No. 07-5127

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

FREE ENTERPRISE FUND; BECKSTEAD & WATTS, LLP,

Plaintiffs-Appellants,

v.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, et al.,

Defendants-Appellees,

UNITED STATES OF AMERICA,

Intervenor Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

**OPPOSITION TO PETITION FOR REHEARING
AND REHEARING EN BANC**

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GLOSSARY

NYSE	New York Stock Exchange
NASD	National Association of Securities Dealers
PCAOB	Public Company Accounting Oversight Board
SEC	Securities and Exchange Commission
SRO	Self-regulatory organization

INTRODUCTION AND SUMMARY

Pursuant to this Court's September 23, 2008 order, the United States respectfully submits this opposition to plaintiffs' petition for rehearing and rehearing en banc.

Congress created the Public Company Accounting Oversight Board ("Board") in the wake of the accounting debacles at Enron, Worldcom and other public companies, which demonstrated the extent to which inadequate oversight of accountants and auditors may jeopardize the interests of the investing public. Congress expressly modeled the Board on self-regulatory organizations (SROs) such as the NASD and NYSE, which have regulated the securities industry for more than seventy years under the comprehensive control of the Securities and Exchange Commission. See generally NASD v. SEC, 431 F.3d 803, 806 (D.C. Cir. 2005) (explaining that the regulatory power of the SROs "ultimately belongs to the SEC, and the legal views of the self-regulatory organization must yield to the Commission's view of the law").

In this facial constitutional challenge, plaintiffs contend that the Act does not permit the President adequate control over the Board. As the panel correctly recognized, plaintiffs can advance this argument only by disregarding the statutory scheme, which makes plain that the Board is subject to complete and pervasive control by the Commission. See 537 F.3d at 669 ("The Commission's authority over the Board is explicit and comprehensive. Indeed, it is extraordinary." (citations

omitted)); id. at 680-85 (describing the Commission's powers over the Board). As the panel explained and as we describe below, every auditing standard, ethics rule, or other rule or modification of a rule promulgated by the Board must be approved by the Commission before it can take effect, and every disciplinary action taken by the Board is subject to automatic stay and de novo review by the Commission. The Commission controls the Board's budget. It can amend, add to, or delete from the Board's rules at any time. It may remove Board members for good cause. And on top of these and other supervisory powers, Congress granted the SEC the authority to rescind, in whole or in part, any aspect of the Board's enforcement authority at any time, based on the Commission's own judgment of what is necessary to protect the public and advance the purposes of the securities laws. 15 U.S.C. § 7217(d)(1).

Against this background, the panel was clearly correct in holding that the statutory scheme does not, "taken as a whole, violate[] the principle of separation of powers by unduly interfering with the role of the Executive Branch." Morrison v. Olson, 487 U.S. 654, 693 (1988). Plaintiffs' petition makes virtually no effort to grapple with the majority's reasoning, instead embracing novel theories that, as the majority explained, would require the Court to disregard more than a century of Supreme Court jurisprudence. See 537 F.3d at 683-84, 684-85.

Plaintiffs' objection at bottom is not to the Board per se, but to the very existence of "independent" agencies such as the Commission. As this Court has previously recognized, the regulatory power exercised by SROs under the same statutory provisions that govern the Board is entirely "derivative" and "ultimately belongs to the SEC." NASD, 431 F.3d 806. The majority thus correctly concluded that "[t]he bulk of the Fund's challenge to the Act was fought — and lost — over seventy years ago when the Supreme Court decided Humphrey's Executor." 537 F.3d at 685. Rehearing is not warranted.

STATEMENT

I. Statutory Background

Congress created the Public Company Accounting Oversight Board as part of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745. It charged the Board with "oversee[ing] the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports." 15 U.S.C. § 7211(a). See 537 F.3d at 669-70.

The Board is in every respect subordinate to the Securities and Exchange Commission. Indeed, as the majority observed, neither plaintiffs nor the dissent could identify a single instance "in which the Board can make policy that the Commission

cannot override," 537 F.3d at 685, or in which the Board can take a final action or impose a sanction not subject to de novo review before the Commission.

Every rule and ethical standard issued by the Board is subject to prior approval by the Commission. 15 U.S.C. § 7217(b). This includes the rules governing Board investigations. Ibid. In addition, the SEC is empowered at any time to modify, add to, or delete from the rules of the PCAOB as the Commission deems necessary to ensure the fair administration of the Board (in the Commission's own judgment), to conform the Board's rules to the requirements of the Act (as interpreted by the Commission), or otherwise to further the purposes of the Act or the securities laws (again, as interpreted by the Commission). Id. § 78s(c), incorporated and modified by id. § 7217(b)(5).

