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Free Enterprise Fund v. PCAOB: A Challenge to the Appointments Clause and its Ramifications to Corporate Governance

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In the aftermath of the Enron and WorldCom scandals, Congress passed the Sarbanes-Oxley Act of 2002, which established the Public Company Accounting Oversight Board (the "PCAOB") to protect investors in publicly traded companies and to promote fair, independent audits of such companies based upon auditing standards promulgated by the PCAOB. The PCAOB, whose members are appointed by the Securities and Exchange Commission (SEC), exercises investigatory and disciplinary powers in overseeing public company audits. My study examines (1) the pending United States Supreme Court case, Free Enterprise Fund v. PCAOB*, in which petitioners allege that vesting the appointment of the PCAOB in the SEC rather than in the President violates the U.S. Constitution's Appointments Clause by effectively removing the President's control over an independent agency and (2) the significant effects that the Supreme Court's ruling in the case will have on public companies and auditing firms by either confirming the PCAOB's investigatory and enforcement powers or invalidating a significant accounting and corporate governance reform.*

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I. Introduction

Independent agencies have become a well-known and integral part of the governmental framework in the United States. This "Fourth Branch" has become increasingly popular in the seventy years that have passed since the United States Supreme Court's seminal decision in *Humphrey's Executor v. United States* (1935), as evidenced by the growth in the number and authority of administrative agencies during and since the New Deal Era. The government-by-administrative-agency model has been further supplemented by industry self-regulation, as seen in the accounting industry. The *Free Enterprise Fund v. PCAOB* case that is examined in this paper presents a constitutional challenge to this schema. Many scholars have written about the U.S. Constitution's Appointments Clause, regulation by the Public Company Accounting Oversight Board (the "PCAOB") and independent agencies. This paper extends that scholarship by laying out the regulatory framework prior to and following the enactment by Congress of the Sarbanes-Oxley Act of 2002, analyzes the constitutional implications of the *Free Enterprise Fund* case, and identifies and explores several issues that may potentially arise from the Court's decision in the case.[1]

II. Background

This section will explore the creation of the regulatory framework for public companies and the accounting profession in use by the United States today. The Securities and Exchange Commission (the "SEC" or "Commission") is the independent agency charged with protecting investors and regulating the securities market in the United States.[2] Its roots trace back to the

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[1] There is a growing body of literature about the PCAOB. *E.g.*, Kimberly N. Brown, *Presidential Control of the Elite "Non-Agency,"* 88 N.C. L. REV. 101 (2010); Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and its Public/Private Status*, 80 NOTRE DAME L. REV. 975 (2005); Michael A. Thomason, Jr., *Auditing the PCAOB: A Test to the Accountability of the Uniquely Structured Regulator of Accountants*, 62 VAND. L. REV. 1952 (2009). This article examines the *Free Enterprise Fund* case now pending before the United States Supreme Court and the potential implications of the Court's decision in the case.
[2] Securities and Exchange Commission, What We Do, http://www.sec.gov/about/whatwedo.shtml

New Deal Era. The history of the Securities and Exchange Commission and auditing standards will be laid out to preface the current regulatory environment. Accounting scandals, such as those at Enron and WorldCom, precipitated the passage of the Sarbanes-Oxley Act of 2002 ("SOX"),[3] which has reformed corporate governance and accounting. Additionally, SOX created the PCAOB (or "Board"), which changed the regulatory environment for the auditors of public companies.

A. The Securities and Exchange Commission

The SEC is a disclosure-enforcing agency.[4] The SEC has broad jurisdiction and is charged with interpreting and enforcing the securities laws of the United States.[5] The federal securities laws and some related laws include: the Securities Act of 1933 (the "1933 Act"),[6] the Securities Exchange Act of 1934,[7] the Public Utility Holding Company Act of 1935,[8] the Trust Indenture Act of 1939,[9] Chapter X of the Bankruptcy Act of 1898, as added by the Chandler Act of 1938,[10] the Investment Company Act of 1940,[11] the Investment Advisers Act of 1940,[12] the Securities Investor Protection Act of 1970,[13] and the Sarbanes-Oxley Act,[14] all as amended.

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[3] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).
[4] JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 561 (rev. ed. 1995); *see* SUSAN M. PHILLIPS & J. RICHARD ZECHER, THE SEC AND THE PUBLIC INTEREST 27 (1981). "Full disclosure is based on a theory that investors will make more informed investment decisions if management is forced to disclose all 'material' information about its company." JERRY M. MARKHAM, A FINANCIAL HISTORY OF MODERN U.S. CORPORATE SCANDALS: FROM ENRON TO REFORM 143 (2006).
[5] The securities laws listed here are federal statutes. The United States is unique in that corporate law is primarily a state function. ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW (2 ed.) (2004).
[6] 15 U.S.C. § 77.
[7] 15 U.S.C. § 78.
[8] 15 U.S.C. § 79.
[9] 15 U.S.C. § 77aaa (publicly traded debt securities are issued only under an SEC-approved trust indenture with an appointed trustee).
[10] 52 Stat. 883 (1938) (SEC acts as an advisor to the courts or party in a bankruptcy proceeding); *see* Joseph L. Weiner, Special Counsel, Sec. & Exch. Comm'n, Address at United Federal Workers of America: Functions of the SEC Under the Chandler Act (Nov. 30, 1938).
[11] 15 U.S.C. § 80a-1-80a-52.
[12] 15 U.S.C. § 80b (in conjunction with Investment Company Act, *supra*, these two acts cover the registration and disclosure of investment companies and advisers and regulate these entities).
[13] 15 U.S.C. § 78aaa.

Generally, the 1933 and 1934 statutes require registration for any security that can be sold to the public and mandate corporate disclosure. These responsibilities are only a fraction of the mandate the SEC fulfills today.

1. The Creation of the Securities and Exchange Commission

Before the Great Depression, Wall Street was self-regulating. As the American legal historian Lawrence Friedman has noted,

> The New York Stock Exchange ran its own (private) system of securities regulation. Any company that wanted to list stock on the exchange had to file financial information, and provide [an] independent legal opinion, about the company and its securities. But companies could get around these requirements by registering stock on some other exchange. The New York Stock Exchange itself never had enough staff to double-check the information; many companies engaged in creative bookkeeping and accounting—which the stock exchange was powerless to detect.[15]

Subsequent to the 1929 stock market crash,[16] the United States government became interested in the regulation of Wall Street. Much of the initial focus under the Hoover administration centered on short-selling and curbing speculation.[17] Ferdinand Pecora, counsel to the Senate Banking and Currency Committee, however, spearheaded an investigation in 1933-1934 into the nation's financial institutions. In this investigation, hearings focusing on the National City Bank garnered much public attention. Bank executives had incorporated National City Company in 1911 to skirt existing banking restrictions aimed at dividing traditional commercial bank practices from riskier investment banking practices.[18] As a result of the Pecora investigation, public opinion toward bankers plummeted,[19] and newly inaugurated President

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[14] Sarbanes-Oxley Act, *supra* note 3.
[15] LAWRENCE M. FRIEDMAN, AMERICAN LAW IN THE TWENTIETH CENTURY 164 (2002).
[16] For a discussion of the 1929 crash, *see* JOHN KENNETH GALBRAITH, THE GREAT CRASH (50th anniv. ed., 1979) (1954).
[17] SELIGMAN, *supra* note 4, at 3, 5.
[18] *Id.* at 23-24. For an account of the Pecora hearings, see ARTHUR M. SCHLESINGER, JR., THE AGE OF ROOSEVELT: THE COMING OF THE NEW DEAL 434-439 (1959).
[19] *See id*. at 29.

Franklin D. Roosevelt furthered the rancorous attitude against financial institutions.[20] After expanding the Banking Committee's authority in its financial practices hearings,[21] Pecora brought J.P. Morgan and Company under scrutiny. This relentless investigation was the basis for the passage of the Banking Act of 1933,[22] and the Pecora hearings, as a whole, influenced the passage of the 1933 Act.[23] There was, however, much more to the creation and passage of the 1933 Act.

Prior to the passage of the final version of the 1933 Act, two versions had existed. The first, proposed by Samuel Untermyer at the request of Raymond Moley,[24] would have vested in the Postmaster General the authority to regulate stock exchanges, securities, and financial statements.[25] President Roosevelt, among others, was reluctant to have the Post Office Department oversee stock exchanges and accounting and created another team to draft a securities reform bill.[26] This new, second bill, drafted largely by Huston Thompson, a former

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[20] *See The Public Papers and Addresses of Franklin D. Roosevelt*, vol. 2, p. 12, *available at* http://quod.lib.umich.edu/cgi/t/text/text-idx?c=ppotpus&cc=ppotpus&type=bib&q1=roosevelt%2C+franklin&rgn1=author&Submit=Search.

[21] *See* N.Y. Times, Mar. 14, 1933, at 1.

[22] Glass-Steagall Act, Pub. L. No. 73-66, 48 Stat. 162 (1933); *see* SELIGMAN, *supra* note 4, at 38.

[23] Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933).

[24] SELIGMAN, *supra* note 4, at 51. Moley, an Assistant Secretary of State and former Barnard College professor at Columbia University, was an important, "[e]ssentially . . . conservative" member of Roosevelt's "Brain Trust" who later broke with FDR and became an opponent of New Deal reform. JAMES MACGREGOR BURNS, ROOSEVELT: THE LION AND THE FOX 153 (1956); FRANK FREIDEL, FRANKLIN D. ROOSEVELT: A RENDEZVOUS WITH DESTINY 59, 107, 201 (1990); WILLIAM E. LEUCHTENBURG, FRANKLIN D. ROOSEVELT AND THE NEW DEAL 1932–1940 at 32 (1963). Untermyer has been described as a "crotchety" lawyer who was "notable for his struggles on behalf of insurance company stockholders and against J. P. Morgan and the trusts." JONATHAN ALTER, THE DEFINING MOMENT: FDR'S HUNDRED DAYS AND THE TRIUMPH OF HOPE 278 (2006); FREIDEL, FDR, *supra*, at 19.

[25] R. MOLEY, AFTER SEVEN YEARS 177 (1939).

[26] SELIGMAN, *supra* note 4, at 52. The unorthodox administrative practice of giving his assistants overlapping assignments of the same task was a favorite of Roosevelt's. *See* ALTER, *supra* note 24, at 278; BURNS, *supra* note 24, at 371-374; FREIDEL, *supra*, note 24, at 84, 120-121; LEUCHTENBURG, *supra* note 24, at 328; SCHLESINGER, *supra* note 18, at 535 (new agencies created with jurisdictions that overlapped each other and spilled into cabinet departments). At the agency level, fierce internal conflicts occasionally resulted from the President's delegation of power "so loosely that bureaucrats found themselves entangled in lines of authority and stepping on one another's toes," but, as the historian James MacGregor Burns has observed,

> The main reason for Roosevelt's methods . . . involved a tenacious effort to keep control of the executive branch in the face of the centrifugal forces of the American political system. By establishing in an agency one power center that counteracted another, he made each official more

chairman of the Federal Trade Commission (the "FTC"), proposed giving power to the FTC to oversee securities regulation. As one student of the Roosevelt presidency has noted, "[t]he fundamental feature of the Thompson bill was disclosure, forbidding the sale of securities not registered with the FTC. The bill made no effort to analyze the quality of stock issues or to protect consumers from weak or fraudulent ones."[27] There were problems, however, with the Thompson bill as well, primarily centering on its proposal to expand the power of the FTC to rescind the registration of an issuer and its strict liability provisions.[28] Roosevelt agreed with the chairman of the House Committee on Interstate and Foreign Commerce, Rep. Sam Rayburn (D-TX), that the bill was overly burdensome and brought in yet a third drafting team.[29]

This team, led by Felix Frankfurter,[30] a proponent of "government-by-administrative-agency,"[31] swiftly prepared a securities reform bill that remedied the deficiencies of the Thompson proposal and that could pass. Frankfurter's proposal continued to utilize the FTC as the responsible securities regulatory agency and became known as the Landis-Cohen draft, after

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> dependent on White House support; the President in effect became the necessary ally and partner of each. He lessened bureaucratic tendencies toward self-aggrandizement; he curbed any attempt to gang up on him. He was, in effect, adapting the old method of divide and conquer to his own purposes.
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> The problem, from Roosevelt's standpoint, was one of power rather than of narrow efficiency. His technique was curiously like that of Joseph Stalin, who used the overlapping delegation of function, a close student of his methods has said, to prevent "any single chain of command from making major decisions without confronting other arms of the state's bureaucracy and thus bringing the issues into the open at a high level." Roosevelt, like Stalin, was a political administrator in the sense that his first concern was power—albeit for very different ends.

BURNS, *supra* note 24, at 371, 373.

[27] GEORGE MCJIMSEY, THE PRESIDENCY OF FRANKLIN DELANO ROOSEVELT 42 (2000).

[28] SELIGMAN, *supra* note 4, at 56.

[29] *Id.* Rayburn had "crusaded for tough securities regulation since his days as a young congressman under Woodrow Wilson." MCJIMSEY, *supra* note 27, at 41.

[30] Felix Frankfurter, a friend of Roosevelt's since the Wilson Administration, was a prolific faculty member at Harvard Law School who became a confidant of President Roosevelt's. For the lengthy relationship between Frankfurter and FDR, see ROOSEVELT AND FRANKFURTER: THEIR CORRESPONDENCE, 1928–1945 (Max Freedman annot., 1967). Frankfurter turned down Roosevelt's offer of an appointment as Solicitor General and was later appointed by Roosevelt to the United States Supreme Court in 1939. SELIGMAN, *supra* note 4, at 58.

[31] SELIGMAN, *supra* note 4, at 62.

Frankfurter's assistants, James M. Landis and Benjamin V. Cohen.[32] Their bill "broadened liability to underwriters, distributors, and brokers instead of concentrating it on corporation executives."[33] Congressman Rayburn introduced the Lanis-Cohen draft, and the measure quickly passed the House with little debate. The Senate, however, still preferred the Thompson proposal, and the two different bills ended up in a conference committee.[34] Ultimately, using the House version as its basis, the conference committee reached a compromise that both houses passed. As enacted, however, the Securities Act of 1933 designated the FTC as the authoritative body to regulate securities. [35] The new statute was, in a summary offered by Lawrence Friedman,

> in fact essentially a disclosure law. People who sold securities had to register them with the Federal Trade Commission. They had to disclose a wealth of information about the securities, the underwriters, and the issuing company, including balance sheets and profit-and-loss statements. Any prospectus dangled before the public also had to contain much of this information.[36]

The Securities Act of 1933 was controversial from its inception, and the process of revising the measure began almost immediately.

The stock exchanges, various Congressional committees, and even the Frankfurter team were involved in the revision process. By this time, Landis had been appointed to the FTC to administer the 1933 Act.[37] A version known as the Fletcher-Rayburn[38] bill was hotly debated and went through several amendments.[39] The most relevant to this discussion was an amendment in the Senate Banking Committee by Sen. Carter Glass (D-VA) to "replace the

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[32] Landis and Cohen, along with Thomas G. Corcoran, were selected by Frankfurter to assist in drafting the securities legislation. All were colleagues of Frankfurter's at Harvard Law School. SELIGMAN, *supra* note 4, at 61-63.

[33] MCJIMSEY, *supra* note 27, at 42.

[34] James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 41 (1959-1960).

[35] SELIGMAN, *supra* note 4, at 70.

[36] FRIEDMAN, *supra* note 15, at 164-165.

[37] Federal Trade Commission, Oral Histories, http://www.ftc.gov/ftc/history/oralhistory.shtm (last visited Mar. 15, 2010); SCHLESINGE, *supra* note 18, at 442.

[38] Congressman Rayburn, *supra*, and Sen. Duncan U. Fletcher (D-FL), chairman of the Senate Banking Committee, which had conducted the Pecora hearings.

[39] SELIGMAN, *supra* note 4, at 96-97.

Federal Trade Commission and Federal Reserve Board as enforcement agencies with a new three-person Securities Exchange Commission."[40] The rationale for transferring such enforcement power from the FTC and the Federal Reserve Board to the proposed SEC was addressed by Sen. Glass in a statement on the Senate floor in May of 1934 and in article by the senator that appeared in the *New York Times* in April of that year. In his remarks on the Senate floor, Sen. Glass noted:

> It ought to be borne in mind that the Federal Trade Commission was not picked by the President—for it is composed of a membership appointed by various Presidents—nor confirmed by the Senate with the idea of its being charged with the extremely complex and important duties which will devolve upon the special commission [the SEC] provided for by the pending bill. I doubt whether the members of the Federal Trade Commission know anything in the world about stock-exchange transactions, unless some one or more of them may have been stock speculators or brokers on the stock exchange.[41]

In the article that appeared in the *New York Times*, Sen. Glass wrote:

> . . . I very decidedly object to having the Federal Reserve System allied or aligned in any way with Stock Exchange transactions. The Federal Reserve Act textually prohibits the Federal Reserve Board from including Stock Exchange securities as collateral for rediscount at Federal Reserve Banks, and it was the original purpose of Congress, which has been maintained to this day, to keep the Federal Reserve System as far away from the Stock Exchange transactions as possible.
>
> The Federal Reserve Board has its hands full ordinarily to manage the credits of the commercial banks which are members of the system, and the attention of the board should not be diverted to other things which are foreign to commercial banking and with which the Federal Reserve Board is not supposed to have familiarity.
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> The same is true with respect to the Federal Trade Commission, the statutory functions of which have nothing to do with Stock Exchange transactions and the members of which are not supposed to have familiarity with such transactions.[42]

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[40] SELIGMAN, *supra* note 4, at 97.
[41] Remarks of Sen. Carter Class, U.S. Senate, 73d Cong., 2d Sess., May 8, 1934, 78 CONG. REC. 8,286 (1934). Apparently even the FTC's Landis favored a new enforcement agency. SCHLESINGER, NEW DEAL at 466.
[42] Carter Glass, *New Market Bill Praised by Glass*, N.Y. TIMES, Apr. 15, 1934, at N11. *See also Committee Trims the Exchange Bill*, N.Y. TIMES, Apr. 10, 1934, at 1.

Despite turmoil from Sen. Duncan Fletcher aimed at keeping the FTC as the regulatory agency, the Glass amendment took hold during the conference committee, and the Securities and Exchange Commission was created[43] as part of the final version of the Securities Exchange Act of 1934 (the "1934 Act").[44] The SEC was given jurisdiction over both the 1933 Act and the 1934 Act yet was provided with no clear mandate.

The SEC, which was comprised of five commissioners as equally divided between the two parties as possible appointed by the President and confirmed by the Senate, was largely the institution as it exists today. The chairman was to be selected from among the commissioners by the President. President Roosevelt's initial appointees to the SEC were the controversial Wall Streeter Joseph P. Kennedy, FTC Commissioners James Landis and George Matthews, FTC Chief Counsel Robert Healy, and Pecora. Though many had heralded Landis for the post,[45] Kennedy was chosen as the SEC's first chairman.[46] (See Appendix A for timeline of SEC chairmen.) The inaugural commissioners established organizational divisions, began promulgating opinions, and, perhaps most importantly, began registering and inspecting exchanges. In its first year, twenty-three hundred cases of potential securities fraud were investigated.[47] Efforts to "reassure capital" and restore the market were part of the "cooperative" policy that Chairman Kennedy established.[48]

Chairman Kennedy, realizing the detail-oriented tasks that lay ahead were better suited for lawyers, was ready to resign as of May 1935. The U.S. Supreme Court's decision in

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[43] SELIGMAN, *supra* note 4, at 99.
[44] Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934).
[45] SELIGMAN, *supra* note 4, at 101-106.
[46] Securities and Exchange Commission, SEC Historical Summary of Chairmen and Commissioners, http://www.sec.gov/about/sechistoricalsummary.htm (last visited Mar. 15, 2010). For the controversy surrounding Kennedy's appointment, see SCHLESINGER, *supra* note 18, at 467-469.
[47] Securities and Exchange Commission, First Annual Report, at 31 (June 30, 1935).
[48] Joseph Kennedy, Chairman, Securities and Exchange Commission, Address at National Press Club (July 25, 1934).

Schechter Poultry Corp v. United States (1935)[49] convinced Kennedy otherwise.[50] The Court struck down the National Industrial Recovery Act,[51] holding that it had effected an unconstitutional delegation of legislative authority. Since the Act had been part of the New Deal reform measures, other statutes were potentially at risk, including the securities acts. This fear was soon realized. After *Schechter*, J. Edward Jones, an oil securities dealer challenged the constitutionality of the 1933 Act. In 1936, a federal appeals court upheld the 1933 Act.[52]

Kennedy was re-elected chairman of the SEC in July 1935 but resigned in September of that year in part due to his opposition to the Roosevelt-sponsored Public Utility Holding Company Act of 1935 (the "Holding Company Act"). Commissioner James Landis took over as SEC chairman and spent the majority of his term involved in litigation regarding the Holding Company Act.[53]

2. The Securities and Exchange Commission Moving Forward

Landis left the SEC in 1937 to become Dean of Harvard Law School, and President Roosevelt appointed William O. Douglas[54] to become the third SEC chairman.[55] Douglas's tenure was an active one, and he simultaneously pursued numerous initiatives such as continuing efforts to reform over-the-counter markets and to establish SEC control under the provisions of the Holding Company Act. Douglas accentuated the SEC's position as the investor's advocate

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[49] Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935).
[50] Seligman, *supra*, note 4, at 121-122.
[51] The National Industrial Recovery Act was a piece of New Deal legislation enacted during President Franklin D. Roosevelt's first term. At issue in the *Schechter* case, *supra*, was the Live Poultry Code promulgated by the NIRA.
[52] SEC v. Jones, — F. 2d — (D.C. Cir. 1935), *reversed on other grounds*, Jones v. SEC, 298 U.S. 1 (1936); SELIGMAN, *supra* note 4, at 150-151. For a discussion of the *Jones* litigation see, note 367, *infra*.
[53] SELIGMAN, *supra* note 4, at 122-138.
[54] For Douglas's tenure at the SEC, see WILLIAM O. DOUGLAS, GO EAST, YOUNG MAN. THE EARLY YEARS: THE AUTOBIOGRAPHY OF WILLIAM O. DOUGLAS 257-293, 297-308 (1974); BRUCE ALLEN MURPHY, WILD BILL: THE LEGEND AND LIFE OF WILLIAM O. DOUGLAS 106-172 (2003). President Roosevelt appointed Douglas to the United States Supreme Court in 1939. MURPHY, *supra*, at 172-175.
[55] SELIGMAN, *supra* note 4, at 154.

and was quite adversarial in his actions.[56] For instance, a battle between Douglas and the New York Stock Exchange ensued during the crash of the late 1930s over Douglas's demands for reorganization of the Exchange, especially of the Exchange's Board of Governors, and for passage of trading rules. Douglas prevailed. Then in 1938, the National Association of Securities Dealers (NASD) was approved by the SEC as the over-the-counter market regulatory organization.[57]

After these accomplishments and continued frustration and work with the Holding Company Act, the SEC was then largely ignored by President Harry S. Truman and began a decline in the late 1940s.[58] President Dwight D. Eisenhower's strict fiscal policy was the next hurdle for the enforcement division of the SEC. Indeed, Joel Seligman writes that during the Eisenhower Administration, the SEC "reached its nadir" and that the SEC's "enforcement and policy-making capabilities were less effective than at any other period in its history."[59] Though the Hoover Commission an Organization of the Executive Branch of the Government identified a backlog of examinations and the SEC acknowledged the need for strengthening its enforcement activities, Eisenhower's efforts and the Korean War necessitated staffing cuts and contributed to a growing backlog of examinations.[60] The SEC did not even have a permanent home; its office

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[56] *Id*. at 157.
[57] *Id*. at 188.
[58] *See id*. at 241.
[59] *Id*. at 265.
[60] *Id*. at 267. There actually were two Hoover Commissions, one created in 1947 and a second established in 1953, both by acts of Congress. President Truman asked former President Herbert Hoover to chair the first (1947–1949), whose aim was to recommend ways for limiting expenditures within the Executive Department "to the lowest amount consistent with . . . efficient performance . . . eliminating duplication . . . consolidating services . . . abolishing services . . . not necessary; and defining and limiting executive functions." The second (1953–1955), also chaired by Hoover upon appointment by President Eisenhower, was supposed to recommend changes in social and economic policies. RONALD C. MOE, THE HOOVER COMMISSIONS REVISITED 1-4, 23-33, 81-90 (1982); DAVID BURNER, HERBERT HOOVER: A PUBLIC LIFE 336-337 (1979).

was moved to Philadelphia during World War II and then back to Washington, where it was stuck in a temporary building.[61]

It was not until the 1960s that the SEC was reinvigorated. President John F. Kennedy, the son of the first SEC head, even brought in former Chairman Landis to make a report on regulatory agencies, though no additional White House support was obtained.[62] William Cary was the SEC chairman during the initial years of this period. Interestingly, Cary had been both a student at Yale Law School and an SEC staff assistant to former Chairman Douglas. While similar in many respects, Cary's philosophy was different than that of the New Dealers, and Cary's leadership during the early 1960s was an integral part of the reinvigoration of the agency.[63] The Commission's *Special Study of the Securities Markets*, completed in 1963, was one of its most important and led to the 1964 Securities Act Amendments, among other changes.[64] These amendments were disclosure-oriented.[65] Upon securing the passage of these amendments, Cary resigned, and President Lyndon Johnson appointed Manuel Cohen as SEC chairman.[66]

Much of the SEC's next decade of work revolved around focusing increased attention on regulating stock exchanges and mutual funds. During the 1960s and 1970s, for instance, the securities industry experienced skyrocketing trading volumes and started to look at automating

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[61] JOHN C. GRAHAM, THE U.S. SECURITIES AND EXCHANGE COMMISSION: A RESEARCH AND INFORMATION GUIDE 7-8 (1993)

[62] *See* SELIGMAN, *supra* note 4, at 290-292. The Kennedy administration largely practiced "noninterference" with regard to the SEC. *See id*. at 293.

