[NOT YET SCHEDULED FOR ORAL ARGUMENT]

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

BRIEF FOR THE UNITED STATES

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CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to D.C. Circuit Rule 28(a)(1), the undersigned counsel certifies as follows:

A. Parties And Amici. Plaintiffs-Appellants are the Free Enterprise Fund and Beckstead & Watts, LLP. Defendants-Appellees are the Public Company Accounting Oversight Board; and Bill Gradison, Kayla J. Gillan, Daniel L. Goelzer, and Charles Niemeier, in their official capacities as members of the Public Company Accounting Oversight Board. The United States intervened as defendant in district court and appears in this Court as intervenor defendant-appellee.

The following parties have appeared or filed notices to participate as amici curiae in this Court: Washington Legal Foundation, Western States Legal Foundation, Council of Institutional Investors, and seven former chairmen of the Securities and Exchange Commission (G. Bradford Cook, Roderick M. Hills, Harold M. Williams, David S. Ruder, Arthur Levitt, Jr., Harvey L. Pitt and William Donaldson).

The following additional parties appeared as amici curiae in the district court: the American Federal of Labor and Congress of Industrial Organizations (AFL-CIO); the California Public Employees' Retirement System; the California State Teachers' Retirement System; the Council of Institutional Investors; the Los Angeles County Employees' Retirement Association; the Public Employees' Retirement Association of Colorado; the Sacramento

County Employees' Retirement System; and the Teachers Insurance and Annuity Association College Retirement Equities Fund.

B. <u>Rulings Under Review</u>. Appellants challenge the final order and opinion of the district court (Robertson, J.), entered on March 21, 2007. The order and opinion appear as items #57 and #58 on the district court docket (D.D.C. No. 06-0217). The district court's opinion is available at 2007 WL 891675.

C. <u>Related Cases</u>. This matter has not previously come before this Court. There are no related cases of which we are aware.

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Mark R. Freeman

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GLOSSARY

APA	Administrative Procedure Act
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

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BRIEF FOR THE UNITED STATES

STATEMENT OF JURISDICTION

Plaintiffs invoked the jurisdiction of the district court under 28 U.S.C. §§ 1331 and 2201. A12.[1] For the reasons discussed in Part I of the Argument, the district court lacked subject-matter jurisdiction over the complaint. The district court entered final judgment on March 26, 2007. A52. Plaintiffs filed a timely notice of appeal on April 13, 2007. A8; see Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

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[1] "JA__" denotes a citation to plaintiffs' appendix.

STATEMENT OF THE ISSUES

Congress created the Public Company Accounting Oversight Board to standardize and regulate the auditing of public companies, subject to comprehensive review by the Securities and Exchange Commission. The issues presented are:

1. Whether the district court lacked jurisdiction because plaintiffs failed to exhaust the exclusive statutory review procedures for parties aggrieved by the Board.
2. Whether Congress violated the Appointments Clause by vesting the power to appoint members of the Board in the SEC.
3. Whether Congress violated the constitutional separation of powers by creating an entity that creates standards and enforces discipline in the accounting and auditing industry, subject to plenary review and oversight by the SEC.

STATUTES AND REGULATIONS

The pertinent statutes are reproduced in the addendum to plaintiffs' brief.

STATEMENT OF THE CASE

Plaintiffs in this civil action challenge Congress's creation of the Public Company Accounting Oversight Board ("PCAOB" or "Board") to regulate the auditing of public companies, subject to the comprehensive oversight and control of

the Securities and Exchange Commission. They contend that Congress violated the Appointments Clause by vesting the power to appoint members of the Board in the SEC, and more generally that the Board violates the constitutional separation of powers because, in plaintiffs' view, the Board is not sufficiently accountable to the President.

Bypassing the exclusive statutory review scheme under the securities laws that Congress expressly made applicable to the PCAOB, plaintiffs brought this facial attack on the Board in federal district court. The United States intervened to defend the constitutionality of the statute. The district court denied defendants' motion to dismiss for lack of jurisdiction but granted summary judgment in favor of defendants on the merits. See A37-A50. This appeal followed.

STATEMENT OF FACTS

A. The Public Company Accounting Oversight Board

Congress enacted the Sarbanes-Oxley Act of 2002, in the aftermath of the accounting debacles at Enron, Worldcom, and other prominent public companies. Pub. L. No. 107-204, 116 Stat. 745. In Title I of the Act, Congress sought to address problems resulting from inadequate oversight of the accounting firms whose auditors failed to detect the fraudulent corporate accounting schemes that proved so damaging to stockholders. 15 U.S.C. §§ 7211-7219.

As the centerpiece of the new regulatory efforts, Congress created the Public Company Accounting Oversight Board. Congress patterned the new Board on the so-called self-regulatory organizations ("SROs"), such as the National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE"), that have long been instrumental in the regulation of the securities industry. Such entities, which are subject to comprehensive oversight and control by the SEC, have functioned "as quasi-governmental agencies in disciplining members for federal securities law violations * * * for almost 70 years." NASD v. SEC, 431 F.3d 803, 804 (D.C. Cir. 2005). As this Court has explained, the "congressional scheme * * * establishes a system in which the Commission not only closely supervises and approves the processes by which [an SRO] brings disciplinary action, but in which the Commission fully revisits the issue of liability, and can completely reject or modify [the SRO's] decision as it deems appropriate." Id. at 806.

In adapting this model to provide oversight of the accounting and auditing industry, Congress made applicable to the PCAOB many of the same statutory provisions that govern the SROs, and subjected it to the same pervasive SEC oversight. S. Rep. No. 107-205, at 12 (2002) (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"); see, e.g., 15 U.S.C. § 78q(b)(1) (SEC's power to examine an SRO's records at any time), incorporated by 15 U.S.C. § 7217(a); 15 U.S.C. § 78s(c) (SEC's power to abrogate, add to, or delete from the rules of an SRO at any time), incorporated and modified by 15 U.S.C. § 7217(b)(5).

The Board is charged 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). Accounting firms that prepare or issue audit reports for publicly traded companies must register with the Board and must comply with auditing, quality control, and ethics standards issued by the Board. 15 U.S.C. § 7213(a)(1). To ensure compliance, Congress directed the Board to "conduct a continuing program of inspections" of registered accounting firms. 15 U.S.C. § 7214(a).

The Board is also authorized to investigate conduct by registered firms and their associated persons that may violate the Act, other securities laws, or its own rules or those of the SEC. 15 U.S.C. § 7215(b). Based on the results of these investigations, the Board may initiate proceedings to impose disciplinary sanctions. 15 U.S.C. § 7215(b)(3). Sanctions may range from censure and mandatory training to civil monetary

penalties to suspension or revocation of an accounting firm's registration, among other authorized sanctions. 15 U.S.C. § 7215(c)(4).

B. SEC Control Over The Board

1. The Sarbanes-Oxley Act provides that the chairperson and members of the PCAOB shall be appointed by "the Commission, after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury." 15 U.S.C. § 7211(e)(4)(A). The Board consists of five members appointed for five-year terms.

Like the SROs, the Board is in all respects subordinate to the SEC. Every rule issued by the Board is subject to approval by the Commission, 15 U.S.C. § 7217(b), and "[n]o rule of the Board shall become effective without prior approval of the Commission." 15 U.S.C. § 7217(b)(2). Thus, for example, rules governing Board investigations must be approved by the SEC. 15 U.S.C. § 7217(b). 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 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, the securities laws, or the rules and regulations thereunder applicable to the

PCAOB (again, as interpreted by the Commission). See 15 U.S.C. § 78s(c), incorporated and modified by 15 U.S.C. § 7217(b)(5).

