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[5] *See also* 148 Cong. Rec. S7350, S7351 (daily ed. July 25, 2002) (statement of Sen. Sarbanes) ("This legislation establishes a strong independent accounting oversight board, thereby bringing to an end the system of self-regulation in the accounting profession which, regrettably, has not only failed to protect investors … but which has in effect abused the confidence in the markets[.]"); 148 Cong. Rec. H5462, H5462-5463 (daily ed. July 25, 2002) (statement of Rep. LaFalce) ("[T]he oversight board included in the final conference report will be independently funded and will have strong disciplinary, investigatory, and most importantly, standard-setting powers.… No longer will the accounting industry be able to set the rules for itself without regard for the interests of shareholders."); 148 Cong. Rec. at S7355 (statement of Sen. Enzi) ("This legislation builds a strong and independent board to oversee the accounting industry. It will eliminate the climate of self-regulation that has historically guided accounting."); 148 Cong. Rec. E1452, E1452 (daily ed. July 29, 2002) (statement of Rep. Markey) ("Cor-

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 accounting profession than existing SROs were with respect to the elements of the securities industry they oversaw. *See, e.g.*, *Accounting Reform Hearings*, at 1091-1092 (colloquy between Sen. Sarbanes and then-Chairman Pitt) (discussing NASD and NYSE as models); *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 527-530, 571-573 (testimony of NASD Chairman Robert R. Glauber) (suggesting new private-sector regulator modeled on NASD).[6]

Thus, like existing SROs, the new board would have authority to propose rules and standards, examine firms for compliance, assess quality controls at all accounting firms that audit public companies, and propose sanctions for noncompliance. To ensure the Board's in-

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porate auditors will no longer be policing themselves, but instead will be subject to an independent accounting oversight board.").

[6] The PCAOB's statutory designation as a private, nonprofit corporation, *see* 15 U.S.C. § 7211(a), (b), thus reflects the Board's roots in the SRO tradition. 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*, at 532-533, 579 (testimony and statement of Prof. Joel Seligman); *id.* at 583-584 (statement of Prof. John C. Coffee, Jr.); *id.* at 527-530, 571-573 (testimony and statement of NASD Chairman Glauber).

dependence, Congress accepted the recommendations of experienced regulators that the Board have a guaranteed source of funding not dependent on voluntary professional contributions. *See* 15 U.S.C. § 7219. Instead, Congress adopted an industry-funded dedicated fee structure similar to those long used in other contexts. *See* PCAOB Br. 19 n.3; U.S. Br. 35-36. As former SEC Chairman Hills put it, the new overseer "should not need to 'pass the hat.'" *CAARTA Hearings*, at 264. 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." S. Rep. No. 107-205, at 7 (2002); *see also Accounting Reform Hearings*, at 937; *id.* at 209, 246 (testimony and statement of former SEC Chief Accountant Turner); *id.* at 1036 (statement of Sen. (Ret.) Metzenbaum).

Congress similarly adopted other structural features to enhance the Board's independence from the accounting profession. For example, then-SEC Chairman Pitt and former Chairman Ruder had advocated "a regulatory body in which all of the members are not connected with the accounting profession." *Accounting Reform Hearings*, at 37 (testimony of former SEC Chairman Ruder); *see also Enron Collapse Hearings*, at 30 (testimony of then-Chairman Pitt). Congress accordingly imposed strict limits on Board member ties to industry. *See* 15 U.S.C. § 7211(e)(2), (3).

While ensuring the Board's independence, Congress also built on the SEC's relationship with the SROs to guarantee that the Board would function under the SEC's full authority and comprehensive control. Thus, many statutory oversight rules governing SROs generally were applied to the PCAOB in Sar-

banes-Oxley. *Compare, e.g.*, 15 U.S.C. §§ 78q(b)(1), 78s(c), *with id.* §§ 7217(a), 7217(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].").[7] But Congress also subjected the Board to even greater SEC authority than the Commission has over SROs. For example, while SRO governing boards are generally selected by their members or shareholders, 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. *See* 15 U.S.C. § 7211(e)(4).[8] In addition, unlike SROs, the PCAOB's budget is subject to SEC approval. *See* 15 U.S.C. § 7219(b); *see also* Nagy, *supra* n.2, at 1025 & n.292 (2005). Thus, as even one of petitioner's own academic amici puts it, the Board "is squarely under the thumb of the SEC's oversight and control." Pritchard, *The Irra-*