[63] *Id.* at 293-294.

[64] GRAHAM, *supra* note 61, at 8. *See* SELIGMAN, *supra* note 4, at 304-319 for a discussion of other changes. Many actions resulting from the *Special Study*, led by Milton Cohen, involved stock exchange reform, which is a topic beyond the scope of this paper.

[65] Hugh F. Owens, Commissioner, Securities and Exchange Commission, The Securities Act Amendments of 1964 Address at the Practising Law Institute (Oct. 16, 1964), *available at* SEC archives, http://www.sec.gov/news/speech/speecharchive/1964speech.shtml.

[66] SELIGMAN, *supra* note 4, at 348. Cohen had been at the Commission since 1942 and was highly regarded as an SEC attorney and commissioner. *See id*. at 356.

their systems.[67] However, under Cohen, the enforcement division of the Commission improved and reversed the dismal activity of the division during the 1950s.[68] Another issue that came toward the end of Cohen's tenure was the swell of conglomerate-mergers, which ultimately involved the SEC, Congress, the accounting profession, and even other federal agencies, all of which debated what standards and policies were best to discourage fraud but still promote business-friendly guidelines. This debate revealed the deficiencies of the SEC's regulation of accounting principles and emphasized the agency's primary focus on the overall securities industry.[69]

Exploring the balance of regulatory activism by the SEC continued into the Nixon presidency, especially since the first three chairmen selected by President Nixon were largely political appointees. Seligman has observed, "[a]s chairman, [Hamer] Budge attempted to reverse the activism of the later Cohen years."[70] Nixon's second chairman, William Casey, managed to land SEC budget and staffing increases but was still controversial and resigned early, as did his successor, G. Bradford Cook. Ultimately, Nixon improved his SEC appointment record by nominating Ray Garrett as chairman. Garrett and his colleagues made the SEC a vibrant agency again.[71] In 1975, for instance, the Garrett-led Commission even ended the decades-long deregulation debate regarding fixed commission rates with Rule 19b-3, which ended the use of fixed rates.[72]

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[67] *Id.* at 352-354.
[68] *Id.* at 360-363.
[69] *Id*. at 416-438.
[70] *Id*. at 441.
[71] *Id.* at 450.
[72] *Id*. at 483; *see* PHILLIPS & ZECHER, *supra* note 4, at 53-54. The NYSE, since its founding in 1792, had employed the use of fixed commission rates. *See* 3 JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES: FROM THE AGE OF DERIVATIVES INTO THE NEW MILLENNIUM (1970-2001) 29 (2002).

Major issues for the SEC between 1975 and 1981 included implementing technology into the securities industry and facilitating the development of a national market system.[73] Interestingly, corporate governance was not given much attention during this time period, and the Commission completed no special studies like those published earlier on other securities and corporate issues facing the SEC. However, progress on this front was made outside the SEC through a Harvard Business School study by Myles Mace, which was perhaps "the most influential academic work" regarding corporate boards and directors.[74] Furthermore, the Watergate Special Prosecution Force and SEC's Enforcement Division vigorously investigated corporate bribery cases and other improprieties. The Commission did not support new federal corporate governance legislation but did push additional voluntary disclosure and director independence measures up through the 1980s.[75] The SEC and its mandate have continued to evolve with the sustained growth of the market, the development of new financial instruments and risk management techniques, globalization, and the changing investor environment (*e.g.*, increasing number of institutional investors like public pension funds). Furthermore, the Commission has had to work alongside the exchanges (*e.g.*, NYSE) and other agencies (*e.g.*, Commodities Futures Trading Commission) as part of the exchange-side of the SEC mandate.[76]

Though the SEC generally has maintained what one commentator has deemed a reputation as "an outstanding example of the independent commission at its best,"[77] the sufficiency of the SEC's mandatory disclosure system has been questioned at times throughout the Commission's history. University of Rochester Professor George Benston hypothesized that "there was no value whatsoever to the mandatory disclosures required by the 1933 and 1934

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[73] *See* SELIGMAN, *supra* note 4, at 486-534.
[74] *Id.* at 537.
[75] *Id*. at 549-550.
[76] *See* SELIGMAN, *supra* note 4, 569-622.
[77] *Id*. at 568; *see* PHILLIPS & ZECHER, *supra* note 4, at 5.

Securities Acts."[78] Failures by the SEC during the financial crisis of 2008 have led to further questioning and criticisms of the SEC.[79] However, the ability of the SEC to maintain a strong disclosure environment lies within its enforcement authority. Legislation has expanded the remedial functions, administrative agency process, and legal action tools of the SEC.[80]

Today, the SEC exists largely as it did at its inception. The SEC has five commissioners and is a bipartisan independent agency. The Commission is charged with enforcing the federal securities laws and has significant rule-making authority. In summary, the SEC has been influenced by the political process, and the effects are evident in the cyclical nature of Commission activism. Though the SEC is an independent agency, the reality is that its commissioners are political appointees. The Commission's broad jurisdiction, however, has not always coincided with sufficient resources to adequately address every issue subject to the SEC's oversight. Therefore, the SEC largely became an overseer of industry self-regulation. Again, the SEC is a disclosure-enforcement agency, and the SEC is at the center of the federal securities laws' mission to effect "the remediation of information asymmetries."[81] The Commission is not in the business of judging or recommending securities offered to investors; rather, the SEC is responsible for protecting investors through requiring and monitoring disclosure from entities involved in the securities market.[82]

B. The Promulgation of Auditing Standards

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[78] SELIGMAN, *supra* note 4, at 563; *see* George Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 AM. ECON. REV. 132 (1973).

[79] *See*, *e.g.,* Michael R. Crittenden & Kara Scannell, *Report Says SEC Missed Many Shots at Stanford*, WALL ST. J., Apr. 17, 2010, *available at* http://online.wsj.com/article/SB10001424052702303491304575188220570802084.html?KEYWORDS=SEC+Missed+Shots; Ianthe J. Dugan & David Crawford, *Accounting Firms That Missed Fraud at Madoff May be Liable*, WALL ST. J., Feb. 18, 2009, at C1; Zachary A. Goldfarb, *SEC Faces Setbacks, Skepticism in Trying to Reform Its Enforcement Image*, WASH. POST., Apr. 6, 2010; Tom McGinty, *Staffer One Day, Opponent the Next*, WALL ST. J., Apr. 5, 2010, at C1; Kara Scannell, *SEC Moves to Fix Its Blind Spots*, WALL ST. J., Mar. 12, 2009, at C3.

[80] SELIGMAN, *supra* note 4, at 617-618, 621.

[81] *Id*. at 604.

[82] GRAHAM, *supra* note 61, at 6.

> *By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This* ***"public watchdog"*** *function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust. To insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations.*
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> — U.S. v. Arthur Young & Co., 465 U.S. 805, 817-818 (1984) (Burger, C.J.)

* * *

This section will discuss the background of auditing standards for public companies in the United States and will reveal the government's neglect for accounting standards. The promulgation of accounting principles and the SEC have interwoven histories. As Seligman has noted, "Kennedy and Landis had viewed accounting reform as subordinate in importance to capital flotation."[83] Moreover, Landis instructed the Commission's Chief Accountant, Carman Blough, not to develop "uniform or industry-wide accounting principles" but to, according to Seligman, merely "pur[sue] a policy of cooperation with the accounting profession."[84] SEC Chairman Douglas (1937-1939) also was unsuccessful in his efforts to change accounting policies during his tenure. During this same time, SEC studies on the topic proved to be ineffective, and the SEC's chief accountant claimed to not have the resources to develop a comprehensive accounting framework.[85] Moreover, even decades later, SEC Chief Accountant Andrew Barr was reluctant to engage the SEC's authority in the accounting standard-setting role except in limited cases.[86]

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[83] SELIGMAN, *supra* note 4, at 198.
[84] SELIGMAN, *supra* note 4, at 198-199.
[85] *Id*.
[86] *See* SELIGMAN, *supra* note 4, at 424-426 (*e.g.*, the "pooling versus purchase" method of accounting controversy in the 1960s-1970s).

Congress exhibited a similar sentiment. For instance, during 1933 hearings of the Senate Banking and Currency Committee, the testimony of Colonel Arthur H. Carter, President of the New York State Society of Certified Public Accountants, helped convince the legislators to rely on the industry's public auditors rather than on government auditors. Carter emphasized the importance of independent auditors. Unfamiliarity with auditing and a lack of interest in the topic on the part of senators is apparent from the hearing transcripts.[87] Not surprisingly, the accounting profession was self-regulated and promulgated accounting standards under the supervision of the SEC. The securities acts did little to define auditing standards but did put the topic on the table. Before Congress created the PCAOB, the SEC had relied upon private organizations affiliated with the accounting profession to set and enforce auditing standards:

> Accounting firms or their representatives controlled or funded those organizations. As a result, "standards tend[ed] to be written to protect the accounting firms." Enforcement was similarly ineffective. While the profession created a Public Oversight Board ("POB") in the 1970s to conduct "peer reviews," for more than 20 years "there ha[d] never been a negative review of a major firm." And when the POB sought to investigate several firms in 2000, the profession cut off its funding.[88]

For decades, the American Institute of Certified Public Accountants (AICPA) was the issuer of auditing standards, from which it is important to distinguish accounting standards (*i.e.*, financial reporting standards) which the Financial Accounting Standards Board (FASB) issues.[89] Both the SEC and AICPA recognize as authoritative the financial accounting standards

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[87] JEREMY WIESEN, THE SECURITIES ACTS AND INDEPENDENT AUDITORS: WHAT DID CONGRESS INTEND?: A RESEARCH STUDY 8, 28-29 (1978)

[88] Brief for PCAOB et al. at 2 (citations omitted). The profession was controlled at the time by the AICPA, which was the entity that actually created the POB.

[89] Financial Accounting Standards Board, http://www.fasb.org/home. The ACIPA was initially the American Association for Public Accountants, created in 1887. This organization became the American Institute of Accountants, which became the AICPA in 1957. The AICPA used its Committee on Accounting Procedure to formulate standards, but years of inactivity by that group followed by *Accounting Research Bulletins* that permitted deviation from the standards led the AICPA to create the Accounting Principles Board (APB) to promulgate accounting standards, which was later replaced with FASB in 1973 after controversy within the profession; *See* JOHN COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 130-133 (2006); SELIGMAN, *supra* note 4, at 420, 554.

promulgated by FASB. The AICPA Board of Directors is comprised of individuals from within the industry and the accounting profession.

With the passage of the Sarbanes-Oxley Act, the framework for developing and enforcing auditing standards for public companies changed. Self-regulation of the profession was to be no more. SOX created the PCAOB to oversee the auditors of public companies.[90] The PCAOB is charged with promulgating auditing and independence and ethics standards, which are subject to approval by the SEC.[91] Additionally, the PCAOB has inspection and enforcement authority over auditors of public companies. In April 2003, the PCAOB adopted auditing standards issued by the AICPA, effective as of April 16, 2003, as *Interim Auditing Standards*.[92] Note that the PCAOB does not oversee auditors of private entities, and the AICPA still promulgates standards for these audits.[93]

C. The Sarbanes-Oxley Act of 2002

The dot-com bust in the late 1990s and highly publicized scandals in the early 2000s led both the public and Congress to call for federal reform.[94] Most argued that legislation to restore investor confidence was needed. Growing skepticism of the thoroughness of accounting firm peer reviews and the self-regulated profession only exacerbated this desire for intervention.[95]

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[90] Sarbanes-Oxley Act § 101(a).
[91] *Id*. at § 101(c)-101(d).
[92] PCAOB History, http://pcaobus.org/About/History/Pages/History.aspx (last accessed March 15, 2010).
[93] Timothy J. Louwers, et al., Auditing & Assurance Services 36 (McGraw-Hill Irwin 2008) (2005). Despite the PCAOB only having authority over public companies, its professional standards have prompted states such as California to incorporate PCAOB rules in the state law applicable to all companies. *Id.* at 546.
[94] For more about Enron and other corporate scandals, see ENRON AND OTHER CORPORATE FIASCOS: THE CORPORATE SCANDAL READER (Nancy Rapoport, Jeffrey D. Van Niel & Bala G. Dharan eds., 2 ed. 2009); GOVERNANCE, RISK, AND COMPLIANCE HANDBOOK: TECHNOLOGY, FINANCE, ENVIRONMENTAL, AND INTERNATIONAL GUIDANCE AND BEST PRACTICES (Anthony Tarantino, ed., 2008); JERRY M. MARKHAM, A FINANCIAL HISTORY OF MODERN U.S. CORPORATE SCANDALS: FROM ENRON TO REFORM (2006); BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003); MALCOLM S. SALTER, INNOVATION CORRUPTED: THE ORIGINS AND LEGACY OF ENRON'S COLLAPSE (2008).
[95] As part of self-regulation, accounting firms used to engage in peer reviews. Generally, favorable reviews were issued. Concern grew over the thoroughness of this practice. See Brief for PCAOB, *supra* note 88.

The scandal and failures at Enron, in particular, motivated Congress to respond to these calls for reform, but it took the events at WorldCom to push SOX through quickly.[96]

Named after its sponsors, Senator Paul Sarbanes (D-MD) and Representative Michael Oxley (R-OH), SOX mandated significant financial reporting and corporate governance reform for public companies. Non-compliance with SOX can result in civil lawsuits against offending companies and in criminal punishment in the form of fines and incarceration for officers of those companies.[97]

1. Sarbanes-Oxley Titles with Short Description

The Sarbanes-Oxley Act is organized into eleven, discrete titles, as follows:

Title I – Public Company Accounting Oversight Board.

Title I establishes the PCAOB, which is charged with registering accounting firms that audit public companies. SOX vests in the PCAOB the authority to promulgate auditing standards and also provides inspection and enforcement authority over registered firms.

Title II – Auditor Independence

Sections in this Title mandate audit firm independence standards, such as partner rotation and reduction in conflicts of interest.

Title III – Corporate Responsibility

Title III requires that principal executive and financial officers (*e.g.*, CEOs, CFOs) of a company sign financial statements certifying that, to their knowledge, the statements contain no material omissions or misstatements. Claw-backs of certain bonuses and payments and insider trading prohibitions are also provided for in Title III.

Title IV – Enhanced Financial Disclosures

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[96] Mary-Jo Kranacher, *The Future of Sarbanes-Oxley: An Exclusive Interview with Former U.S. Senator Paul S. Sarbanes*, 78 THE CPA J. 16, 21(Oct. 2008); SALTER, supra note 94, at 247. Indeed, SOX passed in the Senate 99-0.
[97] GOVERNANCE, *supra* note 94, at 952.

Title IV establishes additional disclosures regarding management and material changes (real-time disclosure through use of the 8-K Form) and prohibits personal loans to executives from companies. Section 404 of SOX, in particular, requires assessment of internal controls both by management and auditors.

Title V – Analyst Conflicts of Interest

This short Title addresses conflicts of interest regarding analysts recommending securities in the exchanges.

Title VI – Commission Resources and Authority

Title VI's provisions deal with appropriations, appearance requirements before the Commission, and broker-dealer qualifications.

Title VII – Studies and Reports

Title VII mandates separate studies by the Comptroller General on the (1) consolidation of public accounting firms, and (2) earnings manipulation by investment banks; and by the Commission on (1) credit rating agencies, (2) violations by professionals, and (3) enforcement actions.

Title VIII – Corporate and Criminal Fraud Accountability

Title VIII reviews federal penalties and sentencing guidelines and provides whistleblower protection for employees of publicly traded companies. It also mandates the length of time audit firms have to retain workpapers.

Title IX – White-Collar Crime Penalty Enhancements

Title IX provides for the continued revision of federal penalties for corporate fraud.

Title X – Corporate Tax Returns

Title X provides that it is the "sense of the Senate that the Federal income tax return of a corporation should be signed by the chief executive officer."

Title XI – Corporate Fraud and Accountability

Title XI also addresses federal penalties for fraud and gives the Commission authority to bar persons from serving as directors or officers of publicly traded companies.

2. On-Going Issues with Sarbanes-Oxley

Most of the issues that have arisen from SOX are beyond the scope of this paper, except for any provisions relating to the constitutionality of the PCAOB. For instance, Section 404, which requires an evaluation of internal controls, has generated significant backlash from the business community.[98]

3. The Public Company Accounting Oversight Board

The PCAOB website states that:

> *the PCAOB is a private-sector, nonprofit corporation created by the Sarbanes-Oxley Act of 2002 to oversee the auditors of public companies in order to protect investors and the public interest by promoting informative, fair, and independent audit reports.*[99]

SOX charges the PCAOB with setting standards and rules for auditing, quality control, ethics, attestation, and independence. The PCAOB compels the registration of accounting firms that

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[98] Outside the PCAOB constitutionality issues, Section 404 has likely been the most controversial piece of SOX, as public companies have objected to the costs of compliance. *See* GOVERNANCE, *supra* note 94, at 911. The PCAOB's Auditing Standard No. 2 (AS2) was issued to cover Section 404 but was later superseded by AS5. *Id*. at 915; *see* PCAOB Standards, http://pcaobus.org/Standards/Auditing/Pages/default.aspx. *See* Letter from Big 4 Firms to Jonathan Katz, SEC Secretary (Apr. 11, 2005) (*available at* http://www.sec.gov/spotlight/soxcomp/soxcomp-all.pdf) (describing compliance costs and remediation of internal control deficiencies). Small public companies (under $75 million in market capitalization) are not yet subject to Section 404 but are thought to likely be subject to this requirement soon. Kranacher, *supra* note 96, at 18.

[99] About the PCAOB, see PCAOB, http://pcaobus.org/About/Pages/default.aspx

audit public companies and also has the authority to inspect these firms. Finally, the PCAOB is vested with investigatory and enforcement authority.[100]

The revenue-raising function of the PCAOB is unusual but not unprecedented. SOX requires that accounting firms pay registration fees, but the bulk of the PCAOB's revenue comes from SOX-mandated support fees paid by public companies.[101] There is a nearly one-hundred percent success rate in the collection of this support fee because, per PCAOB Rule 7103 (b), PCAOB-registered auditors are, absent a waiver, prohibited from signing a report unless their client has paid the fee.[102] Without a report, the company falls out of SEC compliance.[103] The PCAOB was so created to avoid the turnover problems characteristic of the SEC and other governmental agencies, as well as to be able to attract top staff, since the Board can pay higher salaries than the government.

Since adopting the *Interim Auditing Standards* in April 2003, the PCAOB has issued seven auditing standards:

AS No. 1: References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board

AS1 describes the adoption of the Interim Auditing Standards and provides that "reference to generally accepted auditing standards in auditor's reports was not longer appropriate or necessary."[104]

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[100] Sarbanes-Oxley Act §101.
[101] Accounting Support Fee, PCAOB, http://pcaobus.org/About/Ops/Pages/SupportFee.aspx.
[102] *Available at* http://pcaobus.org/Rules/PCAOBRules/Pages/Section_7.aspx.
[103] Joseph V. Carcello, Professor, University of Tennessee, Accounting 519 Class Lecture (Feb. 17, 2010).
[104] PCAOB Standard AS No. 1 § 5.

AS No. 2: An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements

AS2 superseded by AS5, effective May 2007. AS2 was the standard for audits over internal control, as required by SOX Section 404. "AS2 was far more expensive and far more intrusive than expected. It came out of a natural conservatism, post-Enron, and the manner in which it was implemented was far to intrusive,"[105] said Mark W. Olson, former PCAOB chairman.

AS No. 3: Audit Documentation

AS3 describes what documentation is required for audit procedures (*e.g.*, memoranda, confirmations, correspondence, schedules, audit programs, and letters of representation). This documentation must be accurate and conform to certain procedures provided by AS3. Audit workpapers must be kept for seven years, as provided by SOX.

AS No. 4: Reporting on Whether a Previously Reported Material Weakness Continues to Exist

AS4 applies during an engagement to report on whether a previously reported material weakness in internal controls over financial reporting still exists. The standard gives guidance for performing this engagement.

[105] Deborah J. Davidson, *Five Years of the PCAOB: Reflections on the Board*, 32 DIRECTORS MONTHLY 5, National Association of Corporate Directors (May 2008).

AS No. 5: An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements

AS5 supersedes AS2 and directs the auditor's assessment of management's report over internal controls (as required by SOX Section 404). This standard is less controversial than its predecessor.

AS No. 6: Evaluating Consistency of Financial Statements

AS6 pertains to consistency in financial statements and provides guidance on comparability, changes in accounting principle, correction of material misstatement, and changes in classification in financial statements.

AS No. 7: Engagement Quality Review

Each audit engagement is required to have a quality review. AS7 provides guidance for these reviews as well as the qualifications of the reviewers.

The PCAOB also promulgates rules on ethics and independence, has interim standards for other aspects of the audit, and provides guidance on compliance with the auditing standards.[106]

4. SEC Control over the PCAOB

During the legislative process that resulted in the enactment of SOX, Congress appears to have initially considered vesting the new regulatory responsibilities in the SEC itself but rejected that approach because the SEC was "'already overtaxed'" and thus could not "'effectively discharge these additional requirements.'"[107] Once it was decided to vest these duties in the PCAOB, Congress nonetheless recognized the need for extensive, comprehensive SEC supervisory control over the PCAOB both for constitutional reasons and to prevent duplication

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[106] PCAOB Standards *available at* http://pcaobus.org/Standards/Auditing/Pages/default.aspx.