The Board's powers of investigation and enforcement are likewise circumscribed. The Board is required to notify the SEC of investigations of potential violations of the securities laws, and to coordinate with the SEC to the extent there is a simultaneous SEC investigation. 15 U.S.C. § 7215(b)(4). The Board lacks independent subpoena authority, and must apply to the SEC for a subpoena when it seeks to compel documents or testimony from third parties. 15 U.S.C. § 7215(b)(2)(D); compare id. § 78u(d) (SEC power of subpoena). Final inspection reports are subject to review before the SEC at the request of the investigated party. 15 U.S.C. § 7214(h)(1).

Disciplinary sanctions imposed by the Board, like those imposed by the SROs, are subject to plenary SEC review. Indeed, the Commission may institute review of a disciplinary sanction on its own motion. See 15 U.S.C. § 78s(d)(2), as incorporated by 15 U.S.C. § 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. 15 U.S.C. § 7215(e). Disapproval of an accounting firm's application for registration is treated as a disciplinary sanction for these purposes, triggering an opportunity for SEC review and an automatic stay. 15 U.S.C. §§ 7212(c)(2), 7217(c).

Review by the Commission of Board actions is _de novo_, and includes notice and an opportunity for a hearing before the Commission. _See_ 15 U.S.C. § 78s(e)(1), _as incorporated by_ 15 U.S.C. § 7217(c)(2). 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_ 15 U.S.C. § 78s(e)(1)(A), _as incorporated by_ 15 U.S.C. § 7217(c)(2). If the SEC does not affirm the finding of wrongdoing, the sanction must be set aside. 15 U.S.C. § 78s(e)(1)(B), _as incorporated by_ 15 U.S.C. § 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 independent judgment, that the Board's proposed sanction "(A) is not necessary or appropriate in furtherance of this Act or the securities laws; or (B) is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed." 15 U.S.C. § 7217(c)(3).

The statute provides a number of additional tools for SEC oversight. The Commission must approve the Board's budget each year, 15 U.S.C. § 7219(b), as well as the annual accounting support fee that funds its operations, 15 U.S.C. § 7219(d)(1). The SEC may inspect the Board's records at any time. 15 U.S.C. § 78q(b)(1), _as incorporated by_ 15 U.S.C. § 7217(a). The Board cannot refer matters to the Department of Justice or to state

prosecutors for enforcement without the prior consent of the Commission. 15 U.S.C. § 7215(b)(4)(B)(iii). Even the Board's exercise of its "sue and be sued" authority is subject to SEC control: the Board cannot appear in court to defend its rules or enforce its decisions without the express approval of the Commission. See 15 U.S.C. § 7211(f)(1) (granting the Board the authority "to sue and be sued, complain and defend, in its corporate name and through its own counsel, with the approval of the Commission, in any Federal, State, or other court" (emphasis added)).

Board members themselves may be removed or publicly censured by the SEC "for good cause shown before the expiration of the term of that member." 15 U.S.C. § 7211(e)(6); see also 15 U.S.C. § 7217(d)(3). In addition, the Commission is empowered to "censure or impose limitations upon the activities, functions, and operations" of the Board as a whole if it finds that the PCAOB "has violated or is unable to comply with any provision of this Act, 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." 15 U.S.C. § 7217(d)(2).

In addition to these specific grants of oversight authority, the SEC is empowered to rescind, in whole or in part, any aspect

of the PCAOB's 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 15 U.S.C. § 7217(d)(1) ("The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this Act and the securities laws, may relieve the Board of any responsibility to enforce compliance with any provision of this Act, the securities laws, the rules of the Board, or professional standards.").

Finally, the Act expressly preserves the Commission's own authority to adopt and enforce rules relating to accounting and audits. See 15 U.S.C. § 7202(c) ("Nothing in this Act or the rules of the Board shall be construed to impair or limit" the Commission's authority to "regulate the accounting profession, accounting firms, or persons associated with such firms," to "set standards for accounting or auditing practices or auditor independence," or to "take, on the initiative of the Commission, legal, administrative, or disciplinary action against any registered public accounting firm or any associated person thereof"); see also id. § 7218(c).

C. The Present Litigation

Plaintiffs are the Free Enterprise Fund and Beckstead and Watts, LLP ("B&W"), a Nevada accounting firm registered with the PCAOB. Plaintiffs allege that, in May 2004, the Board conducted

an inspection of B&W's offices and identified a variety of deficiencies in B&W's audits of its clients. A26 (compl. ¶¶ 74-75). The Board subsequently opened a formal disciplinary investigation into B&W's practices, which was ongoing at the time of the filing of the complaint. A27 (compl. ¶ 79).

Bypassing the exclusive administrative review procedures in the securities laws that Congress expressly made applicable to the PCAOB, see, e.g., 15 U.S.C. § 7217(b)(4); id. § 7217(c), plaintiffs brought this direct facial challenge to the constitutionality of Title I of the Sarbanes-Oxley Act in federal district court. Plaintiffs contended that, in creating the PCAOB, Congress violated the Appointments Clause and the constitutional separation of powers, as well as non-delegation principles. They sought a declaratory judgment of the Act's invalidity and injunctive relief prohibiting the PCAOB from further operation, including from taking "any further action" against B&W. See A31.

Defendants moved to dismiss, and the United States intervened to defend the constitutionality of the Act. All parties moved for summary judgment. In March 2007, the district court denied defendants' motions to dismiss but granted summary judgment for defendants on the merits. See A37-A50.

As an initial matter, the district court concluded that it possessed jurisdiction to entertain the complaint. The court

reasoned that plaintiffs' constitutional claims are "collateral to the Act's statutory scheme" and "take aim at the very structure of the PCAOB." A43. Accordingly, the court concluded, plaintiffs' complaint "is outside the universe of cases subject to the implicitly exclusive administrative review established by the Act." A43.

On the merits, the district court rejected plaintiffs' contention that the members of the Board are "principal officers" whose appointment must be entrusted to the President, stressing that the PCAOB has "no power to render a final decision on behalf of the United States unless permitted to do so by other executive officers." A45 (quoting Edmond v. United States, 520 U.S. 651, 665 (1997)). Likewise, the district court found no merit to plaintiffs' insistence that the SEC is not a "Department" under the Appointments Clause. A46. The court accepted plaintiffs' position that the SEC Chairman, rather than the Commissioners collectively, is the "Head" of the agency for Appointments Clause purposes. It concluded, however, that plaintiffs lack standing to attack the Board on this ground because the SEC Chairman has voted in favor of each Board member's appointment. A47.

The district court similarly rejected plaintiffs' separation-of-powers claim. Noting that the Supreme Court has never suggested that the Constitution requires the President to possess direct removal authority over inferior officers, the

court concluded that the Act's "good cause" removal protection for PCAOB members is not a facially unconstitutional restriction on the President's control of the Executive branch, either alone or in combination with the SEC's own good cause removal protections. A48.[2]

SUMMARY OF ARGUMENT

The calamitous experiences of Enron, Worldcom and other major companies made clear the extent to which the interests of the investing public may be jeopardized by inadequate oversight of accountants and auditors. In responding to these events, Congress looked to the model of self-regulatory organizations such as the NASD and the NYSE, which have been instrumental in regulating the securities industry for more than half a century. Congress drew on features of these SROs in creating the Public Company Accounting Oversight Board, including by making the new Board subordinate in all respects to the Securities and Exchange Commission.

In this facial challenge to the Board's constitutionality, plaintiffs urge, in essence, that the statutory scheme does not permit adequate control by the President. Such a claim cannot

[2] The district court also rejected plaintiffs' non-delegation claim, concluding that "[t]he legislative delegation effected by the Act is squarely within the bounds of modern non-delegation doctrine." A49. Plaintiffs have not challenged this aspect of the district court's judgment on appeal.

properly proceed in district court, and in any event plaintiffs' constitutional arguments are wholly without merit.

I. As an initial matter, the district court lacked jurisdiction over the complaint because plaintiffs failed to exhaust the exclusive statutory review procedures that require a party aggrieved by the Board to proceed before the SEC as a prerequisite to judicial review. For more than seventy years, the Exchange Act has provided the exclusive statutory mechanism for judicial review of claims involving self-regulatory organizations, and Congress expressly made these procedures applicable to the PCAOB.

