No. 07-5127

IN THE

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

FREE ENTERPRISE FUND, *ET AL.*,

Plaintiffs-Appellants,

v.

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

Defendants-Appellees.

On Appeal from the U.S. District Court
for the District of Columbia

BRIEF OF AMICI CURIAE FORMER CHAIRMEN OF THE SECURITIES AND EXCHANGE COMMISSION

Richard H. Pildes
Counsel of Record
Vanderbilt Hall Room 507
40 Washington Square South
New York, New York 10012
(212) 998-6377 (telephone)
(212) 995-3662 (facsimile)

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Parties and Amici. All parties, intervenors, and amici appearing before the district court and in this Court are listed in the appellants' brief.

Ruling Under Review. The ruling under review is listed in the appellants' brief.

Related Cases. The case under review was not previously before this Court. No related cases are currently pending.

CERTIFICATE OF COUNSEL PURSUANT TO CIRCUIT RULE 29(d)

Counsel for *amici curiae*, seven former Chairmen of the Securities and Exchange Commission, hereby certifies, pursuant to D.C. Circuit Rule 29(d), that it is not practicable for this group to file a joint *amicus* brief with the Council of Institutional Investors and that it is thus necessary for the former Chairmen to file a separate brief to state their views. The former Chairmen have led the Securities and Exchange Commission over the last four decades and have a perspective that is both unique and different from that of the Council. Unlike the Council, the Chairmen address in their brief how the PCAOB fits within the history and structure of the Securities and Exchange Commission's regulatory responsibilities, and the bearing of those issues on the constitutional claims in this case. Because the Council and the Chairmen wish to address separate issues, it is necessary for the former Chairmen to file a separate brief.

____

Richard H. Pildes

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

CASES[1]

[1] Authorities on which this brief chiefly relies are marked by asterisks.

CONSTITUTIONAL PROVISIONS, STATUTES, AND RULES

LEGISLATIVE HISTORY

ADMINISTRATIVE MATERIALS

OTHER AUTHORITIES

GLOSSARY

Act	Sarbanes-Oxley Act of 2002
AICPA	American Institute of Certified Public Accountants
ASB	Auditing Standards Board
Board	Public Company Accounting Oversight Board
CBOE	Chicago Board of Options Exchange
FASB	Financial Accounting Standards Board
FINRA	Financial Industry Regulatory Authority
GAAS	General Accepted Auditing Standards
MSRB	Municipal Securities Rulemaking Board
NASD	National Association of Securities Dealers
NYSE	New York Stock Exchange
PCAOB	Public Company Accounting Oversight Board
POB	Public Oversight Board
Sarbanes-Oxley	Sarbanes-Oxley Act of 2002
SEC	Securities and Exchange Commission
SRO	Self-Regulatory Organization

INTEREST OF AMICI CURIAE

Amici curiae are seven former Chairmen of the Securities and Exchange Commission (SEC), who reflect four decades of SEC leadership under Presidents of both political parties: G. Bradford Cook (1973), Roderick M. Hills (1975-77), Harold M. Williams (1977-81), David S. Ruder (1987-89), Arthur Levitt, Jr. (1993-2001), Harvey L. Pitt (2001-03), and William Donaldson (2003-05). Former Chairmen Hills and Ruder are members of the Advisory Council to the PCAOB. Collectively, *amici* represent decades of experience in the administration of the federal securities laws. Five (Chairmen Hills, Williams, Ruder, Levitt and Pitt) testified during hearings that led to the adoption of the Sarbanes-Oxley Act of 2002, and Congress cited their testimony frequently to support and explain the Act's response to the corporate abuses and financial reporting frauds that made the Act necessary. Two (Chairmen Pitt and Donaldson) were directly responsible for implementing the Act's requirements, including the creation and staffing of the Public Company Accounting Oversight Board.

Based on their expertise, *amici* believe, as did Congress and the President, that major structural defects existed in the pre-Sarbanes-Oxley regulatory system for overseeing the financial reporting by, and audits of, public companies, and that Congress's creation of the Board, functioning under the legal control and authority of the SEC, is essential to remedying those defects. Given the importance of the Act to the integrity of U.S. capital markets, these former SEC Chairmen respectfully submit this brief to assist the Court.

INTRODUCTION

The Plaintiffs' claims amount to little more than thinly disguised attacks on the constitutionality of independent administrative agencies per se. But at least since *Humphrey's Executor v. United States,* 295 U.S. 602 (1935), the Supreme Court has upheld the constitutionality of these agencies time and time again. This challenge is particularly inappropriate in the context of national regulation of the securities and financial system, where the SEC has served as the congressionally designated regulatory overseer since the 1930s for an array of public and mixed public-private regulatory structures. The SEC oversees numerous entities in this complex system, including self-regulatory organizations (SROs) such as the NYSE (New York Stock Exchange) and FINRA (Financial Industry Regulatory Authority, the successor to the NASD (National Association of Securities Dealers[1])), and the CBOE (Chicago Board of Options Exchange). This unique and integrated regulatory system, working as a whole and updated by Congress over the years, has successfully ensured worldwide investor confidence in the integrity of U.S. markets.

In the wake of the massive corporate financial scandals of the last decade, Congress determined that the auditing function in this regulatory system had become compromised through excessive dependency on the regulated entities, the accounting firms. Building on the history of regulatory institutions in this field, Congress in 2002 therefore enacted the Sarbanes-Oxley Act (the Act). As its foundation, the Act created a regulatory body, the Public Company Accounting Oversight Board (PCAOB or "the Board"), to help supervise the accounting and auditing profession. Modeled on the SEC's regulation of SROs, the Board functions under the direct legal oversight and control of the SEC.