All disciplinary sanctions imposed by the Board are likewise subject to de novo review by the SEC, including an opportunity for a hearing before the Commission. Id. § 78s(e)(1), as incorporated by id. § 7217(c)(2). The Commission may institute review of a disciplinary sanction on its own motion. Id. § 78s(d)(2), as incorporated by id. § 7217(c)(2). An application to the SEC for review of a sanction, or the institution of review by the SEC on its own motion, operates as an automatic stay of the disciplinary sanction. Id. § 7215(e). If the Commission affirms the Board's findings, it may affirm or modify the

sanctions imposed by the Board, or remand for further consideration. See id. § 78s(e)(1)(A), as incorporated by id. § 7217(c)(2). If the SEC does not affirm the finding of wrongdoing, the sanction must be set aside. Id. § 78s(e)(1)(B), as incorporated by id. § 7217(c)(2). In addition, the SEC may "enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board" if the SEC concludes — in its own judgment — that the Board's proposed sanction "is not necessary or appropriate" under the Act or the securities laws, is "excessive, oppressive, or inadequate," or is "otherwise not appropriate" on the record. Id. § 7217(c)(3).

Nor is the SEC's power over the Board limited to substantive review of the Board's decisions. The Commission has the authority to remove or publicly censure any member of the PCAOB "for good cause shown before the expiration of the term of that member." 15 U.S.C. § 7211(e)(6); see also id. § 7217(d)(3). And separate from its power to remove PCAOB members, the Commission is empowered to rescind, in whole or in part, any aspect of the PCAOB's enforcement authority at any time, based on the Commission's own judgment of what is necessary to protect the public and advance the purposes of the securities laws. See id. § 7217(d)(1).

The Commission also enjoys complete control over the Board's annual budget. Id. § 7219(b). The Commission may inspect the

Board's records at any time. Id. § 78q(b)(1), as incorporated by id. § 7217(a). Even the Board's exercise of its "sue and be sued" authority is subject to SEC control: the Board cannot appear in court without the approval of the Commission. Id. § 7211(f)(1).

Finally, the Act grants the Commission affirmative authority in its own right to adopt "such rules and regulations, as may be necessary or appropriate in the public interest or for the protection of investors, and in furtherance of this Act." Id. § 7202(a). Pursuant to these powers, the SEC could, for example, adopt a rule that would require the Board to provide advance notice to the Commission of any PCAOB investigation, or that would allow the Commission to take immediate action to disapprove or terminate any such investigation.

II. Prior Proceedings

Plaintiffs filed this facial challenge to the constitutionality of the Board in February 2006, alleging the Act violates the Appointments Clause, the constitutional separation of powers, and non-delegation principles. The United States intervened to defend the validity of the statute, and the district court (Robertson, J.) granted defendants' motion for summary judgment.

A divided panel of this Court affirmed. 537 F.3d 667 (D.C. Cir. Aug. 22, 2008). At the outset, the panel rejected

plaintiffs' contention that the Act violates the Appointments Clause by vesting the power to appoint PCAOB members in the Commission. Observing that PCAOB members, like the Coast Guard judges in Edmond v. United States, 520 U.S. 651 (1997), "'have no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers,'" the panel concluded that PCAOB members are "inferior" officers under the Constitution. 537 F.3d at 672-73 (quoting 520 U.S. at 665). The panel likewise found no merit in plaintiffs' view that the Commission is not a "Department" under the Constitution, see id. at 676-77, or in their contention that the Commission is not the relevant "Head" of the SEC, id. at 677-78.

Turning to plaintiffs' separation-of-powers argument, the panel rejected plaintiffs' efforts to characterize the Board as an executive entity "independent" of the Commission (and thus the President), explaining that plaintiffs' arguments in this respect are "undercut by the vast degree of Commission control at every significant step." 537 F.3d at 683; see id. at 680-85. Comparing the Commission's "extraordinary" (id. at 669), "pervasive" (id. at 681), and "exhaustive" (id. at 685) control over the PCAOB with the Attorney General's severely circumscribed authority over the Independent Counsel in Morrison, the panel concluded that the President's powers over the Board via the Commission "extend comfortably beyond the minimum required to

'perform his constitutionally assigned duties.'" Id. at 681 (quoting 487 U.S. at 696).

