Free Enterprise Fund v. PCAOB: Narrow Separation-of-Powers Ruling Illustrates That the Supreme Court Is Not ''Pro-Business''

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Introduction

Chief Justice John Roberts has often been depicted as an advocate of narrow rulings and a judicial philosophy of minimalism.[1] In his opinion for the Court in *Free Enterprise Fund v. Public Company Accounting Oversight Board*,[2] he took this philosophy to an extreme, refusing to invalidate much of the Sarbanes-Oxley Act despite the fact that its central provisions violated the Constitution's separation of powers. Enacted in 2002, Sarbanes-Oxley has cost the economy $1.4 trillion,[3] making it the biggest expansion of regulation of business since the New Deal.[4] The Supreme Court's decision to leave

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[1] See, e.g., Tara Leigh Grove, The Structural Case for Vertical Maximalism, 95 Cornell L. Rev. 1, 7 (2009); Jeffrey Rosen, John Roberts, Centrist? Partial Solution, The New Republic, Dec. 11, 2006, at 8; Robert Barnes, Roberts Court Moves Right, but with a Measured Step, Wash. Post, Apr. 20, 2007, at A3.

[2] 561 U.S. ____, 130 S. Ct. 3138 (2010).

[3] Henry Butler & Larry Ribstein, The Sarbanes-Oxley Debacle 5 (2006). See also Cesar Conda, A Detour Past Congress, Weekly Standard, Jan. 22, 2007, at 13 (trillion-dollar estimate by economist Ivy Zhang); Editorial, Sarbanes-Oxley on Trial, Wall St. J., Dec. 4, 2009, at A24 (similar estimate in study by the American Enterprise Institute and Brookings Institution).

[4] When President Bush signed it into law, he called it ''the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt.'' Elisabeth Bumiller, Bush Signs Bill Aimed at Fraud in Corporations, N.Y. Times, July 31, 2002, at A1. Sarbanes-Oxley was enacted in ''anger'' and ''haste'' in response to ''public outrage'' over the collapse of Enron and WorldCom and other massive accounting scandals. Tom Fowler, Following the Rules, Houston Chronicle, Jan. 29, 2006, at 1.

the law largely intact despite its constitutional infirmities is one more illustration that it does not have a pro-business tilt. Indeed, the Court in recent years has generally been more hostile to business than the lower federal courts.

In the *Free Enterprise Fund* case, the Supreme Court essentially ruled that Congress cannot create an *independent* agency overseen by another independent agency—but it can create a new subordinate agency whose members are subject to removal at will by an existing independent agency. The Court's ruling will promote accountability by strengthening the government's ability to fire hundreds if not thousands of high-ranking bureaucrats and lawyers. But it may also open the door to messy appointment processes at independent agencies.

The Court struck down tenure protections for leaders of an agency created by Sarbanes-Oxley, the Public Company Accounting Oversight Board.[5] The law prohibited removal without cause of members of the PCAOB—colloquially pronounced ''peek-a-boo''—which regulates the auditing of public companies.[6] Under the statute, any decision to remove PCAOB members had to be made not by the president, but by another independent agency whose members can also only be removed for cause, the Securities and Exchange Commission.[7] Thus, two layers of removal restrictions insulated the PCAOB from any accountability to the president. The Court held that such dual for-cause limitations on removal of government officials violate the Constitution's separation of powers, which vests executive power in the president.[8]

The Court refused to strike down the Sarbanes-Oxley Act as a whole, however, instead merely severing the unconstitutional removal limitations.[9] It did so even though Sarbanes-Oxley lacks a severability clause and the removal provisions were central to it.

[5] See 15 U.S.C. §§ 7211(e)(6), 7217(d)(3) (2006).

[6] 15 U.S.C. § 7211(e)(6) (2006) (PCAOB members can be removed only ''for good cause shown'').

[7] 130 S. Ct. at 3148–49; see also SEC v. Blinder, Robinson & Co., 855 F.2d 677, 681 (10th Cir. 1988) (SEC commissioners removable only for good cause).

[8] 130 S. Ct. at 3151, 3153–54.

[9] *Id*. at 3161–62.

The Court then rejected a challenge to the PCAOB under the Constitution's Appointments Clause, which requires that the president, and no one else, pick the principal federal officers (with Senate approval), while permitting ''Heads of Departments'' to pick so-called inferior officers, who are supervised and directed by principal officers.[10] PCAOB members are picked not by the president, but by the SEC commissioners as a group.[11] By striking down the restrictions on removing PCAOB members, and thus making them subject to termination at will by the SEC, the Court was able to render PCAOB members inferior officers who could be validly picked by someone other than the president under the Appointments Clause. In effect, it used one constitutional violation to cure another, and limit the reach of its decision as narrowly as possible.

Even after the Court's decision, the PCAOB members, whose pay exceeds the president's,[12] retain considerable power. The PCAOB has the power to write regulations controlling the auditing of all public companies, which the SEC is supposed to approve as long as they are consistent with Sarbanes-Oxley or the public interest.[13] The PCAOB has the power to inspect, investigate, and punish accounting firms and accountants for violating its regulations, professional standards, or federal laws.[14] It can fine an accountant up to $100,000 or an accounting firm up to $2 million for a single, inadvertent violation of its rules, although the SEC has plenary power to review and reverse such sanctions.[15] And the PCAOB finances itself with a tax, the accounting support fee, which it levies on all public companies in the United States (although the SEC must first approve its budget).[16] The PCAOB is, in effect, ''an enforcement body that is at once lawmaker, tax collector, inspector, sheriff, prosecutor, judge and jury.''[17]

[10] U.S. Const. art. II, § 2, cl. 2. See Free Enter. Fund, 130 S. Ct. at 3162–64.

[11] *Id*. at 3147, 3163–64.

[12] *Id*. at 3147 n.1 (PCAOB members are paid $547,000 or more).

[13] Sarbanes-Oxley Act, 15 U.S.C. §§ 7213, 7217(b)(2),(5) (2006).

[14] See *id*. §§ 7214, 7215.

[15] See *id*. §§ 7215(c)(4)(D)(i), 7215(e), 7217(c)(3).

[16] See *id*. §§ 7219(c)–(d), 7219(b),(d)(1).

[17] Ilya Shapiro & Travis Cushman, Peekaboo, I See a Constitutional Violation, The American, Dec. 5, 2009, available at http://www.american.com/archive/2009/december-2009/peekaboo-i-see-a-constitutional-violation.

I. History of the Case

The case began after the PCAOB inspected the small Nevada accounting firm of Beckstead & Watts, and ''released a report critical of its auditing procedures.''[18] The firm's principal, Brad Beckstead, responded with a letter objecting to the report. He criticized the PCAOB bureaucrats for applying a gold-plated, one-size fits-all standard to auditing—a standard that would require small public companies to spend ruinously large amounts of their scarce resources on ''additional audit steps'' and ''documentation requirements'' as if money were no object, threatening ''the entire existence of that segment of the marketplace.''[19]

When I saw his letter on the internet in October 2005, I gave it to my colleague, Sam Kazman, who contacted Mr. Beckstead that week and convinced him to pursue a constitutional challenge to the PCAOB. Later that year, the three of us got together with the Jones Day law firm, which was already planning to challenge the PCAOB on behalf of a nonprofit organization called the Free Enterprise Fund.

In February 2006, Jones Day filed a lawsuit against the PCAOB on behalf of the Free Enterprise Fund and our client, Beckstead & Watts, with Sam and me serving as ''of counsel.'' The lawsuit challenged the PCAOB structure as a violation of both the Appointments Clause and the separation-of-powers principles that vest executive power in the president—because the PCAOB members were not removable except for cause, and removable only by the SEC, not the president, who was thus left virtually powerless over the PCAOB.[20]

The trial judge found that the plaintiffs had standing to sue over these alleged violations because Beckstead was regulated by the PCAOB but rejected our lawsuit on the merits.[21] He found that the

[18] 130 S. Ct. at 3149.

[19] See Letter from Brad Beckstead to George H. Diacont of the PCAOB, at 2 (June 24, 2005) (on file with author), also available at PCAOB, Inspection of Beckstead and Watts, LLP, http://pcaobus.org/Inspections/Reports/Documents/2005_Beckstead_and_Watts.pdf, at 11 (last visited Aug. 15, 2010); see also Brad Beckstead, Commentary: Sarbanes-Oxley: The Impact on the Smaller Accounting Firm Industry, Accounting Today, Sept. 2006, at 6 (advocating reforms to help small public companies).

[20] See U.S. Const. art. II, § 1, cl. 1.

[21] Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., No. 06-0217 2007 WL 891675 (D.D.C. Mar. 21, 2007).

PCAOB members were inferior officers who didn't have to be picked by the president, but rather could be picked by the head of a department under the Appointments Clause. He agreed with us that the relevant head of department who could pick officers for the SEC was not the SEC commissioners as a group (whom Sarbanes-Oxley vests with picking PCAOB members), but rather the SEC's chairman (who picks the SEC's own high-ranking officials, subject to the approval of the SEC commissioners as a whole).[22] But that made no difference in our case, he said, since ''the SEC chairman has voted for each PCAOB member'' who was selected by the SEC commissioners voting as a group.[23] In essence, he found that any Appointments Clause violation was harmless.