The Act does not give Congress any direct power to appoint Board members. The Act does not give Congress any direct power to participate in decisions to remove Board members from office. Members of Congress do not sit on the Board. Nor does Congress directly participate in making or vetoing Board policy. In no way does the Act give Congress the power to participate itself directly in the execution and implementation of federal law. For purposes of constitutional law, that is the end of the matter. The separation of powers requires no more.

Properly understood, Plaintiffs' complaint is not with the Board. Rather, it is with Supreme Court decisions that have recognized for generations the constitutionality of independent agencies. Because Congress has the power to create independent agencies, it has the lesser power of creating subunits such as the PCAOB within these agencies, staffed by

[1] The NASD and the NYSE member regulatory functions have been merged recently into the Financial Industry Regulatory Authority (FINRA).

inferior officers, who are appointed by, and function under the control and oversight of, the SEC itself. For these reasons, the lower court held correctly that the Act is constitutional.

STATEMENT

The structure that Congress and the President chose for the PCAOB is best understood in light of the overall governance and regulatory system that has made oversight of the U.S. securities markets perhaps the greatest regulatory success in modern administration.[2] Since the 1930s, the SEC has stood atop that system. Under the umbrella authority of the SEC, Congress has relied on an innovative array of institutional arrangements – some involving direct SEC regulation, and some involving different degrees of SEC oversight over intermediaries, such as the self-regulatory organizations – that, working together, have collectively succeeded in protecting the integrity of U.S. markets. The PCAOB is the logical outgrowth of these prior structures.

1. *The Regulatory Regime for U.S. Securities Markets.* In the wake of the 1929 market crash, Congress concluded that the absence of reliable corporate accounting and auditing practices required legislative response. Over the next decade, Congress enacted the Securities Act of 1933, followed by the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act and Investment Advisors Act of 1940. Reliable accounting and auditing is at the foundation of this system.

From the outset, private SROs, such as the NYSE and the NASD (now FINRA), have played a central role in this regulatory regime. These SROs have broad reach; by statute, for

---

[2] Indeed, nearly all European countries today are attempting to replicate the structure and function of the SEC. *See* Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 Cornell L. Rev. 775, 833 (2006) ("In recent years, every EU member has created its own version of the SEC, not because of requirements, but because of the obvious success of American capital markets operating under the SEC's protective umbrella.").

example, all broker-dealers must be registered with FINRA.[3] Pursuant to the Securities Exchange Act, all rulemaking and disciplinary actions of these SROs take place under the direct and comprehensive oversight of the SEC. By statute, these SROs "exercise authority subject to SEC oversight" and "have no authority to regulate independently of the SEC's control." S. Rep. No. 94-75, at 23 (1975).[4] These SROs have had all their rules approved by the SEC. The SROs must file notice of a proposed rule (or amendment of existing rule) with the SEC; after publishing the rule for public comment, the SEC must then approve or reject it before the rule can take effect. 15 U.S.C. § 78s(b)(2) (2006). *See Business Roundtable v. SEC*, 905 F.2d 406, 408 (D.C. Cir. 1990) (discussing this structure). The SEC may also, on its own initiative, "abrogate, add to, and delete from" any SRO rule. 15 U.S.C. § 78s(c). Those aggrieved by any final SEC decision approving, rejecting, or amending an SRO rule have full statutory rights to judicial review in the court of appeals. Precisely because the SEC must approve the rules of these SROs before they become effective, SRO rules are federal law that preempt conflicting state law. *Credit Suisse First Boston Corp. v. Grunwald*, 400 F.3d 1119 (9th Cir. 2005). Similarly, the Supreme Court has held that SRO rules, such as the fixed-commission rates of the stock exchanges, are exempted from the antitrust laws precisely because those rates are subject to the legal "scrutiny and approval" of the SEC. *Gordon v. NYSE*, 425 U.S. 659, 689 (1975).

In addition, federal law permits and requires these SROs to discipline their members for violations of SRO rules, SEC rules, or the securities laws. As with rulemaking, SRO disciplinary actions take place only under the umbrella of what the courts of appeals have characterized as "plenary" or *de novo* SEC review. *See Nat'l Ass'n of Secs. Dealers* (*NASD*) *v. SEC*, 431 F.3d

[3] Other SROs under the umbrella of the SEC include the Municipal Securities Rulemaking Board (MSRB), which the Securities Acts Amendments of 1975 directed the SEC to establish. *See* Exchange Act Section 15B(b)(1), 15 U.S.C. § 78o-4(b)(1).

[4] These 1975 Amendments to the Exchange Act of 1934 were designed to ensure the SEC had general power to "review and amend *all* self-regulatory organization rules." *Business Roundtable v. SEC*, 905 F.2d 406, 409 (D.C. Cir. 1990) (emphasis added).

803, 804 (D.C. Cir. 2005); *Schultz v. SEC*, 614 F.2d 561, 568 (7th Cir. 1980). Once an SRO imposes a final disciplinary sanction, it must file notice with the SEC, which on its own motion or application, may or must review the sanction. The SEC must make an independent determination of whether a violation occurred and may remit or cancel any sanction that is "excessive or oppressive." 15 U.S.C. § 78s(e)(1) & (2). Again, judicial review of the SEC's decision is available. Thus, as this Court put it in one recent case, "[t]he authority [NASD] exercises ultimately belongs to the SEC . . . ." *NASD v. SEC*, 431 F.3d at 806.