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[7] *See, e.g.*, 148 Cong. Rec. at S6334 (statement of Sen. Sarbanes) (citing "importan[ce]" of SEC oversight); 148 Cong. Rec. H1544, H1546 (daily ed. Apr. 24, 2002) (statement of Rep. Oxley) ("We are giving the SEC the tools to oversee this new [regulatory organization]."); *Accounting Reform Hearings*, at 1120 (statement of then-Chairman Pitt) ("[T]he Commission must have a direct role in the operation of the [board]'s regulatory programs by exercising effective and rigorous oversight of its membership, rules, and activities."); *CAARTA Hearings*, at 307 (statement of then-Chairman Pitt) (regulatory body should be "subject to comprehensive and vigorous SEC oversight.").

[8] The requirement of consultation with Treasury (and the Federal Reserve Board) is noteworthy. It not only reflects the importance of accounting and auditing to the national economy, but further confirms that Congress did not design the Board with any purpose of excluding Executive Branch participation in the selection of Board members.

tional Auditor and Irrational Liability, 10 Lewis & Clark L. Rev. 19, 35 (2006).

To the extent advocates of the new oversight board viewed independence from political influence—rather than from the accounting profession—as a goal, the focus was on political pressure not from the Executive branch, but from Congress itself. Congressional pressure was one way the accounting profession had successfully opposed previous reform efforts. *See Accounting Reform Hearings*, at 1035 (statement of Sen. (Ret.) Metzenbaum, Chairman, Consumer Federation of America); *id.* at 849 (testimony of Robert E. Litan, Brookings Institution). For example, some cited pressure from Congress as a reason FASB had been ineffective: "This well-meaning group must defend itself … from congressional pressure, which is often applied when powerful constituents hope to undermine a rule that might hurt their rulings." *The Fall of Enron: Hearing Before the S. Comm. on Gov'tl Affairs*, 107th Cong. 27 (2002) (testimony of former SEC Chairman Levitt); *see also Accounting Reform Hearings*, at 44 (testimony of former SEC Chairmen Levitt and Williams) (discussing legislative pressure on FASB rulemaking). Members of Congress thus noted the "importan[ce]" of using safeguards such as dedicated funding to curb "influence coming directly from Congress." *Accounting Reform Hearings*, at 1076 (statement of Sen. Gramm); *see also id.* at 186 (statement of Sen. Stabenow) (noting need to "insulate the establishment of accounting standards from politics and pressures, both from the industry and, frankly, from Congress"); *id.* at 913 (statement of Sen. Sarbanes) ("[T]here are tremendous pressure dynamics at work in this arena. Some of them come from Congress, to be quite candid about

it."). Thus, neither in purpose nor effect was the Board designed to be independent of the SEC itself.

D. Congress Rejected Other Possible Structures For The Board For Sound Reasons

Congress considered two polar alternatives that lie on either side of the structure it ultimately enacted: to create a new, independent agency altogether, or to create a new unit within the SEC. Experienced regulators and experts advised Congress, however, that these alternatives would likely create an inefficient or ineffective administrative structure. Congress's rejection of these alternatives thus reveals no purpose to insulate the Board from Executive control.

Congress was advised that an entirely new, standalone 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. *CAARTA Hearings*, at 158-159. Only by putting the Board under complete 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," S. Rep. No. 107-205, at 12, and alleviate the possibility that the PCAOB might duplicate SEC enforcement efforts, *see* 148 Cong. Rec. H4478, H4479 (daily ed. July 10, 2002) (statement of Rep. LaFalce).

At the other pole, some suggested that Congress not create a new entity, but require the SEC itself to

carry out the expanded standard-setting and disciplinary functions contemplated by Sarbanes-Oxley. *See, e.g.*, *Accounting Reform Hearings*, at 36-38 (discussing proposal of former SEC Chairman Richard C. Breeden); *see also CAARTA Hearings*, at 157-158; *Accounting Reform Hearings*, at 219; *id.* at 704-709, 1027, 1087, 1091. 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. As former SEC Chairman Hills testified, "the SEC is way, way short-handed in dealing with accounting problems.... [T]hey do not have the manpower to bring justice swiftly." *Accounting Reform Hearings*, at 38. The Comptroller General agreed. *See CAARTA Hearings*, at 157-158 ("The SEC is already overtaxed as it relates to enforcing the securities laws."); *Accounting Reform Hearings*, at 564 (statement of Comptroller General Walker) ("the SEC's ability to fulfill its mission has become increasingly strained").[9]