The district court mistakenly permitted plaintiffs to bypass these procedures on the ground that their suit presents a facial attack to the Board itself. It is settled law, however, that compliance with an exclusive review scheme is not excused merely because a plaintiff asserts a constitutional claim that cannot be resolved by an agency, provided that (as here) the scheme ensures a meaningful opportunity for judicial review after the administrative process is complete. Plaintiffs' inability to identify any cause of action that would allow their facial challenge to proceed in district court only underscores the exclusivity of the administrative review scheme. By permitting plaintiffs to bypass the SEC, moreover, the district court denied the Commission the opportunity to construe the key statutory

provisions that underlie plaintiffs' claims — such as the scope of the Commission's authority to remove Board members — and thereby alter or even avoid the constitutional questions plaintiffs now urge the Court to address.

II. In any event, plaintiffs' arguments under the Appointments Clause – that Board members are "principal" officers, that the SEC is not a "Department," and that the Commission is not its "Head" – find no basis in doctrine or logic.

Plaintiffs urge that Board members must be deemed principal officers because they exercise authority "equivalent to that of an independent agency." Pl. Br. 25. That mistaken assertion encapsulates the error of plaintiffs' argument. The Board is in every material respect subordinate to the Commission, which enjoys pervasive and plenary control over the Board and its activities. No entity exercises comparable oversight of the Commission, which is accountable only to the President. For that reason, the Commissioners are "principal" officers and the Board members are not.

Plaintiffs' fallback contention — that the SEC is not a "Department" for Appointments Clause purposes, and thus that Congress cannot grant the Commission the authority to appoint its own inferior officers — hinges on a reading of the Supreme Court's decision in Freytag that is unsupported by the Court's

holding (which has no application to plaintiffs' claim) or its reasoning. The pertinent discussion in Freytag concerned the contention that "Department" should be limited to Cabinet-level agencies, and should exclude all agencies below that level. The Court, however, expressly declined to resolve that question, and did not address, let alone endorse, plaintiffs' chief argument that "Department" should not encompass "independent" agencies such as the SEC. The four Justices who did address the question, moreover, reached precisely the opposite result, and would have included the SEC within the ambit of the Appointments Clause without reference to its "independent" status. See 501 U.S. at 918-20 (Scalia, J., concurring in part and concurring in judgment). The same analysis controls here.

Plaintiffs' argument that the Commissioners cannot constitute the "Head" of the agency is similarly without support in the constitutional text or precedent. All substantive rulemaking and adjudicatory authority on behalf of the agency is vested in the five members of the Commission collectively, not in any other person or entity; the Commissioners together perform the role that the Secretary or other chief officer performs in a traditional Cabinet agency. No constitutional problem is posed by this arrangement, and plaintiffs' alternative suggestion that the SEC Chairman should be deemed the relevant "Head" has no basis in the statute. But even if that argument were accepted,

plaintiffs' constitutional argument would reduce to the contention that Congress should have vested appointment authority in the Chairman rather than in "the Commission." If necessary to avoid a constitutional infirmity, this grant of authority could plainly be construed as a grant of authority to the Chairman. In either case, no basis exists for holding the entire statute invalid.

III. Invoking general principles of the separation of powers, plaintiffs urge that the statute does not permit executive officers to exercise sufficient control over the Board. Plaintiffs can make this argument only by ignoring the extraordinary control that the SEC exercises over every aspect of the Board's operations.

At bottom, plaintiffs' argument reduces to the assertion that, irrespective of this comprehensive review scheme, the President cannot exercise adequate control over the PCAOB because he lacks plenary authority to remove the SEC Commissioners. This argument mirrors plaintiffs' contention that Congress could not properly vest appointment authority in an "independent" agency. The argument is no more persuasive when cast in the general rubric of the separation of powers. Congress constitutionally vested the authority to appoint inferior officers in the Commission, and, as the Supreme Court has long made clear, the power to remove is an incident of the power to appoint.

ARGUMENT

I. THE DISTRICT COURT LACKED JURISDICTION BECAUSE PLAINTIFFS FAILED TO EXHAUST THE EXCLUSIVE STATUTORY REVIEW PROCEDURES MADE APPLICABLE TO THE PCAOB BY CONGRESS.

Since the enactment of the Exchange Act in 1934, the federal securities laws have provided the exclusive mechanism for parties aggrieved by self-regulatory organizations to obtain judicial review. That procedure, set forth in sections 19 and 25 of the Exchange Act, 15 U.S.C. §§ 78s(b) & 78y(a)-(b), guarantees the Commission an opportunity to address the questions presented in an authoritative order or ruling, subject to direct review in the court of appeals. Ibid. See, e.g., NASD v. SEC, 431 F.3d 803 (D.C. Cir. 2005) (discussing administrative and judicial review of NASD disciplinary orders); Swirsky v. NASD, 124 F.3d 59, 62-64 (1st Cir. 1997); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. NASD, 616 F.2d 1363, 1370 (5th Cir. 1980); First Jersey Sec., Inc. v. Bergen, 605 F.2d 690, 696 (3d Cir. 1979).

In creating the PCAOB on the model of the SROs, Congress made the same procedures applicable to the Board, see, e.g., 15 U.S.C. § 7217(b)(4); id. § 7217(c), and plaintiffs plainly could have availed themselves of that avenue of review. For example, plaintiffs could have sought Commission review of their claim that "burdensome" auditing standards adopted by the Board "have imposed substantial compliance costs" on B&W and caused the loss of clients, see A24, A26 (complaint ¶¶ 62-64, ¶¶ 72-73), and

raised their constitutional objections before the Commission and on judicial review, see 15 U.S.C. § 7217(b)(4); id. § 78s(b)(1); id. § 78y(b). Likewise, rather than seek a district court order enjoining the Board's ongoing investigation of B&W and "nullifying and voiding any prior adverse action against Beckstead and Watts," A31 (prayer for relief), plaintiffs could have sought de novo review by the Commission of such prior adverse actions, followed by judicial review. See 15 U.S.C. § 7217(c)(2); id. § 78s(d)(2); id. § 78y(a). Indeed, plaintiffs could simply have petitioned the Commission to rescind the PCAOB's authority under the Sarbanes-Oxley Act in its entirety, and then sought review of the Commission's decision in this Court. See 15 U.S.C. § 7217(d)(1); 15 U.S.C. § 78y(b).

Plaintiffs justify their decision to proceed directly to district court on the ground that their lawsuit does not challenge any specific action or rule of the PCAOB. Pl. Br. 9. As an initial matter, plaintiffs' insistence that they do not challenge any action of the Board cannot be reconciled with their complaint, which seeks to preempt the Board's formal investigation of plaintiff B&W and is replete with objections to the Board's rules and conduct. See generally A24-A27.

More fundamentally, plaintiffs' argument misconceives the governing principles of judicial review. Plaintiffs are not free to disregard the statutory review process established by Congress

and, instead, assert facial challenges in district court untethered to particular claims of injury. As this Court has stressed, "[m]any agency adjudication schemes require petitioners to exhaust their administrative remedies before bringing their constitutional claims to Article III courts." American Coalition for Competitive Trade v. Clinton, 128 F.3d 761, 766 (D.C. Cir. 1997). Administrative schemes of this kind do not foreclose constitutional claims; they simply provide "reasonable requirements that ensure that plaintiffs have a concrete stake in the proceedings." Ibid. Thus, in American Coalition, this Court concluded that the plaintiff's failure to exhaust an exclusive administrative review scheme deprived the Court of jurisdiction to consider an Appointments Clause challenge to the NAFTA binational panel system. Id. at 766-67.