2. *Defects in Auditing Regulation.* The regulatory structures and relationships in the accounting and auditing arena drew on a somewhat different mix of public and private institutions, given the historical absence of pre-existing private institutions in this arena with the status of the NYSE. The 1933 and 1934 Securities Acts authorized the SEC to regulate accounting methods used to prepare and audit financial statements included in SEC reports. *See* Securities Act of 1933 § 19(a), 15 U.S.C. § 77s(a) (2000); Securities Exchange Act of 1934 § 13(b), 15 U.S.C. § 78m(b) (2000). But the SEC quickly delegated most of its standard-setting role to private actors.[5] By the time of the corporate scandals of the last decade, the regulatory oversight system for auditing relied on an ineffective, confusing, and inefficient mix of state regulation, direct SEC regulation, and SEC reliance on standards set by private-sector bodies. By 2002, expert witnesses characterized the system as a "positively Byzantine structure of accounting disciplinary bodies which generally lack adequate and assured financial support, clear and undivided responsibility for discipline, and an effective system of SEC oversight."[6] Other

---

[5] *See* David R. Herwitz & Matthew J. Barrett, Accounting for Lawyers 145 (3d ed. 2001); *see also* Administrative Policy on Financial Statements, SEC Accounting Series Release No. 4, 11 Fed. Reg. 10,913 (Sept. 27, 1946); George Mundstock, *The Trouble with FASB,* 28 N.C. J. Int'l L. & Com. Reg. 813, 826 (2003).

[6] *Accounting Reform and Investor Protection Issues Raised by Enron and Other Public Companies: Hearings Before the S. Comm. on Banking, Hous., and Urban Affairs*, 107th Cong. 532 (2002) [hereinafter *Accounting Reform Hearing*] (testimony of Joel Seligman, Dean and Ethan A. H. Shepley Univ. Professor, Washington Univ. Sch. of Law).

witnesses described it as "a veritable alphabet soup of organizations provid[ing] governance"[7] and "a bewildering array of monitoring groups."[8]

For both accounting and auditing, the main trade association of the accounting industry, the wholly private American Institute of Certified Public Accountants (AICPA), had long played a major role.[9] On the accounting side, by 1973 the AICPA and other entities had established the Financial Accounting Standards Board (FASB), designed to be an independent standard-setting body.[10] The SEC gives substantial weight to FASB standards. In an important 1973 Release, the SEC announced that the Commission would treat FASB accounting "principles, standards, and practices" as having "substantial authoritative support," while those contrary to FASB would be treated as lacking such support.[11]

On the auditing side, prior to the Sarbanes-Oxley Act, the SEC had relied on the private AICPA's Auditing Standards Board (ASB), which the AICPA created, funded, and whose members the AICPA selected. Overseen by the SEC, the ASB was the primary actor responsible for setting and interpreting the Generally Accepted Auditing Standards (GAAS). But the fifteen members who volunteered to sit on the ASB were largely practicing accountants, many of them partners in the major accounting firms. "The self-interest endemic to the ASB's structure drew particularly harsh criticism during the Enron congressional hearings." Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and its Public/Private Status,* 80 Notre Dame L.

---

[7] *Id.* at 723 (prepared statement of Shaun O'Malley, Chairman, 2000 Public Oversight Bd. Panel on Audit Effectiveness and Former Chair, Price Waterhouse LLP).

[8] *Id.* at 376 (prepared statement of John Biggs, Chairman, President, and CEO, TIAA-CREF).

[9] *See* Herwitz & Barrett, *supra* note 5, at 145; Mundstock, *supra* note 5, at 826-29; *see also* Policy on Financial Statements, Exchange Act, Accounting Series Release No. AS-4 (April 25, 1938), *available at* 1938 WL 33319 (noting that, in certain circumstances, SEC would accept accounting standards that had "substantial authoritative support" in the profession).

[10] Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and its Public/Private Status,* 80 Notre Dame L. Rev. 975, 986 (2005).

[11] SEC Statement of Policy on Establishment and Improvement of Accounting Principles and Standards, Release No. 34-10552, 39 Fed. Reg. 1260 (Dec. 20, 1973).

Rev. 975, 990 (2005). As a former Chief Accountant at the SEC testified, for example, the standards tended "to be written to protect the accounting firms in case they get in trouble on an audit . . . it's not drafted with the public interest in mind."[12]

Setting of auditing standards for the accounting profession become a major public concern in the 1970s. The massive financial scandals at companies like Penn Central Railway and others in this era prompted congressional hearings and demands for more effective oversight of auditing, which Congress concluded at that time should remain a system of self-regulation. In response, the private sector, in consultation with the SEC, created the Public Oversight Board (POB), with peer review of one accounting firm by another as its foundation. But the POB lacked sanctioning authority and was funded by the AICPA, which made the POB dependent on voluntary contributions from the firms it was overseeing.[13] By 1999, in its Annual Reports to Congress, the SEC reported that it no longer considered the POB system effective.[14] The next year, the AICPA refused to increase the POB's funding in the wake of the POB's announced decision to examine the major accounting firms' compliance with the relevant standards for auditor independence. When Congress re-visited this system in the Sarbanes-Oxley hearings in 2002, numerous witnesses, including five former SEC Chairmen and the current Chairman, testified that, in addition to other structural defects in the design of the POB, the system of peer review itself was fundamentally flawed. Experts characterized peer review as "too incestuous,"[15]

---

[12] *Accounting Reform Hearing, supra* note 6, at 217 (statement of Lynn Turner, former Chief Accountant, Secs. & Exch. Comm'n).