[107] *See* Brief for PCAOB at 3.

of efforts. SOX imposes certain controls over the PCAOB by the SEC by providing that the SEC "shall have oversight and enforcement authority over the Board"[108] as follows:

(1) the SEC is empowered to set Board rules and procedures;[109]

(2) the SEC is empowered to approve the budget of the Board;[110]

(3) the SEC is empowered to approve the "reasonable annual accounting support fee (or a formula for the computation thereof)" established by the Board "as may be necessary or appropriate to establish and maintain the Board;"[111]

(4) the SEC is empowered to "enhance, modify, cancel, reduce, or require the remission of" any sanction imposed by the Board upon a registered public accounting firm or associated person thereof, if the Commission, "having due regard for the public interest and the protection of investors," finds that the sanction either is not necessary or appropriate in furtherance of this Act or the securities laws or is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed;[112]

(5) the SEC is empowered to review any action taken by the Board when a registered public accounting firm or any associated person thereof refuses to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation and when such action consists of (i) a suspension or bar of such person from being associated with a registered public accounting firm or a requirement that the registered public accounting firm end such association, (ii) a suspension or revocation of the registration of the public accounting firm; and (iii) such other lesser sanctions as the Board considers appropriate;[113]

(6) the SEC is empowered to conduct an interim review, at the request of a registered public accounting firm, of certain Board inspection determinations if such firm (i) has provided the Board with a response to the substance of particular items in a draft inspection report and disagrees with the assessments contained in any final report prepared by the Board following such response or (ii) disagrees with the determination of the Board that criticisms or defects identified in an inspection report have not been addressed to the satisfaction of the Board;[114]

(7) the SEC is empowered to limit or relieve the Board of its powers and to censure or impose limitations upon the activities, functions, and operations of the Board if the SEC finds that has violated or is unable to comply with any provision of SOX,

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[108] 15 U.S.C. § 7217(a).
[109] *Id*. at § 7217(b)(2) ("[n]o rule of the Board shall become effective without prior approval of the Commission").
[110] *Id*. at § 7219(b).
[111] *Id*. at § 7219(d)(1).
[112] *Id*. at § 7217(c)(3).
[113] *Id*. at § 7215(b)(3).
[114] *Id*. at § 7214(h)(1).

the rules of the Board, or the securities laws or, without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule or any professional standard by a registered public accounting firm or an associated person thereof;[115]

(8) the SEC is empowered to remove or censure any member of the Board who has willfully violated any provision of SOX, the rules of the Board, or the securities laws; has willfully abused the member's authority; or, without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule or any professional standard by any registered public accounting firm or any associated person thereof;[116]

(9) the SEC is empowered to amend and to "abrogate, add to, and delete from" the Board's rules "to assure the fair administration of the [Board], conform the rules promulgated by the Board to the requirements of Title I of SOX, or otherwise further the purposes of SOX, the securities laws, and the rules and regulations thereunder applicable to that Board;"[117]

(10) the SEC is empowered to review *de novo* all Board adjudications in the form of final disciplinary sanctions imposed by the Board upon an immediate stay when an application for review is filed or *sua sponte* by the SEC;[118]

(11) the SEC has the sole authority to determine whether the Board may sue and be sued in any court;[119] and

(12) the SEC is empowered to exempt any foreign public accounting firm or any class of such firms from any provision of SOX or the rules of the Board or the SEC issued under SOX.[120]

D. The PCAOB Challenged

The constitutionality of the PCAOB has been challenged in *Free Enterprise Fund v. Public Company Accounting Oversight Board* ("*Free Enterprise Fund* case").[121] At the center of this challenge is the United States Constitution's Appointments Clause and separation-of-powers

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115 *Id*. at § 7217(d)(1)-(2).
116 *Id*. at §§ 7217(d)(3), 7211(c)(6).
117 *Id*. at § 7217(b)(5); *see id.* at § 78s(c).
118 *Id*. at § 7217(c)(2); Free Enter. Fund v. Pub. Co. Accounting Oversight Bd. (*PCAOB II*), 537 F. 3d 667, 670 (2008).
119 15 U.S.C. § 7211(f)(1).
120 15 U.S.C. § 7216(c).
121 Free Enter. Fund v. Pub. Com. Accounting Oversight Bd., 537 F. 3d 667 (D.C. Cir. 2008) (hereinafter *PCAOB II*). The United States Supreme Court granted certiorari, and oral arguments were heard Dec. 7, 2009. *See* Free Enter. Fund v. PCAOB, Docket No. 08-861at http://www.supremecourt.gov/oral_arguments/argument_ transcripts.aspx. The decision is expected in the spring or summer of 2010.

principles. The petitioners allege that vesting the appointment of the members of the PCAOB in the SEC violates the Appointments Clause and separation-of-powers principles and thus is unconstitutional. A federal district court granted summary judgment in favor of the PCAOB, and a federal appellate court affirmed. The plaintiffs appealed these adverse rulings to the United States Supreme Court, where a decision is pending.

III. The Legal Issues

A. The Legal Issues—Background and Overview

The primary legal issues raised by the PCAOB appeal now pending in the Supreme Court arise under the Appointments Clause of Article II of the United States Constitution and under the separation-of-powers provisions of the Constitution, but the case also poses potentially significant collateral legal issues concerning the political accountability of the President for the actions taken by independent agencies within the government and the ultimate burden of persuasion in a case in which the plaintiffs assert a facial challenge, as opposed to an as-applied challenge, to the constitutionality of an act of Congress.

B. The Appointments Clause Issues

The Appointments Clause refers to Article II, Section 2 of the United States Constitution, which provides in pertinent part as follows:

> [The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.[122]

As the Supreme Court has long recognized, the Appointments Clause is

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[122] U.S. CONST. art. II, § 2.

> more than a matter of "etiquette or protocol"; it is among the significant structural safeguards of the constitutional scheme. By vesting the President with the exclusive power to select the principal (noninferior) officers of the United States, the Appointments Clause prevents congressional encroachment upon the Executive and Judicial Branches.[123]

The latter provision of the Appointments Clause, which is sometimes referred to as the "Excepting Clause," was "added to the proposed Constitution on the last day of the Grand Convention, with little discussion. . . . [and] its obvious purpose is administrative convenience."[124]

For purposes of appointment, Supreme Court has declared, the Constitution "very clearly divides all its officers into two classes": first, principal officers of the United States who are appointed by the President and confirmed by the Senate and, second, inferior officers whose appointment is vested in the President alone, in the courts of law, or in the heads of departments.[125] As the Supreme Court has noted on several occasions, "The line between 'inferior' and 'principal' officers is one that is far from clear, and the Framers provided little guidance into where it should be drawn."[126]

Several factors are pertinent in determining whether one is a principal or inferior officer: (1) whether the officer is subject to removal by a higher official within the Executive Branch, (2) whether the officer's duties are limited, (3) whether the officer's jurisdiction is narrow, and (4) whether the officer's tenure is limited.[127] Although the Supreme Court's decisions have not established exclusive criteria for distinguishing between principal and inferior officers for purposes of the Appointments Clause, the Court has found that the following governmental positions constitute those of inferior officers: judges of the Coast Guard Court of Criminal

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[123] Edmond v. United States, 520 U.S. 651, 659 (1997).
[124] *Id*. at 660.
[125] United States v. Germaine, 99 U.S. 508, 509-510 (1878); *see* Buckley v. Valeo, 424 U.S. 1, 132 (1976).
[126] Morrison v. Olson, 487 U.S. 654, 671 (1988).
[127] *Id*. at 671-672; *see Edmond*, 520 U.S. at 661.

Appeals,[128] a special trial judge appointed to assist the United States Tax Court,[129] an independent counsel created by provisions of the Ethics in Government Act of 1978,[130] a United States commissioner in federal district court proceedings,[131] a federal district court clerk,[132] a vice consul charged temporarily with duties of the consul,[133] and a federal election supervisor.[134] "Generally speaking," the Court has observed,

> the term "inferior officer" connotes a relationship with some higher ranking officer or officers below the President: Whether one is an "inferior" officer depends on whether he has a superior. . . . [I]n the context of a Clause designed to preserve political accountability relative to important Government assignments, we think it evident that "inferior officers" are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate.[135]

"What is significant," the Court has concluded, "is that [inferior officers] have no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers."[136]

In addition, certain governmental appointees are merely employees and not officers of the United States at all and thus are not subject to the provisions of the Appointments Clause. Among the factors considered in determining whether such an appointee is an officer of the federal government are the appointee's tenure, the duration of that tenure, the appointee's compensation, and the nature and duration of his or her duties.[137] When the appointee's duties are occasional or temporary as opposed to continuing and permanent and when no regular

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[128] *Edmond*, 520 U.S. at 666.
[129] Freytag v. Commissioner, 501 U.S. 868, --- (1991).
[130] *Morrison*, 487 U.S. at 671.
[131] Go Bart Importing Co. v. United States, 282 U.S. 344, 352-354 (1931).
[132] Ex parte Hennen, 38 U.S. (13 Pet.) 230, 258 (1839).
[133] United States v. Eaton, 169 U.S. 331, 343 (1898).
[134] Ex parte Siebold, 100 U.S. 371, 397-398 (1880).
[135] *Edmond*, 520 U.S. at 662, 663.
[136] *Id*. at 665. *Accord* Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 537 F.3d 667, 672 (D.C. Cir. 2008).
[137] *See* United States v. Germaine, 99 U.S. at 509-512.

appropriation is made for the appointee's compensation, the appointee might be determined to be a governmental employee rather than an officer of the government.[138]

Other than in Article II, Section 4, which provides for the removal of the President and Vice President and all civil officers of the United States by impeachment for high crimes and misdemeanors, the Constitution does not contain any provision for the removal from office of officers of the United States. "The subject," the Supreme Court has noted, "was not discussed in the Constitutional Convention,"[139] and there has since remained an extended controversy about whether administrative officers—*i.e.*, officers of administrative agencies within the Executive Branch and those of administrative agencies whose functions and powers are intended to be independent of the Executive Branch—may be removed in the President's sole discretion or whether Congress may play a role in such removals or limit the President's power to remove such officers. The positions of the respective sides to the controversy have been described as follows:

> The argument supporting presidential discretion holds that the chief executive must be free to remove those subordinates who fail to meet the president's expectations or who are not loyal to the administration's policy objectives. It would be unreasonable to require the approval of Congress before such officials could be dismissed. Such a requirement might well paralyze the executive branch, particularly when the legislature and the presidency are under the control of different political parties.
>
> The argument for legislative participation in the [removal] process holds that the Constitution anticipates Senate action. If the president can appoint major executive department officials only with senatorial approval, it is reasonable to infer that the chief executive can remove administrators only by going through the same process and obtaining the advice and consent of the Senate.[140]

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[138] *See id.*
[139] Myers v. United States, 272 U.S. 52, 109-110 (1926).
[140] LEE EPSTEIN & THOMAS G. WALKER, CONSTITUTIONAL LAW FOR A CHANGING AMERICA: INSTITUTIONAL POWERS AND CONTRAINTS 228-229 (6th ed. 2007).

1. Myers v. United States

Myers v. United States[141] involved the removal of a postmaster on order by the President of the United States. An 1876 act of Congress gave the President the authority to appointment postmasters by and with the advice and consent of the Senate. Pursuant to the statute, President Woodrow Wilson appointed Frank Myers as a first-class postmaster of Portland, Oregon, in 1917. The term of his appointment was for four years. In 1920, Wilson asked Myers to resign. Myers refused, and, acting under Wilson's orders, the Postmaster General fired Myers. Myers filed suit in the U.S. Court of Claims for his salary from the date of his removal. The Court of Claims ruled against Myers,[142] who appealed his case to the Supreme Court of the United States.

Chief Justice William Howard Taft[143] delivered the opinion of the Court. Providing a tedious account of the legislative deliberations of the First Congress regarding the debate over the President's appointment power,[144] the Chief Justice wrote:

> The history of the clause by which the Senate was given a check upon the President's power of appointment makes it clear that it was not prompted by any desire to limit removals…[Rather, it] was to lodge in the Senate…power to prevent the President from making too many appointments from the larger States.[145]

It is important to point out that Article II, Section 1 of the Constitution vests the executive power of the government in the President (the "Vesting Clause") and that Section 3 of Article II provides that "he shall take care that the laws be faithfully executed" (the "Take Care

[141] Myers v. United States, 272 U.S. 52 (1926)
[142] *Id*. at 106-107.
[143] William Howard Taft served as President of the United States from 1909-1913. He was later appointed by President Warren G. Harding as Chief Justice of the United States. He served on the Supreme Court from 1921 to just before his death in 1930. *See* White House, http://www.whitehouse.gov/ about/presidents/williamhowardtaft.
[144] *Myers*, 272 U.S. at 106-133 (1926). Justice Oliver Wendell Holmes, Jr. and Louis D. Brandeis filed dissenting opinions. Justice James McReynolds filed a separate opinion. The *Myers* opinions took up 243 pages of the volume of *United States Reports* in which they were printed.
[145] *Id*. at 119-120 .

Clause"),[146] both of which suggest that the president should of necessity be able to select and remove officers acting under his direction. Such was the conclusion that had been reached by the Court in *Shurtleff v. United States*,[147] a case involving President William McKinley's removal from office of a general appraiser of merchandise who had been appointed by McKinley's predecessor. In *Shurtleff*, the Court held that the President has the constitutional authority to remove officers even if they were appointed by and with the advice and consent of the Senate. Furthermore, the consent (or rejection) of an appointment by the Senate is different than the ability to prevent the removal of an officer. As Chief Justice Taft wrote:

> The power of removal is incident to the power of appointment, not to the power of advising and consenting to appointment, and when the grant of the executive power is enforced by the express mandate to take care that the laws be faithfully executed, it emphasizes the necessity of including within the executive power as conferred the exclusive power of removal.[148]

"The power to remove officers, we have recognized, is a powerful tool for control." Thus wrote Justice Antonin Scalia in his opinion in 1997 for the Court in *Edmond v. United States*.[149] More than seven decades earlier, the Court in *Myers* concluded that the Appointments Clause "give[s] to Congress the power to limit and regulate removal of such inferior officers by heads of departments when it exercises its constitutional power to lodge the power of appointment with them":[150]

> Congress, in committing the appointment of such inferior officers to the heads of departments, may prescribe incidental regulations controlling and restricting the latter in the exercise of the power of removal.[151]

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[146] U.S. CONST. art. II, §§ 1, 3.
[147] Shurtleff v. United States, 189 U.S. 311 (1903).
[148] Myers v. United States, 272 U.S. 52, 122 (1926).
[149] Edmond v. United States, 520 U.S. at 664 (Scalia, J.) (*citing* Myers v. United States, 272 U. S. 52 (1926), and Bowsher v. Synar, 478 U. S. at 727).
[150] *Myers*, 272 U.S. at 127. *Accord*, Free Enterprise Fund v. Public Company Accounting Oversight Board, 537 F.3d 667, 674 (D.C. Cir. 2008).
[151] *Myers*, 272 U.S. at 161. " But the Court has never held," Chief Justice Taft continued, "nor reasonably could hold, . . . that the excepting clause enables Congress to draw to itself, or to either branch of it, the power to remove or the right to participate in the exercise of that power." *Id*. at 164.

The authority for the *Myers* Court's conclusion came from the Court's earlier decision in *United States v. Perkins*,[152] which recited with approval the following passage from the opinion of the Court of Claims that was then under review:

> We have no doubt that when congress, by law, vests the appointment of inferior officers in the heads of departments, it may limit and restrict the power of removal as it deems best for the public interest. The constitutional authority in congress to thus vest the appointment implies authority to limit, restrict, and regulate the removal by such laws as congress may enact in relation to the officers so appointed.[153]

Ultimately, the Supreme Court thus affirmed the Court of Claims' judgment against Myers. The Chief Justice wrote, "[the Court] must therefore hold that the provision of the law of 1876, by which the unrestricted power of removal of first class postmasters is denied to the President, is in violation of the Constitution, and invalid."[154] In effect, the Court held that Congress cannot limit the President's removal power.

2. *Humphrey's Executor v. United States*

Less than a decade later, in 1935, the Court decided *Humphrey's Executor v. United States*,[155] which characterized much of Chief Justice Taft's opinion in *Myers* as dicta (and thus not binding) and confined *Myers* to presidential removal of officers within the Executive Branch. President Herbert Hoover had appointed William Humphrey to the Federal Trade Commission in 1931. Humphrey's appointment was for a seven-year term, which was scheduled to expire in 1938. Under the provisions of the Federal Trade Commission Act, FTC commissioners could be removed from office by the President "for inefficiency, neglect of duty, or malfeasance in

[152] United States v. Perkins, 116 U.S. 483 (1886).
[153] *Id*. at 485.
[154] *Myers*, 272 U.S. at 176.
[155] Humphrey's Executor v. United States, 295 U.S. 602 (1935).

office."[156] However, in 1933, President Roosevelt asked for Humphrey's resignation due to their differences regarding policy and the FTC. Humphrey declined, and Roosevelt sent correspondence effectively removing him from the FTC. Humphrey filed suit in the U.S. Court of Claims, seeking an award of compensation for the period of service from the date of his discharge through the end of his statutory term. The Court of Claims certified two questions to the Supreme Court:[157] (1) Does the FTC Act's provision that "any commissioner may be removed by the President for inefficiency, neglect of duty, or malfeasance in office" limit the President's removal authority to these causes only and (2) if so, is such a restriction constitutional?[158] The government drew on *Shurtleff*, but the Court distinguished the appointment of an FTC Commissioner as involving a fixed term whereas the potentially unlimited appointment in *Shurtleff* had not.[159] This creative interpretation allowed the Court to ignore the precedent established by *Shurtleff*. Removal power thus was limited by the Court in *Humphrey's Executor* to facilitate the independence of the FTC, and, hence, the first question was answered in the affirmative.[160] Faced with the second question, the Court yet again distinguished precedent and limited *Myers* to having only "decided…that the President has power to remove a postmaster of the first class without the advice and consent of the Senate."[161] This narrow reading plus "putting aside [the] dicta"[162] of *Myers* meant to the Court that its earlier decision had pertained only to "purely executive officers."[163] The FTC, however, the Court

[156] Federal Trade Commission Act, 15 U.S.C. § 41.
[157] Certification is the procedure used by a federal court of appeals (and, throughout most of the twentieth century, the U.S. Court of Claims) to certify to the Supreme Court for binding instructions concerning questions of law that are at issue in a case and about which the lower court entertains doubt. Tinsley Yarbrough, *Certification*, *in* THE OXFORD COMPANION TO THE SUPREME COURT OF THE UNITED STATES 153-154 (Kermit L. Hall ed., 2d ed. 2005).
[158] *Humphrey's Executor*, 295 U.S. at 619.
[159] *Id*.
[160] *Id*. at 621.
[161] *Id.* at 626.
[162] *Id*. at 627.
[163] *Id*. at 628.

found, "acts in part *quasi*-legislatively and in part *quasi*-judicially,"[164] and, hence, an administrative agency acting in this manner is not solely Executive in nature. Furthermore, ensuring that agencies like the FTC function independently and maintaining fidelity to the separation-of-powers principle demand that the President's removal authority be limited to "for cause" pursuant to the statute. Thus, the second certified question was answered by the Court in the affirmative.

The Court's unanimous decision in *Humphrey's Executor* relied on a functions analysis. Was the FTC not, however, carrying out the laws of the United States, thus rendering it an arm of the President as it relates to the Take Care Clause? Regardless, the case effected a change in thinking about the Appointments Clause that remains a central feature of the analysis used in current Appointments Clause cases. There was no dissenting opinion in the case.

3. Wiener v. United States

Scarcely more than a quarter of a century later, in 1958, the Court in *Wiener v. United States*[165] reaffirmed the principles that had been announced in *Humphrey's Executor*. At issue in *Weiner* was whether the President had the constitutional or statutory power to remove from office a member of the War Claims Commission (the "WCC"), a body that had been created by Congress in the War Claims Act of 1948 to receive, consider, and adjudicate claims for the compensation of individuals who had sustained injuries at the hands of enemies of the United States during World War II. The statute provided that the WCC was to be comprised of three members who were to be appointed by the President by and with the consent of the Senate and that the decisions of the WCC were to be final and "not subject to review by any other official of the United States or by any court." Each commission member was to serve a term that ended

[164] *Id*.
[165] Wiener v. United States, 357 U.S. 349 (1958).

when the WCC had finalized its responsibilities and gone out of existence. The War Claims Act contained no provisions addressing how and under what circumstances a WCC commissioner might be removed from office prior to the completion of the commission's work.

In June of 1950, President Harry S. Truman appointed Myron Wiener to the WCC, and shortly thereafter, Wiener's appointment was confirmed by the Senate. When President Truman's successor, Dwight D. Eisenhower, took office, he wished to replace the WCC's commissioners with members of his own selection. When President Eisenhower asked for the resignations of the incumbent WCC commissioners, however, they refused. In December of 1953, the President ordered them dismissed and made recess appointments to the WCC. When Congress assembled in January of 1954, the President sent the names of the new appointees to the Senate for confirmation, but the Senate had not confirmed the President's nominations when the WCC was abolished by statute later in 1954. Wiener thereafter filed a petition with the U.S. Court of Claims, seeking payment of his salary as a WCC commissioner from the date of his removal from office by the President in late 1953 through the last day of the WCC's existence in 1954. A divided Court of Claims dismissed the petition, and Wiener appealed the adverse decision to the Supreme Court.[166]

A unanimous Supreme Court reversed. Declaring in his opinion for the Court that the case presented "a variant of the constitutional issue decided in *Humphrey's Executor*," Justice Frankfurter reiterated that the Court in *Humphrey's Executor* had narrowly confined the scope of the *Myers* decision to include only "'all purely executive officers'" and had explicitly disapproved the dictum in *Myers* that the President has the inherent constitutional power to remove members of a quasi-judicial bodies:

[166] *Id*. at 350-351.

> The assumption was short-lived that the *Myers* case recognized the President's inherent constitutional power to remove officials, no matter what the relation of the executive to the discharge of their duties and no matter what restrictions Congress may have imposed regarding the nature of their tenure.[167]

"[T]he most reliable factor for drawing an inference regarding the President's power of removal in [this] case," Frankfurter wrote, thus "is the nature of the function that Congress vested in the War Claims Commission."[168] Characterizing that function as adjudicatory or quasi-judicial in nature and noting that the WCC's determinations were final and not reviewable by any court, Frankfurter concluded that the WCC—like the FTC in *Humphrey's Executor*—had been intended by Congress to be "'entirely free from the control or coercive influence, direct or indirect,'" of either the President or the Congress.[169] Then, finding that "[t]he ground of President Eisenhower's removal of [Wiener from the WCC] was precisely the same as President Roosevelt's removal of Humphrey [from the FTC]" and that Wiener as a WCC commissioner had not exercised any purely executive powers, the Court concluded that just as the Court in *Humphrey's Executor* had determined that no power to remove such an official is given to the President directly by the Constitution and that none is impliedly conferred upon him by statute, so, too, the Court in this case was compelled to conclude that the President had no such removal power even when, as here, Congress had said nothing in the War Claims Act about how and under what circumstances a WCC commissioner might be removed before the expiration of his tenure in office. "The philosophy of *Humphrey's Executor*, in its explicit language as well as its implications," Justice Frankfurter wrote, "precludes such a claim."[170]

[167] *Id*. at 352.
[168] *Id*. at 353.
[169] *Id*. at 355-356.
[170] *Id*. at 354, 356.

By re-affirming the principles announced in *Humphrey's Executor* the Court in *Wiener* thus "brought an authoritative end to questions regarding the extent of the [P]resident's power to remove officeholders at his discretion alone."[171]

4. *Buckley v. Valeo*

Buckley v. Valeo[172] dealt with the constitutionality of several provisions of the 1974 amendments to the Federal Election Campaign Act of 1971 (as amended, the "FEC Act"),[173] which created the Federal Election Commission (the "FEC"). Under the FEC Act, the FEC was to be comprised of eight (8) members selected as follows: two (2) non-voting members selected by the secretary of the Senate and the clerk of the House of Representatives; and six (6) voting members, to be confirmed by both the House of Representatives and Senate, comprised of two (2) appointed by the president *pro tempore* of the Senate, two (2) appointed by the Speaker of the House, and two (2) appointed by the President of the United States.[174] The statute vested the FEC with broad authority. The commission, for instance, had rulemaking and adjudicative powers and served as a clearinghouse for information regarding federal elections. The FEC's adjudicative authority included the power to pursue civil legal actions to enforce and implement the FEC Act.[175]

The Court, in its per curiam opinion, broke down the FEC's authority into three categories, as follows: (1) flow of information (receipt, dissemination and investigation); (2) fleshing out the statute (rulemaking); and (3) compliance (informal procedures and civil suits).[176]

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[171] EPSTEIN & WALKER, *supra* note 140, at 239.
[172] Buckley v. Valeo, 424 U.S. 1 (1976).
[173] Federal Election Campaign Act, Pub. L. No. 92-225, 86 Stat. 3 (1972).
[174] *Id.*
[175] *Buckley*, 424 U.S at 109.
[176] *Id*. at 137.