Moreover, simply increasing the SEC's funding would not have achieved the long-recognized benefits of the SRO structure. *See, e.g.*, *Accounting Reform Hearings*, at 570 (statement of NASD Chairman Glauber). The ability to attract and retain experienced profes-

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[9] *See also Accounting Reform Hearings*, 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) ("[o]bviously, the SEC does not have the resources or the talent right now" to serve as an "uber-auditor").

sionals 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, far from creating an unprecedented institution "never before seen in American history" (Cato Br. 9), Congress designed the PCAOB 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. Since The Board's Creation, The SEC Has In Fact Exercised Vigorous And Pervasive Oversight

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 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. SEC Control Over PCAOB Functions

The SEC's statutory authority to disapprove PCAOB rules or budget proposals, reverse the Board's enforcement decisions, or remove Board members and censure the Board—or even rescind its duties altogether—create powerful incentives in advance for the Board to seek and comply with the Commission's direction. The Board must—and does—take account of the SEC's views in all aspects of the Board's work. As a result, the two bodies engage in close, ongoing coordination, as Congress intended. As Christopher Cox, SEC Chairman from 2005 to 2009, has explained, the SEC and the PCAOB routinely "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." *Sarbanes-Oxley at Four: Hearing Before the H. Comm. on Fin. Servs.*, 109th Cong. 24-25 (2006) ("*Sarbanes-Oxley at Four*").

For example, because no PCAOB rule may become effective without the SEC's approval, 15 U.S.C. § 7217(b)(2), and because the SEC can abrogate, delete from, or add to existing Board rules, *id.* § 7217(b)(5), the SEC has enormous leverage over Board rulemaking. That leverage translates in practice into substantial SEC involvement in the development of PCAOB rules from their earliest stages. 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).[10] Thus, during development of PCAOB rules and auditing standards, long before the Board ever submits a proposed rule or standard to the Commission, SEC and PCAOB staff consult and coordinate closely. After submitting an initial proposal, the Board often must continue to refine proposed rules in accordance with SEC staff recommendations in order to secure Commission approval.[11] And when approving final Board rules, the Commission may continue to control PCAOB rulemaking by issuing its own interpretive releases, allowing it to place its own stamp on how the Board's new rule should be applied and to ensure that PCAOB and SEC rules are appropriately aligned.[12]

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[10] 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. *See supra* pp. v-x.

[11] 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, at 48:19-59:43 (Nov. 22, 2005); Board Approves 2006 Budget, Amendments to Tax Rules (Nov. 22, 2005).

[12] 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

The SEC's close control of Board functions is exemplified by the Commission's role in the development of PCAOB rules implementing Section 404 of the Sarbanes-Oxley Act, 15 U.S.C. § 7262. Section 404, which requires auditors to evaluate and report on the effectiveness of public companies' internal control structures and procedures, had become one of the most controversial provisions of Sarbanes-Oxley. *See, e.g.*, *The Impact of the Sarbanes-Oxley Act: Hearing Before the H. Comm. on Fin. Servs.*, 109th Cong. 53-54 (2005) ("*Impact of Sarbanes-Oxley*") (statement of then-SEC Chairman Donaldson); Pritchard, *supra*, at 21. Addressing the costs Section 404 imposes thus became an important Executive branch priority.[13]

At the Administration's urging, the SEC worked closely with the PCAOB over a period of two years to develop a new standard for implementing Section 404. *See* SEC Approves PCAOB Auditing Standard No. 5

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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*, at 63 (2006) (statement of SEC Chairman Cox); *see also* Order Approving Proposed Auditing Standard No. 4, SEC Release No. 34-53227 (Feb. 6, 2006).

[13] *See, e.g.*, George W. Bush, Remarks on the National Economy in New York City, 2/5/07 Weekly Comp. Pres. Doc. 99, 2007 WLNR 3002163 (Feb. 5, 2007); Remarks by Treasury Secretary Henry M. Paulson on the Competitiveness of U.S. Capital Markets, Economic Club of New York (Nov. 20, 2006), *available at* http://www.treas.gov/press/releases/hp174.htm.

Regarding Audits of Internal Control Over Financial Reporting; Adopts Definition of "Significant Deficiency," SEC Press Release No. 2007-144. Throughout this rulemaking, the PCAOB engaged in "frequent—if not daily—dialogue with the SEC at all levels of both organizations." Remarks of PCAOB Chairman Olson on the Proposed New Standard Concerning the Audit of Internal Control 1-2 (Dec. 19, 2006).