That reasoning applies with even greater force here. Plaintiffs do not dispute that judicial review of constitutional claims — including structural constitutional claims — is available on petition for review from decisions of the Securities and Exchange Commission. See, e.g., American Power & Light Co. v. SEC, 329 U.S. 90, 104-06 (1946) (addressing structural non-delegation claim on review from Commission); Blinder, Robinson & Co. v. SEC, 837 F.2d 1099, 1103-08 (D.C. Cir. 1988) (separation-of-powers, structural due process, and Fourth Amendment); Sorrell v. SEC, 679 F.2d 1323, 1325-26 (9th Cir. 1982) (non-delegation

challenge to NASD); R.H. Johnson & Co. v. SEC, 198 F.2d 690, 695 (2d Cir. 1952) (same); see also First Jersey Securities, Inc. v. Bergen, 605 F.2d 690, 696 (3d Cir. 1979) (directing dismissal of lawsuit asserting non-delegation claim against NASD for failure to exhaust administrative remedies under the Exchange Act).

Moreover, in reviewing a Commission order, this Court would have the benefit of the Commission's authoritative construction of the Sarbanes-Oxley Act, which could well be material to plaintiffs' myriad contentions regarding the relative authority of the Commission and the Board — including, for example, the circumstances in which the Commission may properly exercise its power to remove Board members. See, e.g., Pl. Br. 18-22 (discussing hypothetical instances in which the SEC could not, in plaintiff's view, remove Board members). By bringing their claims directly in federal district court, plaintiffs deprived the Commission of the opportunity to consider these arguments in the first instance and, if necessary, to construe its own powers under the Act in light of the asserted constitutional defects. See Ohio Civil Rights Comm'n v. Dayton Christian Schools, Inc., 477 U.S. 619, 629 (1986) ("[I]t would seem an unusual doctrine . . . to say that [an agency] could not construe its own statutory mandate in the light of federal constitutional principles."); Continental Air Lines, Inc. v. Department of Transportation, 843 F.2d 1444, 1455-56 (D.C. Cir. 1988).

In any event, plaintiffs' facial challenge could not properly be heard even if a Commission ruling was not likely to inform judicial consideration of the constitutional claim. As the Supreme Court established in Thunder Basin Coal Co. v. Reich, 510 U.S. 200 (1994), even if an agency cannot rule on the merits of a constitutional claim, a plaintiff cannot bypass exclusive administrative review procedures as long its constitutional claims can be "meaningfully addressed in the Court of Appeals" after administrative review. Id. at 215. See also Am. Fed. of Gov't Employees, AFL-CIO v. Loy, 367 F.3d 932, 936-37 (D.C. Cir. 2004) (administrative review scheme precluded First and Fifth Amendment challenges to TSA directive); Sturm, Ruger & Co. v. Chao, 300 F.3d 867, 876 (D.C. Cir. 2002) (same, Fourth Amendment challenge to OSHA data collection program).

The jurisdictional defects in plaintiffs' complaint are underscored by their implicit invitation to the Court to invent a new cause of action on their behalf. The PCAOB is not "an agency or establishment of the United States Government," 15 U.S.C. § 7211(b), and plaintiffs accordingly do not invoke the Administrative Procedure Act. Indeed, plaintiffs identify no cause of action that would permit their challenge to the Board to proceed in district court, and none exists. The Court should not entertain requests to create implied remedies against quasi-governmental agencies when Congress has expressly provided a

mechanism for judicial review. See Correctional Services Corp. v. Malesko, 534 U.S. 61, 67-68 (2001) (availability of remedial scheme provided by Congress obviates need to fashion new, judicially created remedy). None of the constitutional rulings on which plaintiffs rely arose in the context of such a facial challenge, but instead arose through established statutory mechanisms or as defenses to enforcement actions. E.g., Morrison v. Olson, 487 U.S. 654, 668-69 (1988) (appeal from order denying motion to quash subpoena); Freytag v. Commissioner, 501 U.S. 868, 871-73 (1991) (appeal from adverse decision of Tax Court); Myers v. United States, 272 U.S. 52 (1926) (suit by dismissed officer for unpaid salary); United States v. Germaine, 99 U.S. 508 (1879) (appeals from criminal convictions involving defendants' status as "officers" as element of crime). No basis exists for permitting the facial challenge asserted here.

II. BOARD MEMBERS ARE "INFERIOR OFFICERS" WHO MAY BE APPOINTED BY THE COMMISSION CONSISTENT WITH THE APPOINTMENTS CLAUSE.

The Sarbanes-Oxley Act provides that the chairperson and members of the PCAOB shall be appointed by "the Commission, after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury." 15 U.S.C. § 7211(e)(4)(A). In plaintiffs' view, this grant of authority runs afoul of the Appointments Clause, U.S. Const., art. II, § 2, cl. 2.

The Appointments Clause divides "Officers of the United States" into two categories: principal officers and inferior officers. The prerogative to appoint principal officers must remain with the President, subject to the advice and consent of the Senate. In contrast, Congress may "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." Ibid. See Buckley v. Valeo, 424 U.S. 1, 132 (1976).

Plaintiffs propose two theories under which the Act should be held to violate these principles. First, they contend that Board members are "principal" officers who must be appointed by the President. Second, assuming that Board members are "inferior" officers, plaintiffs urge that the Securities and Exchange Commission is not a "Department" in which the power to appoint officers may properly be vested, and in any event, that the SEC Chairman, not the Commission collectively, is the relevant "Head." These contentions are equally unavailing.

A. PCAOB Members Are "Inferior" Officers

The precise line of demarcation between principal and inferior officers "is one that is far from clear, and the Framers provided little guidance into where it should be drawn." Morrison, 487 U.S. at 671. At bottom, however, the inquiry is straightforward: "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." Edmond v. United States, 520 U.S. 651, 662 (1997).

The Supreme Court in Edmond made clear that an officer may be "inferior" in the constitutional sense even though his "superior" exercises something less than plenary control over his performance of his duties. The Court in that case reviewed the status of judges of the Coast Guard Court of Criminal Appeals, who are subject to divided oversight by the Judge Advocate General and the Court of Appeals for the Armed Forces. The Judge Advocate General exercises significant administrative oversight, including a general removal power; the Court of Appeals provides substantive review of individual decisions. Id. at 664-65.

As the Supreme Court recognized, under this scheme of divided review, the Court of Criminal Appeals judges (i) cannot be directed to decide particular cases in particular ways in the first instance, (ii) cannot be removed based on their rulings in individual cases, and (iii) enjoy substantial deference to their factual findings by the Court of Appeals. In holding that the judges are, nevertheless, "inferior" officers, the Supreme Court emphasized the crucial point 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." Id. at 665.

This analysis leaves no doubt as to the constitutional status of Board members as "inferior" officers. Like the judges in Edmond, PCAOB members "have no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers." And like the judges in Edmond, Board members are "directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate." 520 U.S. at 663.

Indeed, the Commission possesses the power to reverse, modify, or set aside every significant act the Board is empowered to take. The statute gives the SEC a variety of tools for exerting its supervisory control over the PCAOB, from its authority to abrogate, delete, or add to the PCAOB's rules as it deems necessary or appropriate, 15 U.S.C. § 7217(b)(5), to its power to "relieve the Board of any responsibility to enforce compliance with any provision," 15 U.S.C. § 7217(d)(1), to its ability to "impose limitations upon the activities, functions, and operations of the Board," 15 U.S.C. § 7217(d)(2), to its authority to "enhance, modify, cancel, reduce, or require the remission" of sanctions imposed by the Board, 15 U.S.C. § 7217(c)(3), to its veto power over the PCAOB's annual budget, 15 U.S.C. § 7219(b). Cf. United States v. Nixon, 418 U.S. 683, 696 (1974) (special prosecutor was a "subordinate office[r]" because the President or Attorney General could have effectively

removed him at any time, if necessary by amending or revoking the regulations defining his authority); In re Sealed Case, 829 F.2d 50, 56 (D.C. Cir. 1987) (Independent Counsel was inferior officer because, inter alia, the Attorney General could rescind the relevant regulation delegating authority and "thereby abolish[] the Office of Independent Counsel").