The Court concluded that the functions comprising the first category, largely informative and investigatory, were justified but that those in the third category, enforcement, were not. The Court held that the enforcement power of the FEC clearly violated the Appointments Clause because these were functions that should be carried out by "Officers of the United States."[177] "[A]ny appointee exercising significant authority pursuant to the laws of the United States is an 'Officer of the United States,'" the Court concluded, "and must, therefore, be appointed in the manner prescribed by § 2, cl. 2, of ... Article [II]."[178] Relying upon *Myers* and *Ex parte Hennen*,[179] the Court concluded that FEC commissioners must be "at the very least, such 'inferior officers' within the meaning of that Clause."[180] With regard to appointment, two classes of officers exist,[181] and "[u]nless…elsewhere provided for, *all* officers of the United States are to be appointed in accordance with the [Appointments] Clause."[182] Even faced with its earlier decision in *Humphrey's Executor*, the Court reiterated its view that, even when agencies are clearly intended by Congress to be independent of executive authority, "the members of [such] independent agencies are not independent of the Executive with respect to their appointments."[183]

5. *Morrison v. Olson*

Morrison v. Olson[184] provides yet another approach to the Appointments Clause. At issue in *Morrison* were the independent-counsel provisions of the Ethics in Government Act of

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[177] *Id*. at 141.
[178] *Id*. at 126.
[179] Ex parte Hennen, 38 U.S. (13 Pet.) 230 (1839).
[180] *Buckley*, 424 U.S. at 126.
[181] *See* United States v. Germaine, 99 U.S. 508, 509-510 (1879).
[182] *Buckley*, 424 U.S. at 132.
[183] *Id*. at 133. *See* Wiener v. United States, 357 U.S. 349 (1958) (applied *Humphrey's* to the War Claims Commission, so the president could not remove members from this independent group at will).
[184] Morrison v. Olson, 487 U.S. 654 (1988).

1978 (from time to time referred to as the "EGA"),[185] which created an independent counsel to investigate and prosecute high-ranking Executive Branch officials for federal criminal violations. The EGA provided for the appointment by a special judicial panel (the "Special Division") of an independent counsel upon a preliminary investigation by the Attorney General and after a determination by the Attorney General that such an appointment was warranted. The EGA vested in the independent counsel the "full power and independent authority to exercise all investigative and prosecutorial functions and powers of the Department of Justice, the Attorney General, and any other officer or employee of the Department of Justice."[186] Congress retained no control over the independent counsel other than providing for periodic reports on his or her activities to be submitted to Congress and retaining the ultimate authority to impeach and remove him or her from office upon conviction. The independent counsel could be removed, short of impeachment, in two ways: (1) by the Attorney General "for cause" and (2) upon the completion of the independent counsel's investigation. The Court of Appeals invalidated the Ethics in Government Act on various constitutional grounds, and the Supreme Court agreed to review the case.[187]

The Supreme Court's opinion in *Morrison*, written by Chief Justice William Rehnquist, examined several issues. First, the Court concluded that the independent counsel was an "inferior officer" for purposes of the Appointments Clause based upon consideration of the following factors: (1) the independent counsel could be removed by a higher Executive Branch official, (2) the independent counsel performed limited duties, (3) the jurisdiction of the independent counsel was limited, and (4) the tenure of the independent counsel was limited. The Court made this determination, however, without defining what constitutes an "inferior officer"

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[185] Ethics in Government Act, 28 U.S.C. §§ 591-599.
[186] *Id*. at § 594 (a).
[187] *See* In re Sealed Case, 267 U.S. App. D.C. 178.

or a "principal officer" and without clearly delineating how one is distinguishable from the other.[188]

A second issue in *Morrison* was whether the EGA's providing for the interbranch appointment of the independent counsel by the special panel of federal judges violated the Excepting Clause of the Appointments Clause. The Court initially noted that the Excepting Clause does not, on its face, prohibit interbranch appointments. Moreover, by including the clause "as they think proper" in the Excepting Clause, the framers of Article II seemed "clearly to give Congress significant discretion to determine whether it is 'proper' to vest the appointment of . . . executive officials in the 'courts of law.'" Ultimately, therefore, the Court held that interbranch appointments are allowable under the Excepting Clause and that vesting authority for the appointment of the independent counsel in the Special Division was permissible.[189]

6. *Freytag v. Commissioner*

Another major relevant case in the construction of the Excepting Clause portion of the Appointments Clause is *Freytag v. Commissioner*,[190] in which the constitutionality of a congressional statutory provision authorizing the appointment of a special trial judge (formerly know as a "commissioner"[191]) appointed by the United States Tax Court (the "Tax Court") was at issue.

The chief judge of the Tax Court had the authority, by statute, to appoint special trial judges for certain types of complex litigation in that court.[192] During review of the petitioners' case in 1984, the chief judge of the Tax Court assigned a special judge to the case subsequent to the illness and retirement of the initial Tax Court judge. The special trial judge, Carleton Powell,

[188] *Morrison*, 487 U.S. at 671-672.
[189] *Id*. at 673-679.
[190] Freytag v. Commissioner, 501 U.S. 868 (1991).
[191] *Id*. at 870. The Tax Reform Act of 1984 changed the title of "commissioner" to "special trial judge." *Id*. at 870.
[192] I.R.C. § 7443A(b)

found that the petitioners owed additional taxes, and the chief judge adopted the opinion of Judge Powell as that of the Tax Court.[193] The Court of Appeals affirmed, but the argument of the petitioners was that the appointment of the special trial judge had been in violation of the Appointments Clause.

As a preliminary matter, the Court emphasized that the Appointments Clause was not designed only or even primarily to protect Executive Branch prerogatives. Justice Blackman wrote in the Court's opinion that "[t]he Appointments Clause prevents Congress from dispensing power too freely; it limits the universe of eligible recipients of the power to appoint,…[and] the structural interests protected by the Appointments Clause are not those of any one Branch of government but of the entire Republic."[194] The Court went on to use *Buckley* to hold that the special trial judges are "inferior officers" for Appointments Clause purposes. Rejecting the Commissioner's assertion that the judges are mere employees who are not subject to the provisions of the Appointments Clause, the Court noted that the judges perform more than mere ministerial tasks, are given significant responsibility by law, and exercise "significant discretion."[195] The Court distinguished the case at hand from *Morrison* on the ground that *Freytag* did not involve an interbranch appointment.[196]

The Court also rejected the Commissioner's argument that "every part of the Executive Branch is a department the head of which is eligible to receive the appointment power" and held that the Tax Court "is not a 'Department.'"[197] In deciding that the Tax Court is not a department, however, the Court left open the question of what constitutes a "Head of Department"[198] for

[193] *Freytag*, 501 U.S. at 872 (petitioners had engaged in a tax shelter scheme, *Id.* at 871).
[194] *Id.* at 880.
[195] *Id.* at 882; *see* Go-Bart Importing Co. v. United States, 282 U.S. 344.
[196] *Freytag*, 501 U.S. at 883.
[197] *Id.* at 885.
[198] U.S. CONST. art. II, § 2.

purposes of the Excepting Clause. Instead, the Court ruled that the Tax Court was one of the "Courts of Law."[199] Justice Blackmun wrote that, despite traditionally having been viewed as part of the Executive Branch, "the Tax Court's function and role…[resemble]…those of the federal district courts, which indisputably are 'Courts of Law.'"[200] Furthermore, the Appointments Clause "does not limit 'the Courts of Law' to those courts established under Article III of the Constitution."[201]

In his concurring opinion,[202] Justice Scalia disagreed on this point, writing that "the definite article 'the' [in the Appointments Clause] obviously narrows the class of eligible 'Courts of Law' to those Courts or Law envisioned by the Constitution. Those are Article III courts, and the Tax Court is not one of them."[203] Justice Scalia also considered what constitutes a "Department," though he did not provide a clear standard. While not binding, the language provided by Justice Scalia is important to one of the principal issues in the *Free Enterprise Fund* case. He wrote:

> A number of factors support the proposition that "Heads of Departments" includes the heads of all agencies immediately below the President in the organizational structure of the Executive Branch…This evident meaning -- that the term "Departments" means all independent executive establishments -- is also the only construction that makes sense of Art. II, 2's sharp distinction between principal officers and inferior officers…In short, there is no reason, in text, judicial decision, history or policy, to limit the phrase "the Heads of Departments" in the Appointments Clause to those officials who are members of the President's Cabinet.[204]

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[199] *Id*.
[200] *Freytag*, 501 U.S. at 891.
[201] *Id.* at 888.
[202] *Id.* at 892 (Scalia, J., with whom O'Connor, Kennedy, and Souter, J.J., join, concurring.) Scalia and his colleagues concurred in the judgment but asserted (1) that petitioners had not made a "timely assertion" regarding their constitutional challenge and (2) that the Court erred and should have instead held that the chief judge of the Tax Court was a head of a department.
[203] *Id.* at 902.
[204] *Id*. at 918-920.

If Justice Scalia were to have garnered a majority in *Freytag*, any non-Article III court would have been treated as a Department.[205] Ultimately, despite the debate over classifying the Tax Court, the United States Supreme Court held that the appointment of the special trial judge had been valid under the Appointments Clause.

7. *Edmond v. United States*

At issue in the most recent of the Supreme Court's Appointments Clause cases, *Edmond v. United States*,[206] was the constitutionality of the appointment of civilian judges to the Coast Guard Court of Criminal Appeals (the "CGCCA") by the Secretary of Transportation. The CGCCA, which is composed of both military and civilian judges, hears appeals from decisions of court martial, and decisions by the CGCCA are reviewable by the United States Court of Appeals for the Armed Forces. Because the military and civilian judges who served on the CGCCA at the time of the *Edmond* case had been designated by Congress as officers of the U.S. Department of Transportation[207] and because of the Court's decision in *Weiss v. United States*,[208] the Secretary of Transportation had reappointed the two civilian judges then serving on the CGCCA.[209]

Justice Scalia rejected the petitioners' argument that Article 66(a) of the Uniform Code of Military Justice (the "UCMJ")[210] gives the Judge Advocate General exclusive authority to appoint the judges of the CGCCA. Instead, Justice Scalia held that this provision of the UCMJ

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[205] JAMES B. STAAB, THE POLITICAL THOUGHT OF JUSTICE ANTONIN SCALIA: A HAMILTONIAN ON THE SUPREME COURT 68 (2006).
[206] Edmond v. United States, 520 U.S. 651 (1997).
[207] Under the provisions of the Homeland Security Act of 2002, the Coast Guard operates as part of the Department of Homeland Security except in time of war when it becomes a service of the United States Navy. Until 2003, the Coast Guard was part of the Department of Transportation. *See* 14 U.S.C. §§ 1-3; Homeland Security History, http://www.dhs.gov/xabout/history/ editorial_0133.shtm.
[208] In *Weiss v. United States*, 510 U.S. 163 (1994), the Court held that military trial and appellate judges are offers of the United States who must be appointed pursuant to the Appointments Clause.
[209] *Edmond*, 520 U.S. at 654.
[210] Codified at 10 U.S.C. § 866(a).

concerns "not the appointment of Court of Criminal Appeals judges, but only their assignment"[211] and that, accordingly, the Secretary of Transportation has the authority to appoint CGCCA judges.[212] The Court then turned to the constitutionality of the Secretary's appointments. Using Appointments Clause precedent, Justice Scalia reiterated the Court's long-standing recognition that the Excepting Clause language had been added to the Constitution for the "obvious purpose [of] administrative convenience"[213] and that, although several of the Court's earlier cases had provided examples of "inferior officers,"[214] the Court had not yet fashioned a set of controlling criteria for distinguishing between "inferior officers" and "principal officers." Rejecting the applicability of most of the factors that had been relied upon in *Morrison* to the facts in *Edmond*, Justice Scalia instead focused on the factor in *Morrison* that considers whether there is a relationship that exists between the officer in question and some higher ranking officer or officers below the President. "[W]hether one is an 'inferior' officer," Scalia wrote,

> depends on whether he has a superior. It is not enough that other officers may be identified who formally maintain a higher rank, or possess responsibilities of a greater magnitude. It that were the intention, the Constitution might have used the phrase "lesser officer." Rather, in the context of a clause designed to preserve political accountability relative to important government assignments, we think it evident that "inferior officers" are officers whose work is directed and supervised at some level by others who were appointed by presidential nomination with the advice and consent of the Senate.[215]

Such a supervisory relationship exists, the Court found, between the CGCCA judges and both the Judge Advocate General (the General Counsel of the Department of Transportation was at the time, ex officio, the Judge Advocate General of the Coast Guard), which has oversight and

[211] *Edmond*, 520 U.S. at 658.
[212] 49 U.S.C. § 323(a).
[213] *Edmond*, 520 U.S. at 660.
[214] *Id*. at 661.
[215] *Id*. at 662-663.

removal authority with respect to the judges, and the U.S. Court of Appeals for the Armed Forces, which exercises the power of judicial review over decisions by the judges of the CGCCA.[216] Accordingly, the Court concluded that the CGCCA judges were inferior officers for purposes of the Appointments Clause. "What is significant," Scalia emphasized,

> is that the judges of the Court of Criminal Appeals have no power to render a final decision on behalf of the United States unless permitted to do so by other executive officers.[217]

The Court rejected the petitioners' argument that the CGCCA judges more closely resemble Tax Court judges (who the Court in *Morrison*, according to the petitioners, implied were principal officers) than they do the special trial judges whose appointments were at issue in *Morrison*. "We note initially," Justice Scalia wrote,

> that *Freytag* does not hold that Tax Court judges are principal officers; only the appointment of special trial judges was at issue in that case. Moreover, there are two significant distinctions between Tax Court judges and Court of Criminal Appeals judges. First, there is no Executive Branch tribunal comparable to the Court of Appeals for the Armed Forces that reviews the work of the Tax Court; its decisions are appealable only to courts of the Third Branch [*i.e.*, the federal judiciary under Article III]. And second, there is no officer comparable to a Judge Advocate General who supervises the work of the Tax Court, with power to determine its procedural rules, to remove any judge without cause, and to order any decision submitted for review. *Freytag* does not control our decision here.[218]

The Court determined, therefore, that, because the judges are inferior officers and because Congress had properly authorized the Secretary of Transportation to appoint the CGCCA judges in question, the appointments were constitutional under the Appointments Clause.[219]

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[216] *Id*. at 664.
[217] *Id*. at 665.
[218] *Id*. at 665-666.
[219] *Id*. at 666.

C. The Separation-of-Powers Issues

Because of its significance as a tool for control, the power to remove governmental officers can also raise significant separation-of-powers issues.

The Supreme Court stated the obvious when in 1983 it noted that "[t]he Constitution sought to divide the delegated powers of the new Federal Government into three defined categories, Legislative, Executive, and Judicial."[220] The purpose of this separation-of-powers feature of the Constitution was to "diffus[e] power the better to secure liberty,"[221] a purpose echoed by James Madison in *Federalist* No. 47 when he wrote that "[t]he accumulation of all powers legislative, executive and judiciary in the same hands, whether of one, a few or many . . . may justly be pronounced the very definition of tyranny."[222] Although the Constitution's diffusion of power among the three branches can produce "conflicts, confusion, and discordance" within the government, "it was deliberately so structured to assure full, vigorous, and open debate on the great issues affecting the people, and to provide avenues for the operation of checks on the exercise of governmental power."[223]

The Supreme Court first comprehensively addressed the separation-of-powers ramifications of the removal power in *Myers*, in which Chief Justice Taft, in his opinion for the Court, declared unconstitutional the statute requiring Senate approval of the President's exercise of the power to remove a postmaster on the ground that for Congress to retain the power to participate in the exercise of such power "would be . . . to infringe [upon] the constitutional principle of the separation of governmental powers."[224] In its subsequent decision in *Humphrey's Executor*, the Court reiterated "the crucial role of separated powers in our

[220] Bowsher v. United States, 478 U.S. 714, 721 (1986) (*quoting* INS v. Chadha, 462 U.S. 919, 951 (1983)).
[221] *Id*. (*quoting* Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 635 (1952) (Jackson, J., concurring)).
[222] THE FEDERALIST NO. 47 at 331 (James Madison) (Jacob E. Cooke ed. 1961).
[223] *Bowsher*, 478 U.S. at 722.
[224] Myers v. United States, 272 U.S. at 161.

system"[225] when it sustained the constitutionality of congressional limitations on the President's power to remove members of the Federal Trade Commission:

> The fundamental necessity of maintaining each of the three general departments of government entirely free from the control or coercive influence, direct or indirect, of either of the others has often been stressed, and is hardly open to serious question. So much is implied in the very fact of the separation of the powers of these departments by the Constitution, and in the rule which recognizes their essential co-equality.[226]

Of special concern to the framers of the Constitution were the dangers of congressional usurpation of the functions of the Executive Branch. As the Court observed in *Bowsher*:

> [T]he debates of the Constitutional Convention, and the Federalist Papers, are replete with expressions of fear that the Legislative Branch of the National Government will aggrandize itself at the expense of the other two branches.[227]

Hardly more than a half-century later, the Court revisited the separation-of-powers repercussions of the removal power in *Bowsher v. Synar*.

1. *Bowsher v. Synar*

The Balanced Budget and Emergency Deficit Control Act of 1985 (the "Balanced Budget Act")[228] vested in the Comptroller General the authority to take certain steps to control the federal budget deficit. Specifically, each year the directors of the Office of Management and Budget (the "OMB") and the Congressional Budget Office (the "CBO") were required to prepare independent estimates of the amount of the anticipated federal budget deficit for the ensuing fiscal year and if the projected deficit exceeded the maximum targeted deficit amount designated by the Balanced Budget Act for that fiscal year by more than a specified amount, the directors of the OMB and the CBO were to calculate, on a program-by-program basis, the budget reductions

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[225] *Bowsher*, 478 U.S. at 725.
[226] Humphrey's Executor v. United States, 295 U.S. at 629-630.
[227] *Bowsher*, 478 U.S. at 727 (*quoting* Buckley v. Valeo, 424 U.S. at 129)).
[228] The Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings Act), Pub. L. 99-177, 99 Stat. 1038 (1985), 2 U.S.C. § 901

that would be necessary to ensure that the deficit for that fiscal year did not exceed the maximum targeting deficit amount. The Balanced Budget Act further provided that the directors of the OMB and the CBO then were to submit a joint report containing their deficit estimates and budget reduction calculations to the Comptroller General, who, after having reviewed the same, was directed to report his conclusions to the President, who in turn was required to order the spending reductions specified by the Comptroller General.[229] *Bowsher v. Synar* challenged the constitutionality of this feature of the Balanced Budget Act on several grounds, including an assertion that the statute violated the separation-of-powers feature of the Constitution.

Central to the *Bowsher* case was the removability of the Comptroller General, an officer who is nominated by the President and confirmed by the Senate but who, by statute is removable only by Congress, either by impeachment or by joint resolution based on certain specified grounds.[230] Chief Justice Warrant Burger's opinion for the Court found that the Comptroller General had consistently over an extended period of time been viewed as part of the Legislative Branch and concluded that this arrangement, coupled with the congressional removal provisions, meant that the Comptroller General could not exercise executive powers.[231] The Court determined, however, that the Balanced Budget Act had vested the Comptroller General with executive power, since he could "exercise judgment concerning facts that affect the application of the Act...[and] must interpret…the Act"[232] before mandating what cuts the President was required to make. "Decisions of that kind," the Court observed, "are typically made by officers charged with executing a statute."[233] After passing the Balanced Budget Act, in other words, Congress, in effect, had impermissibly attempted to retain control over enforcement of the Act,

[229] *Id*.
[230] *Bowsher*, 478 U.S. at 727-728.
[231] *Id*. at 732.
[232] *Id*. at 733.
[233] *Id*. at 733.

since one of its own officers—the Comptroller General—was charged with carrying out the statute's mandates,[234] and, simply put, Congress must not retain control over any executive functions. The Court thus affirmed the decision by a special three-judge panel of the U.S. District Court for the District of Columbia invalidating the Balanced Budget Act.[235] The Court, rather than perform "statutory surgery,"[236] elected to allow the Balanced Budget Act's fallback provisions[237] go into effect and stayed the judgment for no more than 60 days.[238]

2. *Morrison v. Olson*

The Court in *Morrison* also held that the Government in Ethics Act did undermine the Executive Branch, so no separation-of-powers problem existed. Distinguishing the case from *Bowsher*, the Court noted that, here, Congress was not trying impermissibly to retain control over the execution of a statute. With regard to removal power, the Court characterized the case as being more like *Humphrey's Executor* than *Myers*.[239] The appellees argued the case was different from *Humphrey's Executor* because the independent counsel, unlike an FTC commissioner, performed a "core executive function."[240] Significantly, however, the Court chose not to define what "core executive function" is. Moreover, the Court was of the view that

> the determination of whether the Constitution allows Congress to impose a "good cause"-type restriction on the President's power to remove an official cannot be made to turn on whether or not that official is classified as "purely executive." The analysis contained in our removal cases is designed not to define rigid categories of those officials who may or may not be removed at will by the President, but to ensure that Congress does not interfere with the President's exercise of the "executive power" and his constitutionally appointed duty to "take

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[234] *Id*. at 734.
[235] *Id*. at 736. The lower court's decision in *Synar v. United States*, 626 F. Supp. 1374 (D.D.C 1986), was in the form of a per curiam opinion, which, it is believed, was authored by then Judge Antonin Scalia. STAAB, *supra* note 205, at 60.
[236] *Id*., at 736.
[237] The Balanced Budget Act was created with a fallback deficit reduction process to take effect should the reporting provisions be invalidated. *See*, *supra*, note 134, at § 274 (f).
[238] *Bowsher*, 478 U.S. at 736.
[239] *Morrison*, 487 U.S. at 687.
[240] *Id*. at 688.

care that the laws be faithfully executed" under Article II. *Myers* was undoubtedly correct in its holding, and in its broader suggestion that there are some "purely executive" officials who must be removable by the President at will if he is to be able to accomplish his constitutional role. But as the Court noted in *Wiener*:

> The assumption was short-lived that the Myers case recognized the President's inherent constitutional power to remove officials no matter what the relation of the executive to the discharge of their duties and no matter what restrictions Congress may have imposed regarding the nature of their tenure.

At the other end of the spectrum from Myers, the characterization of the agencies in *Humphrey's Executor* and *Wiener* as "quasi-legislative" or "quasi-judicial" in large part reflected our judgment that it was not essential to the President's proper execution of his Article II powers that these agencies be headed up by individuals who were removable at will. We do not mean to suggest that an analysis of the functions served by the officials at issue is irrelevant. But the real question is whether the removal restrictions are of such a nature that they impede the President's ability to perform his constitutional duty, and the functions of the officials in question must be analyzed in that light.

. . . .

This is not a case in which the power to remove an executive official has been completely stripped from the President, thus providing no means for the President to ensure the "faithful execution" of the laws. Rather, because the independent counsel may be terminated for "good cause," the Executive, through the Attorney General, retains ample authority to assure that the counsel is competently performing his or her statutory responsibilities in a manner that comports with the provisions of the [Ethics in Government] Act.[241]

The *Morrison* Court, therefore, held that it did not violate the Appointments Clause for Congress to vest appointment of the independent counsel in the Special Division; that the powers granted to the Special Division under the EAG did not violate Article III of the Constitution; and that the EAG did not violate the separation-of-powers feature of the Constitution by impermissibly interfering with the functions of the Executive Branch.[242]

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[241] *Id*. at 690-691 (original footnotes and citations omitted).
[242] *Id*. at 696-697.