The trial judge also found no problem with Sarbanes-Oxley's removal restrictions. The president, he concluded, has not been ''completely stripped of his ability to remove PCAOB members, because SEC commissioners can be removed by the president for cause, and PCAOB members can be removed by the SEC 'for good cause shown[.]'''[24] Moreover, he reasoned, PCAOB members were not ''purely executive'' officials that the president or his subordinates needed to have the power to remove at will, but rather independent agency employees who could reasonably be protected against removal without cause.[25]

The Supreme Court's precedents provided no clear answer as to whether these removal restrictions were permissible.[26] It had struck down restrictions on presidential removal of purely executive officers like postmasters in a 1926 decision, reasoning that the president has been stripped of his constitutional power to ''faithfully execute'' the law if he cannot choose the very people on whom he relies to carry it out.[27] But shortly thereafter it upheld restrictions on the

[22] *Id*. at *4 (''Multi-member bodies may, on occasion, properly constitute heads of departments for Appointments Clause purposes, but the SEC is not one of them.'').

[23] *Id*. at *5.

[24] *Id*. at *5 (internal citations omitted).

[25] *Id*. at *5 (quoting Morrison v. Olson, 487 U.S. 684, 690 (1988)).

[26] Free Enter. Fund, 130 S. Ct. at 3167 (Breyer, J., dissenting) (arguing that the PCAOB was entirely constitutional, but admitting that ''the question presented lies at the intersection of two sets of conflicting, broadly framed constitutional principles. And no text, no history, perhaps no precedent provides any clear answer.'').

[27] Myers v. United States, 272 U.S. 52, 132–34 (1926); Compare U.S. Const. art. II, § 3 (President shall ''take Care that the Laws be faithfully executed'').

removal of independent agency heads in its 1935 *Humphrey's Executor* decision, citing their need to be ''independent in character'' to perform their ''quasi-legislative,'' ''quasi-judicial'' role.[28] In 1988, it upheld the independent counsel statute, which protected prosecutors charged with investigating administration officials against removal without cause.[29] Despite the prosecutors' clearly executive function, the Court concluded that the removal restrictions did not hamper the president's ability to perform his constitutional duties.[30]

The Free Enterprise Fund and Beckstead appealed the dismissal of their lawsuit to the U.S. Court of Appeals for the D.C. Circuit. At oral argument in April 2008, it looked like the appeals court might strike down the PCAOB.[31] But in August 2008, it ruled in favor of the PCAOB in a 2–1 decision[32] that was aptly described by the *Harvard Law Review* as ''contradicted by its own reasoning''[33] and by the *Wall Street Journal* ''a ruling at odds with itself.''[34]

First, the court held that PCAOB members are inferior officers, not principal officers, because, it claimed, the PCAOB is just ''a heavily controlled component of an independent agency,'' not a truly independent agency.[35] The court conceded, however, that if

[28] Humphrey's Ex'r v. United States, 295 U.S. 602, 619, 629 (1935) (upholding requirement that Federal Trade Commission members cannot be removed without cause).

[29] Morrison v. Olson, 487 U.S. 654 (1988).

[30] *Id*. at 691–93.

[31] Jonathan Weil, SOX Appeal Judge Offers Peek Underneath His Robe, Bloomberg News, May 28, 2008, available at http://www.bloomberg.com/apps/news?pid=21070001&sid=aYZZ9vduqaMU.

[32] Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 537 F.3d 667, 680 (D.C. Cir. 2008).

[33] D.C. Circuit Holds That the SEC Chairman Is Not the ''Head'' of the SEC—*Free Enterprise Fund v. Public Co. Accounting Oversight Board,* 122 Harv. L. Rev. 2267, 2271 (2009) (discussing in detail why the SEC's chairman is its ''head'' both in practical terms and for the purposes of, and the rationale behind, the Constitution's Appointments Clause).

[34] Editorial, Sarbox and the Constitution: Supreme Scrutiny for a Harmful Law, Wall St. J., May 19, 2009, at A16.

[35] Free Enter. Fund, 537 F.3d at 680; but see Free Enter. Fund, 130 S. Ct. at 3159 (approvingly citing Judge Kavanaugh's then-description of the PCAOB as an ''independent agency . . . removable only for cause by another independent agency'') (quoting Free Enter. Fund, 537 F.3d at 669 (Kavanaugh, J., dissenting)). Note that the General Accounting Office at the time Sarbanes-Oxley was enacted had conceded that ''the PCAOB is an independent board with sweeping powers and authority.'' U.S. Gen. Accounting Office, Rep. No. GAO-03-339, Securities and Exchange Commission:

''the Board is itself an independent agency. . . . the dissent's conclusion that the Board's structure is unconstitutional conveniently follows.''[36]

The appeals court then contradicted itself about who really runs the SEC: its chairman or the commissioners as a group. As the *Wall Street Journal* put it: ''To reject the Appointments Clause challenge, the court held that the SEC Commissioners, rather than the Chairman alone, serve as the collective 'head' of the agency and can therefore pick PCAOB members without violating the Constitution. But to reject the separation of powers challenge, the same ruling suggests that the SEC chairman is in fact the head of the agency,''[37] because he ''dominate[s] commission policymaking,'' ''select[s] most staff, set[s] budgetary policy,'' and ''command[s] staff loyalties.''[38] Moreover, the Court reasoned that since the SEC's chairman, unlike its commissioners, serves at the president's pleasure, the PCAOB is indirectly accountable to the White House. Having begun by claiming that the chairman was ''simply one commissioner'' among several, and a mere ''administrative'' figurehead,[39] it ended by implying that he so dominated the SEC that he effectively controlled it, thereby in turn giving the president abundant influence over the PCAOB.[40]

By selectively touting the chairman's dominance when it was convenient, the court was able to play up the president's purported influence over the SEC's actions (like its oversight of the PCAOB), because the president has more influence over the SEC's chairman than he does over other commissioners. For example, the president can reassign at will which commissioner acts as chairman, but he cannot remove a commissioner from the commission without cause.[41] By virtue of the president's alleged influence over the SEC, which can remove wayward PCAOB members for cause, the Court felt that the president's authority to execute the laws and oversee the

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Actions Needed to Improve Public Company Accounting Oversight Board Selection Process, at 6 (2002), available at http://www.gao.gov/products/GAO-03-339.

[36] See Free Enter. Fund, 537 F.3d at 680 n.9.

[37] Sarbox and the Constitution, *supra* note 34 at A16.

[38] Free Enter. Fund, 537 F.3d at 680.

[39] *Id*. 537 F.3d at 678.

[40] *Id*. at 680.

[41] SEC v. Blinder, Robinson & Co., 855 F.2d 677, 681–82 (10th Cir. 1988).

PCAOB had not been ''unduly'' encumbered by its removal restrictions.[42]

In dissent, Judge Brett Kavanaugh argued that PCAOB members were ''principal officers'' who had to be picked by the president, largely because they could be removed ''only for cause,'' not ''at will.''[43] His conclusion that PCAOB members were principal officers was consistent with a number of legal scholars, who pointed to the fact that the SEC lacked the tool of removal at will to fully control the PCAOB.[44]

He also concluded that the removal restrictions, which ''completely stripped'' the president of any ability to remove rogue PCAOB members,[45] violated separation-of-powers principles[46] reflected in Article II of the Constitution, which vest the executive power in the presidency and give the president the sole authority and duty to ''take Care that the Laws be faithfully executed.''[47]

Judge Kavanaugh rejected the majority's argument that these removal restrictions were sanctioned by *Humphrey's Executor*, which permitted independent agency leaders to be protected against presidential removal without cause.[48] He noted that no one had ''identified any independent agency other than the PCAOB that is appointed by and removable only for cause by another independent agency.''[49] He observed that a ruling in favor of the PCAOB was not ''*Humphrey's Executor* redux,'' but ''*Humphrey's Executor* squared,'' because the PCAOB was insulated from presidential influence by not just one layer of removal protection (like most agencies), but two

[42] Free Enter. Fund, 537 F.3d at 682, 684 n.14.

[43] *Id.* at 687, 709 (Kavanaugh, J., dissenting).

[44] See, e.g., Donna M. Nagy, Is the PCAOB a ''Heavily Controlled Component'' of the SEC?: An Essential Question in the Constitutional Controversy, 71 U. Pitt. L. Rev. 361, 396, 400 (2010) (citing Edmond v. United States, 520 U.S. 651, 662 (1997)); Whitney Innes, The Unaccountability of the Accounting Regulators: Analyzing the Constitutionality of the Public Company Accounting Oversight Board, 42 J. Marshall L. Rev. 1019, 1036 (2010).

[45] Free Enter. Fund, 537 F.3d at 698 (Kavanaugh, J., dissenting) (quoting Morrison, 487 U.S. at 692).