The "superior/inferior" relationship is even more direct and comprehensive in the present case than in Edmond, where supervisory functions were divided between the Judge Advocate General and the Court of Appeals for the Armed Forces. In contrast, the SEC is authorized not only to remove Board members and to disapprove or modify their substantive decisions, but also to withdraw any aspect of the Board's authority at any time. 15 U.S.C. § 7217(d)(1). Moreover, whereas the Court of Appeals for the Armed Forces reviewed only a subset of decisions of the Coast Guard judges, Edmond, 520 U.S. at 665-66, the SEC reviews all PCAOB rules and all appealed PCAOB disciplinary sanctions, as well as final PCAOB inspection reports if duly challenged. See 15 U.S.C. §§ 7217(b), (c). And, in contrast to the deferential standard of review employed by the Armed Forces Court of Criminal Appeals, SEC review of the Board's action is plenary.

This Court's decision in NASD v. SEC, 431 F.3d 803 (D.C. Cir. 2005), underscores the degree of control exercised by the SEC. The Court in that case addressed SEC oversight of

disciplinary sanctions imposed by a self-regulatory organization, the National Association of Securities Dealers, under an identical statutory review scheme:

> The congressional scheme, in short, establishes a system in which the Commission not only closely supervises and approves the processes by which NASD brings disciplinary action, <u>but in which the Commission fully revisits the issue of liability, and can completely reject or modify NASD's decision as it deems appropriate</u>. NASD's disciplinary process essentially supplants a disciplinary action that might otherwise start with a hearing before an ALJ.

431 F.3d at 806 (emphasis added). As the Court explained, "NASD's authority to discipline its members for violations of federal securities law is entirely derivative." <u>Id</u>. The Court emphasized that "[t]he authority [NASD] exercises <u>ultimately belongs to the SEC</u>, and the legal views of the self-regulatory organization <u>must yield to the Commission's view of the law</u>." <u>Id</u>. at 806 (emphases added). <u>See also</u>, <u>e.g.</u>, <u>Gold</u> v. <u>SEC</u>, 48 F.3d 987, 990 (7th Cir. 1995) (interpreting same statutory scheme as providing for <u>de novo</u> SEC review of disciplinary sanctions imposed by the New York Stock Exchange); <u>Shultz</u> v. <u>SEC</u>, 614 F.2d 561, 568 (7th Cir. 1980) ("In reviewing a decision of the Exchange, the Commission makes a <u>de novo</u> determination of the facts and the law."); <u>compare</u> <u>Edmond</u>, 520 U.S. at 665 ("so long as there is some competent evidence in the record to establish each element of the offense beyond a reasonable doubt, the Court

of Appeals for the Armed Forces [would] not reevaluate the facts”).

Plaintiffs’ mistaken assertion that “the Board exercises extraordinarily broad and very significant authority, equivalent to that of an independent agency,” Pl. Br. 25, epitomizes the difficulties with their argument. Board decisions are subject to plenary oversight by the SEC. No superior officers exercise comparable control over the decisions of the SEC commissioners, who are accountable only to the President. That is why the SEC Commissioners are “principal” officers and Board members are “inferior” officers.

B. Congress May Vest The Power to Appoint Inferior Officers in the SEC.

Plaintiffs urge that Congress cannot authorize the SEC to appoint inferior officers because the Commission is not a “Department” under the Appointments Clause, and because its Commissioners collectively are not the “Head” of the agency.

1. At the time of the framing, the term “department” referred to a “separate allotment or part of business; a distinct province, in which a class of duties are allotted to a particular person.” Freytag, 501 U.S. at 920 (Scalia, J., concurring in part and concurring in the judgment) (quoting 1 N. Webster, American Dictionary 58 (1828)). As used in the Appointments Clause, the term “has reference to the subdivision of the power of the Executive into departments, for the more convenient

exercise of that power." United States v. Germaine, 99 U.S. 508, 510 (1879).

The SEC is the principal federal agency charged with administration of the securities laws, and exercises executive power. Like the Cabinet agencies, the Commission is subject only to the oversight of the President, without being subordinated to (or contained within) another component of the Executive Branch. 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"). Like Cabinet officials, SEC Commissioners are appointed by the President with the advice and consent of the Senate. See 15 U.S.C. § 78d(a). The Commission, in turn, is vested with authority to appoint officers and employees. See 5 U.S.C. § 4802(b) (authorizing "the Commission" to "appoint and fix the compensation of such officers, attorneys, economists, examiners, and other employees as may be necessary for carrying out its functions under the securities laws"); 15 U.S.C. § 78d(b).

Plaintiffs' contention, if accepted, would rob the Commission of authority to appoint not only members of the PCAOB, but any officers of the SEC. As Justice Scalia observed in his concurring opinion in Freytag, it would be "a most implausible disposition" to create a system where any inferior officers

within non-Cabinet agencies could not be appointed by their immediate superiors, but instead "must be appointed by the President, the courts of law, or the 'Secretary of Something Else.'" Freytag, 501 U.S. at 919-20 (Scalia, J., concurring in part and concurring in the judgment).

Plaintiffs mistakenly rely on Freytag to support the proposition that "Department" should be limited to agencies headed by persons over whom the President has plenary removal authority. Neither the holding nor the reasoning of the decision supports that contention. The Court in Freytag concluded that it is constitutional for the chief judge of the Tax Court to appoint special trial judges because the Tax Court, though an Article I legislative court, "exercise[s] judicial power and perform[s] exclusively judicial functions," and is thus a "Court[] of Law" for purposes of the Appointments Clause. Id. at 892.

After considering arguments that would limit "Departments" to Cabinet-level agencies, the Court in Freytag expressly reserved the question whether the heads of non-Cabinet "principal agencies" may appoint inferior officers. See 501 U.S. at 887 n.4. Much of plaintiffs' argument consists of a misguided effort to redefine the Court's discussion of this question to distinguish between "independent agencies" such as the SEC and typical non-Cabinet executive agencies such as the Central Intelligence Agency. Such distinctions, however, formed no part

of the Court's analysis, which turned instead on distinctions between Cabinet-level agencies and "principal" agencies — a category in which the Court explicitly placed both the SEC and the CIA. See ibid; see also Separation of Powers Between the President and Congress, 20 Op. O.L.C. 124, 151-53 (1996).

The same error underlies plaintiffs' repeated assertions that treating the SEC as a Department empowered to appoint inferior officers would undermine political accountability because the President lacks plenary power to remove the Commissioners. The various authorities cited by plaintiffs do not bear on this contention. Indeed, plaintiffs' professed concerns have less to do with the Appointments Clause than with the operation of the Commission and other "independent agencies" generally.

While the Freytag majority expressly reserved the question whether heads of non-Cabinet "principal agencies" may appoint inferior officers, Justice Scalia, in a concurring opinion joined by three other Justices, strongly urged that "Departments" should be understood to encompass "all agencies immediately below the President in the organizational structure of the Executive Branch," including "all independent executive establishments." Id. at 918-19 (Scalia, J., concurring in part and concurring in judgment). To conclude otherwise would — as plaintiffs' argument here illustrates — "cast[] into doubt the validity of many

appointments and a number of explicit statutory authorizations to appoint." Id. at 918. The concurrence explained that the Framers "chose the word 'Department[]'. . . not to connote size or function (much less Cabinet status), but separate organization -- a connotation that still endures even in colloquial usage today[.]" Id. at 920; see also id. at 916-17 (noting that "[t]here is no basis in text or precedent" for the proposition that the term "department" means "Cabinet-level agency," because "[t]he term 'Cabinet' does not appear in the Constitution, the Founders having rejected proposals to create a Cabinet-like entity").

Plaintiffs' argument thus finds no support in the Freytag majority opinion and is directly at odds with the views of the four concurring Justices.