D. The Accountability Issue

Related but at the same time collateral to the separation-of-powers issues is the separate issue of whether, and if so the extent to which, Congress might be free to render independent agencies "unaccountable to the public through a democratically-elected branch of government."[243] As one commentator has noted, the Supreme Court's decision in "*Morrison* on its face leaves Congress tremendous leeway to configure independent agencies in a manner that severs them from traditional mechanisms of accountability."[244]

In his opinion for the Court in *Edmond*, Justice Scalia noted, "By requiring the joint participation of the President and the Senate, the Appointments Clause was designed to ensure public accountability for both the making of a bad appointment and the rejection of a good one."[245] The rationale for such accountability, according to Justice Scalia, was provided by Alexander Hamilton in his *Federalist* No. 77 essay:

> The blame of a bad nomination would fall upon the president singly and absolutely. The censure of rejecting a good one would lie entirely at the door of the senate; aggravated by the consideration of their having counteracted the good intentions of the executive. If an ill appointment should be made, the executive for nominating, and the senate for approving, would participate, though in different degrees, in the opprobrium and disgrace.[246]

Justice Scalia's observation was made in obvious reference to the provisions of the Appointments Clause relating to principal officers whose appointments are required to be made by the President by and with the consent of the Senate and not in connection with the Excepting Clause. The cases do not provide a clear answer to the question of whether, as a constitutional requirement, the notion of accountability must extend beyond Presidential political answerability for the actions of principal officers within the Executive Branch and extend to answerability for

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[243] Kimberly N. Brown, *Presidential Control of the Elite "Non-Agency,"* 88 N.C. L. REV. 101, 119 (2010).
[244] *Id.*
[245] *Edmond*, 520 U.S. at 663.
[246] *Id.*; *see* THE FEDERALIST NO. 77, at 517 (Alexander Hamilton) (Jacob Cooke ed., 1961).

the actions of every one of the hundreds, perhaps thousands, of inferior officers—regardless of whether appointed by the President, by the heads of departments, or by the courts of law—within the federal government, as opposed to all inferior officers within the Executive Branch.

At least one noted constitutional scholar has suggested that perhaps the political accountability doctrine should, indeed, extend at least to those lower-level inferior officers within the federal government who are appointed by persons who are themselves not accountable politically to the President or to anyone who is accountable to the President. Professor Laurence H. Tribe has described the potential problem in the following manner:

> [I]n the particular situation in which an inferior officer is appointed by persons who are themselves not politically accountable . . . ongoing supervision by a politically accountable official, whether by the President or by someone serving at the President's pleasure, seems particularly important. In such circumstances, where there is little or no political accountability at the front end for the choice of that officer, a 'for cause' limitation on removal that renders political supervision impossible appears troubling from an accountability perspective.[247]

A statement by Justice John Paul Stevens in his now "famous opinion" for the Court in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council*[248] has led to some speculation that the doctrine of political accountability does (or should) extend at least to inferior officers serving in agencies within the Executive Branch.[249] At issue in the *Chevron* case was a question under administrative law of whether the intermediate appellate court, rather than the applicable administrative agency, had properly construed the definition of a term contained in a rule promulgated by the Environmental Protection Agency (the "EPA") in the light of certain amendments to the Clean Air Act that were enacted in 1977. Before concluding that the appellate court had erred, Justice Stevens observed that the statutory amendments had represented an attempt on the part of Congress to accommodate "the economic interest in

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[247] LAURENCE H. TRIBE, 1 AMERICAN CONSTITUTIONAL LAW § 4-8, at 684 (3d ed.2000).
[248] Chevron, U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984) (Stevens, J.).
[249] *See* Brown, *supra* note 243, at 142.

permitting capital improvements to continue and the environmental interest in improving air quality"; that the subsequent rules promulgated by the EPA (including those under challenge) reflected a change in policy brought about by a change in presidential administrations in 1981; and that the ultimate remedy sought by the respondents, an environmental advocacy group, lay with the two political branches of the government, *i.e.*, the President or Congress, and not with the judiciary. The truism articulated by Justice Stevens (with the language that has given rise to the suggestion that the political accountability doctrine should apply to agencies within the Executive Branch highlighted in italics) occurs in the following context:

> Judges are not experts in the field, and are not part of either political branch of the Government. Courts must, in some cases, reconcile competing political interests, but not on the basis of the judges' personal policy preferences. In contrast, an agency to which Congress has delegated policy-making responsibilities may, within the limits of that delegation, properly rely upon the incumbent administration's views of wise policy to inform its judgments. ***While agencies are not directly accountable to the people, the Chief Executive is***, and it is entirely appropriate for this political branch of the government to make such policy choices—resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities. When a challenge to an agency construction of a statutory provision, fairly conceptualized, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail. In such a case, federal judges—who have no constituency—have a duty to respect legitimate policy choices made by those who do. The responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones: "Our Constitution vests such responsibilities in the political branches."[250]

One way of interpreting Justice Stevens's observation, of course, is that it appears in a decision that was not concerned with the constitutional aspects of the accountability doctrine and that it was intended to be merely a statement of political reality and not a statement of binding constitutional principle.

[250] *Chevron*, 467 U.S. at 865-866 (Stevens, J.) (emphasis added).

Even assuming, however, that Justice Stevens's statement in *Chevron* does, indeed, amount to a statement of binding constitutional principle and that, by application of that principle to inferior officers appointed under the Excepting Clause of the Appointments Clause, the accountability doctrine does, indeed, apply to inferior officers serving within independent agencies, then the issues in each such case would be, first, whether such officer is appointed by persons who are indeed, in Professor Tribe's words, "themselves not politically accountable" and, second, if so, whether there is "ongoing supervision" of such official "by a politically accountable official."[251]

E. The Burden of Persuasion

Alexander Bickel once argued that

> when the Supreme Court declares unconstitutional a legislative act . . ., it thwarts the will of representatives of the actual people of the here and now; it exercises control, not in behalf of the prevailing majority, but against it. That, without mystic overtones, is what actually happens. . . . [I]t is the reason the charge can be made that judicial review is undemocratic.[252]

Because judicial review is thus inherently countermajoritarian, the courts have fashioned a number of doctrines that have as their purpose the limiting of the exercise of judicial power and that reflect "an underlying philosophy of judicial restraint." Perhaps the most fundamental of these doctrines is the "presumption of constitutionality," under which

> courts will presume a challenged statute is valid until it is demonstrated otherwise. In other words, the party attacking the validity of the law carries the burden of proof. This doctrine is based on an appreciation for the countermajoritarian character of judicial review and a fundamental respect for the legislative bodies in a democratic system.[253]

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[251] *See* TRIBE, *supra* note 247, at 684.
[252] ALEXANDER M. BICKEL, THE LEAST DANGEROUS BRANCH OF GOVERNMENT: THE SUPREME COURT AT THE BAR OF POLITICS 16–17 (1962).
[253] OTIS H. STEPHENS, JR. & JOHN M. SCHEB, II, AMERICAN CONSTITUTIONAL LAW 118, 131-132 (1993); *see* United States v. Carolene Products Co., 304 U.S. 144, 152 n.2 (1938).

Consistent with the presumption-of-constitutionality doctrine is one of the now famous *Ashwander* Rules identified by Justice Louis D. Brandeis in 1936, which provides as follows:

> When the validity of an act of the Congress is drawn in question, and even if a serious doubt of constitutionality is raised, it is a cardinal principle that this Court will first ascertain whether a construction of the statute is fairly possible by which the question may be avoided.[254]

Also consistent with both the presumption-of-constitutionality doctrine and *Ashwander* Rule No. 7 is the judicially created distinction between "facial" constitutional challenges and "as-applied" constitutional challenges.

The constitutionality of an act of Congress may be tested in either a "facial" challenge or in an "as-applied" challenge.[255] The Supreme Court has recently observed that the distinction between the two types of constitutional challenges is "both instructive and necessary, for it goes to the breadth of the remedy employed by the Court."[256] The normal mode of constitutional adjudication involves an as-applied challenge, in which a party argues that a statute cannot be applied to him or her because its application would violate his or her constitutional rights.[257] In a facial challenge, the court is asked to vindicate a party's right not to be bound by a statute that is unconstitutional on its face, *i.e.*, because its very enactment is inconsistent with some express provision, or violates some express prohibition, of the Constitution.[258] Within the customary understanding of the distinction, facial attacks maintaining that a statute is generally invalid, as opposed to invalid as applied to the challenger, have been considered "rare and suspect."[259] As the Supreme Court has noted, "A facial challenge to a legislative Act is . . . the most difficult

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[254] Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 348 (1936) (Brandeis, J., concurring) (*Ashwander* Rule No. 7) (citations omitted).
[255] *See* Richard H. Fallon, Jr., *As-Applied and Facial Challenges and Third-Party Standing*, 113 HARV. L. REV. 1321, 1339 (2000).
[256] Citizens United v. Fed. Election Comm'n, — U.S. —, 130 S.Ct. 876, 893 (2010).
[257] *Id.*
[258] *See* United States v. Treasury Employees, 513 U.S. 454, 477-478 (1995).
[259] *See* Fallon, *supra* note 255, at 1339.

challenge to mount successfully, since the challenger must establish that no set of circumstances exists under which the Act would be valid."[260]

IV. The *Free Enterprise Fund* Case

This challenge to the constitutionality of the PCAOB started after the Board inspected a small, regional accounting firm based in Nevada in 2004. Firms with less than 100 public company audit clients are subject to PCAOB inspection at least every three years.[261] This was the firm's first inspection by the PCAOB.

A. Facts

Beckstead and Watts, LLP ("B&W" or the "Firm") is a small accounting firm headquartered in Henderson, Nevada.[262] B&W is a "small 'niche' audit firm serving the needs of 'micro-cap' and 'development stage' companies."[263] B&W is subject to PCAOB inspection pursuant to the Sarbanes-Oxley Act.[264] A PCAOB inspection team conducted fieldwork in the Nevada office of the Firm from May 17, 2004, through May 18, 2004.[265] The inspection involved a review of sixteen financial statement audits completed for B&W clients.[266] The PCAOB report provided that:

> The inspection team identified matters that it considered to be audit deficiencies. The deficiencies identified in eight of the audits reviewed included deficiencies of such significance that it appeared to the inspection team that the Firm did not obtain sufficient competent evidential matter to support its opinion on the issuers' financial statements. Those deficiencies included –
> (1) the failure to perform and document sufficient procedures to analyze the appropriate accounting treatment for an acquisition of a rental property;
> (2) the failure in two audits to perform and document sufficient procedures to evaluate the recorded balance of capitalized software costs for impairment despite

[260] United States v. Salerno, 481 U.S. 739, 745 (1987).
[261] Sarbanes-Oxley Act § 104 (b)(B).
[262] *See* http://www.becksteadwatts.com/.
[263] Inspection of Beckstead and Watts, LLP, PCAOB Release No. 104-2005-082, at 10 (2005).
[264] Sarbanes-Oxley Act §104.
[265] Inspection, *supra* note 263, at 4 (report indicated that B&W had one office, one partner, two professional staff, and sixty-one clients).
[266] *Id*. at 5.

> the presence of factors indicating potential impairment;
> (3) the failure in three audits to perform and document sufficient procedures to test the fair value of equity securities issued in several transactions;
> (4) the failure in two audits to perform and document sufficient procedures to test liabilities for completeness and accuracy;
> (5) the failure to perform and document sufficient procedures to test the appropriateness of the issuer's revenue recognition;
> (6) the failure to perform and document sufficient procedures to test the valuation of an expense recorded upon the termination of an agreement;
> (7) the failure to perform and document sufficient procedures to test the collectibility of a note receivable despite evidence of impairment; and
> (8) the failure in two audits to perform and document an adequate evaluation with respect to the issuers' ability to continue as a going concern.[267]

The PCAOB inspection team also evaluated the quality of the control system of B&W.[268] Any deficiencies in this portion of the report were, by rule, confidential and not to be reported to the public for twelve months.[269] In 2007, the PCAOB issued a clearance letter to the Firm acknowledging that "the Firm [had] addressed the quality control criticisms or defects described in the Board's September 28, 2005 inspection report to the satisfaction of the Board."[270] This letter meant that the Firm had made "good faith progress toward achieving . . . quality control objectives"[271] and that, consequently, the Board's criticisms and any defects identified by the Board would remain private.

Firms are allowed to review and comment on their PCAOB reports.[272] In their response, B&W characterized the PCAOB's 2004 inspection as having been "overwhelming for [their] small office."[273] The Firm acknowledged the inherent risk in micro-cap and developmental stage companies but contended that investors knew this and would either "embrace [the] level of risk .

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[267] *Id*. at 5-6.
[268] *Id*. at 6.
[269] Sarbanes-Oxley Act §§ 104(g)(2) and 105(b)(5)(A).
[270] Clearance Letter from PCAOB to B&W (June 15, 2007), *available at* http://www.becksteadwatts.com/files/Clearance_ltr_dated_6-25-07.pdf.
[271] *Id*.
[272] Sarbanes-Oxley § 104(f); *see* 15 U.S.C. § 7214(f) and PCAOB Rule 4007(a)).
[273] Inspection, *supra* note 263, at 10.

. . or avoid it by investing their dollars elsewhere."[274] The Firm noted that many of its clients had "going-concern" audit reports.[275] Finally, the Firm addressed the costs of compliance with SOX and distinguished their clients, which, it should be noted, traded on the Over-the-Counter Bulletin Board Exchange,[276] from Fortune 1000 companies. The Firm wrote, in part, that:

> The Sarbanes Oxley Act of 2002 ("SOX") has tremendously impacted our firm's ability to compete in the small business issuer marketplace…. When the "Big Four" accounting firms double their fees, their multi-national clients absorb the costs; when we double our fees, our clients go out of business. It is thus a constant struggle for us to perform audits in conformity with the requirements of SOX. If the Board were to simply ignore these cost and efficacy issues, this segment of the market likely will not be able to remain in existence.
>
> . . . We found the inspectors evaluated our audits in the same manner one might evaluate the audits of Fortune 1000 companies. . . .
>
> [T]he SEC is and always has been aware of the micro-cap/development stage market segment in which we work, and has allowed that segment to endure. It is our belief that effectively eliminating that segment of the market should not be a collateral consequence of the Board's inspection process; rather, if anyone should decide the fate of that segment of the market, it should be the SEC.[277]

B&W took action to respond to the PCAOB inspection and expectations. The 2007 clearance letter is evidence of this action; however, as a result, B&W reduced its client base from over sixty companies to approximately ten.[278]

The Firm was again inspected by the PCAOB in 2008, and a report was issued in 2009.[279] This report was much more succinct than the 2005 report. The inspection involved the review of

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[274] *Id*.
[275] *Id*; *see* SAS 59, codified AU 341 (guidance on entity's ability to continue as a going concern)).
[276] The OTCBB is an off-exchange medium to trade securities directly between parties. OTC securities are not listed on other, national exchanges (*e.g*., NYSE or NASDAQ).
[277] *Id*. at 11; *see* Brad Beckstead, *Sarbanes-Oxley: The Impact on Smaller Firms*, ACCOUNTING TODAY, Vol. 20, Iss. 15, Aug. 2006, at 6; Brad Beckstead, *Hello Regulation, Goodbye American Dream*, 2006, *available at*: http://www.beckstеadwatts.com/OpEds.html (describing the PCAOB inspection of Beckstead and Watts, LLP.
[278] *Id*. at 11 (noting that fifty of the more than sixty clients of B&W's were described as development stage companies).
[279] Inspection of Beckstead and Watts, LLP, PCAOB Release No. 104-2009-098 (2009). Compare to note 263, *supra* (the 2009 report indicated one office, two partners, zero professional staff, and zero clients).

an audit for one issuer, and no audit performance issues were reported.[280] As with the earlier report, any control criticisms or defects were kept confidential. There was no comment from the B&W in the 2009 report.

The Free Enterprise Fund[281] (the "Fund"), a plaintiff in the case, "is a non-profit public-interest organization under Section 501(c)(4) of the Internal Revenue Code. [The Fund] promotes economic growth, lower taxes, and limited government through… advertising campaigns…[and] policy guidance."[282] The identities of the members of the Fund are not disclosed in any of the applicable pleadings or other court documents, although B&W is named as a member of Fund in the opinion of the court of appeals.[283]

B. Procedural History

1. The District Court

On February 7, 2006, after the PCAOB's 2004 inspection and investigation, B&W and the Fund filed a complaint against the Board and four individuals in their capacities as members of the PCAOB in the United States District Court for the District of Columbia.[284] The plaintiffs presented a facial constitutional challenge[285] to "the formation and operation of the Public Company Accounting Oversight Board," asserting that the PCAOB provisions of SOX violate both "the Constitution's separation of powers principles and the Appointments Clause."[286] The plaintiffs argued that "[t]he Board's exercise of wide-ranging, core executive power, immune

[280] *Id*. at 5.
[281] *See* http://www.fefund.org; Jacob Gershman, *Mallory Factor Decamps New York, Surprising Many*, NEW YORK SUN, Aug. 15, 2006 (regarding Free Enterprise Fund Chairman Mallory Factor); David D. Kirpatrick, *Leadership Dispute Causes a Split in a Powerhouse of Fund-Raising for Conservative Causes*, N.Y. TIMES, July 8, 2005(creation of the Free Enterprise Fund).
[282] Complaint for Declaratory and Injunctive Relief at 4, Free Enter. Fund v. Pub. Co. Accounting Oversight Bd. (*PCAOB I*), No. 1:06CV00217 (D.D.C. Feb. 7, 2006).
[283] Free Enter. Fund v. Pub. Co. Accounting Oversight Bd. (*PCAOB II*), 537 F. 3d 667, 670 (2008).
[284] Complaint*, supra* note 282, at 1, 5-6, 23.
[285] For a discussion of the distinction between a "facial" challenge and "as-applied" challenge, see Part III.E, *supra*.
[286] Complaint, *supra* note 282, at 2.

from Presidential oversight, impermissibly impedes and undermines the President's ability to perform his constitutional duties and prerogatives. As a result, the creation of the Board, as well as its implementation of its delegated responsibilities under the Act, violates the separation of powers."[287] The plaintiffs also alleged that SOX improperly delegates legislative power outside the Legislative Branch.[288]

With regard to the alleged violation of the Appointments Clause, the plaintiffs asserted that members of the PCAOB are principal officers and, accordingly, must be appointed by the President by and with the advice and consent of the Senate. In the alternative, the plaintiffs argued that members of the PCAOB are inferior officers that must be appointed by the President, courts of law, or heads of departments. The plaintiffs contended further that the Securities and Exchange Commission is not a department for purposes of the Appointments Clause. Compounding the alleged violation of the Appointments Clause, the plaintiffs asserted, are Sarbanes-Oxley's requirement that the SEC consult with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury and SOX's limitations on the number of Board members who may be appointed from the accounting profession.[289]

The plaintiffs requested that the district court invalidate the PCAOB provisions of SOX as unconstitutional and issue an injunction barring the PCAOB from any further proceedings against B&W. Their prayer for relief also asked the court to nullify any prior adverse action by the Board against B&W.[290]

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[287] *Id*. at 20.
[288] *Id*. at 22.
[289] *Id*. at 22; *see* Sarbanes-Oxley Act § 104 (e)(4)(A).
[290] Complaint, *supra* note 282, at 23.

The defendants filed pre-trial motions to dismiss the plaintiffs' complaint and, in the alternative, for summary judgment. In their motions to dismiss, the defendants asserted a lack of standing on the part of the plaintiffs and a lack of subject-matter jurisdiction. The defendants' standing argument was based on several grounds, the most significant of which was that the Fund had not alleged that it had sustained any specific injury. The defendants' jurisdictional argument also was based on numerous grounds, the most important of which was that the plaintiffs had by-passed the exclusive process of review of the PCAOB's actions prescribed by SOX and had failed to exhaust their administrative remedies. District Judge James Robertson denied the defendants' motions to dismiss but granted the defendants' motions for summary judgment. In a relatively short, unreported memorandum opinion, Judge Robertson initially found that the defendants had essentially conceded the standing of B&W and that the Fund likewise had standing because at least one of its members (B&W) was being regulated by the PCAOB. Judge Robertson then concluded that the plaintiffs' facial constitutional challenges, which targeted the very structure of the PCAOB, were collateral to SOX's statutory scheme and were, therefore, "outside the universe of cases subject to the implicitly exclusive administrative review established by [SOX]."[291]

Addressing the cross-motions for summary judgment, Judge Robertson noted that all the parties had agreed that, for purposes of these motions, the PCAOB should be considered and treated as a governmental entity.[292] Then, relying heavily upon the Supreme Court's decision in *Edmond*, the court concluded that the members of the PCAOB are inferior officers because they "'have no power to render a final decision on behalf of the United States unless permitted to do

[291] *PCAOB I*, 2007 WL 891675, at 3.
[292] *Id*.

so by other executive officers,' and are subject to administrative oversight and removal authority by the [Securities and Exchange] Commission."[293]

The court then rejected the plaintiffs' separation-of-powers argument on the ground that the Supreme Court has never held that the Constitution requires the President to maintain direct removal power over inferior officers and that here, as in *Morrison*, the President has not been "'completely stripped' of his ability to remove PCAOB members."[294] Finally, Judge Robertson concluded that Congress had not, as alleged by the plaintiffs, unlawfully delegated legislative power to the PCAOB in violation of Article I of the Constitution because SOX, in authorizing regulation by the Board in the public interest, had properly prescribed intelligible standards that the PCAOB is required to apply in exercising its regulatory powers.[295]

In ruling against the plaintiffs, Judge Robertson concluded his opinion by asserting that they had presented "nothing but an [*sic*] hypothetical scenario of an over-zealous or rogue PCAOB investigator."[296]

2. The Court of Appeals

The plaintiffs appealed the district court's adverse decision to the United States Court of Appeals for the District of Columbia Circuit,[297] which affirmed, 2-1, the lower court's ruling.[298]

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[293] *Id*. at 4. The court then effectively eliminated as an issue in the case the plaintiffs' alternative argument in their cross-motion for summary judgment that, even if PCAOB members are inferior officers, their appointment by the SEC is unconstitutional because the SEC is not a "department" for purposes of the Excepting Clause of the Appointment Clause and because, even if the SEC were considered to be a department, the appointment power must be vested in the SEC's chairman, as the "head of a department," and not in the entire SEC. The court's decision on this portion of the plaintiffs' motion was based upon the court's finding that the plaintiffs did lack standing to assert that, even were the SEC considered a "department" for constitutional purposes, the members of the PCAOB should be appointed by the SEC chairman rather than by the entire SEC because the injury alleged by the plaintiffs is not traceable to such an infirmity (the evidence showed that the SEC chairman had voted for the appointment of each PCAOB member) and because they do not allege that the injury that they have sustained is in any way attributable to the current membership of the PCAOB, as opposed to the statutory procedure by which PCAOB members are appointed. *Id*.
[294] *Id*. at 5.
[295] *Id*.
[296] *Id*.

Circuit Judge Judith Rogers initially reviewed the lower court's denial of the defendants' motion to dismiss and held that the district court had properly denied that motion. Because this was a facial challenge of SOX, the circuit court reasoned, the plaintiffs' failure to use the administrative review procedures prescribed by SOX was not dispositive and thus the "exhaustion doctrine [did] not apply."[299] Indeed, as the circuit court had held in *Time Warner Entertainment Co. v. FCC*, a district court has "general federal question jurisdiction to consider a facial challenge to a statute's constitutionality so long as that challenge is not raised in a suit challenging the validity of agency action taken pursuant to the challenged statute or in a suit that is collateral to one challenging the validity of such agency action."[300]

Turning to the district court's granting of the defendants' motion for summary judgment, Judge Rogers relied upon *Edmond* to hold that the PCAOB members are inferior officers:

> "Generally speaking, the term 'inferior officer' connotes a relationship with some higher ranking officer or officers below the President: Whether one is an 'inferior' officer depends on whether he has a superior. Under this standard, the Board is composed of officers inferior to the Commission. The Commissioners . . . are "appointed by Presidential nomination with the advice and consent of the Senate," and they exercise comprehensive control over Board procedures and decisions and Board members. For instance, the Commission approves all Board rules, and may abrogate, delete, or add to them. All Board sanctions are subject to plenary review by the Commission, and the Commission "may enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board." As such, the Board's disciplinary authority "ultimately belongs to the [Commission], and the legal views of the [Board] must yield to the Commission's view of the law." The Commission both appoints and removes Board members. It also may impose limitations upon Board activities and relieve the Board of its enforcement authority altogether.
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> . . . . Contrary to the Fund's suggestion, the fact that the Board is charged with exercising extensive authority on behalf of the United States does not mean that

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[297] *PCAOB II*, 537 F. 3d 667. The plaintiffs, however, did not pursue their non-delegation claim on appeal. *Id.* at 670 n.2.
[298] *Free Enterprise Fund*, 537 F. 3d at 668.
[299] *PCAOB II*, 537 F. 3d at 671; s*ee* Sarbanes-Oxley Act §§ 104 (h)(1), 107 (c) (establishing procedures for Commission review of disciplinary action taken by the PCAOB)).
[300] Time Warner Entertainment Co. v. FCC, 93 F. 3d 957, 965 (D.C Cir. 1996).