[46] *Id.* at 689, 701–04.

[47] U.S. Const, art. II, § 3.

[48] Humphrey's Ex'r, 295 U.S. at 629–30.

[49] Free Enter. Fund, 537 F.3d at 699 (Kavanaugh, J., dissenting).

(one layer protecting the SEC from the president and another protecting the PCAOB from the SEC), meaning that the '''power to remove an executive official has been completely stripped from the President.' ''[50]

The full D.C. Circuit then denied rehearing by a razor-thin margin of 5–4.[51]

II. The Supreme Court's Decision

In another 5–4 decision, the Supreme Court struck down the statutory restrictions on removing PCAOB members as a violation of the Constitution's separation of powers but upheld the process by which they are appointed against a challenge under the Appointments Clause.[52]

Echoing Judge Kavanaugh's dissent below, the Court noted that while it had previously upheld a law restricting removal of leaders of independent agencies in *Humphrey's Executor*, that ruling nevertheless left presidents with some influence over agencies by allowing removal of their leaders for cause. By contrast, PCAOB members cannot be removed by the president at all and could only be removed for cause by the SEC, a body which itself can only be removed by the president for cause.

Concluding that ''two layers are not the same as one,'' the Court held that this structure deprived the president ''of adequate control over the Board, which is . . . the primary law enforcement authority for a vital sector of our economy.''[53] The president was, under the circumstances, unable ''to execute the laws'' by ''holding his subordinates accountable for their conduct.''[54]

The Court's ruling was based partly on the fear that presidents would acquiesce in removal restrictions precisely to avoid taking the blame for government failures—noting that the result was ''a Board that is not accountable to the President, and a President who is not responsible for the Board.''[55] Accountability is a major rationale

[50] *Id*. at 686, 697.

[51] *See* Innes, *supra* note 44, at 1020.

[52] Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138 (2010).

[53] *Id*. at 3157, 3161.

[54] *Id*. at 3154.

[55] *Id*. at 3153.

behind separation of powers: the principle that ''the buck stops with the President,'' and that ''the President cannot escape responsibility for his own choices by pretending that they are not his own.''[56]

The Court reasoned:

> The Constitution that makes the President accountable to the people for executing the laws also gives him the power to do so. That power includes, as a general matter, the authority to remove those who assist him in carrying out his duties. Without such power, the President could not be held fully accountable for discharging his own responsibilities; the buck would stop somewhere else. Such diffusion of authority ''would greatly diminish the intended and necessary responsibility of the chief magistrate himself.''[57]

Accordingly, it struck down the restrictions on removal, marking the first time in 84 years—and only the second time ever—that the Supreme Court had found a removal restriction invalid.

After declaring the removal provisions unconstitutional, the Court decided to sever them from the remainder of Sarbanes-Oxley, rather than striking down the law as a whole.[58] This was an unexpected development because courts commonly strike down an entire law if one of its central provisions is invalid, even if it contains a severability clause.[59] That practice would seem apt here given that Sarbanes-Oxley's ''very purpose'' was ''to create an accounting board that would operate'' independently ''from the SEC, not one that would

[56] *Id*. at 3152, 3155. Both the Bush and Obama administrations had defended the removal restrictions in court. The justices may have been aware that politicians had taken credit for Sarbanes-Oxley and its purported successes, while conveniently blaming its failures and excessive costs on unaccountable PCAOB regulators. See Scott Leibs, Five Years and Accounting, CFO Magazine, July 1, 2007, at 11 (Bush defends Sarbanes-Oxley, even while criticizing the way it was implemented); Newt Gingrich & David W. Kralik, Repeal Sarbanes-Oxley, S.F. Chronicle, Nov. 5, 2008, at B17 (law's cosponsor Oxley blamed PCAOB for the expense of Sarbanes-Oxley's rules).

[57] Free Enterprise Fund, 130 S. Ct. at 3164 (quoting The Federalist No. 70, at 428 (Alexander Hamilton) (Clinton Rossiter ed., 1961)).

[58] *Id*. at 3161–62.

[59] See, e.g., Carter v. Carter Coal Co., 298 U.S. 238 (1936) (wholly invalidating a law some of whose provisions violated the ''non-delegation doctrine''—fundamentally a separation-of-powers notion—despite the presence of a severability clause). See also EEOC v. CBS, 743 F.2d 969, 973 (2d Cir. 1984); Hotel Employees v. Davis, 981 P.2d 990, 1010 (Cal. 1999).

be 'directed and supervised' by the SEC,'' since Congress felt that ''the successful operation of the Board depends upon its independence.''[60] Indeed, commentators had frequently suggested that the act as a whole should be invalidated if it contained a separation-of-powers violation because Sarbanes-Oxley does not contain a severability clause[61] and the invalid removal provisions were central to the PCAOB's creation.[62] Yet the Court chose to preserve as much of the Sarbanes-Oxley statute as it possibly could, a decision that contrasts sharply with earlier cases in which it struck down laws in their entirety even when they had ''a broad severability clause.''[63]

The Court then used its finding of a removal violation to make the broader Appointments Clause violation retroactively disappear. Although Judge Kavanaugh, below, had found PCAOB members to be principal officers largely because of their protections against removal, the Court analyzed whether they were principal officers based on their status *after* the Court had excised those very protections against removal—leaving them firmly subordinate to the SEC.[64]

[60] Free Enter. Fund, 537 F.3d at 687 (Kavanaugh, J., dissenting) (quoting S. Rep. No. 107-205, at 6 (2002); 148 Cong. Rec. S6331 (daily ed. July 8, 2002) (statement of Sen. Paul Sarbanes) (''[W]e need to establish this oversight board . . . to provide an extra guarantee of its independence. . . .'')).

[61] See, e.g., Editorial, Sarbanes-Oxley on Trial, Wall St. J., December 4, 2009, at A24 (''[A] ruling against the PCAOB could bring down the whole law because Sarbox does not have a 'severability clause.'''); Jane Bryant Quinn, Lawsuit Threatens Sarbanes-Oxley Act, Wash. Post, July 20, 2008, at F1 (''Linda Lord, head of legislative and regulatory affairs for the banking giant UBS, called it 'highly likely' that PCAOB would lose the case. . . . 'SOX in its entirety will fall.'''').

[62] Free Enter. Fund, 537 F.3d at 687–88 (Kavanaugh, J., dissenting) (''Members of Congress designed the PCAOB to have 'massive power, unchecked power.'''') (quoting 148 Cong. Rec. S6334 (daily ed. July 8, 2002) (statement of Sen. Phil Gramm)); *id*. at 709 (''[T]he whole point of this statute—as evidenced in the statutory text and history—was to create an Accounting Board that would not be part of the SEC and not be subject to direction and supervision by the SEC.'')

[63] See, e.g., Thornburgh v. Am. Coll. of Obstetricians & Gynecologists, 476 U.S. 747, 764–65 (1986) (abortion case); see also Am. Booksellers v. Hudnut, 771 F.2d 323, 332 (7th Cir. 1985), aff'd, 475 U.S. 1001 (1986).

[64] Free Enter. Fund, 130 S. Ct. at 3162. See also Gordon Smith, Donna Nagy on Free Enterprise Fund v. Public Company Accounting Oversight Board, Conglomerate Blog, June 28, 2010, http://www.theconglomerate.org/2010/06/donna-nagy-on-free-enterprise-fund-v-public-company-accounting-oversight-board.html (''The Court's decision to excise from the SOX the restrictive removal provisions also allowed for a quick rejection of the Appointments Clause challenge. Here, instead of analyzing the statute as written, the Court analyzed its new post-surgery version. . . . Had the

Having thus retroactively rewritten the law to move the goalposts, the Court then found that the PCAOB members were inferior officers who could be picked by the head of a department rather than the president. It then concluded that the SEC, despite not being a cabinet department, qualified as a ''department'' for Appointments Clause purposes and that the SEC commissioners, collectively, were the ''head'' of that ''department.'' Thus, the commissioners, rather than the SEC's nominal head, its chairman, could constitutionally pick PCAOB members.[65]

The Supreme Court thus rejected plaintiffs' Appointments Clause challenge even though the logic of its decision suggested that the board had operated in violation of that clause from its inception all the way until the Court's decision,[66] and even though the Constitution deems such violations to be intrinsically menacing to liberty.[67]

In a dissent for four justices, Justice Stephen Breyer argued that the PCAOB's removal and appointment mechanisms were entirely constitutional because they insulated ''experts'' from ''political influence'' and supposedly had little ''practical'' effect on the president's exercise of executive authority.[68] Indeed, he claimed that the removal restrictions would help the president ''regulate through impartial regulation'' by safeguarding the PCAOB's independence.[69] Breyer's claim ignored empirical evidence that the PCAOB's independence had instead ''resulted in widespread policy failures'' and a ''lack of coordination with other agencies'' like the SEC that ''created duplicative and overly burdensome regulation'' as a result.[70] For

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Court not excised the restrictive removal provisions, it is unlikely that it could have [rejected the challenge]'').