2. Plaintiffs are on no firmer ground in urging that the Commissioners should not be considered the "Head" of the SEC. See 15 U.S.C. § 78d (establishing SEC as headed by five individuals appointed by the President with the advice and consent of the Senate). The Commissioners as a group exercise the same final authority as is vested in the single "Head" of a traditional Cabinet agency, and the statutory provisions granting rulemaking, investigative, and adjudicatory authority to the SEC uniformly vest that authority in "the Commission." Treating the Commissioners as the SEC's "Head" is surely more natural than

saying that the SEC has no "Head," or that its "Head" is somewhere other than where Congress vested final decisionmaking authority on the agency's behalf. See Silver v. Postal Service, 951 F.2d 1033, 1044 (9th Cir. 1991) (Postal Service is a "Department" under the Appointments Clause, and its nine Governors collectively constitute the "Head" for appointment purposes); Authority of Civil Service Commission 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)).[3]

Indeed, the Appointments Clause itself contemplates that collective bodies may appoint inferior officers, specifically

[3] The Ninth Circuit in Silver divided on whether the individuals in fact constituted the Head of the Department, but all members of the panel accepted the premise that there is no constitutional problem with a group serving collectively as the Head of a Department. Indeed, the dissent observed that "[a]lthough the Supreme Court has never addressed the question of whether a group, as opposed to an individual, could be a department head, many independent regulatory agencies are headed by groups with no apparent constitutional infirmity, and the Attorney General determined as early as 1933 that groups could be 'Heads of Departments.'" Id. at 1044 n.3 (O'Scannlain, J., dissenting) (citing Authority of Civil Service Commission to Appoint a Chief Examiner, 37 Op. Atty. Gen. 227 (1933)).

providing that such powers may be vested in the "Courts of Law."[4] Thus, the Judiciary Act of 1789 provided for the appointment of the Clerk of the Supreme Court by the Supreme Court, a body then consisting of six Justices. See Act of Sept. 24, 1789, §§ 1, 7, 1 Stat. 73, 76. See also 28 U.S.C. §§ 671, 672 (Justices of the Supreme Court appoint Clerk and Marshal of Supreme Court); id. § 631(a) (judges of each district court appoint magistrate judges); id. § 152(a)(1) (judges of each court of appeals appoint bankruptcy judges); id. § 751(a) (judges of each district court appoint clerk of court). Likewise, the independent counsel in Morrison was appointed by the three-judge Special Division of this Court. See 487 U.S. at 661 & n.3; 28 U.S.C. § 49.

Plaintiffs urge that "the meaning of the phrase 'Heads of Departments' was well known at the time of the framing and is spelled out in early Supreme Court precedent." Pl. Br. 40. The phrase, plaintiffs argue, "was understood to encompass the cabinet secretaries — single individuals all — who would supervise their respective departments and answer directly to the President and, therefore, share his accountability." Id. Inasmuch as the Supreme Court has never adopted plaintiffs' limited understanding of "Department," it is unsurprising that the Court has never adopted a definition of "Heads of

[4] Indeed, the text of the Appointments Clause refers to the "Heads of Departments," not "the single Head of each Department," and there is no reason to impose such a limitation.

Departments" limited to Cabinet secretaries. As the cases cited by plaintiffs indicate, the Court has merely recognized that the phrase "encompasses" Cabinet secretaries; it has never suggested that the term is limited to such persons. See, e.g., United States v. Mouat, 124 U.S. 303 (1888); Cunningham v. Neagle, 135 U.S. 1 (1890); see also Freytag, 501 U.S. at 916-919 (Scalia, J., concurring in part and concurring in the judgment) (rejecting the notion that "Heads of Departments" is limited to Cabinet members).

3. Plaintiffs alternatively argue that "if there is a head of the SEC, it is the SEC's Chairman." Pl. Br. 40. In support of this contention, plaintiffs list persons appointed by the Chairman pursuant to the delegation of authority in Reorganization Plan No. 10 of 1950, § 1(a) (codified at 5 U.S.C. app. 1) ("Reorganization Plan No. 10"). Pl. Br. 41. Plaintiffs assert that these persons are not mere employees but "officers," and argue that their appointments would be invalid if the Court concluded that the Commissioners collectively constitute the "Head" of the agency.

Such concerns ring hollow coming from plaintiffs, whose primary contention is that the SEC is not a "Department" under the Appointments Clause at all, and thus lacks the authority to appoint any of its own officers irrespective of the internal arrangement of authority.

In any event, assuming that the persons identified by plaintiffs are "officers" rather than employees, appointments by the SEC Chairman subject to the approval of the Commission do not contravene the Appointments Clause. The Supreme Court has long construed the Clause to permit a person other than an agency head to appoint an inferior officer as long as he does so with the approval of the agency head. Thus, in United States v. Hartwell, 73 U.S. (6 Wall.) 385 (1867), the Court concluded that the Assistant Treasurer (who was not the head of the department) could properly appoint an inferior officer when the appointment power was exercised "with the approbation" of the Secretary of the Treasury. 73 U.S. (6 Wall.) at 392, 393-94. See also United States v. Smith, 124 U.S. 525, 532-33 (1888) (emphasizing that the approval of the Secretary in Hartwell "rendered [the] appointment one by the head of the department within the constitutional provision upon the subject of the appointing power"); Germaine, 99 U.S. at 511.

The provisions of Reorganization Plan No. 10 plainly meet this standard. Although plaintiffs stress that section 1(a) of the plan transferred to the Chairman the power of "appointment" of SEC personnel, e.g., Pl. Br. 24, the plan also expressly provided that "[t]he appointment by the Chairman of the heads of major administrative units under the Commission shall be subject to the approval of the Commission." § 1(b)(2). The

reorganization plan thus expressly anticipated plaintiffs' professed concerns — and underscored that it is the Commission, not the Chairman, that is the "Head" of the agency for Appointments Clause purposes.

Alternatively, if this Court (like the district court) were to accept plaintiffs' argument that the SEC Chairman should be deemed the "Head" of the agency, plaintiffs' arguments regarding the exercise of appointment authority by a multi-member body would be entirely obviated, and the claimed error would reduce to Congress's failure to identify the Chairman rather than "the Commission" in vesting appointment power. In that circumstance, canons of constitutional avoidance would dictate that the grant of appointment authority to "the Commission" be deemed a grant to the Chairman. See Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 575 (1988) (when "an otherwise acceptable construction of a statute would raise serious constitutional problems," a federal court must "construe the statute to avoid such problems unless such a construction would be plainly contrary to legislative intent"). There is no reason to doubt that Congress would have preferred this reading to the invalidation of the statute as a whole. Moreover, inasmuch as the Chairman has already cast his vote in favor of all appointees to the Board, see A33-A34, no additional action would be required.

III. CONGRESS CONSTITUTIONALLY VESTED POWERS IN THE PCAOB SUBJECT TO REVIEW BY THE SEC, WHICH MUST APPROVE ANY SIGNIFICANT ACTION TAKEN BY THE BOARD, MAY CURTAIL OR WITHDRAW THE BOARD'S AUTHORITY IN ANY RESPECT, AND MAY REMOVE ITS MEMBERS FOR CAUSE.

As we have shown, the PCAOB is fully consistent with the Appointments Clause. Plaintiffs urge, however, that locating authority in the Board offends the separation of powers, focusing in particular on the provisions for removing Board members. These arguments are no more persuasive than plaintiffs' contention that the SEC lacks authority to appoint Board members in the first place.

A. Self-regulatory organizations such as the New York Stock Exchange have in practice regulated the securities markets with implicit or explicit government involvement since the so-called Buttonwood Tree Agreement of 1792, when private stock brokers in New York City undertook by agreement to regulate the sale of securities. Those organizations, and their instrumental roles in federal securities regulation, have been recognized in federal law since the first Securities Exchange Act of 1934, which required registration and provided for SEC oversight. E.g., 15 U.S.C. § 78f.