> Board members must be appointed by the President, for principal as well as inferior officers, by definition, " 'exercis[e] significant authority pursuant to the laws of the United States.'" Instead, what is key under the Edmond analysis is the fact that Board members "have no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers. [SOX] vests a broad range of duties in the Board, but its exercise of those duties is subject to check by the Commission at every significant step.[301]

Moreover, the majority held, PCAOB members are subject to greater oversight than both the Coast Guard judges in *Edmond* and the independent counsel in *Morrison*.[302]

Rejecting the Fund's argument that the for-cause limitation on the Commission's removal power requires that Board members be deemed principal, rather than inferior, officers, the circuit court observed that such a suggestion "overinflates the importance of removal authority":

> Recognizing that "[t]he power to remove officers . . . is a powerful tool for control," the Supreme Court has indicated that courts should consider removal authority as *one* factor in determining whether an official is an inferior officer. The Court has held that both the Coast Guard Judges in *Edmond*, who were subject to the Judge Advocate General's at-will removal authority, and the Independent Counsel in *Morrison*, who was subject to removal only for cause, were inferior officers. Here, [SOX] vests removal authority in the Commission, providing that "[a] member of the Board may be removed by the Commission from office . . . for good cause shown." Just as in Morrison, "the fact that [Board members] can be removed by the [Commission] indicates that [they are] to some degree 'inferior' in rank and authority."
>
> The Supreme Court has expressly permitted legislatively-imposed limitations on executive officers' removal authority:
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>> We have no doubt that when congress, by law, vests the appointment of inferior officers in the heads of departments, it may limit and restrict the power of removal as it deems best for the public interest. The constitutional authority in congress to thus vest the appointment implies authority to limit, restrict, and regulate the removal by such laws as congress may enact in relation to the officers so appointed.[303]

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[301] *PCAOB II*, 537 F. 3d at 672 (relationship with higher ranking officer and supervised work) (citations omitted).
[302] *PCAOB II*, 537 F. 3d at 672.
[303] *Id*. at 673-674 (citations omitted; emphasis added).

Responding to the assertion by the dissenting circuit judge that an officer removable only for cause is ordinarily not "directed and supervised" for purposes of *Edmond* unless the statute expressly provides either (1) that the officer can be removed for failing to follow a supervisor's direction and supervision, or (2) that a superior officer other than the President has authority to manage—on a before-the-fact basis—the ongoing conduct of all of the officer's exercises of executive authority (such as conducting investigations and taking enforcement actions), Judge Rogers noted that nothing in *Edmond* suggests that the appropriate supervisor's direction and supervision requires managing the officer's ongoing conduct of every day-to-day function and that, even under the dissenting judge's suggested "novel" test, the PCAOB provisions of SOX would survive scrutiny because the statute mandates that "*all* of the Board's duties are 'subject to action by the Commission.'"[304] As for the dissent's position that the Board's decisions concerning inspections, investigations, and enforcement actions cannot be prevented, affirmatively commanded, and managed by the Commission *before* such decisions are made, the majority observed that, first, SOX requires the Board to inspect all registered public accounting firms in accordance with a predetermined schedule that can be modified by the Board only by rule pre-approved by the SEC (*i.e.*, the Board does not have the discretion *not* to inspect any particular firm) and to issue an inspection report, which is subject to SEC review at the request of any inspected firm; second, SOX preserves the SEC's own investigative authority and authorizes the SEC *not* to affirmatively command an investigation by the Board, which means that the Board may not usurp the SEC's investigative authority; and third, "and most important," because the Board must establish by rule "fair procedures for the investigation and disciplining" of accounting firms and individuals and because no such rule shall become effective without prior SEC approval, the SEC is empowered by SOX to modify the Board's investigative authority as it

[304] *Id*. at 675 (emphasis in original).

sees fit and may mandate "that all decisions regarding investigation or enforcement actions against a firm be approved by the Commission." Discounting the significance of dissent's distinction between managerial control exercised *before* the officer has taken an action and managerial control exercised *after* the officer has acted, Judge Rogers emphasized that the significant point is that, "'[a]s in *Edmond*, any sanctions imposed by the Board are 'subject to review by the 'Commission' *before* the decisions t[ake] effect on the accused.'"[305]

The Circuit Court also rejected the Fund's contention, even assuming that Board members are inferior officers, that the SEC is not a department and the SEC commissioners are not the "head" of such a department for purposes of the Excepting Clause of the Appointments Clause. Judge Rogers noted that although no definition of "Heads of Departments" has yet been provided, the Supreme Court has explained that the term "Departments" refers to "'the subdivision of the power of the Executive into departments, for the more convenient exercise of that power'"; that "Departments" are " '*like* the Cabinet-level departments'" but not limited to cabinet-level departments; and that the four concurring justices in *Freytag* urged that the term be understood to encompass " 'all agencies immediately below the President in the organizational structure of the Executive Branch,' including 'all independent executive establishments.'"[306] The majority of the circuit judges determined that the SEC is "Cabinet-like" because it exercises "executive authority over a major aspect of government policy" and that, given the Supreme Court's acknowledgment in cases like *Humphrey's Executor* of the constitutionality of independent agencies like the FTC and the SEC, "such entities must be able to constitutionally exercise appointment authority to permit their proper functioning."[307] Quoting with approval from an Attorney General's Opinion from 1933 concerning the Civil Service Commission, the

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[305] *Id*. (emphasis added).
[306] *Id*. at 676 (emphasis in original).
[307] *Id*. at 677.

majority opined that the SEC, too, is " 'not a subordinate Commission attached to one of the so-called executive departments but is in itself an independent division of the Executive Branch of the Government with certain independent duties and functions'" and concluded that, as Congress has authorized the SEC to appoint officers and employees, "it would be illogical to handicap its ability to effectuate its statutory mandate because of the very independence that Congress has deemed necessary and the Supreme Court has deemed constitutional."[308]

The majority also determined that the SEC commissioners, as a group, collectively exercise the same final authority as is vested in a single head of an executive department and thus qualify as one of the "Heads of Departments" for Appointments Clause purposes. Analogizing the SEC commissioners to the nine governors of the U. S. Postal Service (the "USPS") and relying upon a decision by the U. S. Court of Appeals for the Ninth Circuit that the governors of the USPS constitute its "head" and that " 'Congress carefully vested ultimate control and authority of the Postal Service in the Governors,'" the majority concluded that "[t]he same is true here" and noted that the Fund had cited no authority suggesting that the framers of the Constitution had intended to foreclose Congress from granting multi-member commissions the authority to appoint inferior officers under the Excepting Clause of the Appointments Clause.[309] Hence, the Court of Appeals held that, because Board members are inferior officers and because the SEC is a department whose head consists collectively of the SEC's commissioners, the provision of SOX authorizing the SEC commissioners to appoint the members of the PCAOB does not violate the Appointments Clause.[310]

Addressing the separation-of-powers portion of the plaintiffs' claim, the Court of Appeals characterized that challenge not as an assertion that Congress or the federal judiciary had

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[308] *Id.*
[309] *Id*. at 677-678.
[310] *Id*. at 678.

impermissibly encroached on the President's appointment, removal, or decision-making authority "by aggrandizing their own powers," but rather as an argument that SOX had impermissibly effected "an excessive attenuation of Presidential control over the Board":

> The crux of the Fund's challenge – that the double for-cause limitation on removal makes it impossible for the President to perform his duties – is a question of first impression as neither the Supreme Court nor this court has considered a situation where a restriction on removal passes through two levels of control. But . . . [t]he removal power does not operate in a vacuum; rather it is one of several criteria [identified by *Morrison* as] relevant to assessing limits on the President's ability to exercise Executive power.[311]

The Supreme Court, Judge Rogers noted, "has long recognized that some types of restrictions on Presidential authority within the Executive Branch are permissible, especially in the case of independent agencies."[312] In *Morrison*, for instance, the Court had determined that " 'the real question [is] whether . . . the President's ability to perform his constitutional duty' to 'take Care that the Laws be faithfully executed' was impeded" and had concluded that, in the light of the Attorney General's ability to remove the independent counsel for cause, her limited jurisdiction and tenure, and her lack of policy-making authority, congressional "restrictions on the 'amount of control or supervision' that the President ultimately exercised over the functions of the Independent Counsel were constitutional given the 'several means of supervising or controlling the . . . powers that may be wielded.' "[313]

The dual for-cause feature of the removal provisions applicable to Board members under SOX are entirely consistent with *Humphrey's Executor* and *Morrison*, the Court of Appeals held. The nature and extent of the controls exercised by the SEC over the Board and the President's ability to remove SEC commissioners for cause, the court concluded, do not mean that the President's ability to carry out his Executive responsibilities are unconstitutionally restricted.

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[311] *PCAOB II*, 537 F. 3d at 679.
[312] *Id*.
[313] *Id*.

"When assessed in the context of the restrictions on Presidential power upheld in *Morrison*," the court averred, "the President's powers under [SOX] extend comfortably beyond the minimum required to 'perform his constitutionally assigned duties.' Although the President does not directly select or supervise the Board's members, the President possesses significant influence over the Commission, which in turn possesses comprehensive control over the Board." Thus rejecting the plaintiffs' separation-of-powers challenge "[b]ecause of the reality of the President's broad-ranging authority under [SOX]," the Court of Appeals observed that "the bulk of the Fund's challenge to [SOX] was fought—and lost—over seventy years ago when the Supreme Court decided *Humphrey's Executor*."[314]

Dissenting Court of Appeals Judge Brett M. Kavanaugh's view of the case and approach to the constitutional issues were diametrically opposed to those of the majority. "This case," Judge Kavanaugh declared, "is *Humphrey's Executor* squared. There is a world of difference between the legion of *Humphrey's Executor*-style agencies and the PCAOB: The heads of the *Humphrey's Executor* independent agencies are removable for cause *by the President*, whereas members of the PCAOB are removable for cause only *by another independent agency, the Securities and Exchange Commission*." Thus characterizing the PCAOB as a discrete "independent executive agency," presumably separate and apart from and independent of the SEC, Judge Kavanaugh focused upon the removal power as a significant tool of control:

> The President's power to remove is critical to the President's power to control the Executive Branch and perform his Article II responsibilities. Yet under this statute, the President is two levels of for-cause removal away from Board members, a previously unheard-of restriction on and attenuation of the President's authority over executive officers. This structure effectively eliminates any Presidential power to control the PCAOB, notwithstanding that the Board performs numerous regulatory and law-enforcement functions at the core of the executive power. . . . [N]ever before in American history has there been an independent agency whose heads are appointed by and removable only for cause

[314] *Id*. at 681, 685.

> by another independent agency, rather than by the President or his alter ego. But that is the case with the PCAOB members, who are removable for cause only by the SEC—and it is undisputed that the SEC as an independent agency is not the President's alter ego. The PCAOB thus goes well beyond what historical practice and *Humphrey's Executor* authorize.[315]

Judge Kavanaugh also attempted to distinguish the PCAOB case from existing Supreme Court precedent on the ground that here, contrary to the majority's assertion, the removal power has been effectively and completely stripped from the President. Moreover, according to Kavanaugh, the members of the PCAOB are not inferior officers, but principal officers who must be appointed by the President by and with the advice and consent of the Senate.[316]

Although not addressing the "Heads of Departments" issue directly,[317] Judge Kavanaugh attempted to rebut the majority's characterization in discussing the control aspect of the Appointments Clause issue, writing:

> None of the . . . authorities [cited by the Board] gives the SEC power to prevent and affirmatively command, and to manage the ongoing conduct of, Board inspections, investigations, and enforcement actions… After-the-fact judicial or quasi-judicial review of enforcement decisions following an investigation does

[315] *Id*. at 686-687 (Kavanaugh, J., dissenting) (emphasis in original).
[316] *Id*. at 687. Even were PCAOB members construed to be inferior officers, Judge Kavanaugh opined, SOX permits the SEC to remove a member from office only when such member has "willfully" broken the law, has "willfully abused" his or her authority, or "without reasonable justification or excuse" has "failed to enforce compliance." Such a for-cause standard, according to Kavanaugh, "is more restrictive removal language than the traditional for-cause language of inefficiency, neglect of duty, or malfeasance." *Id*. at 703. "The statutory language and history [of SOX] show, in short," Kavanaugh asserts, "that the effect and purpose of this statute were to wall off the PCAOB from comprehensive SEC control, not to make the PCAOB 'an arm or an eye' of the SEC. The Board's counter-factual, counter-textual argument [in the Court of Appeals] ignores the double for-cause reality of this statutory scheme." *Id*. at 704 (citation omitted).
[317] Judge Kavanaugh explained that it was unnecessary for him to address the "heads-of-departments" issue because he found PCAOB members to be principal, not inferior, officers requiring appointment by the President by and with the consent of the Senate, thus rendering the Excepting Clause inapplicable. Nonetheless, Kavanaugh noted that, on that issue, he generally agreed with the majority that

> plaintiffs' submission is inconsistent with current Supreme Court precedents. On the . . . issue of what entities constitute departments, *Freytag* nominally left open whether the SEC is a department; but as Justice Scalia explained in his persuasive concurrence for four Justices, it would not make much sense to hold that independent agencies are not departments so long as *Humphrey's Executor* is good law. On the . . . issue of who is a head of a department, both text and longstanding Executive Branch interpretation confirm that the head of a department can consist of multiple persons.

Id. at 712 n.24 (citations omitted).

> note remotely equate to direction and supervision for purposes of *Edmond* . . . . [T]he SEC's exercising, taking over, or limiting the Board's responsibilities does not amount to directing and supervising the PCAOB.[318]

In his consideration of the plaintiffs' challenge of the PCAOB provisions of SOX under the Appointments Clause, Judge Kavanaugh read *Edmond* as establishing a two-part test and as mandating that an officer who is removable only for cause is ordinarily not "directed and supervised" for purposes of *Edmond* "at least unless (1) the statute expressly provides that the officer can be removed for failing to follow a supervisor's direction and supervision, or (2) the statute expressly provides that a superior officer other than the President has authority to prevent and affirmatively command, and to manage the ongoing conduct of, all of the officer's exercises of executive authority against the public (such as conducting investigations and taking enforcement actions)." Applying such an analysis to this case, Kavanaugh concluded that PCAOB members are principal officers and that because they are not appointed by the President by and with the advice and consent of the Senate, the PCAOB provisions of SOX are unconstitutional.[319]

Responding to the majority's observation that the plaintiffs' separation-of-powers challenge was not that Congress or the federal judiciary had impermissibly encroached on the President's appointment, removal, or decision-making authority by aggrandizing their own powers but that SOX had impermissibly effected an excessive attenuation of Presidential control over the Board, Judge Kavanaugh noted that such a distinction is "not an entirely accurate summary of separation of powers principles" and quoted from a decision in 1996 by Justice Anthony Kennedy to the effect that "[e]ven when a branch does not arrogate power to itself, . . . the separation-of-powers doctrine requires that a branch not impair another in the performance of

[318] *PCAOB II*, 537 F. 3d at 709-710 (Kavanaugh, J. dissenting).
[319] *Id*. at 709.

its constitutional duties."[320] Kavanaugh went on to assert his view that SOX's restriction on the President's removal power over the PCAOB is unconstitutional under both *Humphrey's Executor* and *Morrison*, primarily on the grounds that, unlike the facts in either of those cases, "neither the President nor a Presidential alter ego can remove the members of the PCAOB" and that, contrary to the dictates of *Morrison*, this is a case in which the power to remove an executive official has been completely stripped from the President, " 'thus providing no means for the President to ensure the "faithful execution" of the laws.' "[321] Concluding that SOX impermissibly attenuates the President's removal power over the PCAOB, Kavanaugh declared:

> *Humphrey's Executor* and *Morrison* represent what up to now have been the outermost constitutional limits of permissible congressional restrictions on the President's removal power. Therefore, given a choice between drawing the line at the holdings in *Humphrey's Executor* and *Morrison* or extending those cases to authorize novel structures such as the PCAOB that further attenuate the President's control over executive officers, we should opt for the former. We should resolve questions about the scope of those precedents in light of and in the direction of the constitutional text and constitutional history.[322]

In a final section of his dissenting opinion, Judge Kavanaugh noted that "from an accountability perspective, the whole of this statute is worse than the sum of its parts because neither the President nor his alter ego has any role in the *appointment* of Board members or in the *removal* of Board members." Each of these problems, Kavanaugh maintained, compounds the other. Quoting a passage from Professor Laurence H. Tribe, the dissenting court of appeals judge emphasized the accountability problem with "this kind of structure":

> [I]n the particular situation in which an inferior officer is appointed by persons who are themselves not politically accountable . . . ongoing supervision by a politically accountable official, whether by the President or by someone serving at the President's pleasure, seems particularly important. In such circumstances, where there is little or no political accountability at the front end for the choice of

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[320] *Id*. at 695 n.4.
[321] *Id*. at 697, 698.
[322] *Id*. at 698.

> that officer, a 'for cause' limitation on removal that renders political supervision impossible appears troubling from an accountability perspective.[323]

"Even assuming," Judge Kavanaugh concluded, "that the statutory scheme structuring the PCAOB is an effective means to regulate the accounting industry, 'that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution.'"[324]

C. The Proceedings before the Supreme Court of the United States

The Free Enterprise Fund and Beckstead Watts filed a petition for a writ of certiorari,[325] which the Supreme Court granted in May 2009. Several questions were presented to the Court and are as follows:

> 1. Whether the Sarbanes-Oxley Act of 2002 violates the Constitution's separation of powers by vesting members of the Public Company Accounting Oversight Board ("PCAOB") with far-reaching executive power while completely stripping the President of all authority to appoint or remove those members or otherwise supervise or control their exercise of that power, or whether, as the court of appeals held, the Act is constitutional because Congress can restrict the President's removal authority in any way it "deems best for the public interest."
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> 2. Whether the court of appeals erred in holding that, under the Appointments Clause, PCAOB members are "inferior officers" directed and supervised by the Securities and Exchange Commission ("SEC"), where the SEC lacks any authority to supervise those members personally, to remove the members for any policy- related reason or to influence the members' key investigative functions, merely because the SEC may review some of the members' work product.
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> 3. If PCAOB members are inferior officers, whether the Act's provision for their appointment by the SEC violates the Appointments Clause either because the SEC is not a "Department" under Freytag v. Commissioner, 501 U.S. 868 (1991), or because the five commissioners, acting collectively, are not the "Head" of the SEC.[326]

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[323] *Id*. at 713 (*quoting* Laurence H. Tribe, 1 AMERICAN CONSTITUTIONAL LAW § 4-8, at 684 (3d ed.2000).
[324] *Id*. at 714 (citing INS v. Chada, 462 U.S. 919, 944 (1983)).
[325] Petition for a Writ of Certiorari, Free Enterprise Fund v. PCAOB, No. 08-861 (U.S. Jan. 5, 2009) (cert. granted May 18, 2009); *see* http://www.supremecourt.gov/Search.aspx?FileName=/ docketfiles/08-861.htm (timeline of Court filings).
[326] *Id*. at i.

A review of the parties' briefs and the transcript of oral argument before the Supreme Court in December 2009 reveals that the parties employ differing interpretations of the applicable precedent to resolve these questions. The lack of clear standards provided by the Court's prior decisions is a factor in the dissimilar arguments set forth by the parties in support of their positions in the appeal.

1. The Appointments Clause Issues

a. Principal or Inferior Officers?

The crux of the *Free Enterprise Fund* case is the claim that SOX violates the Appointments Clause, which the Supreme Court has recognized "is among the significant structural safeguards of the constitutional scheme."[327]

The petitioners have claimed that Board members are principal officers[328] and that the supervision described in *Edmond* is absent for Board members. They argue that Presidential removal power is necessary for the "effective discipline" of inferior officers and that, secondly, supervision requires "day-to-day oversight."[329] Both are absent here, the petitioners contend. Moreover, the petitioners claim:

> in addition to determining whether an officer has a superior, the Court must look to the nature of the office and its duties, asking whether the officer enjoys broad authority to "formulate policy" in a permanent office with statutory authority, or rather is "empowered… to perform only certain, limited duties," in an office "limited in tenure."[330]

When viewed by this standard, the petitioners contend, Board members clearly are principal officers because they are independent and autonomous, possess policy-making authority, and circumvent the usual congressional appropriations process. Moreover, the petitioners argue, the

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[327] *Edmond*, 520 U.S. at 651.
[328] Brief for Petitioners at 43.
[329] *Id*. at 46-47.
[330] *Id*. at 48 (citing *Morrison*, 487 U.S. at 671-672).

PCAOB was created by SOX expressly as an independent agency, and, as such, "the heads of *all* agencies or quasi-governmental corporations are appointed by the President with Senate confirmation."[331] The Board is its own independent agency, the petitioners argue, so the Appointments Clause should apply to the Board's members as principal officers.

Conversely, both respondents rely on *Edmond* to argue just the opposite: that Board members are inferior officers.[332] The Board, for instance, asserts that

> [t]he standard for distinguishing principal from inferior officers is clear. Under *Edmond*… "[w]hether one is an 'inferior' officer depends on whether he has a superior." Consequently, "'inferior officers' are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate." Here, Board members are comprehensively "directed and supervised" by the presidentially appointed Commissioners of the SEC.[333]

This supervision includes, but is not limited to, *de novo* review by the SEC of any disciplinary action taken by the Board, the SEC's ability to rescind the Board's authority, and the Commission's rule-approval procedures and informal supervision.[334] Having the authority to supervise and control is enough, the respondents contend; that the SEC does not actually exercise its authority does not mean that the SEC does not *have* such authority.[335] Is, however, the SEC's authority over Board functions the same as at-will removal over Board members? The court of appeals and the respondents answered in the affirmative.[336] In response to a question from Justice Anthony Kennedy during oral argument before the Court in December 2009, Solicitor General Elena Kagan noted that

> the statutory scheme and structure makes it clear that the SEC has comprehensive authority not just over the rulemaking, but over the investigative and inspection

[331] Brief for Petitioners, *supra* note 328, at 50.
[332] *See* Brief for PCAOB at 15; Brief for United States, at 29-30.
[333] Brief for PCAOB at 15 (citing *Edmond*, 520 U.S. at 662-663) (citation omitted).
[334] *See* PCAOB Rule 5206; Sarbanes-Oxley Act §§ 106 (d)(1), 107 (b); Brief for United States at 27.
[335] *See* Brief for PCAOB at 24 ("oversight powers… enable control by their existence, not just their exercise").
[336] *PCAOB II* at 30; Brief for United States at 28.

> activities of the board; that no – no sanction arising from an investigation can be issued except if the board agrees; that no inspection report can be issued, except if the . . . the SEC agrees.
>
> And further, as I said before, that the SEC can reach further back into the process and say, not only do we have this kind of veto authority over any sanction that comes out of an investigation or over any report that comes out of an inspection, but we can also change the way those inspections and investigations are conducted in the first place.[337]

Also, during oral argument, counsel for the petitioners attempted to minimize the SEC's statutory authority to rescind the Board's authority to investigate and inspect and to distinguish between the SEC's authority to restrict before-the-fact action by the Board and the Commission's authority to review and rescind proposed Board action after-the-fact. "If I relieve my associate of the responsibility to give me a brief tomorrow, I haven't told him he can't do it," counsel argued. "Don't . . . you think that's what it means, though, realistically?" Justice Scalia responded, "When you no longer have responsibility to perform a . . . governmental act, you no longer have the authority to perform it."[338]

Following this exchange, Justice Kennedy asked counsel for the petitioners, "What other harms or dangers or risks are inherent in the power of the Board unmonitored, unchecked by the SEC, to investigate?" Counsel responded, "The burden here is the burden that Mr. Olson suffered in Morrison v. Olson. He was never indicted. There was [*sic*] never any sanctions subject to review. But he was subject to a burdensome investigation and that is the burden that affects American citizens that is beyond the review of the SEC."[339]

Additionally, the PCAOB challenges the petitioners' assertion that prohibiting for-cause removal of Board members makes them de facto principal officers. *Perkins* held that the removal of inferior officers could indeed be limited, and the respondents highlighted that

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[337] Transcript of Oral Argument at 36-37.
[338] *Id.* at 8.
[339] *Id.* at 12.