[13] *See* Framework for Enhancing the Quality of Financial Information Through Improvement of the Auditing Process, 67 Fed. Reg. 44,970 (July 5, 2002); Nagy, *supra* note 10, at 994.

[14] *See* SEC Annual Report 1999; *Accounting Reform Hearing, supra* note 6, at 247 (testimony and prepared statement of Lynn Turner, Chief Accountant, Secs. & Exch. Comm'n, 1998-2001).

[15] *Accounting Reform Hearing, supra* note 6, at 76 (prepared statement of Harold M. Williams, Former Chairman, Secs. & Exch. Comm'n).

because it involved "competitors reviewing competitors,"[16] and had "not produced a credible result."[17] Indeed, one former SEC Chairman testified that "to my knowledge, there has never been a negative review of a major firm."[18] Thus matters stood on the eve of the Enron collapse.

3. *The Sarbanes-Oxley Act of 2002*. As the crisis to the U.S. financial system associated with auditing practices of the past decade mounted, the Senate Committee on Banking, Housing, and Urban Affairs in 2002 heard testimony from 36 witnesses over 10 days. This testimony centered on "the systemic and structural weaknesses affecting our capital markets which were revealed by repeated failures of audit effectiveness and corporate and financial and broker-dealer responsibility in recent months and years." S. Rep. No. 107-205, at 2 (2002). Among those testifying were five former SEC Chairmen and the current Chairman.

Nearly all who testified concluded that the system of industry self-regulation of auditing required major revision. Most witnesses supported creation of a more effective and more independent entity to oversee auditing. Most agreed that this new entity should not be dependent on the accounting profession for financing. As Arthur Levitt, Chairman of the SEC during the 1990s, testified: "We need a truly independent oversight body that has the power not only to set the standards by which audits are performed, but also to conduct timely investigations that cannot be deferred for any reason and to discipline accountants." S. Rep. No. 107-205, at 10. Even the POB, which had been established to oversee the prior self-regulatory process, concluded by early 2002 that it could not effectively perform this role. As the POB Chairman testified to Congress, "a new regulatory structure" was "essential," but to be effective, "it must

---

16 *Id.* at 533 (prepared statement of Joel Seligman, Dean and Ethan A. H. Shepley Univ. Professor, Washington Univ. Sch. of Law).

17 *Id.* at 1116 (prepared statement of Harvey L. Pitt, Chairman, Secs. & Exch. Comm'n).

18 *Id.* at 76 (prepared statement of Harold M. Williams, Former Chairman, Secs. & Exch. Comm'n).

be totally independent of the accounting profession and it must be based on the foundation of congressional action . . . ."[19]

Congress ultimately passed the Sarbanes-Oxley Act of 2002 with overwhelming support: 423-4 in the House and 99-0 in the Senate. In signing the bill into law, President George W. Bush endorsed it as one of "the most far reaching reforms of American business practice since the time of Franklin Delano Roosevelt." 38 Weekly Comp. Pres. Doc. 1283 (Aug. 5, 2002). The President's signing statement expressed no concern that the Act interfered with the President's constitutional powers. Statement by President George W. Bush Upon Signing H.R. 3763, 2002 U.S.C.C.A.N. 543 (July 30, 2002).

4. *The Board.* A centerpiece of the Act was the creation of the PCAOB, to be located, like other entities in the securities-regulatory regime, under the pervasive legal authority and control of the SEC. Congress concluded that the prior system of industry-dependent self-regulation of auditing had contributed to the corporate financial scandals and debacles of the recent past. As the Senate report noted, "successful operation of the Board depends upon its independence and professionalism." S. Rep. No. 107-205, at 6. By independence, Congress meant independence from the regulated industry, the accounting firms. Thus, Congress paid close attention to structuring the conditions, constraints, and appointment methods for members of the Board. *See* 15 U.S.C. § 7211(e)(1), (2), (3), (4), (f)(4); *see also* S. Rep. No. 107-205, at 7. As the Board's brief documents in detail, the Board functions under even more extensive SEC legal oversight and control than the SROs that have long played a major role, under the SEC's oversight and control, in regulating the securities markets. *See* PCAOB Br. at 2-7.

SUMMARY OF ARGUMENT

The Constitution permits Congress to create administrative agencies with diverse structures, including independent agencies and subunits of these agencies. The separation of

[19] *Id.* at 942 (prepared statement of Charles A. Bowsher, Chairman, Pub. Oversight Bd. and former Comptroller Gen. of the United States).

powers limits Congress in only one particular way: Congress cannot retain any legal right to participate *itself* directly in the appointment or removal of officials who execute and implement federal law, nor can Congress retain any right to veto (or otherwise directly participate in) an agency's policymaking or adjudicative decisions. Because Congress has none of these powers over the Board or the SEC, the Act is constitutional.

The Plaintiffs invoke abstract and general propositions about the separation of powers, but ignore this essential principle. The Supreme Court has only rarely invalidated the structure of administrative agencies. In each and every case, the Court has done so because Congress had attempted to insert *itself* directly into the appointment or removal process or to directly control the agency's decisions through a veto-like power. Plaintiffs do not identify – and cannot, because none exists – a single Supreme Court decision that invalidates an administrative agency structure on constitutional grounds when Congress has not directly inserted itself into the administrative process in one of these three specific ways. For this fundamental reason, Plaintiffs' constitutional claims must fail and the District Court's decision should be affirmed.

