

Appellate Law and Securities Litigation Alert: A Challenge to the Constitutionality of the Public Company Accounting Oversight Board

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In a case that could have far-reaching effects on every single public company's auditing and accounting practices—or, even more broadly, on the shape of present and future federal regulatory schemes—the Supreme Court heard oral arguments this past Monday, December 7, 2009, in *Free Enterprise Fund v. Public Company Accounting Oversight Board*, Docket No. 08-861. The petitioning plaintiffs in this case are challenging the constitutionality of the Public Company Accounting Oversight Board (PCAOB), which was created in 2002, as part of the Sarbanes-Oxley Act, in response to scandals at Enron, Worldcom, and other companies. The purpose of the Board, which is appointed and controlled by the Securities and Exchange Commission, is to oversee public company auditors and auditing practices, conduct investigations, and, on finding any improper activity, impose sanctions.

The PCAOB's members are not appointed (nor subject to removal) directly by the President, but rather by the Securities and Exchange Commission—and there lies the heart of the issue before the Supreme Court. The plaintiffs argue that Article II of the Constitution provides for a “unitary executive” and that its “Appointments Clause” specifically dictates that only the executive branch can exercise the power to appoint and control such an entity. Therefore, the plaintiffs argue, the provision of Sarbanes-Oxley setting up the Board is unconstitutional and the SEC's control of it is invalid. Petitioners further argue that Congress, in setting up the PCAOB, impermissibly infringed upon Presidential power and violated the separation-of-powers doctrine.

In prior proceedings, the D.C. Circuit Court of Appeals rejected the plaintiffs' arguments by a 2-1 vote, leaving the PCAOB intact and Sarbanes-Oxley unscathed. The majority relied on Supreme Court precedents endorsing independent entities over which the President has limited removal power, such as the Federal Trade Commission and the Office of the Independent Counsel. In dissent, however, Judge Kavanaugh argued that the PCAOB's structure is different from other independent agencies because it is even further insulated from Presidential power as “an independent agency appointed by and removable for cause by another independent agency.” Judge Kavanaugh also raised even more fundamental questions, as to whether the Supreme Court precedents relied on by the majority went too far in authorizing “a significant intrusion on the President's Article II authority.” Judge Kavanaugh's opinion is widely seen as providing a roadmap that the Roberts Court may follow—the question is whether it can attract a majority of the Justices and, if so, how far they may choose to go down that road.

At Monday's oral argument before the Supreme Court, Solicitor General Elena Kagan began with a “simple syllogism”—“The president has constitutionally sufficient control over the SEC. The SEC has comprehensive control over the accounting board; therefore the president has constitutionally sufficient control over the accounting board.” She also emphasized the Supreme

Court's precedents endorsing independent federal regulatory entities. Chief Justice Roberts and Justices Scalia and Alito voiced concern over the lack of Presidential power to directly remove PCAOB members and control the Board's activities. Justices Ginsburg and Stevens, on the other hand, noted the value of such boards' independence. Justice Kennedy is thought to be the deciding swing vote; he stated, matter-of-factly, without tipping his hand, "The history and tradition of boards like this is that their investigative powers are independent."

If the Court agrees with the plaintiffs and Judge Kavanaugh, it could do so either narrowly or more broadly. A narrow ruling would simply invalidate the PCAOB, requiring Congress to overhaul the relevant provisions in Sarbanes-Oxley. This would no doubt have a significant impact, but such a decision would not necessarily cast larger aspersions on other independent federal agencies. A broader ruling, however, as some of the *amici* especially seem to urge, could rewrite the Supreme Court's precedents concerning independent agencies and raise questions about their constitutionality. Such a result could lead to a significant upheaval in the country's existing federal regulatory structure. In addition, a broader ruling could impact the various legislative proposals now making their way through Congress concerning health care reform, financial regulation and energy. Drafters of those bills would need to tailor the structure and authority of any new oversight mechanisms to fit the Supreme Court's decision.

Mintz Levin will continue to monitor this case closely. The Court will likely issue its decision in the spring or early summer of 2010.

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