[65] Free Enter. Fund, 130 S. Ct. at 3162–64.

[66] See Keith Bishop, PCAOB Unconstitutional: So What?, S.F. Recorder, July 26, 2010, at 34, available at 2010 WLNR 14862387 (Under the Supreme Court's own logic, ''[t]he PCAOB's constitutional infirmity was present at birth. Simply put, the PCAOB never was a constitutional entity'' before the Court's decision.).

[67] Pub. Citizen v. U.S. Dep't of Justice, 491 U.S. 440, 468 (1989) (Kennedy, J., concurring) (''liberty is always in peril'' when structural safeguards like separation of powers are violated); Bowsher v. Synar, 478 U.S. 714, 730 (1986).

[68] Free Enter. Fund, 130 S. Ct. at 3170, 3174 (Breyer, J., dissenting).

[69] *Id*. at 3169.

[70] Brief for the Cato Institute and Professors Larry Ribstein and Henry Butler as Amici Curiae in Support of Petitioners at 17, 24, Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138 (2010) (No. 08-861), 2009 WL 2406376 (citing studies).

example, ''[t]he SEC and PCAOB have issued two sets of guidance rules to perform the same assessment task . . . resulting in unnecessary confusion and complexity for management,''[71] and the PCAOB imposes duplicative rules governing banks' internal controls.[72]

Breyer lamented that many high-ranking bureaucrats in other independent agencies might be rendered removable in the future under the Court's decision. The PCAOB members were not unique, he noted, in being subject to for-cause removal only by officials who were themselves protected against removal except for cause: ''Hundreds, perhaps thousands of high-level government officials [are] within the scope of the court's holding, putting their job security and their administrative actions and decisions constitutionally at risk.''[73] At least 573 members of the Senior Executive Service working for independent agencies were now removable at will as a result of the Supreme Court's decision, he said, including the executive directors of the Nuclear Regulatory Commission, Federal Trade Commission, and Federal Energy Regulatory Commission, ''virtually all of the leadership of the Social Security Administration,'' and ''the general counsels of the Chemical Safety Board, the Federal Mine Safety and Health Review Commission, and the National Mediation Board.''[74]

Chief Justice Roberts responded by arguing that rule by unaccountable bureaucrats was a much bigger danger than political influence over the bureaucracy, and that multiple layers of for-cause removal could ultimately shift the federal government's ''vast power'' to remote and arbitrary bureaucratic mandarins:

> One can have a government that functions without being ruled by functionaries, and a government that benefits from expertise without being ruled by experts. Our Constitution was adopted to enable the people to govern themselves, through their elected leaders. The growth of the Executive Branch, which now wields vast power and touches almost every aspect of daily life, heightens the concern that it may

[71] *Id*. at 25 (citing Press Release, IMA Responds to SEC and PCAOB Exposure Drafts on SOX: Much More Is Needed to Get It Right (Feb. 27, 2007)).

[72] *Id*. at 24 (quoting Rep. Oxley, cosponsor of the act).

[73] Free Enter. Fund, 130 S. Ct. at 3179 (Breyer, J., dissenting).

[74] *Id*. at 3180.

> slip from the Executive's control, and thus from that of the people.[75]

The Court's decision broke down along ideological lines, with the four ''liberal'' justices in dissent and the more ''conservative'' justices in the majority. This voting breakdown is perhaps understandable in that, over the long run, a ruling that enables high-ranking bureaucrats to be removed more easily may benefit conservative presidents more than liberal ones because bureaucrats tend to be liberal.[76]

Moreover, bureaucrats tend to favor expanded regulation by their agency, reflecting their inherent incentive to maximize their agency's budget.[77] The PCAOB is perhaps an extreme example. Even Sarbanes-Oxley's cosponsor, Rep. Michael Oxley, has said that the PCAOB's rules ''gave the accounting industry 'almost carte blanche to do almost everything they wanted to do, which turned out to be far more expensive than anticipated. . . . They just went crazy.''[78] The Obama administration also tacitly recognized that the PCAOB had overregulated when it joined Republicans and moderate Democrats in backing an exemption to the PCAOB's internal-controls rules for small public companies.[79]

III. The *Free Enterprise Fund* Ruling Shows That the Court Is Not ''Pro-Business''

The Court's ruling excised as little as it could of a law that is incredibly costly to business and retroactively rewrote it to rehabilitate an otherwise unconstitutional regulatory structure that existed

[75] *Id*. at 3156.

[76] See., e.g., James Q. Wilson, American Government: Brief Edition 276 (9th ed. 2009); Joel D. Aberbach & Bert A. Rockman, Clashing Beliefs within the Executive Branch: The Nixon Administration Bureaucracy, 70 Am. Pol. Sci. Rev. 456, 461–63 (1976).

[77] Mark Seidenfeld, Why Agencies Act: A Reassessment of the Ossification Critique of Judicial Review, 70 Ohio St. L.J. 251, 280 (2009). See also generally William A. Niskanen, Bureaucracy and Representative Government (1971).

[78] Liz Alderman, A Second Look at Sarbanes-Oxley, Int'l Herald-Tribune, Mar. 3, 2007, at 16.

[79] Investors Beware, N.Y. Times, Nov. 6, 2009, at A22. Ironically, that exemption later became law as part of a financial ''reform'' bill that otherwise expanded the reach of federal regulation. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 989G, 124 Stat. 1376 (July 21, 2010).

from Sarbanes-Oxley's very inception.[80] By doing so, the Court demonstrated that it is not ''pro-business,'' as liberal politicians and journalists falsely claim.[81]

A classic example of the false meme that the Supreme Court is ''pro-business'' comes from *Slate*'s Dahlia Lithwick. She breathlessly reported that in the Supreme Court, ''big business always prevails, environmentalists are always buried, female and elderly workers go unprotected, death row inmates get the needle, and criminal defendants are shown the door.''[82] This claim was strikingly divorced from reality. On the criminal law side alone, over the last dozen years, the death penalty has been dramatically cut back, and Supreme Court rulings have invalidated literally thousands of criminal sentences.[83]

More importantly for this article, business has lost ground repeatedly. Environmentalists have won many cases at the business community's expense, including one of the most economically significant decisions ever, *Massachusetts v. EPA* (2007)[84]—which potentially opened the door to Environmental Protection Agency regulation of virtually every economic activity on the grounds that virtually all activity emits carbon dioxide. That decision even created a special rule to allow state attorneys general to bring lawsuits that would otherwise be dismissed for lack of standing.[85] Similarly, the Supreme Court recently allowed businesses to be sued even for products the

[80] Bishop, *supra* note 66.

[81] See, e.g., Jarrett Wampler, Liberal Fairy Tales about A Mythical ''Pro-Business'' Supreme Court; Senator Patrick Leahy's False Meme, Freedom Action, July 29, 2010, http://www.freedomaction.net/profiles/blogs/liberal-fairy-tales-about-a (Sen. Leahy bashed the Supreme Court as ''pro-business'' by distorting ''the facts of many recent Supreme Court decisions,'' including *Free Enterprise Fund v. PCAOB*).

[82] Dahlia Lithwick, Spoonfuls of Sugar: Americans' Continued Love Affair with the John Roberts Court, Slate, Sept. 26, 2009, http://www.slate.com/id/2229517/.

[83] See, e.g., Roper v. Simmons, 543 U.S. 551 (2005) (barring executions of minors); Atkins v. Virginia, 536 U.S. 304 (2002) (barring execution of the retarded); Ring v. Arizona, 536 U.S. 584 (2002) (only juries, not judges, can impose death sentences); United States v. Booker, 543 U.S. 220 (2005) (gutting the U.S. Sentencing Guidelines); Blakely v. Washington, 542 U.S. 296 (2004) (striking down state sentencing guidelines similar to those in many states).

[84] 549 U.S. 497 (2007).

[85] *Id*. at 520.

Food and Drug Administration deems to be safe and effective.[86] And it has steadily expanded businesses' liability and damages for the most common forms of discrimination, such as gender and age discrimination, in rulings that reversed lower courts and overturned the weight of federal appellate precedent.[87]

The Supreme Court's refusal to invalidate Sarbanes-Oxley despite important constitutional defects (and despite its lack of a severability clause) contrasts sharply with other courts' willingness to strike down pro-business laws in their entirety based on the presence of a few putatively unconstitutional provisions, even when the challenged law contains many unobjectionable provisions as well as a severability clause.[88] If the Supreme Court had any sympathy for American business at all, it would have struck the law down in its entirety.

The Court bent over backward not to do that, however, by engaging in radical judicial surgery that fundamentally changed the future relationship between the SEC and the PCAOB. While that surgery

[86] Wyeth v. Levine, 129 S. Ct. 1887 (2009); Roger Pilon, Into the Pre-emption Thicket: *Wyeth v. Levine*, 2008-2009 Cato Sup. Ct. Rev. 85 (2009); see also Ted Frank, Wyeth v. Levine, Overlawyered, Mar. 4, 2009 (describing this ruling as the ''worst anti-business decision'' in 43 years) (http://overlawyered.com/2009/03/wyeth-v-levine/); Michael Kinsley, Drug Regulators in the Jury Box, Wash. Post, March 13, 2009, at A17 (even liberal commentator says Court went too far in allowing ''regulation by lawsuits'').