ARGUMENT

I. CONGRESS'S CREATION OF THE PCAOB, A REGULATORY SUBUNIT THAT FUNCTIONS UNDER THE CONTROL AND OVERSIGHT OF THE SEC, DOES NOT VIOLATE THE SEPARATION OF POWERS

Plaintiffs' primary claim, that the PCAOB violates the separation of powers, is difficult to decipher. At times, the claim appears to be that the President must *himself* have the power directly to remove PCAOB members for cause. At other times, the claim appears to be that the *SEC* must have more expansive powers than the Act purportedly provides to remove Board members. Regardless of this confusion, Supreme Court precedent has rejected either theory for many decades.

1. The only cases in which the Supreme Court has held the structure of an administrative agency unconstitutional are those cases (rare, indeed) in which Congress has attempted to insert itself directly into the appointment or removal process or to control directly an agency's

decisions through a veto-like power. *See, e.g.*, *Metro. Wash. Airports Auth. v. Citizens for Abatement of Aircraft Noise, Inc.*, 501 U.S. 252 (1991) (direct congressional participation in agency decisionmaking); *Bowsher v. Synar*, 478 U.S. 714 (1986) (direct congressional involvement in removal process); *I.N.S. v. Chadha*, 462 U.S. 919 (1983) (direct congressional veto over agency decisions); *Buckley v. Valeo*, 424 U.S. 1 (1976) (per curiam) (direct congressional participation in appointment process); *Myers v. United States*, 272 U.S. 52 (1926) (direct Senate participation in removal). The Supreme Court has never held the design of an administrative agency unconstitutional when Congress has *not* inserted itself directly into the administrative process in one of these three specific ways. *Cf. Morrison v. Olson*, 487 U.S. 654, 686 (1988) (distinguishing *Bowsher* and *Myers* as cases in which Congress itself seized a statutory role in the removal of executive officials).

None of these three forms of unconstitutional congressional aggrandizement is present here: Congress does not retain legal power to interfere in removal or appointment decisions, nor to interfere directly in Board decisionmaking processes. The Act does not insert Congress directly in any of these ways – or, indeed, in any way at all – into Board and SEC administration of the Act.

2. In addition, Board members are, at most, "inferior officers" of the United States, as the Board's brief amply demonstrates. *See* PCAOB Br. at 19-30. Thus, any claim that the President must have direct "for cause" removal power over Board members reduces to the principle that the President must have "for cause" removal power over all government officials who act as "inferior officers." But such a principle would be radically inconsistent with longstanding political practice, as well as Supreme Court precedent. This claim goes beyond an attack on independent agencies alone: it is an attack on the structure of nearly all administrative agencies, both those whose heads serve at the pleasure of the President (executive agencies) and those whose heads the President can remove only for cause (independent agencies). For generations, the President has not had, and has not been constitutionally required to have, the

direct power to remove inferior officers of the United States, for cause or under any other standard.

The independent agencies, for example, appoint numerous inferior officers. As Justice Scalia has noted, Congress has given the FCC the power to appoint its managing director; the SEC, the power to appoint "such officers . . . as may be necessary;" the FTC, the power to appoint its secretary; and the CFTC, the power to appoint its general counsel. *Freytag v. Comm'r of Internal Revenue*, 501 U.S. 868, 918 (1991) (Scalia, J., concurring in part and concurring in the judgment). Nearly all other independent agencies have similar powers, by statute, to select their own inferior officers. Thus, the Consumer Product Safety Commission appoints its general counsel and various executive and associate executive directors, 15 U.S.C. § 2053(g)(1)(A); the Federal Election Commission appoints its general counsel, 2 U.S.C. § 437c(f)(1); the Federal Maritime Commission, 46 C.F.R. § 501.5(a) (2006), and the Federal Mine Safety and Health Review Commission, 30 U.S.C. § 803(b)(2), appoint key agency officials; the Nuclear Regulatory Commission appoints the heads of its various administrative units, 42 U.S.C. § 5841(a)(4); and so on. *See generally* Marshall Breger & Gary Eldes, *Established by Practice: The Theory and Operation of Independent Federal Agencies*, 52 Admin. L. Rev. 1111, 1236-82 (2000).

None of these statutes, as far as *amici curiae* are aware, authorizes or permits the President directly to fire any of these inferior officers, for cause or under any other standard. In *Freytag*, for example, the Court held that special trial judges of the Tax Court were "inferior officers" of the United States. *See Freytag*, 501 U.S. at 868. Congress gave the Chief Judge of the Tax Court the power to appoint and remove these special trial judges. Neither the statute nor the Court's opinion suggested that the President has the power himself to fire special trial judges, for cause or any other reason – let alone that the Constitution *requires* that the President have such power. Indeed, for over a century the Supreme Court has made clear that Congress has the constitutional power to set the terms under which inferior officers of the United States hold their positions. *See United States v. Perkins*, 116 U.S. 483, 485 (1886); *Ex Parte Hennen*, 38 U.S. (13. Pet.) 230, 260 (1839).

Here, Congress gave the power to the SEC to appoint Board members, as well as the power to remove them. That is the common and longstanding practice by which inferior officers in administrative agencies, independent as well as purely executive, are appointed and removed. The Constitution does not deny Congress the power to create such familiar structures. Indeed, even *Myers* itself, on which Plaintiffs place so much weight, expressly recognized this principle: the authority of Congress "to vest the appointment of such inferior officers in the heads of departments carries with it authority incidentally to invest the heads of departments with power to remove." 272 U.S. at 161. *Myers* held the removal scheme at issue unconstitutional only because Congress had given *itself* the right to participate in the removal of the inferior officers involved. *See id.*

Here, the President can remove SEC Commissioners under a "for cause" standard. *See SEC v. Blinder, Robinson & Co.*, 855 F.2d 677, 681 (9th Cir. 1988).[20] In turn, the SEC appoints, oversees, controls, and has removal power over its inferior officers, such as the Board. For separation of powers purposes, that suffices. Congress is free to decide such an administrative structure best promotes Congress's policy objectives – here, to protect investor confidence and ensure proper regulation of the capital markets.