This close coordination was aimed in part at ensuring that the Board's rule would be consistent with the SEC's own implementation of Section 404. *See, e.g.*, Statements of SEC Chairman Christopher Cox and Chief Accountant Conrad Hewitt Regarding PCAOB's Proposed Section 404 Auditing Standard, SEC Press Release No. 2006-213 (Dec. 19, 2006) (SEC and Board are "work[ing] together" to ensure Commission's proposed interpretative guidance and PCAOB's proposed standard are "mutually reinforcing"); SEC Release No. 34-55876 (June 7, 2007) (consultations sought to "[a]lign[] the PCAOB's new auditing standard … with the SEC's proposed new management guidance").[14] Thus, in response to SEC direction, the Board refined its proposal to conform it to the SEC's policy preferences for implementing 404 and to the guidance the SEC was providing to corporate managers. As PCAOB Chairman Olson stated when the Board issued its proposed standard:

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[14] *See also Impact of Sarbanes-Oxley*, at 9, 54, 56-57 (testimony and statement of then-SEC Chairman Donaldson) (Commission and PCAOB are "closely coordinating" to clarify issues and reduce costs of implementing Section 404); *Sarbanes-Oxley at Four*, at 24-25, 61 (2006) (testimony of then-SEC Chairman Christopher Cox) (SEC working with PCAOB to ensure Section 404's improved implementation).

> We have … worked closely with counterparts at the SEC to ensure that the recommendations are consistent with the guidance provided by the Commission … , which included the importance of appropriately coordinating the standard with the SEC's management guidance[.]
>
> Importantly, the package before us today is also responsive to the comments received on the proposals and guidance provided by the SEC. I would like to acknowledge the important and open dialogue we have had with Chairman Cox and the SEC Commissioners, and the value the SEC staff has added to this initiative.

Open Meeting, Introductory Statement of Chairman Olson On the New Standard Concerning The Audit of Internal Control 4, 5-6 (May 24, 2007); *see also* SEC Release No. 34-55876 (June 7, 2007) (Board proposal reflected "careful consideration of … input from the SEC").

Moreover, when the SEC in July 2007 approved the PCAOB's new Auditing Standard No. 5, which implemented Section 404, the Commission exercised further control by promulgating its own new definitions and guidance to harmonize the PCAOB's new standard with the SEC's own rules. *See* SEC Press Release No. 2007-144. These SEC-PCAOB rulemaking efforts, in turn, reflected and served the Executive branch's goal of reducing audit costs by adopting a standard designed to "ensur[e] that the internal control audit is top down, risk based, and focused on what truly matters to the

integrity of a company's financial statements," as the Administration had recommended.[15]

The SEC's vigorous exercise of control over the Board's statutory functions is further illustrated by implementation of the Act's registration and inspection requirements. Section 106 of the Act subjects foreign accounting firms to the same registration and inspection requirements as U.S. firms. *See* 15 U.S.C. § 7216(a)(1). Like Section 404, the foreign-firm registration requirement became a controversial provision of substantial importance. And like Section 404, application of the registration and inspection requirements to foreign firms was the subject of close SEC oversight of the Board.[16] The SEC, for example, convened a roundtable for discussion with foreign regulatory authorities, foreign accounting firms, and investor groups, at which SEC and Board leadership and staff jointly participated, to assess the concerns of these key actors. *See Accounting Under Sarbanes-Oxley: Hearing Before the H. Comm. on Fin. Servs.*, 108th Cong. 11, 54 (2003) (testimony and statement of then-SEC Chairman William H. Donaldson). As a result, the Board proposed, and the SEC approved, registration rules that required foreign auditing firms to register but

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[15] *See* Remarks by Treasury Secretary Henry M. Paulson on the Competitiveness of U.S. Capital Markets Economic Club of New York, *supra* n.13 (endorsing SEC's and PCAOB's implementation of Administration's preferred reforms to internal control audits under Section 404).