Nor did the panel find any merit in plaintiffs' arguments regarding the removal power. The panel explained that plaintiffs' insistence that the President must have direct removal authority over all executive officers, including "inferior" officers such as PCAOB members, is contrary to precedent. Id. at 674 (citing, e.g., United States v. Perkins, 116 U.S. 483, 485 (1886)). And in light of the Commission's pervasive control over the Board — including its power to rescind any aspect of the Board's enforcement authority at any time — the panel reasoned that the "good cause" limitation on the removal of PCAOB members raises no concerns of constitutional dimensions. Id. at 680-81. The panel concluded: "Given the constitutionality of independent agencies and the Commission's comprehensive control over the Board, the Fund cannot show that the statutory scheme so restricts the President's control over the Board as to violate separation of powers." Id. at 685.

Judge Kavanaugh dissented, urging that the Act violates both the separation of powers and the Appointments Clause. Id. at 685-715.

ARGUMENT

The panel's decision is correct and rehearing is not warranted. Stripped of its rhetoric, plaintiffs' claim is that the Public Company Accounting Oversight Board is unconstitutional because the President lacks adequate control over the Board's exercise of executive functions. Yet the constitutional sufficiency of the President's control over the Securities and Exchange Commission is unquestioned, and the Act grants the Commission complete and pervasive control over every aspect of the Board's authority and operations. Indeed, Congress explicitly created the Board on the model of self-regulatory organizations (SROs) such as the NASD, see S. Rep. No. 107-205, at 12 (explaining that "[t]he rules for SEC oversight of the Board are generally the same as those that apply to SEC oversight of the National Association of Securities Dealers"), and this Court has previously recognized that the authority wielded by the SROs under the securities laws is entirely "derivative" and "ultimately belongs to the SEC." NASD v. SEC, 431 F.3d 803, 806 (D.C. Cir. 2005). The panel thus correctly held that "[t]he bulk of the Fund's challenge to the Act was fought — and lost — over seventy years ago when the Supreme Court decided Humphrey's Executor." 537 F.3d at 685.

The hyperbole that pervades plaintiffs' rehearing petition is thus entirely misplaced. Cf. id. at 681 n.11 ("The 'sky is

falling' approach to the Board's separation of powers implications is an exaggerated response to a relatively insignificant innovation."). As the panel explained, the Board is in every respect subordinate to the Commission: there is no rule the Board may adopt, sanction the Board may impose, or other final action the Board may take unless the Commission permits it to do so; the Commission retains its own authority to bring enforcement actions, including actions to enforce the rules of the Board (as approved or amended by the Commission); and the Commission may rescind the Board's enforcement authority at any time, based on the Commission's own judgment of what is necessary to protect the public and advance the purposes of the securities laws. See id. at 680-81. For these reasons, the PCAOB members are "inferior" officers whose appointment Congress may constitutionally vest in the SEC, and neither the Board nor its relationship to the Commission violates the separation of powers.

I. The Panel Correctly Held That PCAOB Members Are "Inferior" Officers.

"Whether one is an 'inferior' officer depends on whether he has a superior." Edmond v. United States, 520 U.S. 651, 662 (1997). The Supreme Court has accordingly explained that an inferior officer is an officer "whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate." Id. at 663. As the panel recognized, there is little

doubt as to the constitutional status of the Board under this analysis: "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.'" 537 F.3d at 672-73 (quoting Edmond, 520 U.S. at 665). No entity exercises comparable oversight of the Commission, which is accountable only to the President. For that reason, the Commissioners are "principal" officers and Board members are "inferior" officers.

Plaintiffs urge that Board members cannot be "inferior" officers because they are not removable at will. Pet. 12-13. But as the majority explained, this contention is flatly contrary to Supreme Court precedent. See 537 F.3d at 673-76 & n.4. The independent counsel in Morrison, for example, enjoyed for-cause removal protection, but was nevertheless an "inferior" officer. See 487 U.S. at 663.

Equally baseless is plaintiffs' contention that the Board members are "principal" officers because the Commission's comprehensive oversight of the Board is limited to merely "veto[ing] mistakes." Pet. 13. This claim typifies plaintiffs' refusal to come to grips with the statutory scheme, which makes clear that the Commission's powers over the Board are both affirmative and wide-ranging. For example, Board rules and regulations do not become effective absent "prior approval of the

Commission," 15 U.S.C. § 7217(b)(2), and the Commission may at any time modify, add to, or delete from the Board's rules, id. § 78s(c), incorporated and modified by id. § 7217(b)(5). Similarly, the Commission is not limited to "veto[ing]" sanctions, but may "enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board" as necessary in the Commission's judgment. Id. § 7217(c)(3). Indeed, the Commission controls the Board's budget, id. § 7219(b), and may withdraw any aspect of the Board's enforcement authority at any time, id. § 7217(d)(1). These provisions leave no question that the PCAOB members are "directed and supervised at some level" by other Executive officers, and consequently are "inferior officers" under Edmond.