Were it otherwise, the President would have the constitutional right to remove for cause every inferior officer in the United States: administrative law judges, agency general counsels, FTC investigators, civil service workers, law clerks, special trial judges in the Tax Court, and all others. Moreover, the particular history and structure of governmental regulation of the capital

---

[20] The precise legal standard under which the SEC is empowered to remove Board members is not critical to the Act's constitutionality, given the vast array of powers the SEC has over the Board. Section 101(e)(6) of the Act authorizes the SEC to remove Board members for "good cause." 15 U.S.C. § 7211(e)(6). Similarly, the Senate Committee Report, the most authoritative Committee report from the legislative process, states that the SEC can remove Board members "for cause." *See* S. Rep. No. 107-205, at 12 (2002).

markets makes this the least apt arena to create a new constitutional rule of this sort. As noted above, this integrated system has long relied on a unique combination of public-private structures functioning under the authority and oversight of the SEC. Because of the SEC's role in deciding whether to endorse the actions of these SROs, the courts hold that the SROs exercise a form of governmental power. Rules of the NASD that the SEC approves, for example, are federal law and preempt conflicting state law. Yet the President had no power to appoint or remove NASD officers or directors and continues to have no such power concerning officers or directors of the NYSE or FINRA.

Instead of creating the PCAOB, Congress could have given similar power over auditing regulation to the preexisting private organization, the AICPA's ASB. Had Congress done so, the President would not have had inherent constitutional power to remove the heads of FASB or ASB, just as the President has no power to remove the heads of the NYSE or FINRA. In creating the industry-independent PCAOB instead, Congress gave the SEC far *more* power over the Board than the SEC has over the NYSE or FINRA, or than the SEC had over the Board's predecessors, such as ASB. The SEC, for example, appoints Board members. It would be perverse to conclude that Congress, by creating a subunit of the SEC under even greater SEC control than other subunits of the SEC, such as the SROs, could not then decide to permit only the SEC to remove Board members and only for specified reasons. Nothing in the Constitution or any Supreme Court decision requires such a nonsensical result.

3. At other times, Plaintiffs' "separation of powers" challenge seems to rest on the view that the Act is unconstitutional because Congress has given the *SEC* too little power to remove Board members. But for two reasons at least, this theory has no support in the Act itself.

First, as noted above, the SEC has a broad array of oversight authority and control over the Board. To the extent the specific design of the SEC's removal power is relevant, those removal provisions cannot be assessed, constitutionally or practically, by abstracting them from the rest of the statutory structure. The removal power is one *means* through which a superior can exercise effective control over an inferior. But the ultimate issue is whether the principal can exercise effective control. In this case, the SEC has numerous means of controlling and overseeing the Board, in addition to the removal power. Taken as a whole, these powers leave no doubt that the SEC has more than enough legal authority and power to effectively control the Board. *See* PCOAB Br. at 19-23 (documenting SEC power over the Board).

Apart from "plenary" power over the most important legal actions of the Board – the issuance of rules or sanctions – the SEC has general powers far more expansive than the power to remove Board members. The SEC's powers fully to rescind the Board's authority and to approve the Board's budget, as well as to take over the regulatory process itself at any moment, for example, give the SEC effective, practical control over all of the Board's activities. The SEC can also leverage its power over Board rules and sanctions to supervise the Board's other activities. These are far greater powers, in fact, than the SEC has over the SROs that also function under its supervision. On top of all this, the SEC also has power to remove Board members. Though Plaintiffs try to present the Board as a free-wheeling, unchecked agency, the Act makes clear that the Board, like SROs and related entities in the securities regulatory regime, functions under the legal authority and control of the SEC.[21]

Second, the Plaintiffs misrepresent the legal relationship between the SEC and the Board. For example, Plaintiffs assert, without foundation, that the SEC must give *Chevron*-type

[21] With respect to the SROs, the SEC has censured the NASD, for example, for its failure to regulate properly the quotation practices of NASD market makers. *See* In the Matter of Nat'l Ass'n of Sec. Dealers, Exchange Act Release No. 37538, [1996-1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,825 (Aug. 8, 1996).

As the public record demonstrates, extensive staff-to-staff interaction also exists between the SEC and the Board. For example, the Board has amended proposed rules in response to informal recommendations from the SEC's staff in order to secure approval by the SEC. *See* Audio Webcast: PCAOB Open Meeting (Nov. 22, 2005), *available at* http://www.pcaobus.org/News_and_Events/Webcasts.aspx#33; *see also* SEC, Annual Report 2003, at 28 (2004) (noting that the SEC's Office of International Affairs "worked with the [Board] to address the concerns of foreign authorities regarding the international implications of the PCAOB's system for registering accounting firms"); *id.* at 66 (SEC's Office of Chief Accountant "[p]rovided extensive oversight of the formation and start-up activities of the [Board]").