Edmond had intimated that removal is not the only method of supervision: "while '[t]he power to remove officers * * * is *a* powerful tool for control,' it is not the *only* such tool."[340]

b. Is the SEC a Department?

Even if the Board members are found to be inferior officers, does SOX still violate the Appointments Clause because the SEC is not a "Department" or because the SEC's commissioners are not, collectively, the "Head" of a department? The SEC is not directly accountable to the President, petitioners allege, because the President does not have the authority to remove the SEC's commissioners at will and because the commissioners together do not constitute a department's "Head."[341]

The United States countered:

> Treating the Commissioners as the SEC's "Head" therefore is much more natural than saying that the SEC has no "Head," or that its "Head" is a person in whom Congress has *not* vested the agency's final decision-making authority. See *Silver* v. *Postal Serv.*, 951 F.2d 1033, 1038 (9th Cir. 1991) (holding that the Postal Service is a "Department" under the Appointments Clause, and its nine Governors collectively constitute the "Head" for appointment purposes); *Authority of Civil Serv. Comm'n to Appoint a Chief Examiner*, 37 Op. Att'y Gen. 227, 231 (1933) (opining that the three commissioners of the Civil Service Commission collectively served as "the 'head of a Department' in the constitutional sense"); cf. Classification Act of 1923, ch. 265, § 2, 42 Stat. 1488 (" 'the head of the department' means the officer *or group of officers* in the department who are not subordinate or responsible to any other officer of the department") (emphasis added).[342]

Moreover, the government noted, the Court has long construed the Appointments Clause to permit a person other than the agency head (here, for the sake of argument, the SEC's commissioners) to appoint an inferior officer so long as the appointment is made with the approval or approbation of the agency head (presumably, again for the sake of argument, in those cases when the chairman, who is also an SEC commissioner, votes with a majority of the

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[340] *See* Brief for PCAOB at 22 (*quoting Edmond*, 520 U.S. at 664) (emphasis in original brief).
[341] Brief for Petitioners at 56.
[342] Brief for United States at 40.

commissioners to appoint a particular Board member).[343] While petitioners used the Reorganization Act of 1949[344] to show that the chairman exercised significant authority, the Commission, collectively, the government noted, was given control over Board appointments under SOX, which is consistent with other existing rulemaking and enforcement authority of the SEC.[345]

The petitioners interpret *Freytag* to mean that appointments under the Excepting Clause must go to those "directly answerable" to the President, so that any holding otherwise by the Court would overrule that precedent.[346] The independent agencies are "part of the Executive Branch," the respondents counter.[347] Moreover, emphasized the respondent, the Chairman *is* accountable to the President, though the petitioners are not satisfied with that. Finally, the petitioners charge that if the Chairman were not the "Head" of the SEC, then all inferior officer appointments within the SEC made by the Chairman *alone* rather than by the whole Commission (limited, in fact, to certain staff members) would be unconstitutional,[348] to which the respondents reply, "But those staff members are not appointed 'by the Chairman *alone*.' . . . '[T]he appointment[s] by the Chairman of the heads of major administrative units under the Commission [*are*] *subject to the approval of the Commission*.'"[349] During oral argument, this exchange between counsel for the petitioners and Justice Scalia, captured that idea:

MR. CARVIN: [I]f you accept their view of who the head of the department is,

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343 *Id*. at 41.
344 Reorganization Plan No. 10 of 1950, § 1 (a), 15 Fed. Reg. 3175 (May 25, 1950) (delegating to the SEC chairman executive and administrative functions).
345 Brief for PCAOB at 33.
346 Brief for Petitioners at 59.
347 Brief for PCAOB at 30 (citing *Fed. Maritime Comm'n v. S.C. State Ports Auth.*, 535 U.S. 743, 773 (2002) (Breyer, J., dissenting, joined by Stevens, Souter, and Ginsburg, JJ.) (although independent agencies are "sometimes referred to pejoratively as part of a 'headless Fourth Branch,' . . . agencies, even "independent agencies," are more appropriately considered to be part of the Executive Branch").
348 Brief for Petitioners at 62.
349 Brief for PCAOB at 35 (*citing* Reorganization Plan No. 10, § 1 (b)(2), 15 Fed. Reg. 3175) (emphasis in original brief).

which is the commission --

JUSTICE SCALIA: All those appointments are presumably invalid.

MR. CARVIN: -- all those appointments are unconstitutional, so under their theory --

JUSTICE SCALIA: That would be a shame.[350]

2. The Separation of Powers Issues

The principle of "separation of powers… is at the heart of our Constitution."[351] The Constitution vests power in three separate branches of government and allocates power among the Legislature, the Executive, and the Judiciary.[352] The power of the Executive over the PCAOB is one of the principal issues at hand in the *Free Enterprise Fund* case.

The petitioners allege that the power of the Executive has been encroached upon by Congress with the creation of the PCAOB.[353] The creation of the Board, however, was a congressional response to increasing demand from the public for reform, especially during the post-Enron, post-WorldCom period. Moreover, the Center for Audit Quality (the "CAQ"), as *amicus curiae*, has urged the Court to consider the purpose that Congress attempted to serve when it created the PCAOB. Even comments by Justice Ruth Bader Ginsburg during oral argument in the case allude to the need for the Board. Indeed, during the rebuttal by counsel for the petitioners, Justice Ginsburg commented that "[t]here is a problem that Congress had to solve. It wanted to tighten the oversight of the auditing function."[354] The *amicus* brief[355] elaborates this perspective for the Court. Instead of supporting the respondent's constitutional

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[350] Transcript of Oral Argument at 26.
[351] *Buckley*, 424 U.S. at 119; *see* M.J.C. VILE, CONSTITUTIONALISM AND THE SEPARATION OF POWERS (2d ed., Liberty Fund 1998) (1967).
[352] *See* INS v. Chadha, 462 U.S. 919 (1983) (one-house legislative veto violated separation of powers).
[353] *See Bowsher*, 478 U.S. at 727 ("dangers of congressional usurpation of Executive Branch functions have long been recognized").
[354] Transcript of Oral Argument at 65.
[355] Brief for the Center for Audit Quality as *Amicus Curiae* Supporting Respondent Public Company Accounting Oversight Board, PCAOB III, No. 08-861 (U.S. Oct. 20, 2009).

arguments, the CAQ emphasizes the PCAOB's role in the markets as a compelling reason for upholding the legitimacy of the PCAOB. The CAQ notes that

> PCAOB inspections have improved audit quality in a number of ways. . . . . Moreover, the PCAOB's oversight of the profession brings with it stability and predictability that is beneficial to both the investing public and the audit profession. The profession appreciates the benefits that a tough but fair, well-informed and appropriately focused regulator can bring to audit quality, and recognizes that an entity charged with audit regulation provides corresponding benefits to investors.[356]

By enacting SOX, petitioners claim, Congress has completely "circumvent[ed]… basic controls on governmental power…by, for the first time in our Nation's history, vesting this potentially tyrannical authority in a purportedly *private* 'corporation' whose members are *not* 'officer[s]… or agent[s of] the Federal Government.'"[357] Moreover, they argue that the statute impedes the President's ability to perform his constitutional duty to carry out the laws of the United States.[358] The petitioners contend that "this is quite a simple case because (i) the President has *no* ability to control or supervise Board members, (ii) Congress has at least equivalent ability to influence the Board, and (iii) there is no legitimate justification, let alone an 'overriding need,' for this intrusion."[359] By this, the petitioners mean that the President has no "at-will" removal authority, no authority via an "alter ego," and no direct or indirect influence over Board action.[360] Congress, they argue, even impermissibly retains control over the removal of Board members since it has, in effect, an ultimate "veto power over any Board member's

[356] *Id*. at 4.
[357] Brief for Petitioners at 9, PCAOB III, No. 08-861 (U.S. July 27, 2009) (citing Sarbanes-Oxley Act §§ 101 (a) and (b)) (emphasis in original).
[358] *See* U.S. CONST. art. II, § 3 ("shall take care that the laws be faithfully executed"); *Loving v. United States*, 517 U.S. 748 at 757 (1996) ("[e]ven when a branch does not arrogate power to itself,… the separation of powers doctrine requires that a branch not impair another in the performance of it constitutional duties").
[359] Brief for Petitioners at 25, PCAOB III, No. 08-861 (citing *Nixon v. Administrator*, 433 U.S. 425, 443 (1977)).
[360] *Id*. at 25-30.

removal" in the form of denying confirmation of new SEC Commissioners who might be nominated by the President for the purpose of firing Board members:[361]

> Upholding the Board here would therefore plainly authorize Congress to reduce the President to the largely symbolic and hortatory role of appointing bipartisan independent commissioners who, in turn, would appoint independent board members who do the actual governing but could not be removed or supervised by the President in any circumstance, and where any indirect removal effort would necessarily involve the Senate's participation. This arrangement cannot reasonably be squared with the Constitution's plain language and is precisely the unaccountable plural executive that the Framers expressly rejected because it would both place the executive under the thumb of Congress and place citizens under the thumb of unelected functionaries. If the Constitution's express vesting of the "executive power" in the President, and the Court's consistent endorsement of the Constitution's liberty-enhancing separated powers, are anything more than meaningless rhetoric, the Act's complete separation of the executive power from the Executive must be patently unconstitutional.[362]

The government, in response, relies on *Humphrey's Executor* as having established the constitutional sufficiency of the President's control over independent agencies as settled law for more than seventy years.[363] Moreover, respondent United States argues, the Court has long recognized since well before *Perkins* that Congress clearly has the authority to restrict the President's power to remove inferior officers when the power to appoint such officers is vested in the head of a department or in the courts of law under the Excepting Clause.[364] Hence, the Appointments Clause actually contemplates the attenuation of Presidential power to control and supervise (and ultimately, Presidential accountability) because "the power of removal is incident to the power of appointment."[365]

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[361] *Id*. at 31 ("this case is actually *worse* than *Myers* because the Senate's acquiescence in confirming the replacement Commissioners would not result in the removal of the Board member the President wants to fire—it would only be the first, speculative step toward such removal) (*Id*. at footnote 4).
[362] *Id*. at 38.
[363] Brief for the United States at 42, PCAOB III, No. 08-861 (U.S. Oct. 13, 2009).
[364] *Id*. at 34, 44; *see Perkins*, 116 U.S. at 485; *Hennen*, 38 U.S. (13 Pet.) at 260 ("the power of removal is incident to the power of appointment"). *See also Myers*, 272 U.S. at 161-162 ("Congress, in committing the appointment of such inferior officers to the heads of departments, may prescribe incidental regulations controlling and restricting the latter in the exercise of the power of removal").
[365] *Hennen*, 38 U.S. (13 Pet.) at 260.

The United States further notes that petitioners do not dispute the constitutionality either of independent agencies, which has been well established since *Humphrey's Executor*,[366] or of the SEC, which apparently has never seriously been questioned since the Supreme Court declined to address the constitutionality of the Securities Act of 1933 in 1936.[367] Additionally, respondent PCAOB argues that Congress, in fact, has less control than suggested by the petitioners because SOX actually places the PCAOB outside the congressional budget and appropriation process.[368]

The issue of removal is vital to the discussion of the separation-of-powers argument. The Petitioners allege that SOX violates the *Morrison* two-part test, which, according to the petitioners, is "whether the restriction on Presidential removal 'by itself' impermissibly prevents his 'control [and] supervision' and, if not, whether the Act, 'taken as a whole,' does.[369] SOX prevents "at-will" removal of Board members; instead, the SEC can only remove Board

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[366] Brief for the United States at 42-43. Although some of the petitioners' amici argue in their briefs filed with the Supreme Court in this case that *Humphrey's Executor* should be overruled or that the 1935 decision has been superseded by *Morrison*, which itself, they contend, should be overruled, the United States notes that petitioners themselves do not ask the Court to overrule *Humphrey's Executor* and emphasize why such an action by the Court would be extremely disruptive. "In the seven decades since [*Humphrey's Executor*]," the United States observes, " 'independent' agencies have become an accepted part of American government." *Id*. at 43 n.16.

[367] *See* Jones v. SEC, 298 U.S. 1 (1936). The *Jones* case arose from a ruling by the SEC refusing to permit J. Edward Jones, the nation's largest dealer in oil royalty securities, to withdraw a registration statement that the agency considered to be seriously misleading. When the SEC filed an application in a federal district court for an order requiring Jones to appear and give evidence in the matter of Jones's registration statement, he challenged the constitutionality of both the 1933 Act and the SEC's rule preventing the withdrawal of his registration statement. The district court issued the order, and Jones appealed. The court of appeals affirmed, ruling in favor of the SEC on all of the issues raised by Jones, and, among other things, upheld the constitutionality of the 1933 Act (and presumably the constitutionality of the SEC as well). When the case reached the Supreme Court in March 1936, the Court reversed on the ground that the SEC should have followed controlling equity rules and permitted the withdrawal. At the conclusion of Justice George Sutherland's decision for the Court in Jones, the Court noted that, in the light of the reversal of the decision by the court of appeals on that ground, it was "unnecessary to consider the constitutional validity of the act." *Id*. at 28. At least one noted historian of the SEC has concluded that by not reaching and reversing that portion of the court of appeals' decision that upheld the constitutionality of the 1933 Act (and presumably the constitutionality of the SEC), the Court in effect had allowed the ruling by the court of appeals on that issue "to stand as controlling law." SELIGMAN, TRANSFORMATION OF WALL STREET, *supra* note 4, at 150-151. There do not appear to be any subsequent federal decisions that address any challenges to the constitutionality of the 1933 Act, the 1934 Act, or the SEC.

[368] Brief for the PCAOB, et al. at 52, PCAOB III, No. 08-861 (U.S. Oct. 13, 2009); *see* Sarbanes-Oxley Act §§ 109 (b)-(d) (budget subject to SEC approval; funded from registration fees and accounting support fees).

[369] Brief for Petitioners, at 38-39, PCAOB III, No. 08-861 (citing *Morrison*, 487 U.S. at 685, 695).

members "for cause."[370] This limitation is, petitioners argue, too restrictive and impermissibly limits the President's control. This limitation is further complicated because there are two levels of for-cause removal, which according to the petitioners effectively removes the President from exercising control over the Board. Indeed, as Judge Kavanaugh wrote in his dissent:

> But this case is *Humphrey's Executor* squared. . . . [U]nder this statute, the President is two levels of for-cause removal away from Board members, a previously unheard-of restriction on and attenuation of the President's authority over executive officers. This structure effectively eliminates any Presidential power to control the PCAOB.[371]

According to the government, however, "the Court observed in *Morrison* . . . with respect to an inferior officer, 'we cannot say that the imposition of a 'good cause' standard for removal by itself unduly trammels on executive authority."[372] In addition to violating the "two-part test," the petitioners further argue that, of course, in *Morrison* there was a need to have restrictions on the President's removal power, since the independent counsel was investigating alleged wrongdoing within the Executive Branch. That is, they argue, not the situation in the case at hand.[373] Interestingly, the PCAOB argues that the President's overall control in the traditional sense of chain-of-command authority, and not removal alone, should be the focus of the Court's inquiry and that, in the light of SOX's grant to the SEC of "multiple powers that are equivalent to at-will removal authority," SOX "does not unconstitutionally restrict the President's traditional chain-of-command authority" because the SEC controls "each and every exercise of the Board's authority" and "SOX does not diminish the President's authority over the SEC in the slightest."[374] Moreover, the PCAOB argues, the "removal-follows-appointment rationale does not depend on whether the department head is removable for cause or at will. The department

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[370] Sarbanes-Oxley Act § 107 (d)(3).
[371] *PCAOB II*, 537 F. 3d at 686 (Kavanaugh, J., dissenting).
[372] Brief for United States, at 45 (citing *Morrison*, 487 U.S. at 691) (citation omitted).
[373] Brief for Petitioners at 42-43.
[374] Brief for PCAOB at 45, PCAOB III, No. 08-861 (U.S Oct. 13, 2009).

head must be sufficiently accountable to the President that the department is, in fact, a 'department' capable of appointing inferior officers. . . . But neither the Constitution nor precedent supports a further requirement that the department head be removable at will."[375]

Wholly apart from the legal issues here is Justice Scalia's well-known hostility towards *Humphrey's Executor*,[376] as evidenced by this exchange at oral argument:

> CHIEF JUSTICE ROBERTS: . . . Humphrey's Executor says you can limit the President's removal power. That doesn't get you down to the board. You have to also say the principal officers, there can be limits on their removal authority of the board members.
>
> GENERAL KAGAN: I -- I understand the temptation to say something like, well, we don't really much like Humphrey's Executor, but we are stuck with it, but not an inch further.
>
> CHIEF JUSTICE ROBERTS: I didn't say anything bad about Humphrey's Executor.
>
> (Laughter.)
>
> GENERAL KAGAN: But -- but --
>
> JUSTICE SCALIA: I did, I did.
>
> (Laughter.)
>
> GENERAL KAGAN: But this in fact --

JUSTICE SCALIA: We did overrule it, by the way, in -- in Morrison, didn't we?[377]

V. Analysis of the *Free Enterprise Fund* Case

As of the date of the submission of this paper in early May 2010, the Supreme Court has not issued a decision in the *Free Enterprise Fund* case, and there is no realistic way of predicting what result the Court might reach when its decision is announced.

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[375] *Id*. at 42 (building on *Hennen*'s removal-follows-appointment principle).
[376] STAAB, *supra* note 205, at 62-63.
[377] Transcript of Oral Argument at 42-43.

It is possible, however, to anticipate the possible analytical approaches that the Court might employ. This section addresses those approaches and, when appropriate, suggests which of those approaches the Court is likely to take.[378]

There are several questions to be answered by the Court. Precedent has laid the foundation for principal/inferior officer status and the definition of a "Department," but the parties have interpreted the cases quite differently. Ultimately, it is up to the Court to decide the issues and determine the constitutionality of the PCAOB.

It seems evident that the SEC does not have the resources or interest to promulgate auditing standards. Indeed, the SEC has historically vested the setting of accounting standards in the private sector (*i.e.*, FASB, AICPA).[379] Now, subsequent to the scandals at Enron and other firms, the government has increased authority over the audit function. Therefore, accountability has been increased since this oversight was removed from the private sector. The constitutionality of this transfer, however, is at stake in the *Free Enterprise Fund* case.

It should be kept in mind that this is a facial challenge brought by the petitioners. Facial constitutional challenges are not favored by the courts, and the petitioners should have to satisfy a substantial burden of persuasion in order to prevail in the Supreme Court.[380]

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[378] This analysis is based on existing Court precedent. It should be noted, however, that an alternative checks-and-balances approach has been suggested that asks not whether congressional efforts to insulate agency independence from Presidential control impermissibly infringe on the President's appointment and removal power from the perspective of a particular facet of separation-of-powers theory, but whether there are sufficient checks and balances on the actions of the agency in question relative to all three branches of government. Brown, *supra* note 243, at 146. Such a checks-and-balances approach would, according to its proponent, safeguard "an important structural interest protected by the Appointments Clause: accountability." *Id*. at 153. Such "structural interests [*sic*] may be satisfied by a variety or combination of [ten] oversight tools grounded in the three-branch system." *Id.* Although the proposed checks-and-balances approach might have some appeal as a theoretical matter, it is difficult to envision how such an approach might be incorporated into and applied as a viable judicial test. As a result, it seems unlikely that the current Court will embrace and apply such an approach in the *Free Enterprise Fund* case as an alternative to the well-established standards under the Court's existing legal precedent.

[379] Brief for *Amici Curiae* Former Chairman of the Securities and Exchange Commission in Support of Respondents at 7, PCAOB III, No. 08-861 (U.S. Oct. 20, 2009).

[380] For a discussion of the burden-of-persuasion issue, see Part III.E, *supra*.

A. Appointments Clause Issues

1. Principal/Inferior Officers Question

Foremost, the Court will need to resolve the issue of the principal/inferior officer status of Board members.[381] Will the Court establish a definition for officer status? Most likely not, but the Court ultimately should use *Edmond* or *Morrison* to decide this Appointments Clause issue.

Board members are subject to removal by a higher Executive authority (*i.e.*, the SEC), and, arguably, the PCAOB has limited jurisdiction (*i.e.*, the auditing of public companies). Furthermore, Board members are term-limited.[382] Hence, applying three of the *Morrison* criteria, the Court should conclude that PCAOB members are inferior officers. The Court might very well conclude, however, that the final criterion of *Morrison*—whether the officers have limited duties—is not present because the Board performs a policy-making function and has both investigatory and enforcement authority. Are the functions of the PCAOB quasi-legislative or quasi-judicial in the same sense that the Court in *Humphrey's Executor* concluded that the FTC performed? While Justice Scalia might like the opportunity presented by the *Free Enterprise Fund* case to overturn *Humphrey's Executor*,[383] the assumption is that he will be unable to persuade four other members of the Court to join him in doing so[384] and that the Court's decision in the earlier case will continue to serve as applicable precedent in this case. If so, then the PCAOB facts provide support for answering this question in the affirmative. The WCC

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[381] Board members are clearly not employees, and neither the petitioners nor the respondents argue otherwise.
[382] Sarbanes-Oxley Act § 105 (e) (5).
[383] *See* note 235, *infra*, and accompany text.
[384] The consensus among constitutional scholars is that "*Humphrey's Executor* is considered the seminal case that legitimated independent agencies as a constitutional matter" and that "the Supreme Court has signaled a reluctance to disturb the well-entrenched legality of independent agencies since *Humphrey's Executor*." Brown, *supra* note 243, at 122; Peter L. Strauss, *Formal and Functional Approaches to Separation-of-Powers Questions—A Foolish Inconsistency?*, 72 CORNELL L. REV. 488, 490 (1987). Indeed, the Court "has consistently endorsed the constitutionality of independence from the President." Brown, *supra* note 243, at145.

members in *Wiener*, for instance, were deemed to be inferior officers who performed not purely executive functions, but quasi-judicial functions, and they did not even answer to a higher review or supervisory authority. Conversely, PCAOB members are subject to comprehensive oversight and review by the SEC and, hence, the likelihood that Board members will be characterized as inferior officers is even stronger than was the case with respect to the WCC members in *Wiener*.