[87] For example, it rejected limits on punitive damages recognized by the vast majority of federal appeals courts. Kolstad v. Am. Dental Ass'n, 527 U.S. 526 (1999). It expanded the definition of sexual harassment, rejecting longstanding limits on lawsuits where there is no economic or psychological harm, Harris v. Forklift Systems, 510 U.S 17 (1993), and overturned earlier limits on vicarious liability, Faragher v. City of Boca Raton, 524 U.S. 775 (1998). It also allowed businesses to be sued for unintentional ''discrimination'' against elderly workers. Smith v. Jackson, 544 U.S. 228 (2005). It expanded the statute of limitations for racial discrimination claims, Jones v. R.R. Donnelley & Sons, 541 U.S. 369 (2004), and disparate-impact claims of all types. Lewis v. City of Chicago, 130 S. Ct. 2191 (2010). It broadened the definition of discriminatory ''retaliation.'' Burlington Northern v. White, 548 U.S. 53 (2006) (rejecting limits on retaliation claims accepted in every circuit but the Ninth Circuit). Whether or not correct as a matter of law, all these rulings reversed lower-court ''pro-business'' decisions.

[88] See, e.g., Best v. Taylor Machine Works, 698 N.E.2d 1057 (Ill. 1997) (invalidating tort reform law in its entirety, based on certain provisions deemed to violate separation of powers and the state constitution, and holding that the provisions deemed invalid would not be severed from remainder of the law despite the law's severability clause).

may fix the Appointments Clause problems going forward, it does nothing about past constitutional violations. As one lawyer noted,

> The PCAOB's constitutional infirmity was present at birth. Simply put, the PCAOB never was a constitutional entity. Moreover, the PCAOB's lack of accountability infected all of its actions *ab initio*. To allow the PCAOB's actions to stand may be the least disruptive remedy, but it hardly promotes the constitutional rule of law.[89]

Yet the Court effectively treated that constitutional violation as trivial.

Doing that was particularly inappropriate in the context of the Appointments Clause, which the Framers regarded as one of the Constitution's most crucial provisions. They drafted it as an essential check on overweening bureaucracy. As English colonists, they had seen offices created by both the king and Parliament spawn what the Declaration of Independence called a ''multitude of new offices'' and ''swarms of officers to harass our people and eat out their substance.''[90] In its 1991 *Freytag* decision, the Supreme Court cited historian Gordon Wood, who wrote that ''the power of appointment to offices'' was considered by the American revolutionary generation to be ''the most insidious and powerful weapon of eighteenth-century despotism.''[91] Thus, the clause ''reflects our Framers' conclusion that widely distributed appointment power subverts democratic government.''[92]

IV. Effect of the Decision on Sarbanes-Oxley and the PCAOB: More Bureaucratic Accountability

Despite its narrowness, the Supreme Court's ruling does have certain concrete ramifications for how the PCAOB functions and manages itself. It will make the PCAOB more accountable to the SEC and introduces various constitutional safeguards.

[89] Bishop, *supra* note 66.

[90] The Declaration of Independence para. 12 (U.S. 1776).

[91] Freytag v. Comm'r of Internal Revenue, 501 U.S. 868, 883 (1991) (quoting Gordon Wood, The Creation of the American Republic, 1776–1787 at 79, 143 (1969)).

[92] Freytag, 501 U.S. at 883.

A. The Board's Rules

The Court's decision should give the SEC more ability, by relying on the unstated threat of removal, to prod the PCAOB into revising burdensome rules that SEC commissioners have come to view as flawed but not so flagrantly wrong as to warrant wholesale repeal. While the SEC can theoretically veto PCAOB rules if they are contrary to Sarbanes-Oxley and not in the public interest,[93] SEC commissioners are usually not accounting specialists and the enormous costs of the PCAOB's accounting rules became clear only after the SEC approved them.

A classic example is the PCAOB's ''internal controls'' rules, widely criticized as wasteful and unduly burdensome.[94] These vague rules have been interpreted as requiring micromanagement of company trivia, such as the number of letters in employee passwords.[95] Section 404 of Sarbanes-Oxley authorizes the board to regulate companies' ''internal controls''—a provision that Sarbanes-Oxley's cosponsor notes was just ''two paragraphs long'' in the statute, but which the PCAOB used to issue ''330 pages of regulations'' that were ''far'' more ''expensive than anyone anticipated.''[96]

These rules' estimated cost of $35 billion a year is 20 to 30 times higher than what was originally projected.[97] The compliance cost has been ''wildly in excess of the per-firm cost estimated by the SEC.''[98] Yet the PCAOB's rules did nothing, on balance, to improve

[93] 15 U.S.C. §§ 7217(b)(2)&(5) (2006).

[94] See, e.g., Stephen Barlas, Jury Is Still Out on AS5 Impact, Investment Dealers' Digest, Oct. 29, 2007, available at 2007 WLNR 21290970 (''[C]ompanies and auditors'' criticized PCAOB's ''reviled Auditing Standard 2'' for focusing on ''insignificant controls'' and ''minutiae.'').

[95] Paul Tharp, Sarbanes-Oxley Ruling Is Costly, N.Y. Post, June 29, 2010, at 24; Steve Forbes, Evil Agency—and It Ain't the CIA, Forbes Magazine, Jun. 22, 2009, at 15.

[96] Stephen Taub, Oxley: I'm Not Happy with Sarbox, CFO Magazine, Apr. 6, 2007, at 2 (quoting Rep. Oxley).

[97] Hon. Frank H. Easterbrook, The Race for the Bottom in Corporate Governance, 98 Va. L. Rev. 685, 696 (2009); Ken Small, Octavian Ionici & Hong Zhu, Size Does Matter: An Examination of the Economic Impact of Sarbanes-Oxley, Review of Business, Apr. 1, 2007, at 47.

[98] Roberta Romano, Does the Sarbanes-Oxley Act Have a Future?, 26 Yale J. on Reg. 226, 240 (2009); see also Joseph A. Grundfest & Steven E. Bochner, Fixing 404, 105 Mich. L. Rev. 1643, 1645–46 (2007).

corporate governance[99] or to detect the accounting failures that contributed to the 2008 financial crisis, such as the faulty valuation of subprime mortgage-backed securities.[100] Countrywide Financial, a shady subprime mortgage lender at the epicenter of the financial crisis, was a celebrated paragon of Sarbanes-Oxley compliance.[101]

If the SEC had had the power to remove PCAOB members at will, a chastened PCAOB would likely have made major revisions to those internal-controls rules, which SEC commissioners viewed as being too sweeping and onerous.[102] But secure against the possibility of removal, the PCAOB did the absolute minimum necessary to appease the SEC, making only minor revisions to its rules, and reportedly rebuffing the SEC's chairman when he suggested that they ''exempt some small firms'' from the most burdensome aspects of those rules.[103]

[99] Roberta Romano, The Sarbanes-Oxley Act and the Making of a Quack Corporate Governance, 114 Yale L. J. 1521, 1529–43 (2005) (reviewing 50 studies and finding Sarbanes-Oxley's provisions to be ineffective in improving corporate governance or investor protection).

[100] Forbes, *supra* note 95 (''[T]he PCAOB was out to lunch on the biggest economic/accounting issue of our time: the subprime mortgage disaster,'' preoccupied with ''such minutiae as which workers in a company can have office keys.''); Editorial, Sarbox Routed in House, Wall St. J., Dec. 12, 2009, at A18 (''the law wasn't of much use to investors in'' mismanaged companies like ''Bear Stearns, Lehman Brothers, AIG''); William M. Sinnett, Does Internal Control Improve Operations and Prevent Fraud?, Financial Executive, Dec. 1, 2009, at S32 (article answers its title's question with a resounding no).

[101] See Eric Krell, Inflection Point: How to Chart Your Path Beyond SOX, Business Finance, Sept. 1, 2007, at 22; John Berlau, Freedom and Its Digital Discontents, The Economist, Mar. 17, 2008, available at http://cei.org/op-eds-and-articles/freedom-and-its-digital-discontents (''In 2007, the Institute of Internal Auditors' Research Foundation profiled'' Countrywide Financial in a laudatory ''case study'' that ''described in breathless tones how the company's unique risk management software featured '530 risk matrices, 9,500 risks, and 27,000 controls.'''').

[102] See Andrea James, SEC Unanimously Votes for New Rules to Lower Audit Costs, Seattle Post-Intelligencer, July 26, 2007, at E1 (Auditing Standard 2(AS2) was replaced with new Auditing Standard 5 (AS5) in July 2007; SEC chairman called the old rule ''unduly expensive and inefficient,'' while ''Commissioner Paul Atkins said he was 'happy to put [it] out of its misery'''').