deference to the Board's construction of the Act. But nothing in the Act, past SEC practice, or general administrative law and practice, supports this odd claim. The Act specifies that the courts review the Commission's rules and orders, not those of the Board. Thus, the agency that implements the Act, and to which the courts would give *Chevron* deference, is the SEC, not the Board. *See, e.g., Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.,* 545 U.S. 967, 980-81 (2005) (noting that *Chevron* requires courts to defer to "the implementing agency's [reasonable] construction [of a statute]") (citing *Chevron U.S.A. v. Natural Res. Defense Council*, 467 U.S. 837, 843-44 (1984)); *Business Roundtable v. SEC*, 905 F.2d at 408 (deferring to the SEC under *Chevron*); *Belenke v. SEC*, 606 F.2d 193, 197, 199 (7th Cir. 1979) (deferring to SEC's interpretation of the securities laws, not to that of the SRO, the CBOC, whose proposed rule change the SEC approved). Nor has the SEC given *Chevron*-style deference to the legal interpretations of the SROs or similar entities that it has overseen for many years. *See, e.g.*, *Sorrell v. SEC*, 679 F.2d 1323, 1326 n.2 (9th Cir. 1982) (holding that SEC engages in "independent" and "*de novo*" "review of NASD decisions"); *Todd & Co. v. SEC*, 557 F.2d 1008, 1012-13 (3d Cir. 1977) (holding that SEC engages in "full review" of NASD rules and "must base its [the SEC's] decision on its own findings"); *Belenke*, 606 F.2d at 198 (SEC makes an independent determination that an SRO's proposed rules are consistent with the securities laws); *R.H. Johnson & Co. v. SEC*, 198 F.2d 690 (2d Cir.) (same), *cert. denied*, 344 U.S. 855 (1952).

Yet the SEC has even greater statutory power over Board sanctions than it does over those, for example, of the NASD. For the latter, the SEC has no power to enhance an NASD-proposed penalty, but is limited to affirming, remanding, or, in certain circumstances, modifying it. *See* 15 U.S.C. § 78s(e). But the SEC has the additional statutory power to "enhance" any Board-proposed sanction, § 7217(c)(3), and can disapprove a proposed sanction because, among other factors, it is "inadequate." *Id.*

Similarly, Plaintiffs assert, equally without support in the text of the Act, that the SEC exercises only "appellate-like review" of the Board's final decisions. But the SEC has the power, among others, to "enhance" or "modify" agency sanctions, as well as to rescind the

Board's authority altogether or to take over regulating areas the Board regulates. It is the findings of the *Commission* as to facts that the Act makes conclusive if supported by substantial evidence. 15 U.S.C. § 78y(a)(4); *cf. R.H. Johnson & Co.*, 198 F.2d at 694 (holding under the 1934 Securities Exchange Act that courts review orders of the Commission only, not those of the NASD, which the SEC must approve before they have legal effect). Unlike the relationship of an administrative agency to a court, the Board functions as a subunit under the legal authority and control of its parent, the SEC.

4. Finally, Plaintiffs apparently claim that, over and above their challenges to the Act's removal and appointments provisions, the Act somehow violates the "separation of powers" when "taken as a whole." But this rhetoric adds nothing to Plaintiffs' other claims. If the structure by which Board members can be appointed and removed is constitutional, as it is, then the specific way in which an agency's structure could nonetheless violate the separation of powers is mysterious. Plaintiffs offer no theory, nor any coherent principle, over and above their removal and appointments challenges, as to what Congress would have to do to correct any such nebulous constitutional violation as one resting on the structure of the Act "taken as a whole." The President-principal officer-inferior officer hierarchical structure is routine and fully suffices for separation of powers purposes. Nothing more about an Act of Congress, "taken as a whole," is constitutionally required.

II. THE CONSTITUTION DOES NOT FORBID CONGRESS FROM CHOOSING TO VEST IN THE SEC THE APPOINTMENT OF INFERIOR OFFICERS WHO FUNCTION UNDER THE SEC'S AUTHORITY

The Board's brief amply demonstrates that the SEC is a "Department" within the meaning of the Appointments Clause. *See* PCAOB Br. at 30-32. *Amici curiae* seek to add one functional consideration that explains *why* the Constitution's design requires this conclusion. If the Constitution were instead understood to permit Congress to create independent agencies, as it does, but to forbid Congress from assigning those agencies the power to appoint their inferior officers, the Constitution would require a dysfunctional and illogical structure of administration.

Not only would such a principle require dismantling longstanding structures of administrative organization, it could create a system of administration organized at cross-purposes with itself.

Here, Congress created the PCAOB to function under the oversight and control of the SEC. This structure, as with the longstanding SROs, enables the SEC to bring its expertise to bear on a comprehensive and integrated regulatory system. If Congress could not lodge the appointments power for Board members in the SEC, Congress would be constitutionally obligated to locate the appointments power with, for example, the Secretary of the Treasury. But the Secretary of the Treasury has no legal power to oversee the SEC, nor would he have any further, ongoing power to oversee the acts of Board members. It is the SEC, not the Secretary, that can remove or censure Board members, abolish functions of the Board, and that must approve Board rules or sanctions to give them legal effect. If the Secretary appointed Board members who did not share the legal understandings and policy positions of the SEC, this system would be a recipe for institutional paralysis and constant internal institutional conflict. Indeed, the Appointments Clause frowns upon "interbranch appointments," precisely because of the distortions in government functioning that would ensue. *See Freytag*, 501 U.S. at 883; *Morrison*, 487 U.S. at 675-77.