[16] *See, e.g.*, SEC Annual Report 2003, at 28 (2004) (SEC "worked with the [Board] to address the concerns of foreign authorities regarding the international implications of the PCAOB's system for registering accounting firms").

eased the burdens of doing so. *See id*; *see generally The PCAOB and the Oversight of Non-U.S. Auditors*, Remarks by PCAOB Board Member Daniel L. Goelzer (Apr. 19, 2004). And in later rulemakings, the PCAOB continued to follow SEC directives in developing a cooperative framework for inspection of registered foreign firms. *See* Order Approving Proposed Rules Relating to Oversight of Non-U.S. Registered Public Accounting Firms, SEC Release No. 34-50291 (Aug. 30, 2004). The SEC has thus vigorously exercised its statutory authority over the Board's rulemaking and other functions to control the Board's actions and ensure their alignment with SEC policy.[17]

B. SEC Authority To Review And Approve The PCAOB's Budget

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. *See* 15 U.S.C. § 7219(b), (d)(1). As with the Board's rulemaking and enforcement, the SEC's approval authority has translated in practice into substantial control over the Board's actions at their inception. In particular, the

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[17] PCAOB enforcement and disciplinary proceedings are private, *see* 15 U.S.C. § 7215(c)(2), but publicly available evidence indicates that the SEC has been just as active in overseeing those activities as in other areas. *See, e.g.*, PCAOB 2005 Annual Report 17 (PCAOB enforcement staff "works closely" with the SEC to coordinate investigations); PCAOB 2007 Annual Report 12 (same); *see also* Remarks of the SEC Associate Chief Accountant Before the 2005 AICPA National Conference on Current SEC and PCAOB Developments (Dec. 5, 2005) (same).

SEC has closely coordinated with the PCAOB in developing the Board's annual budgets; indeed, the SEC has established a formal review process for doing so. Moreover, the SEC has used that authority to influence the Board's implementation of the Act.

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. *See* Order Approving Public Company Accounting Oversight Board Budget And Annual Accounting Support Fee For Calendar Year 2006, SEC Release No. 33-8676 (Apr. 13, 2006). Likewise, the PCAOB's 2007 budget was the result of "many months of close-knit teamwork and coordination between" the Board and the Commission. Speech by SEC Commissioner: Remarks Before the SEC Open Meeting on the 2007 PCAOB Budget by Commissioner Roel C. Campos (Dec. 4, 2006). 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.

Id.

Where the PCAOB has failed to incorporate the SEC's views into the initial budget, the Commission has forced the PCAOB to reconsider. During the 2005 budget cycle, for example, the PCAOB submitted a proposed budget that did not satisfy SEC staff. The SEC raised several concerns with the initial proposal and required the Board to revise it. After the Board addressed these concerns, the SEC approved the revised budget. *See* Order Approving Public Company Accounting Oversight Board Revised Budget and Annual Accounting Support Fee for Calendar Year 2005 (Mar. 3, 2005); *see also* Speech by SEC Staff: Opening Remarks before the Open Meeting on PCAOB Budget and PCAOB and FASB Support Fees by Donald T. Nicolaisen, Chief Accountant, U.S. Securities and Exchange Commission (Mar. 3, 2005).

To regularize these review procedures, "the SEC and the PCAOB … established a formal process for the determination of the Board's annual budget and accounting support fees." *Sarbanes-Oxley at Four*, at 61 (statement of SEC Chairman Cox). In this review process, "both [agencies'] staffs … interact, analyze, and prepare a sound and appropriate budget on an annual basis" with the goal of "ensuring that the PCAOB's budget is created and considered in a timely and comprehensive manner, and with the full input of relevant staff at both the PCAOB and the SEC." Speech by SEC Commissioner: Remarks Before the SEC Open Meeting on the 2007 PCAOB Budget by Commissioner Roel C. Campos (Dec. 4, 2006). As one SEC Commissioner explained, the budget-review process "sets forth a very clear and reasonable framework for annual approval of the PCAOB's budget, and memorializes a framework for ongoing communication,

transparency, and feedback between the PCAOB and the SEC." *Id.*; *see also Sarbanes-Oxley at Four*, at 24-25 (testimony of then-Chairman Cox).

The SEC has used this budgeting authority as a means to influence and supervise 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 the recommendations of a Treasury Department advisory committee. The SEC directed the Board, in particular, to submit a project plan to the Commission and provide an opportunity for the Commission to respond before the Board began developing proposed rules to implement Treasury's recommendations. *See* Order Approving Public Company Accounting Oversight Board Budget and Annual Accounting Support Fee For Calendar Year 2009, SEC Release No. 33-8989, at 4 (Dec. 17, 2008). 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. *See id.* at 3-4. 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.

C. SEC Authority To Inspect The PCAOB

The SEC also directs and supervises PCAOB actions through the SEC's statutory inspection authority. Under the 1934 Exchange Act and subsequent amend-

ments, the SEC may examine the records of self-regulatory organizations any time the Commission deems it necessary or appropriate. *See* 15 U.S.C. § 78q(b)(1); *see also id.* § 78q(a)(1). Sarbanes-Oxley made these provisions applicable to the PCAOB, *id.* § 7217(a).