[103] Roberta Romano, Does the Sarbanes-Oxley Act Have a Future?, 26 Yale J. on Reg. 229, 243 & n.53 (2009); Stephen Barlas, Jury Is Still Out on AS5 Impact, Investment Dealers' Digest, Oct. 29, 2007 (critics called the change ''weak gruel,'' not meaningful reform, and Sarbanes-Oxley's cosponsor said, ''It does not go far enough'').

As one commentator explained, ''After the PCAOB produced their 'Audit Standard 2,' 'all five' SEC commissioners were in favor of 'radical' changes to it, and yet it took the SEC years to even make 'some' changes to the auditing standards due in part to PCAOB recalcitrance.''[104] The SEC's ''power'' at the time was ''not plenary'' over the PCAOB, but rather akin to ''pushing on a string.''[105]

But even in the aftermath of the Supreme Court's decision, major reform of these PCAOB rules is unlikely. The SEC's composition has since changed, as the terms of the biggest advocates of such reforms, such as Paul Atkins, have expired. Sitting on the SEC in their place are commissioners who blame the current financial crisis entirely on (mythical) deregulation under the George W. Bush administration, despite the fact that regulation vastly expanded under Bush due to Sarbanes-Oxley.[106] Such commissioners are unlikely to use their added sway over the PCAOB to push for further major revisions to its internal-controls rules.[107] In short, the SEC's expanded authority over the PCAOB may come too late for advocates of Sarbanes-Oxley reform.

The SEC's stance may change, however, if a more market-friendly administration comes to power in Washington. In 2008, many Republican presidential contenders were critical of the cost of the

[104] Jonathan Moore, Peekaboo! PCAOB More Powerful and Less Accountable than Government Claims, OpenMarket.Org, Dec. 4, 2009, available at http://www.openmarket.org/2009/12/04/peekaboo-pcaob-more-powerful-and-less-accountable-than-government-claims (quoting SEC Commissioner Paul S. Atkins's remarks at a December 3, 2009, panel discussion at the American Enterprise Institute entitled ''Public Company Accounting Oversight Board: A Preview''). Video of this event can be found at the following link, which subdivides the panel discussion by speaker: http://www.aei.org/video/101187. I also spoke at the event, which is described at http://www.aei.org/event/100177.

[105] *Id*.

[106] Aguilar Calls for Strong Financial Reform and Enforcement Measures, Banking & Financial Services Policy Report, July 2010, at 27 (''Commissioner Luis Aguilar, in remarks at a recent Compliance Week conference, blamed years of deregulation for the financial crisis.''); Robert Hardaway, The Great American Housing Bubble: Re-Examining Cause and Effect, 35 U. Dayton L. Rev. 33 (2009) (discussing federal policies, regulations, and subsidies that spawned the financial crisis; debunking ''deregulation'' as a ''simplistic explanation'').

[107] See, e.g., Floyd Norris, U.S. Justices Vote to Keep Regulatory Committee, Int'l Herald-Tribune, June 29, 2010, at 18 (''There is no indication that the S.E.C. has any desire to fire any board members.'').

PCAOB's rules, which have been widely criticized for undermining American competitiveness and driving business, initial public offerings, and financial jobs overseas to countries with less burdensome regulations.[108] Indeed, so much financial activity moved from New York to London that City bankers wanted ''to erect a solid gold statue in honor of the legislators who sponsored [Sarbanes-Oxley], for their efforts . . . certainly resulted in shifting a massive proportion of the mergers and acquisitions boom to Britain.''[109]

The logic of the Court's decision also suggests that rules influenced by the SEC's limited influence over the PCAOB can be challenged by private parties as constitutionally tainted.[110] But except with regard to the PCAOB's controversial internal-controls rules, such influence would probably be hard to show as to any particular rule. Indeed, the challengers in *Free Enterprise Fund* did not raise objections to ''any of its auditing standards,'' which were putatively subject to exhaustion.[111] Beckstead did complain, however, of the PCAOB's ''uncomplimentary inspection report.''[112]

In theory, the board's rules adopted before *Free Enterprise Fund* should be considered null and void. If the PCAOB members were principal officers before the Court's decision expanding SEC authority over them—as legal commentators and Judge Kavanaugh in fact argued—then, purely as a matter of logic, the PCAOB's rules from that period were adopted by invalidly appointed officers.[113] But the

[108] See, e.g., Rick Merritt, Tech Off Radar in '08 Race, Electronic Engineering Times, Jan. 28, 2008, at 1 (''Both [former New York Mayor Rudolph] Giuliani and [former Massachusetts Governor Mitt] Romney call for reining in the excesses of Sarbanes-Oxley, particularly for small businesses.'').

[109] Claire Berlinski, There Is No Alternative: Why Margaret Thatcher Matters 148–49 (2008).

[110] See, e.g., Allen v. Carmen, 578 F. Supp. 951, 969 (D.D.C. 1983) (holding that unconstitutional legislative veto used by one House of Congress to disapprove agency's regulation required invalidation of agency's subsequently adopted regulations, which were influenced and thus ''tainted'' by the veto).

[111] Free Enter. Fund, 130 S. Ct. at 3150 (narrowing reach of exhaustion doctrine).

[112] Free Enter. Fund, 130 S. Ct. at 3150; see also *id.* at 3164 (challengers entitled to order against enforcement by agency not constitutionally ''accountable to the Executive''). See also Columbus Educ. Ass'n v. Columbus City Sch. Dist., 623 F.2d 1155 & n.1 (6th Cir. 1980) (expunging government reprimand, which was sufficient injury for suit).

[113] See Williams v. Phelps, 482 F.2d 669, 671 n.3 (D.C. Cir. 1973) (labor union could sue to challenge policies harming employees carried out by improperly appointed agency head); Freytag v. Comm'r of Internal Revenue, 501 U.S. 868, 879 (1991).

question is largely academic because the PCAOB would likely simply readopt any such rules if they were called into question. The Supreme Court held that the petitioners were ''not entitled to broad injunctive relief against the Board's continued operations,''[114] and that ''the Sarbanes-Oxley Act remains 'fully operative as a law''' going forward.[115]

Moreover, the regulated entities with the resources to bring far-reaching challenges to PCAOB rules adopted when it was not operating as a constitutional agency—that is, the big accounting firms—have no incentive to do so. They are the beneficiaries of the PCAOB's burdensome rules, not its victims. They ''have reaped huge profits'' due to all the PCAOB's red tape, and have vigorously defended the PCAOB's most burdensome auditing rules for that very reason.[116] Even if they were not enriched by its rules, however, as parties regulated by the PCAOB, there would be little point in their offending the board by challenging rules it could simply readopt going forward.

Finally, a law enacted just after the Supreme Court's decision, the massive Dodd-Frank financial overhaul, moots some potential challenges by exempting from the PCAOB's ''internal controls'' rules the small public companies most heavily burdened by them.[117] Added in response to prodding from financial regulation scholars like my colleague John Berlau,[118] Section 989G of that law exempts publicly traded companies with market capitalizations of less than $75 million from internal-controls audits under Sarbanes-Oxley.[119]

[114] Free Enter. Fund, 130 S. Ct. at 3164.

[115] *Id.* at 3161 (quoting New York v. United States, 505 U.S. 144, 186 (1992)).

[116] See, e.g., Eric Dash, S.E.C. Revises Its Standards for Corporate Audits, N.Y. Times, May 24, 2007, at C3; Stephen Labaton, U.S. Commission Set to Ease Audit Rules for Small Companies, Int'l Herald-Tribune, Dec. 12, 2006, at 14.

[117] Romano, 114 Yale L.J. at 1588 (''SOX imposed a far more significant burden on small than on large firms''); William J. Carney, The Costs of Being Public After Sarbanes-Oxley: The Irony of ''Going Private,'' 55 Emory L.J. 141, 151 (2006) (same).

[118] John Berlau, Obama's Latest Monstrosity, American Spectator, July 21, 2010, available at http://spectator.org/archives/2010/07/21/obamas-latest-monstrosity; John Berlau, Obama Can Aid Small Businesses by Providing Regulatory Relief, Daily Caller, Feb. 2, 2010, available at http://dailycaller.com/2010/02/02/obama-can-aid-small-businesses-by-providing-regulatory-relief/.

[119] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 989G, 124 Stat. 1376 (July 21, 2010), adding Sarbanes-Oxley Act, Section 404(c), 15 U.S.C. § 7262(c).