Even Justice Scalia, who has long been concerned about the existence of independent agencies and the correctness of *Humphrey's Executor*, recognizes that the Constitution must be understood to permit independent agencies to appoint their inferior agents. As long as *Humphrey's Executor* remains the law, Justice Scalia acknowledges it follows that independent agencies must have the power, if Congress so decides, to appoint their inferior officers – and that independent agencies are therefore "Departments." *See Freytag*, 501 U.S. at 920 (Scalia, J., concurring in part and concurring in the judgment). As he put it, "adjusting the remainder of the Constitution to compensate for *Humphrey's Executor* is a fruitless endeavor." *Id.* at 921. That is precisely the principle upon which Plaintiffs' Appointments Clause claim must fall: given the constitutionality of independent agencies, they are necessarily "Departments" and, as such, are permitted to appoint their own inferior officers.

Finally, Plaintiffs also claim that, even if the SEC is a Department, only the Chairman can be the "Head" of that Department under the Appointments Clause. Again, this position lacks any constitutional logic, given that it is Congress that has the discretion in the first place whether and how to create an independent agency structure at all. Congress can create an independent agency with a single head or with a plural head; Congress has created many multi-headed commissions, including the SEC. For multi-headed commissions, Congress need not create the position of a Chairman at all. Thus, Congress has the power to decide that the SEC acting as a Commission is the "Head" of the SEC. Given that the legal position of Chair exists only to the extent Congress creates and recognizes it, and that Congress can abolish the position of Chair at any time, no other conclusion makes sense of the Constitution's structural provisions.

Similarly, Congress could decide that only the Commissioners, acting as a whole, can remove any SEC inferior officer. *See Perkins*, 116 U.S. at 485*; see also Morrison*, 487 U.S. at 689 n.27 (citing *Perkins*). Under Plaintiffs' view, the Constitution would require Congress to give the Chair appointment power, while permitting Congress to authorize the Commission to turn around and fire those whom the Chair appointed. The Constitution does not require such an illogical and dysfunctional system of administrative organization. That is why, as the Board's brief establishes, the courts and the Department of Justice have long understood the "Head" of a Department to include multi-member bodies. *See, e.g.*, *Morrison*, 487 U.S. at 661 n.3; *Silver v. United States Postal Service*, 951 F.2d 1033, 1035-41 (9th Cir. 1991); 37 Op. Att'y Gen. 227 (1933).

Once again, Plaintiffs' real complaint is with the existence of independent agencies per se. Because Congress has constitutional power to create independent agencies, headed by multi-member commissions, it follows that Congress has discretion to treat those commissions as "Heads" of the agencies that Congress itself has created.

CONCLUSION

Plaintiffs lost this battle many decades ago, when the Supreme Court recognized the constitutionality of independent agencies and the modern structure of government administration. Congress does not retain any right to participate itself directly in the appointment or removal of the Board, nor does Congress retain any power to veto (or otherwise directly participate in) the Board's or SEC's policymaking or adjudicative decisions. The Board acts under the pervasive legal authority of the SEC. For these reasons, the Act is constitutional, and the decision of the District Court should be affirmed.

Respectfully submitted,

____

Richard H. Pildes
Vanderbilt Hall Room 507
40 Washington Square South
New York, New York 10012

CERTIFICATE OF COMPLIANCE

The undersigned counsel for *amici curiae* former Chairmen of the SEC certifies that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) and the typeface and type-style requirements of Fed. R. App. 32(a)(5) and 32(a)(6), as modified by Circuit Rule 32(a)(1). This brief contains 6,996 words, excluding the Table of Contents, Table of Authorities, Certificates, and Glossary and is printed in a proportionally spaced typeface, 12-point Times New Roman, utilizing Microsoft Office WORD.

February 22, 2008

____
Richard H. Pildes

CERTIFICATE OF SERVICE

I certify that today, February 22, 2008, I caused an original and 14 copies of the foregoing *amici curiae* brief to be filed with the Court by hand delivery. I further certify that I caused two copies of the foregoing *amici curiae* brief to be served via overnight mail on each party separately represented:

Viet D. Dinh
BANCROFT ASSOCIATES PLLC
601 13th St., N.W.
Suite No. 930 South
Washington, D.C. 20005
(202) 234-0090

Kenneth W. Starr
24569 Via De Casa
Malibu, CA 90265
(310) 506-4621

Mark B. Stern
Mark R. Freeman
Civil Division, Appellate Staff
U.S. DEPARTMENT OF JUSTICE
950 Pennsylvania Avenue, N.W.
Washington, D.C. 20530-0001
(202) 514-5089

Christian J. Ward
YETTER &WARDEN
221 W. 6th Street
Suite 750
Austin, TX 78701

Elizabeth Gallaway
William Perry Pendley
MOUNTAIN STATES LEGAL FOUNDATION
2596 South Lewis Way
Lakewood, Colorado 80227

Michael A. Carvin
Noel J. Francisco
Christian G. Vergonis
JONES DAY
51 Louisiana Avenue, N.W.
Washington, DC 20001-2113
(202) 879-3939

Sam Kazman
Hans Bader
COMPETITIVE ENTERPRISE INSTITUTE
1001 Connecticut Avenue, N.W.
Suite 1250
Washington, D.C. 20036
(202) 331-1010

R. Craig Lawrence
U.S. ATTORNEY'S OFFICE
Civil Appellate
555 4th Street NW
Washington, DC 20530

Robert J. Katerberg
U.S. DEPARTMENT OF JUSTICE
Civil Division, Federal Programs
20 Massachusetts Ave., NW
Washington, DC 20530

Jeffrey A. Lamken
Joe Robert Caldwell, Jr.
James R. Doty
Robert K. Kry
Joshua A. Klein
BAKER BOTTS L.L.P.
1299 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2400
(202) 639-7700

Helgi C. Walker
WILEY REIN LLP
1776 K Street, NW
Washington, DC 20006
202-719-7000

____
Richard H. Pildes