Shortly thereafter, Congress enacted the Maloney Act, 52 Stat. 1070 (1938) (codified at 15 U.S.C. § 78o-3), to authorize the creation of "registered securities associations" that, among other purposes, would prescribe and enforce ethical standards in

the securities industry, subject to SEC oversight and control.[5] The express purpose of that Act was to adopt a program of "cooperative regulation," in which regulation of the industry would "be largely performed by representative organizations of investment bankers, dealers, and brokers, with the Government exercising appropriate supervision in the public interest, and exercising supplementary powers of direct regulation." S. Rep. No. 75-1455, 3-4 (1938). Then-SEC Chairman William O. Douglas declared that the philosophy of securities regulation was to "let[] the exchanges take the leadership with the Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used." Douglas, Democracy and Finance 82 (1940), quoted in 6 Loss, Securities Regulation 2704 (3d ed.). Accordingly, as this Court has recognized, "[a] statutory system authorizing self-regulatory organizations to act as quasi-governmental agencies in disciplining members for federal securities law violations has existed for almost 70 years." NASD, 431 F.3d at 804.

Plaintiffs are therefore wholly mistaken in their insistence that the PCAOB embodies a congressional innovation that poses unique problems for the separation of powers. Congress

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[5] The only registered securities association under the Maloney Act is the National Association of Securities Dealers (NASD), whose members include nearly every significant player in the securities industry.

explicitly modeled the PCAOB on the NASD and other familiar self-regulatory organizations, and subjected the Board to the same wide-ranging SEC oversight. 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"). Thus, in addition to the exclusive jurisdictional procedures already discussed, Congress made applicable to the PCAOB many provisions of the Exchange Act that govern the SROs. See, e.g., 15 U.S.C. § 78q(b)(1) (SEC's power to examine organization's records at any time), incorporated by 15 U.S.C. § 7217(a); 15 U.S.C. § 78s(c) (SEC's power to abrogate, add to, or delete from the rules of an SRO at any time), incorporated and modified by 15 U.S.C. § 7217(b)(5).

Like the SROs, the PCAOB is in all crucial respects subordinate to the SEC. See generally NASD v. SEC, 431 F.3d at 806. As discussed, every auditing standard, ethics rule, or other rule or modification of a rule promulgated by the Board must be reviewed and approved by the Commission before it can take effect, see 15 U.S.C. § 7217(b)(2); every inspection report issued by the Board is subject to review by the Commission, see 15 U.S.C. § 7214(h); and every disciplinary action taken by the Board is subject to automatic stay and review by the Commission, at the instance of the sanctioned party or on the Commission's

own motion, <u>see</u> 15 U.S.C. § 78s(d)(2), <u>as incorporated by</u> 15 U.S.C. § 7217(c)(2). Furthermore, the SEC may rescind, in whole or in part, <u>any</u> of the PCAOB's authority, based on the Commission's own judgment of what is necessary to protect the public and advance the purposes of the securities laws. <u>See</u> 15 U.S.C. § 7217(d)(1).

Even apart from these provisions, Congress granted to the SEC broad "oversight and enforcement authority over the Board," 15 U.S.C. § 7217(a) (incorporating 15 U.S.C. §§ 78q(a)(1), (b)(1)), including the power to add to, delete from, or modify the Board's rules in any manner that the Commission deems necessary, <u>see</u> 15 U.S.C. § 78s(c), <u>incorporated and modified by</u> 15 U.S.C. § 7217(b)(5). In addition, the Sarbanes-Oxley Act granted to the Commission sweeping rulemaking powers of its own. <u>See</u> 15 U.S.C. § 7202(a) ("The Commission shall promulgate 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."). Pursuant to these provisions, the SEC could, for example, adopt a rule that would require the Board to provide advance notice to the Commission of any PCAOB inspection, investigation, or disciplinary proceeding, and that would allow the Commission to take immediate action to approve, terminate, or initiate any such Board action. The Commission has already exercised its authority under these provisions to impose

additional transparency requirements on the Board, restrict the Board's budgetary discretion, and enhance the Commission's powers of oversight.[6]

Moreover, the Board's jurisdiction to adopt and enforce rules for the accounting and auditing industry is not exclusive. Congress expressly preserved the Commission's own authority "to establish accounting principles or standards for purposes of enforcement of the securities laws," 15 U.S.C. § 7218(c); id. § 7202(c), and the SEC may bring enforcement actions on its own initiative for violations of any rule adopted by the Board (as approved by the Commission), based on the Commission's own judgment of what is necessary or appropriate to advance the public interest or for the protection of investors. 15 U.S.C. § 78u(e); id. § 7202(b)(1); id. § 7202(c)(3).

Against this background, plaintiffs' suggestion that the Commission's relationship to the Board is "the functional equivalent" of a reviewing court's relationship to an administrative agency, Pl. Br. 34, is difficult to fathom. The

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[6] For example, in July 2006 the Commission issued a detailed regulation establishing rules and timetables for its review of the Board's annual budget, see 17 C.F.R. § 202.11, including explicit limitations on the Board's ability to depart from limits approved by the Commission or to use approved funds for different purposes, id. § 202.11(e). When the Board failed to satisfy the Commission's expectations, the Commission imposed additional requirements, directing the Board to produce a revised budgetary plan with additional information and prohibiting the Board from increasing the salaries of the Board members by more than a specified percentage. See 72 Fed. Reg. 73051 (Dec. 26, 2007).

comprehensive control that the Commission exercises over the Board's activities is utterly unknown in the APA. A court reviewing a final agency order or rulemaking does not survey the law and facts de novo; it does not possess the authority to add to, modify, or delete any aspect of the agency's decision at will, or to solicit additional public comments; it does not inquire whether the agency's action is consistent with the court's own preferred conception of the statutory purposes and the public interest; it does not enjoy the prerogative to withdraw any aspect of the agency's substantive jurisdiction at any time.

Equally impossible to reconcile with the terms of the statute are plaintiffs' characterizations of the Commission's review of Board action as "highly deferential," "severely restricted," and "severely circumscribed." Pl. Br. 7, 33, 34. Nor can such descriptions be reconciled with this Court's analysis of the same statutory review provisions in the context of self-regulatory organizations. See NASD v. SEC, 431 F.3d at 806 (explaining that "[t]he authority [NASD] exercises ultimately belongs to the SEC, and the legal views of the self-regulatory organization must yield to the Commission's view of the law"); id. at 807 (SROs have "'no authority to regulate independently of the SEC's control'" (quoting S. Rep. No. 94-75, at 23 (1975))).

It should thus be evident that the regulatory structure does not, "taken as a whole, violate[] the principle of separation of powers by unduly interfering with the role of the Executive Branch." Morrison, 487 U.S. at 693. The authority that the Board exercises "ultimately belongs to the SEC, and the legal views of the [Board] must yield to the Commission's view of the law." 431 F.3d at 806. Moreover, nothing in Title I of the Sarbanes-Oxley Act evinces an attempt by Congress to aggrandize its own powers at the expense of the Executive Branch: the Board does not depend on Congress for its budget, and Congress does not otherwise purport in the statute to retain control over the Board's actions. Cf. Bowsher v. Synar, 478 U.S. 714, 730-31 (1986). As the Court observed in United States v. Mistretta, 488 U.S. 361 (1989), separation of powers concerns are most salient when indications of such "encroachment and aggrandizement" are present. Id. at 382; see also Morrison, 487 U.S. at 694.

B. At bottom, plaintiffs' separation of powers argument reduces to a challenge to the provisions governing removal of PCAOB members. "Although the removal power is nowhere specifically set out in the Constitution, the Supreme Court has established that the President exercises this power as a result of his constitutional appointment power and obligation to take care that the laws are faithfully executed." Swan v. Clinton, 100 F.3d 973, 979 (D.C. Cir. 1996). See generally Myers v.

United States, 272 U.S. 52 (1926) (holding unconstitutional a statute limiting the President's power to remove certain postal officials without the approval of the Senate).