B. Investigations and Inspections of Accounting Firms

The PCAOB publicly styles itself as a private entity immune from constitutional constraints, a claim parroted by gullible journalists.[120] It does this even though, in the Supreme Court, its lawyers admitted the obvious, ''that the Board is 'part of the Government' for constitutional purposes,'' and ''that its members are 'Officers of the United States' who 'exercise significant authority''' under federal law.[121] Sarbanes-Oxley itself declares the PCAOB to be ''private,'' but the Supreme Court held years ago that such statutory labels are meaningless.[122]

The fact that the PCAOB is, in reality, a government agency means that it must respect constitutional rights in its investigations and rulemaking. As Donna Nagy, the leading PCAOB scholar, has explained, one such right is the Fifth Amendment right against self-incrimination.[123] Thus, the PCAOB could not force an accountant with a reasonable fear of criminal prosecution to testify in an investigation or subject him to discipline solely for his failure to cooperate—although it could draw a negative inference from that failure to testify.[124] That right may also affect the enforceability of the ''consents'' to cooperation that accountants are required to sign as a condition of their employment with a registered accounting firm.[125] Such consents will be limited by the well-established ''doctrine of 'unconstitutional conditions,''' which prohibits requiring waivers of constitutional rights as a condition of government benefits.[126] Similarly, PCAOB inspections should be subject to Fourth Amendment

[120] PCAOB website, http://pcaobus.org/Pages/default.aspx (last visited, July 28, 2010) (claiming the ''PCAOB is a private sector, non-profit corporation''); AP Washington Daybook, July 13, 2010 (repeating PCAOB claim that ''the PCAOB is a private-sector, non-profit corporation'').

[121] Free Enter. Fund, 130 S. Ct. at 3148 (quoting Lebron v. National Railroad Passenger Corporation, 513 U.S. 374, 397 (1995)).

[122] Lebron, 513 U.S. at 397 (Amtrak is a government-controlled corporation bound by the Constitution, even though federal law declares it to be private.).

[123] Donna M. Nagy, Playing Peekaboo with Constitutional Law: The PCAOB and Its Public/Private Status, 80 Notre Dame L. Rev. 975, 1044–48 (2005).

[124] *Id*. at 1045–46 (citing cases).

[125] *Id*. at 1046.

[126] Dollan v. City of Tigard, 512 U.S. 374, 385 (1994); see, e.g., Garrity v. New Jersey, 385 U.S. 493 (1967) (state may not condition continued public employment on relinquishment of right to invoke Fifth Amendment privilege against self-incrimination). Constitutional safeguards apply with greater force to ''regulated entities'' like

limits,[127] and the PCAOB's investigations would have to respect accountants' right to counsel and right to due process.[128] When the PCAOB imposes large monetary sanctions, subsequent sanctions by the SEC or Justice Department could be barred in extreme cases as a violation of the Fifth Amendment's Double Jeopardy Clause.[129] Finally, PCAOB auditing standards can be challenged if they restrict an accountant or accounting firm's right to free speech or association.[130]

C. Employment and Contracting by the PCAOB

Since it is now recognized as a government agency for constitutional purposes, the PCAOB must now afford its employees and contractors various rights that do not apply against private employers, but do apply against government agencies. For example, it will have to put up with controversial speech on matters of public concern by its employees, since that is protected by the First Amendment.[131] It will also be liable for a wider range of discrimination against employees and contractors, since the Constitution is not limited to protected classes covered by civil rights statutes,[132] and

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accounting firms than they do to the government's own employees. Carepartners LLC v. Lashway, 545 F.3d 867, 880 (9th Cir. 2008); see also Waters v. Churchill, 511 U.S. 661, 671 (1994).

[127] Nagy, Playing Peekaboo, *supra* note 123 at 1046 (citing cases). Consents executed by accountants would not change this. A.F.G.E. v. Weinberger, 651 F. Supp. 726, 736 (S.D. Ga. 1986) (''Advance consent to future unreasonable searches is not a reasonable condition of employment.'').

[128] Nagy, Playing Peekaboo, *supra* note 123, at 1046–48.

[129] *Id*. at 1047–48.

[130] *Id*. at 1048. See Edenfield v. Fane, 507 U.S. 761 (1993) (invalidating accounting board's rule restricting unsolicited phone calls); Pfizer v. Giles, 46 F.3d 1284 (3d Cir. 1995) (holding that a state may not use means of imposing liability that hamper free association if less restrictive means are available).

[131] Nagy, Playing Peekaboo, *supra* note 123, at 1048 (citing cases). Congress has preempted constitutional lawsuits with administrative remedies for many federal employees, but such preemption doesn't apply to the PCAOB, because it is nominally private, even though it is in fact a federal agency. Sculthies v. Nat'l Passenger R.R. Corp., 650 F. Supp.2d 994, 999 (N.D. Cal. 2009) (Amtrak employee could bring free speech claim because Amtrak is a de facto government agency; judicial remedy not preempted because Amtrak, like PCAOB, is nominally private).

[132] See, e.g., Peightal v. Metro. Dade County., 26 F.3d 1545 (11th Cir. 1991) (affirmative action plan upheld under Title VII but not under the Constitution); Brunet v. City of Columbus, 1 F.3d 390, 405 (6th Cir. 1993) (plan held unconstitutional despite its possible validity under Title VII).

since the Constitution—unlike Title VII of the Civil Rights Act—allows employees to sue not just the agency that employs them but also the individual government officials who engage in discrimination.[133] The PCAOB is now clearly subject to Fourth Amendment limits on things like random employee drug testing.[134] And it must respect due process by not firing those employees who have a reasonable expectation of continued employment without first giving them notice and an opportunity to be heard, and by not disciplining them in ways that contravene its written policies and procedures.[135]

V. The Decision Strengthens the Government's Ability to Fire Mediocre and Recalcitrant Officials

The Supreme Court's holding directly governs only independent agencies, which can now remove high-ranking civil servants at will. But its logic is not limited to independent agencies. Over the long run, it will probably also affect other executive branch employees, such as those who work for the 15 cabinet departments.

Free Enterprise Fund breathed new life into the Supreme Court's previously eroded 1926 decision in *Myers v. United States*, which gave the president the ability to remove executive-branch officers like postmasters without Senate approval.[136] Indeed, the *Free Enterprise Fund* Court explicitly relied on *Myers* even though dicta in subsequent cases suggested that *Myers* had been largely overruled and limited to the context ''where Congress granted itself removal authority over Executive Branch officials.''[137] By applying *Myers*'s

[133] Compare Fantini v. Salem State Coll., 557 F.3d 22, 30 (1st Cir. 2009) (Title VII does not hold individual supervisors liable) with Alexander v. Estepp, 95 F.3d 312, 317 (4th Cir. 1996) (individual supervisors liable for ''reverse discrimination'' against white employees under Constitution).

[134] Nagy, Playing Peekaboo, *supra* note 123, at 1045.

[135] *Id*. at 1047 (citing cases); see Wilkinson v. Legal Servs. Corp., 27 F. Supp. 2d 32, 62 (D.D.C. 1998) (despite statutory language calling it a ''private'' corporation, the LSC is a government actor that must provide due process).

[136] 272 U.S. 52, 162 (1926).

[137] Compare Free Enter. Fund, 130 S. Ct. at 3152 (relying on ''the landmark case of *Myers*'' and its removal principles) with *id*. at 3167, 3176 (Breyer, J., dissenting) (stating that *Humphrey's Executor* ''explicitly disapproved of most of the reasoning in *Myers*'') (citing Wiener v. United States, 357 U.S. 349, 357 (1950)); Morrison v. Olson, 487 U.S. 654, 686 (1988) (*Myers* held ''the Constitution prevents Congress from draw[ing] to itself . . . the power to remove'') (quoting *Myers*, 272 U.S. at 161).

holding to a statute where Congress did not seek to expand its power over the executive branch—but rather sought to limit its *own* authority[138]—*Free Enterprise Fund* shows that *Myers*'s principles cannot be so easily cabined, and that the president and his cabinet secretaries likely have broad constitutional authority to fire executive officers at will.

If that is so, then the Court's decision may empower administrations to remove administrators, lawyers, and other civil servants who flout their policies. For example, liberal Justice Department lawyers have routinely resisted the policies of Republican administrations, pressing for race-based redistricting and nullification of state voter-identification laws even when doing so cuts against administration policy and Supreme Court rulings.[139] As civil-service employees, these officials ''are almost impossible to fire,'' despite the theoretical possibility of dismissal for cause.[140] But if high-ranking civil servants are officers of the United States—as Justice Breyer's dissent laments[141]—then they may logically be removable at will under *Myers*, which upheld the removal without cause of an ''inferior officer'' whose authority was no greater than theirs (a postmaster).[142]

Low-level bureaucrats do not qualify as federal ''officers'' removable at will under *Myers*, since they are mere ''employees,'' not ''officers'' for constitutional purposes.[143] But many Justice Department lawyers clearly do qualify as federal officers, since they either

[138] Free Enter. Fund, 130 S. Ct. at 3176 (Breyer, J., dissenting) (Congress sought to limit its own influence over the PCAOB by not selecting its leaders and by ''providing the Accounting Board with a revenue stream independent of the Congressional appropriations process.'').

[139] See, e.g., LULAC v. Perry, 548 U.S. 399 (2006) (upholding all but one district in the 2003 Texas redistricting plan); Crawford v. Marion County. Election Bd., 553 U.S. 181 (2008) (upholding state's voter ID requirement); Voter-Fraud Activist on Election Panel Faces Hearings, NPR All Things Considered, June 12, 2007 (Bush appointee approved Texas redistricting plan and voter ID over resistance from career Justice Department lawyers), available at http://www.npr.org/templates/story/story.php-?storyId = 10991498.