In practice, this inspection authority has provided the SEC with yet another effective means of supervising the Board's activities. The Commission has used its inspection authority, for example, to set long-range goals for the Board and examine whether the Board is fulfilling those aims. 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 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.

Impact of Sarbanes-Oxley, at 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.

Sarbanes-Oxley at Four, at 63 (statement of then-Chairman Cox).

SEC oversight of the PCAOB's implementation of internal control audits under Section 404 of the Sarbanes-Oxley Act, *see supra* p. 22, again illustrates the way the SEC exercises its authority. To gather information about implementation of Section 404, the SEC used its inspection authority to examine the PCAOB's process of inspecting registered accounting firms. 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." *Sarbanes-Oxley at Four*, at 63. 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." *Id.* at 24-25.

After the PCAOB adopted and the SEC approved the new standard for implementing Section 404, the SEC again continued its inspection and used that authority to monitor whether the PCAOB's inspections were conducted consistently with the SEC's expectations under the new rules.[18] As stated in its order approving the new standard, the Commission would continue to use its inspection authority to "carefully moni-

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[18] *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 (follow link).

tor[]" 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. Order Approving Proposed Auditing Standard No. 5, SEC Release No. 34-56152, at 9 (July 27, 2007).

D. SEC Power To Censure The Board Or Remove Its Members

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. 15 U.S.C. § 7217(d). 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. 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. *See* Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance* 698-702 (3d ed. 2003). 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. *See* Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and Nasdaq Market 50 n.111 (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).

As noted above, the SEC has even more power over the Board than the SROs. *See supra* pp. 15-16; *see also* Pritchard, *supra*, at 33 (SEC's authority to "direct[] and control" the PCAOB is "substantially more intrusive" than the authority it exercises with respect to 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 have no doubt that, should it choose, the SEC can dictate Board management.[19]

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[19] With respect to petitioners' argument that the Chairman rather than the Commission as a whole is the "Head" of the SEC within the meaning of the Appointments Clause, the former Chairmen note that, contrary to petitioners' assertion (Pet. Br. 61-62), the Chairman alone does not appoint the SEC's Division Heads and General Counsel. No appointment of major SEC personnel can be made unless the Commission approves the appointment, even when the Chairman has the power to initiate the process. Thus, as the Solicitor General correctly notes, even when the Chairman may initiate an appointment, that casts no doubt on the fact that the Commissioners collectively are the "Head" of the SEC for Appointments Clause purposes. *See* U.S. Br. 41-42 (citing

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Since the 1930s, financial regulation has been characterized by a unique set of public-private regulatory structures, with the SEC atop this system. In response to massive failures of accounting and auditing regulation, Congress created the PCAOB as the latest installment in the development of these structures, and subjected it to the SEC's plenary control to ensure effective and unified regulation of the accounting profession. The SEC's legal authority on paper to direct and supervise the PCAOB fully satisfies the Constitution's requirements. But the Commission's actual exercise of that authority in practice confirms that the Board is subject to the Commission's constant control and oversight in every facet of its operations—just as Congress intended. In this context, focusing on the SEC's power to remove Board members in isolation, as petitioners do, fundamentally misapprehends the legal powers the SEC wields over the Board and the practical effect of those powers. With or without at-will removal power, the SEC has effective authority over every action the Board might propose or take. Particularly in light of the unique, long-established history of financial regulation, petitioners' constitutional challenges are inconsistent with this Court's precedent, the powers of the SEC over the PCAOB, and the realities of the SEC-PCAOB relationship in practice.

Reorganization Plan No. 10 of 1950 § 1(b)(2), 5 U.S.C.A. App. 1, at 124 (2007)). Moreover, in the former Chairmen's decades of experience, the Chairman, even when authorized to initiate an appointment, routinely solicits input on possible candidates from the other Commissioners. No meaningful distinction exists, in practice, between whether the Chairman or the Commission has the formal power to initiate an appointment.

CONCLUSION

For the foregoing reasons, the decision below should be affirmed.

Respectfully submitted.

RICHARD H. PILDES
Counsel of Record
Vanderbilt Hall Room 507
40 Washington Square South
New York, N.Y. 10012
(212) 998-6377

CHRISTOPHER J. MEADE
WILMER CUTLER PICKERING
HALE AND DORR LLP
399 Park Avenue
New York, N.Y. 10022
(212) 230-8800

CATHERINE M.A. CARROLL
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 663-6000

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