Finally, are Board members sufficiently supervised and controlled to satisfy *Edmond*? In *Edmond*, of course, the Judge Advocate General was authorized to remove a CGCCA judge from his judicial assignment at will, or without cause,[385] and the Judge Advocate General presumably was removable without cause by the Secretary of Transportation, who himself was removable by the President without cause whereas in the *Free Enterprise Fund* case, the SEC only has the authority to remove PCAOB members and only for cause. Is that distinction significant for purposes of the Appointments Clause? The Court in *Edmond* seems to have indicated that it was not. For although the Judge Advocate General was authorized to remove a CGCCA judge from his or her judicial assignment, the Court noted that the Judge Advocate General's control over the CGCCA was "not complete" and that the power to reverse decisions of the CGCCA was vested in another Executive Branch entity, the Court of Appeals for the Armed Forces.[386] The removal power, however, was not in itself determinative of the question of whether CGCCA judges were inferior or principal officers. "What is significant," the *Edmond* Court emphasized, "is that the judges of the [CGCCA] have no power to render a final decision on behalf of the United States unless permitted to do so by other executive officers."[387] Moreover, in holding

[385] *Edmond*, 520 U.S. at 664. It is not clear from the Court's decision whether the removal of a CGCCA judge from his assignment was the equivalent of the removal of the judge from his or her office. One of the holdings of the *Edmond* Court was that it was the Secretary of Transportation, and not the Judge Advocate General, who had the authority to appoint the judges of the CGCCA, rather than merely assign such judges to a Court of Criminal Appeals. *Id*. at 658.
[386] *Id.* at 664.
[387] *Id*. at 665.

some six decades earlier that the FTC Act's provision that "any commissioner may be removed by the President for inefficiency, neglect of duty, or malfeasance in office" permissibly limits the President's authority to remove FTC commissioners to these causes only, *i.e*., for cause, the Court in Humphrey's Executor specifically sanctioned the restriction to "for cause" of the President's power to remove the member of an independent agency for separation-of-powers purposes.[388]

Moreover, the Court in *Morrison* observed that, with respect to an inferior officer, "we cannot say that the imposition of 'good cause' standard for removal by itself unduly trammels on executive authority."[389]

Relying upon *Edmond*, the PCAOB in the *Free Enterprise Fund* case argues that the determination of the issue of whether Board members are inferior or principal officers does not turn on removal alone and that, in any event, the SEC's comprehensive control over the PCAOB constitutes the "*equivalent*" of at-will removal power.[390] Although there does not appear to be any legal precedent for the latter proposition, the former argument seems to be the better view. Just as with the judges of the CGCCA, whom the Court in *Edmond* concluded were inferior officers, there is with respect to the PCAOB a superior Executive Branch entity—the SEC—that is similar to the Court of Appeals for the Armed Forces (and ultimately the Supreme Court) with respect to the CGCCA and that supervises the work of the PCAOB, with power to determine its procedural rules, to remove any member of the PCAOB for cause, and to order any adjudicative

[388] *Humphrey's Executor*, 295 U.S. at 626.
[389] *Morrison*, 487 U.S. at 691 (citation omitted).
[390] Brief for PCAOB at 45.

decision by the Board submitted for review.[391] As the Court of Appeals in *Free Enterprise Fund* concluded,

> [SOX] subjects Board members to greater supervision than the Coast Guard judges in *Edmond*, whom the Supreme Court held to be inferior officers even though supervision of the judges was fractured between two different bodies, and their decisions were not subject to *de novo* review. Contrary to the Fund's suggestion, the fact that the Board is charged with exercising extensive authority on behalf of the United States does not mean that Board members must be appointed by the President, for principal as well as inferior officers, by definition, 'exercis[e] significant authority pursuant to the laws of the United States.'" Indeed, what is key under the *Edmond* analysis is the fact that Board members "have no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers. [SOX] vests a broad range of duties in the Board, but its exercise of those duties is subject to check by the Commission at every significant step.[392]

Hence, wholly apart from the PCAOB's "equivalency" argument, the Court in the *Free Enterprise Fund* case should conclude that the members of the PCAOB are inferior, rather than principal, officers.

2. Department Question

In deciding *Freytag*, the Court did not provide a definition for what constitutes a Department for purposes of the Appointments Clause. Justice Scalia's concurring opinion in *Freytag* indicated "that the term 'Departments' means all independent executive establishments . . .[, and] there is no reason, in text, judicial decision, history, or policy, to limit the phrase "the Heads of Departments" in the Appointments Clause to those officials who are members of the

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[391] *See* Edmond v. United States , 520 U.S. at 665-666. All PCAOB adjudications are subject to the SEC's *de novo* review. 15 U.S.C. § 7217(c)(2); National Association of Securities Dealers, Inc. v. SEC, 431 F.3d 803, 804 (D.C. Cir. 2005). In addition, the SEC is empowered by SOX to "modify, cancel, reduce, or require the remission of a sanction imposed by the Board" and to "relieve the Board of its enforcement authority altogether." 15 U.S.C. § 7217(d)(1); *PCAOB II*, 537 F.3d at 670, 672. The SEC also is authorized to "abrogate, add to, and delete from" the rules adopted by the Board and to conform the Board's rules to the requirements of Title I of SOX and to the purposes of SOX. 15 U.S.C. §§ 7217(b)(5), 78s(c). Indeed, the SEC's authority and control over the PCAOB is both "explicit and comprehensive." 15 U.S.C. §§ 7217, 7218; *PCAOB II*, 537 F.3d at 670, 669.

[392] *PCAOB II*, 537 F.3d at 672 (citations omitted).

President's Cabinet."[393] Yet, during oral argument, Justice Scalia commented to counsel to the petitioners that, "I hope your case doesn't rest on *Freytag*."[394]

If it is determined that the SEC is a department, the Court must also consider whether, acting together as one, the commissioners of the SEC are the "Head" of the department. *Silver* is judicial precedent supporting this concept. Moreover, the fact that all but the most basic of administrative functions are subject to Commission approval is solid support for holding that the Commission, collectively, is the "Head."

B. Separation-of-Powers Issues

In her opinion in the Court of Appeals decision, Judge Rogers described the "crux" of the *Free Enterprise Fund* case as the double for-cause limitation on the President's removal power, which "makes it impossible for the President to perform his [constitutional] duties."[395] During oral argument before the Court, the following exchange occurred between Solicitor General Kagan and Chief Justice Roberts:

> GENERAL KAGAN: The ultimate constitutional question is the level of presidential control, and the presidential control here is exactly the same with respect to the board's activities as it is with respect to the SEC staff's activities.
>
> CHIEF JUSTICE ROBERTS: Oh, no, no, because you have got an extra layer there. Let's say, I mean, that you have to have two violations of the for-cause provision. You have got to have -- you have to meet the requirement in two places. When the SEC wants to remove the board member, they can only do that for cause. And if they decide, well, there isn't cause; I'm not going to do it, then the President under your theory has to remove the SEC commissioners, all of them, not just -- not just the chairman, and he can only do that for cause.
>
> So you have got "for cause" squared, and that's -- that's a significant limitation that Humphrey's Executor didn't recognize and Morrison didn't recognize.[396]

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[393] *Freytag*, 501 U.S. at 918, 920 (Scalia, J. concurring).
[394] Transcript of Oral Argument at 23.
[395] *PCAOB II*, 537 F. 3d at 679.
[396] Transcript of Oral Argument at 44-45.

The issue presented by the double for-cause limitation on the President's removal power is, as Judge Rogers noted in her opinion for the Court of Appeals, one of "first impression"[397] in that the Supreme Court has to date not been faced a restriction on removal that passes through two levels of control. Because of these two levels of control, neither *Morrison* nor *Edmond* is directly applicable. In both *Morrison* and *Edmond*, there was "flow-through" Executive control in the form of removal power. In *Morrison*, the independent counsel was removable by Attorney General, a cabinet-level officer, who was removable at will by the President. Similarly, in *Edmond*, the Secretary of Transportation, also a cabinet-level officer, was removable at will by the President, and the judges of the United States Court of Appeals for the Armed Forces are removable by the President for cause.[398] In both *Morrison* and *Edmond*, a cabinet-level officer who was removable at will by the President exercised either oversight or removal control. That is what makes the *Free Enterprise Fund* case different from both *Morrison* and *Edmond*—in the *Free Enterprise Fund* case, only the SEC, whose commissioners are removable by the President only for cause, stands between the President and the Board (*i.e.*, there is no "flow through" control by the President over the Board). The question that is presented here is whether the absence of "flow-through" control is sufficient for separation-of-powers purposes. The parties' differing characterizations of *Morrison* and *Edmond* probably arise because this case is not conclusively governed by either of those cases.

If one juxtaposes the holding in *Humphrey's Executor*, which found for-cause removal control to be sufficient for independent agencies, with the preceding analysis, the

[397] PCAOB II, 537 F. 3d at 679.
[398] The United States Court of Appeals for the Armed Forces is deemed be located within the Executive Branch. *See Edmond*, 520 U.S. at 665 n.2. For the President's removal authority, see 10 U.S.C. § 942 (c).

absence of "flow-through" control might well be found to constitute sufficient Presidential control over the Board.

C. Accountability Issue

Justice Stevens's observation in *Chevron* that administrative "agencies are not directly accountable to the people, the Chief Executive is"[399] constitutes, as had been noted merely a statement of political reality, not a constitutional principle. Even assuming, however, that Justice Stevens's statement does, indeed, amount to a statement of binding constitutional principle and that, by application of that principle to inferior officers appointed under the Excepting Clause of the Appointments Clause, the accountability doctrine does, indeed, apply to such officers serving within independent agencies, then the issues in each such case would be, first, whether such officer is appointed by persons who are indeed, in Professor Tribe's words, "themselves not politically accountable" and, second, if so, whether there is "ongoing supervision" of such official "by a politically accountable official."[400]

Here, given the President's ability to remove SEC commissioners (including the chairman) for cause, which appears to have been sanctioned by both *Humphrey's Executor* and *Morrison*, the answer to Processor Tribe's first question seems to be that the PCAOB members *are* appointed and removable by persons—the SEC commissioners—who *are* politically accountable to the President. Moreover, in the light of the comprehensive non-removal controls over the PCAOB exercised by the SEC, the answer to Tribe's second question seems to be that there is, indeed, ongoing supervision of Board members by politically accountable officials. Hence, the Court should resolve any political accountability issues in favor of the PCAOB.

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[399] Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 851, 865-866 (1984) (citation omitted).
[400] *See* TRIBE, *supra* note 247, at 684.

D. Severability Issue

Commentators have suggested that if the PCAOB is declared unconstitutional, then the remainder of SOX will be invalidated because of the absence of a severability provision in the statute. As the Supreme Court has noted, however,

> The unconstitutionality of a part of an act does not necessarily defeat or affect the validity of its remaining provisions. Unless it is evident that the Legislature would not have enacted those provisions which are within its power, independently of that which is not, the invalid part may be dropped if what is left is fully operative as a law . . . [The] invalidity of any part of the act shall not in any manner affect the remaining portions. That discloses an intention to make the act divisible, and creates a presumption that, eliminating invalid parts, the Legislature would have been satisfied with what remained, and that the scheme of regulation derivable from the other provisions would have been enacted without regard to [the invalid power].[401]

Hence, even the absence of a severability provision in SOX would not necessarily result in the invalidation of the entire statute were the Court to rule that the statute's PCAOB provisions are unconstitutional. Under the long-recognized judicially created severability doctrine (the "Severability Doctrine"), that would be the result only if the Court determines that Congress would not have enacted the remaining portions of SOX without the PCAOB provisions.

The application of the Severability Doctrine by the Court in the *Free Enterprise Fund* case, however, would not necessarily mean that the remaining provisions of SOX would survive if the PCAOB provisions fail. The Court might well find that Congress would not have enacted the remaining provisions of SOX independently of the PCAOB provisions. It is true that SOX includes numerous provisions that are designed to protect investors and that are not dependent on the PCAOB, *e.g.,* the provisions requiring the certification of financial statements by CEOs and CFOs that no material misstatement exists (§ 302); the requirement of an assessment by management on internal controls as well as a report on that assessment by the independent

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[401] Champlin Refining Co. v. Corporation Commission, 286 U.S. 210, 234 (1932) (citation omitted). *Accord*, Buckley v. Valeo, 424 U.S. 1, 108-109 (1976).

auditor (§ 404); requiring disclosure on a financial expert on the audit committee (§ 407); and the protection of whistleblowers (§ 806). Many of the requirements outside of the PCAOB provisions in SOX are independent of the PCAOB and are enforceable by the SEC and, moreover, would remain fully functional and operational without the PCAOB. As the CAQ noted in the *amicus* brief that it filed in this case:

> [SOX] has many provisions focused on enhancing the accuracy and reliability of financial statements, including a requirement for management certifications relating to financial statements, new disclosures and audit procedures related to internal controls, and an enhanced role for audit committees.[402]

The CAQ concedes, however, that "[t]he centerpiece of the legislation is the creation of the Public Company Accounting Oversight Board" and that the passage of SOX "created a new paradigm for audit regulation, which relies heavily on the newly created PCAOB."[403]

On the other hand, the invalidation of SOX—which has been viewed by the public as a major piece of investor protection legislation—in its entirety could have a potentially significant detrimental effect on investor confidence and on enforcement of the federal securities laws, and the Court conceivably could consider that potential impact in its assessment of whether Congress would have enacted SOX as an investor-protection measure even without the PCAOB provisions.

VI. Implications of the Court's Decision

The Court's decision in the *Free Enterprise Fund* case will result in one of two scenarios. In the first, the constitutionality of the PCAOB is upheld. In the second, the Court would deem the PCAOB to be unconstitutional. Several public policy questions and governance implications arise from the second scenario.

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[402] Brief for CAQ, *supra* note 355, at 2-3.
[403] *Id*. at 3.

A. Scenario 1: Constitutionality of PCAOB Upheld

Should the Court affirm the judgment of the Court of Appeals, the constitutionality of the PCAOB will have been validated. The PCAOB, having passed constitutional muster, would continue as the regulatory authority for auditors. As the CAQ observed in its *amicus* brief:

> . . . [T]he establishment of the PCAOB has generally been seen by auditors as a net positive for the profession, capital markets, and investors. Were the Court to strike down the PCAOB, all of these benefits—expert, focused regulation; improved audit quality through a system of inspections emphasizing remediation; and stability of the regulatory regime—would be cast aside.[404]

Furthermore, the negative effects that the *Free Enterprise Fund* case has had on the on-going ability of the organization to recruit Board members will be remediated.[405] The Sarbanes-Oxley Act was designed to improve investor confidence and the public responsibility of independent auditors that Chief Justice Burger described in *U.S. v. Arthur Young & Co*., and both objectives would appear to continue to be served by a decision affirming the constitutionality of the PCAOB.

B. Scenario 2: PCAOB Declared Unconstitutional

In the second scenario, the Court would declare the PCAOB unconstitutional. Such a decision, simply put, would drastically alter the existing regulatory framework established by SOX for the audit profession. The PCAOB is responsible for both standard-setting and enforcement, so the accounting profession would lose both of these important functions should the Court strike down the PCAOB. Beyond this very basic change, overturning the Court of Appeals decision would have a number of other significant implications.

First, there would be vast uncertainty within the business community and accounting profession if the PCAOB were struck down. Foremost, what would happen to the auditing

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[404] Brief for the Center for Audit Quality, *supra* note 355, at 4-5.

[405] Greg Stohr & Ian Katz, *Sarbanes-Oxley May Be Reshaped by U.S. Supreme Court Clash*, BLOOMBERG.COM, Dec. 4, 2009, http://www.bloomberg.com/apps/news?pid=20670001&sid=arQ0N_KviWz0.

standards-setting and enforcement role that the PCAOB performed? Cindy Fornelli, Executive Director of the Center for Audit Quality, recently opined that the SEC could formally adopt the standards promulgated by the PCAOB, which would provide consistency for auditors and public companies, but the SEC is not set up to create such standards and is neither equipped nor interested in doing so.[406] Although the SEC has approved the existing PCAOB auditing standards and could adopt these standards as their own should the PCAOB be declared unconstitutional, the SEC would likely delegate the responsibility for promulgating future auditing standards, such as the Commission has with accounting standards, to FASB. The problem with such an approach, however, is that the delegation to FASB contradicts the original purpose of the PCAOB—independence from the profession.

Second, the elimination of the PCAOB would mean that there would be no rigorous inspection process for audit firms. The SEC itself does not likely have the resources to assume the responsibility for inspecting audit firms, and, has been seen, the peer reviews used by the profession before the creation of the PCAOB simply did not work.

Finally, the SEC historically has been under-staffed and over-worked, so, eliminating the PCAOB would not be in the long-term best interests of investors.

Is a "quick fix" available to make the PCAOB constitutional? Counsel for the petitioners suggests that, no, there is not, given the numerous flaws of the statute.[407] Judge Kavanaugh, in his dissent in the Court of Appeals decision, however, provides two alternatives to remedy the problems of the PCAOB provisions of SOX:

> . . . Congress could easily fix the constitutional flaws by, for example, making PCAOB members subject to Presidential appointment with the advice and consent of the Senate and therefore removable by the President. Alternatively, Congress could fix the problem by making the PCAOB a truly subordinate part of the SEC

[406] Interview with Cindy Fornelli, Executive Director, Center for Audit Quality, in Knoxville, TN (Apr. 7, 2010).
[407] Transcript of Oral Argument, at 71-73.

> – for example, by giving the SEC express authority to direct and supervise all Board actions and to fire Board members at will. In such a structure, the Board would not differ from any other inferior officers in the SEC. In the meantime, in my judgment, the Board's structure violates the Constitution of the United States.[408]

Although Judge Kavanaugh's first alternative might well raise issues concerning the salary and revenue-raising fee structure of the PCAOB, making PCAOB members principal officers would not conflict with the objective of Congress in making the PCAOB an independent entity. The purpose of the PCAOB provisions of SOX was to replace self-regulation of the profession with a "'strong independent accounting oversight board'—'independent,' that is, from the accounting profession,"[409] *not* independent from the President, as had been intent of the independent-counsel statute in *Morrison*.

In the second alternative, while perhaps increasing the SEC's removal power by authorizing the Commission to remove Board members at will, rather than only for cause, the proposed change would not restore any Presidential control over the PCAOB, which is the *Free Enterprise Fund* petitioners' primary objection.

Even if Congress could perform "statutory surgery"[410] to remedy any constitutional problems with the PCAOB appointment provisions, such a revision of SOX might not just be a simple "quick fix." Indeed, some commentators believe that if Congress were to revisit SOX, the amendments would not be limited to the PCAOB provisions.[411] For instance, the SEC has granted smaller companies temporary exemptions from the Section 404 requirements through June 15, 2010, but has announced

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[408] PCAOB II, at 715 (citations omitted).
[409] Brief for PCAOB, at 2.
[410] *Bowsher*, 478 U.S. at 736.
[411] Stohr, *supra* note 405. *See* Jennifer Levitz, Shielding the Whistleblower, Wall St. J., Dec. 1, 2009, http://online.wsj.com/article/SB10001424052748703939404574568272685253690.html?KEYWORDS=levitz+++whistleblower (House seeking to amend whistleblower protection created by SOX).

that "there will be no further Commission extension."[412] Many have already called for this temporary exemption to be made permanent, and the House Financial Services Committee has approved a measure to amend SOX accordingly in the interests of smaller public companies.[413]

If SOX were to be revisited along the lines suggested by Kavanaugh, there is, of course, no assurance that Congress would actually pass such a revised bill. The political and social environment has changed since the Enron/WorldCom era during which the bill first passed. As time has passed, the Enron affair is no longer a pressing issue, though reference is often made to the scandal. Moreover, the current financial crisis has resulted in an onslaught of new issues. Bank failures and the Madoff scandal have led the both the public and legislators again to call for reform. For instance, Congress, led by Senate Banking Chairman Christopher Dodd (D-CT), is working on a broad-sweeping financial reform bill.[414] It should be noted that some commentators believe that legislation, like SOX, is not the most efficient means of effecting changes in corporate governance.[415]

As has been discussed, the issue of severability presents a considerable question: Should the Court declare the PCAOB unconstitutional, does the remainder of SOX fall with it? SOX

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[412] Press Release, U.S. Securities & Exchange Commission, Small Public Companies to Begin Providing Audited Assessment of Internal Controls Over Financial Reporting in Nine Months (Oct. 2, 2009), *available at* http://www.sec.gov/news/press/2009/2009-213.htm.

[413] Fawn Johnson, *House Panel OKs Small-Business Exemption on Accounting Rules*, WALL ST. J., Nov. 4, 2009, http://online.wsj.com/article/SB125735033507128259.html?KEYWORDS=SEC+exemption.

[414] See http://online.wsj.com/article/SB10001424052748703465204575208342455198272.html?KEYWORDS=bank+bill

[415] "In the aftermath of Enron's collapse, Congress enacted new rules governing the composition and practices of boards [of directors] of all publicly listed companies. These rules, embodied in the Sarbanes-Oxley Act of 2002, were designed to strengthen the monitoring and control of public companies by their boards of directors. Whatever the eventual impact of this supposed remedy to Enron-style breakdowns, we need not—and cannot—rely on the legislature (or courts) to solve our long-run corporate governance problems. Indeed, Sarbanes-Oxley arguably has made it more difficult to recruit highly experienced executives and other professionals to board [of directors] service, by threatening to increase the perils of lawsuits and the risks of damaged reputations." SALTER, *supra* note 94, at 245. Salter goes on to suggest that a private-equity model of corporate governance may be most conducive to reform.

was passed to protect investors and restore confidence in the markets. Invalidating a significant piece of securities legislation like SOX, which was specifically designed by Congress to protect investors in response to pressure from the investing public, thus could have a detrimental effect on investor confidence and the enforcement of federal securities laws, especially given the worry over the current financial crisis. Independent auditors provide a check, if you will, in the overall balance of the business community, and SOX was intended to facilitate and balance that check.

Even if SOX remains, though without the PCAOB, a successful constitutional challenge to the statute's PCAOB provisions is very likely to encourage additional challenges—inside and outside the courts—to SOX. Indeed, Congress is already attempting to amend SOX, and further legislative proposals to alter the statute in ways that are inconsistent with the original purpose of SOX might well be forthcoming. For instance, the PCAOB has time and again been compared to the stock exchanges and self-regulatory organizations ("SROs") currently reporting to the SEC.[416] The PCAOB contends that the oversight of the SROs is similar to the SEC oversight of the PCAOB. The web of SROs within the securities industry, like the National Association of Securities Dealers or New York Stock Exchange, would potentially become a target of subsequent constitutional challenges.

VII. Conclusion

The PCAOB is an important organization—for good or bad, the Board affects auditors, investors, public companies, and arguably the general public. The *Free Enterprise Fund* case is a serious challenge to what is, in reality, the cornerstone of the Sarbanes-Oxley Act, which is itself a significant piece of reform legislation designed to protect the investing public. The implications of the case could be far-reaching. Indeed, the auditing profession, the business community, constitutional law, independent agencies, the government, and the public interest

[416] Brief for PCAOB, at 4-5.

each has an important stake in the Court's decision in the case, and each is very likely to be affected by that decision. The legal principles at play in the *Free Enterprise Fund* case are open to interpretation, and the choices that the Court makes in rendering its decision will provide the legal framework for investor-protection measures enacted by Congress in the foreseeable future.

APPENDIX A–TIMELINE OF SEC CHAIRMEN**

President	Chairman	Term
Roosevelt		
	Joseph P. Kennedy (D)	7/2/34 - 9/23/35
	James M. Landis (D)	9/23/35 - 9/15/37
	William O. Douglas (D)	9/21/37 - 4/16/39
	Jerome N. Frank (D)	5/18/39 - 4/9/41
	Edward C. Eicher (D)	4/9/41 - 1/20/42
	Ganson Purcell (D)	1/20/42 - 6/30/46
	James J. Caffrey (D)	7/23/46 - 12/31/47
Truman		
	Edmond M. Hanrahan (D)	5/18/48 - 11/3/49
	Harry A. McDonald (R)	11/4/49 - 2/25/52
	Donald C. Cook (D)	2/26/52 - 6/17/53
Eisenhower		
	Ralph H. Demmler (R)	6/17/53 - 5/25/55
	J. Sinclair Armstrong (R)	5/25/55 - 6/27/57
	Edward N. Gadsby (R)	8/20/57 - 3/26/61
Kennedy		
	William L. Cary (D)	3/27/61 - 8/20/64
	Manuel F. Cohen (D)	8/20/64 - 2/22/69
Johnson		

Nixon		
	Hamer H. Budge (R)	2/22/69 - 1/2/71
	William J. Casey (R)	4/14/71 - 2/2/73
	G. Bradford Cook (R)	3/3/73 - 5/16/73
	Ray Garrett, Jr. (R)	8/6/73 - 10/28/75
Ford		
	Roderick M. Hills (R)	10/28/75 - 4/10/77
Carter		
	Harold M. Williams (D)	4/18/77 - 3/1/81
Reagan		
	John Shad (R)	5/6/81 - 6/18/87
	David S. Ruder (R)	8/7/87 - 9/30/89
G.H.W. Bush		
	Richard C. Breeden (R)	10/11/89 - 5/7/93
Clinton		
	Arthur Levitt (D)	7/27/93 - 2/9/01
G.W. Bush		
	Harvey L. Pitt (R)	8/3/01 - 2/17/03
	William H. Donaldson (R)	2/18/03 - 6/30/05
	Christopher Cox (R)	8/03/05 - 1/20/09
Obama		
	Mary L. Schapiro (I)	1/27/00 – present

**Adapted from http://www.sec.gov/about/sechistoricalsummary.htm

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