II. The Panel Correctly Rejected Plaintiffs' Separation-Of-Powers Claim.

1. For the same reasons, the panel correctly held that, "[g]iven the constitutionality of independent agencies and the Commission's comprehensive control over the Board, the Fund cannot show that the statutory scheme so restricts the President's control over the Board as to violate separation of powers." 537 F.3d at 685. The Supreme Court established more than seventy years ago that "independent" agencies such as the Securities and Exchange Commission do not violate the separation of powers. The Commission, in turn, enjoys comprehensive and plenary control over every aspect of the Board's activities. If

the President's control over the Commission's execution of the securities laws satisfies the Constitution, then so too does his control over the Commission's supervision of the Board.

Plaintiffs urge that the Commission's pervasive powers over the Board are "irrelevant" because, although the Commission could, for example, issue rules (or amend the Board's rules) to require the Board to obtain the Commission's approval before conducting even the most rudimentary investigation, it has not done so.[1] Pet. 10. But that is itself irrelevant: the mere fact that the Commission could institute such a rule (or reject the Board's budget, or limit Board members' salaries, or withdraw the Board's enforcement authority in whole or in part) ensures the Commission's — and hence the President's — control over the Board's discharge of its functions.

2. In the alternative, plaintiffs urge that the for-cause limitation on the Commission's power to remove Board members by itself renders the scheme unconstitutional. Pet. 4-9. As the panel correctly held, see 537 F.3d at 680-84, this claim fails in multiple respects. Because the Constitution does not require

[1] Plaintiffs erroneously claim that the Commission cannot limit the Board's functions absent specific findings. Pet. 11. Although the particular provision plaintiffs cite requires specific predicate findings, see 15 U.S.C. § 7217(d)(2), the Commission has many other powers over the Board — including the power to modify or supplement the Board's rules at any time, id. § 78s(c), incorporated and modified by id. § 7217(b)(5), and the power to withdraw any aspect of the Board's enforcement authority at will, id. § 7217(d)(1) — that are not so limited.

that the President have the direct power to remove inferior officers, see, e.g., Ex parte Hennen, 38 U.S. (13 Pet.) 230, 259-60 (1839), plaintiffs' complaint that the President cannot directly remove Board members is without merit. Nor is there anything untoward in Congress's placing restrictions on the removal of inferior officers: the Supreme Court has repeatedly recognized that, when Congress vests the appointment of inferior officers in the Heads of Departments, it may impose at least some restrictions on the removal of those officers. See United States v. Perkins, 116 U.S. 483, 485 (1886); see also Morrison, 487 U.S. at 689 n.27; id. at 723-24 (Scalia, J., dissenting) (reaffirming the Perkins principle). Contrary to plaintiffs' claim (Pet. 7), the panel did not suggest that any such restriction will automatically be valid. The majority merely held that a for-cause restriction is within Congress's power under Perkins, at least when coupled with the at-will authority to rescind, reject, direct, or alter any substantive decision made by the inferior officer at any time. Cf. 537 F.3d at 683 (describing the Commission's unlimited authority to rescind Board powers as "essentially granting at-will removal power over Board functions").

Finally, plaintiffs contend that the for-cause removal provisions of the Act are uniquely restrictive. But as the panel observed, "it is far from clear that the Commission would share

the Fund's cramped interpretation of its removal authority." Id. at 683. As the panel explained, "'[f]acial challenges are disfavored' precisely because they do not permit the Executive Branch to attempt to 'implement[] [statutes] in a manner consistent with the Constitution.'" Id. at 684 (quoting Wash. State Grange v. Wash. State Republican Party, 128 S. Ct. 1184, 1191 (2008)). Plaintiffs are not entitled to assume that the Commission would interpret its mandate to create, rather than avoid, constitutional concerns.

CONCLUSION

For the foregoing reasons, the petition for rehearing should be denied.

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I hereby certify that on this 22nd day of October, 2008, I caused copies of the foregoing opposition to be filed with the Court by hand delivery, and served upon the following counsel by electronic mail and first-class U.S. mail:

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