The Constitution does not, however, require that the President have direct removal authority over "inferior" officers such as PCAOB members. See Ex parte Hennen, 38 U.S. (13 Pet.) 230, 259-60 (1839).[7] Nor does it preclude Congress from imposing some restrictions on the removal of inferior officers. See Morrison, 487 U.S. at 689 n.27; see also id. at 723-24 (Scalia, J., dissenting) (describing as "established" the proposition that the President's power "to remove inferior officers who exercise purely executive powers, and whose appointment Congress [has] removed from the usual procedure of Presidential appointment with Senate consent, could be restricted, at least where the appointment had been made by an officer of the Executive Branch").

Indeed, even in Myers, the seminal case affirming the President's authority to remove principal officers performing

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[7] Plaintiffs invoke the legislative "Decision of 1789" for the proposition that "the President must retain the exclusive removal authority over those executing the laws." Pl. Br. 14-15. But that debate "related . . . to the power of the President to remove officers appointed with the concurrence of the Senate: and the great question was whether the removal was to be by the President alone, or with the concurrence of the Senate, both constituting the appointing power." Ex parte Hennen, 38 U.S. (13 Pet.) at 259 (emphasis added). Nothing in the "Decision of 1789" addressed legislative restrictions on the removal of inferior officers such as the PCAOB members.

"purely executive" functions, the Court distinguished restrictions placed on the removal of inferior officers. See Myers, 272 U.S. at 161-62; see also United States v. Perkins, 116 U.S. 483 (1886) (Congress's authority to vest appointment of inferior officers in the heads of departments implies authority to impose restrictions on removal).

Plaintiffs suggest that special difficulties are presented here because the SEC is an "independent" agency. This contention mirrors plaintiffs' mistaken assertion that Congress could not vest authority in the Commission to appoint the PCAOB members in the first instance. As discussed, Congress did not violate the Appointments Clause by vesting appointment power in the Commission. And it likewise did not violate the Constitution by authorizing the Commission to remove inferior officers that the Commission itself appointed. See Ex parte Hennen, 38 U.S. (13 Pet.) at 259-60 (explaining that "the power of removal [is] incident to the power of appointment"); Morrison, 487 U.S. at 689 n.27; Myers, 272 U.S. at 161-62; Perkins, 116 U.S. at 485; see also Nat'l Treasury Employees Union v. Reagan, 663 F.2d 239, 247 (D.C. Cir. 1981) ("[T]he power to remove [inferior officers] is held by the appointing authority, and only by the appointing authority.").[8]

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[8] Nor is there any constitutional defect in the fact that the Commission's broadest powers over the Board — such as its authority to rescind any aspect of the Board's jurisdiction at (continued...)

Plaintiffs purport to discover a constitutional defect in the provision that PCAOB members may be removed for "good cause shown." As the Court observed in Morrison, 487 U.S. at 691-92, "we cannot say that the imposition of a 'good cause' standard for removal by itself unduly trammels on executive authority." See also id. at 696 ("the power to remove the counsel for 'good cause' . . . provides the Executive with substantial ability to ensure that the laws are 'faithfully executed' . . . ."); id. at 724 n.4 (Scalia, J., dissenting) (with respect to inferior officers, it is sufficient if they are "removable for cause, which would include, of course, the failure to accept supervision" (emphasis in original)); Perkins, 116 U.S. at 485. Even with respect to certain narrow categories of principal officers, the Supreme Court has held that removability for good cause may be constitutionally sufficient. See Humphrey's

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[8](...continued)
any time, 15 U.S.C. § 7217(d)(1) — require the Commission to proceed "by rule." Although plaintiffs repeatedly summon the specter of "cumbersome" notice-and-comment rulemaking proceedings, e.g., Pl. Br. 33, it is far from clear that such procedures would typically be required, see 5 U.S.C. § 553(b)(A), or that the Commission could not act as expeditiously as necessary in the public interest, see id. § 553(b)(B). And where the Act does require notice-and-comment procedures, those procedures generally enhance, rather than restrict, the authority of the Commission over the Board. See, e.g., 15 U.S.C. § 78s(b)(1) (barring any proposed rule of an SRO from taking effect until the Commission has permitted interested parties "to submit written data, views, and arguments concerning such proposed rule change"), incorporated by 15 U.S.C. § 7217(b)(3).

Executor v. United States, 295 U.S. 602 (1935); Wiener v. United States, 357 U.S. 349 (1958).

The Court in Morrison, moreover, emphasized that the animating concern of the Court's removal-power cases is not formal but functional: "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 care that the laws be faithfully executed' under Article II." 487 U.S. at 689-90. Removal is simply a "powerful tool for control." Edmond, 520 U.S. at 664. The "real question" in a removal challenge, the Court has explained, 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." Morrison, 487 U.S. at 691.[9] Here, in addition to the removal power, Congress has

[9] Contrary to plaintiffs' contentions, Pl. Br. 24-26, the Court's reasoning in Morrison underscores the constitutionality of the Board. First, just as the Attorney General had the power to remove the independent counsel for "good cause," the SEC has the power to remove the members of the PCAOB for "good cause shown." Second, while the Attorney General in Morrison could only request that the Special Division appoint an independent counsel, and lacked the authority to choose the particular person for the office, the SEC selects and appoints the Board members itself. Third, while the independent counsel was generally required to abide by Justice Department policy, the PCAOB is (continued...)

provided sweeping mechanisms to guarantee substantive control by the SEC of the Board's use of its powers under the Act. Because the Commission can withdraw or preempt any aspect of the Board's substantive regulatory authority at any time to effectuate the Commission's own understanding of "purposes of th[e] Act and the securities laws," no functional concern of constitutional dimension should be raised by the "good cause" restriction on its ability to remove particular officers.

Plaintiffs stress that two of the three provisions describing situations that may trigger removal refer to actions taken "willfully." See 15 U.S.C. §§ 7217(d)(3)(A) ("has willfully violated any provision of this Act, the rules of the Board, or the securities laws"), 7217(d)(3)(B) ("has willfully abused the authority of that member"). But "willful" is "a word of many meanings, its construction often being influenced by its context," Spies v. United States, 317 U.S. 492, 497 (1943), and it is far from clear that the Commission would share plaintiffs' cramped interpretation of its removal authority over the Board. Cf. Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000) (discussing "willfulness" in the securities context, and

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[9] (...continued)
required to abide by the rules, regulations, and orders of the SEC without exception. Finally, unlike the Attorney General in Morrison, who had no authority to rescind the jurisdiction of the independent counsel once appointed, the Commission has broad authority to rescind any aspect of the Board's authority at any time, to examine the Board's papers at any time, and to veto its budget, among other potent tools of control.

upholding the Commission's imposition of sanctions for "willful" conduct based only on a broker's failure to conduct a reasonable factual inquiry).

Moreover, plaintiffs' argument requires the Court to assume that the Commission would interpret its mandate to create, rather than avoid, constitutional concerns. It should be assumed instead that the Commission would construe the removal provisions consistent with the constitutional separation of powers. Indeed, the Commission may not necessarily conclude that § 7217(d)(3) defines the exclusive circumstances in which "good cause" for removal may be established, as that term is used in § 7211(e)(6). See Bowsher, 478 U.S. at 729.

In any event, having failed to present their arguments to the Commission in the first instance, plaintiffs cannot properly insist that the Court indulge their assumptions regarding the circumstances in which the Commission may believe removal appropriate. Such speculation is plainly not a legitimate basis upon which to invalidate an act of Congress on its face.

CONCLUSION

For the foregoing reasons, the judgment of the district court should be vacated for lack of jurisdiction, or, in the alternative, affirmed.

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)(7)(c)
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I hereby certify pursuant to Fed. R. App. P. 32(a)(7)(C) that the foregoing brief contains 11,514 words, according to the count of Corel WordPerfect 12.

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CERTIFICATE OF SERVICE

I hereby certify that on this 7th day of February, 2008, I caused copies of the foregoing brief 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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