[140] Carl Nolte, Bush Aides Scramble for Federal Jobs, S.F. Chronicle, Nov. 30, 1992, at A1 (also noting that civil service includes bureaucrats who ''head up nationwide or department wide program''); Jim Balow, Raises Not Big, But Jobs Secure, Houston Chronicle, Aug. 8, 2000, at 1 (few employees with ''poor'' ratings ever get fired).

[141] Free Enter. Fund, 130 S. Ct. at 3179 (Breyer, J., dissenting).

[142] Buckley v. Valeo, 424 U.S. 1, 126 (1976) (postmaster in *Myers* was an inferior officer).

[143] Free Enter. Fund, 130 S. Ct. at 3160.

possess ''significant authority''[144] or meet alternative tests for officer status. Under Supreme Court precedent, ''officers'' include *each* of the following categories of federal employees: '''(1) those charged with 'the administration and enforcement of the public law,' . . . (2) those granted 'significant authority,' . . . and (3) those with 'responsibility for conducting civil litigation in the courts of the United States.'''[145] Government lawyers commonly meet one or more of those tests.

Indeed, federal lawyers typically have far more authority than many minor officials whom the Supreme Court long ago held to be officers within the meaning of the Appointments Clause, such as ''thousands of clerks'' and an ''assistant surgeon.''[146] The fact that civil-service regulations may purport to bar their removal without cause does not change this; indeed, the Supreme Court in *Myers* noted that ''a vast majority of all civil officers'' as defined in the Constitution were covered by the Civil Service Law.[147]

VI. The Decision Opens the Door to Messy Selection Processes at Independent Agencies

To reject petitioners' Appointments Clause challenge, the Supreme Court embraced contradictory reasoning that is not sustainable in the long run and could undermine agencies' efficiency. The Court held that the members of the PCAOB can validly be picked by the SEC commissioners as a group, rather than by the SEC's chairman, based on the dubious theory that the commissioners are collectively the SEC's true ''head'' and thus constitutionally authorized to make appointments within their department.

But with the exception of the PCAOB members, all key appointments made by the SEC (like its general counsel) are made by its chairman, not by the SEC commissioners as a group.[148] If the Supreme Court is right that the SEC's chairman is not its ''head,'' then he has no authority to make these other appointments under the Appointments Clause. That situation is troubling for independent agencies

[144] *Id*. at 3148 (quoting Buckley v. Valeo, 474 U.S. 1, 125–26 (1976)).

[145] *Id*. at 3179–80 (Breyer, J., dissenting) (quoting Buckley, 474 U.S. at 126, 139–40).

[146] *Id*. at 3179 (Breyer, J., dissenting) (citing examples from Supreme Court precedent).

[147] Myers, 272 U.S. at 173.

[148] SEC Chairman Is Not the ''Head'' of the SEC, *supra* note 33, at 2273 (quoting SEC v. Blinder, 855 F.2d 677, 681 (10th Cir. 1988)).

because virtually all of them—not just the SEC—vest appointments in their chairman. Taken to its logical conclusion, *Free Enterprise Fund* would call into question virtually all important appointments made by independent agencies.

The Supreme Court sought to finesse this problem by noting that appointments by the SEC's chairman are subject to approval by a majority of SEC commissioners. The Court then declared in dicta that such after-the-fact approvals rendered the chairman's pick the group-appointment of the commissioners.[149] But that's like saying that the Senate's approval of the president's judicial nominations makes judges senatorial appointees!

Not only is this dictum unpersuasive, it contradicts what the Court said earlier in its opinion, when it noted that it was improper to ''assume . . . that the Chairman would have made the same appointments acting alone'' as the full commission, merely because ''no member of the Board has been appointed over the Chairman's objection.''[150] In short, the Supreme Court itself admitted that there is a big difference between appointing someone and merely consenting to his or her appointment. For example, many Democratic senators voted to confirm Chief Justice Roberts but no one seriously believes that they would have appointed him if it were their choice.

The Supreme Court claimed that petitioners had effectively conceded that approval was the same as appointment by not asking the Supreme Court to overturn its past decisions in cases like *United States v. Hartwell*, which deemed an officer's appointment valid even though he was selected by a department head's subordinate, and then approved by that department head.[151] But there is a big difference between a busy department head's delegating a selection to one of his subordinates—who is eager for his approval and likely to carry out his every wish—and stripping officials of their appointment power and transferring it to a colleague who may have very different wishes (like shifting appointments from the SEC commissioners to the SEC's chairman). For example, federal appellate judges

[149] Free Enter. Fund, 130 S. Ct. at 3163 n.13.

[150] *Id.* at 3163 n.12.

[151] *Id*. at 3163 n.13 (citing, e.g., United States v. Hartwell, 73 U.S. (6 Wall.) 385, 393–94 (1868)).

are informally selected by ''judge-pickers'' subordinate to the president, who make sure that such selections reflect the president's judicial philosophy.[152] That is very different from having judges formally picked by the president's political competitors, like the Senate, and then approved by the president.

In a future case, the Court should remedy its contradictory Appointments Clause holding by ruling that an independent agency is headed by its chairman, not its commissioners as a group. Such a ruling would both affirm the validity of the vast majority of independent agency appointments and vindicate one of the purposes of the Appointments Clause, which was aimed precisely at ''the lack of accountability in a multimember body.''[153] As the *Harvard Law Review* notes, treating the commissioners of independent agencies as their collective heads is both factually wrong and contrary to the purpose of the Appointments Clause, which seeks to prevent ''widely distributed appointment power'' and maximize officials' accountability to democratically elected leaders.[154] It is factually wrong because the SEC's chairman, like other independent agency chairs, '''exerts far more control than [her] one vote would seem to indicate' because she 'controls key personnel, internal organization, and the expenditure of funds'''; because ''every important position in the SEC is appointed by the chairman,'' including the general counsel, the chief accountant, and the chief economist; and because the SEC chairman is listed as the SEC's ''head'' and ''chief executive'' on the SEC's own website and in the *Federal Register*.[155]

Moreover, ''vesting the appointment power in the multimember Commission violates the Appointments Clause's intent by not reserving the appointment power in the SEC's most politically accountable actor, the Chairman.''[156] Unlike other SEC commissioners—but like cabinet secretaries, the paradigmatic department

[152] See, e.g., Jonathan Groner, Judiciary Battles Start Anew, Legal Times, Jan. 13, 2003, at 10.

[153] Freytag, 501 U.S. at 904–05 (Scalia, J., concurring).

[154] SEC Chairman Is Not the ''Head,'' *supra* note 33, at 2273 (quoting Freytag, 501 U.S. at 885).

[155] *Id*. at 2272 (quoting S.E.C. v. Blinder, 855 F.2d at 681 and citing lists of agency ''heads'' published in the *Federal Register* by the Office of Management and Budget, which show independent agencies' chairmen are their ''heads'').

[156] *Id*. at 2270.

heads—the SEC's ''chairman serves at the pleasure of the president,'' making him the most democratically accountable member of the SEC.[157] ''This removal power is critical for political accountability, for 'it is only the authority that can remove him . . . that [an officer] must fear and, in the performance of his functions, obey.'''[158]

It is that accountability that makes the SEC's chairman, but not other SEC commissioners, qualify as a potential department head for Appointments Clause purposes: ''According to the Supreme Court, appointment power can be vested in department heads because they are 'subject to the exercise of political oversight and share the President's accountability to the people.'''[159] The SEC's chairman is subject to such oversight, but that is manifestly not true of other SEC commissioners, who can be removed from their positions only for cause. Treating them as a department head for purposes of the Appointments Clause defeats its purpose of accountability.

The PCAOB's own history illustrates the foolishness of letting groups act as if they were an independent agency's ''head.'' Sarbanes-Oxley's requirement that SEC commissioners as a group agree on the appointment of PCAOB members triggered a messy and divisive process for selecting the initial board members. As the General Accounting Office later found, ''The selection process broke down in early October [2002] when the Commission was unable to agree on a consensus candidate for chairman.''[160] Different commissioners backed different candidates, and this ''inability to choose a final slate of candidates until the eve of the Commission's vote resulted in the appointment of PCAOB members who had not been fully vetted.''[161] Retired Judge William Webster, the first PCAOB chairman, resigned shortly after he was appointed when his service on the audit board of U.S. Technologies, a company under SEC investigation for accounting problems, became public.[162] The SEC's own chairman, Harvey Pitt, was blamed for withholding this information from his fellow commissioners, and he ended up resigning

[157] *Id*. at 2274 n. 81 (citing Free Enter. Fund, 537 F.3d at 680).

[158] *Id*. at 2274 (quoting Bowsher v. Synar, 478 U.S. 714, 726 (1986)).

[159] *Id*. at 2273 (quoting Freytag, 501 U.S. at 886).

[160] U.S. Gen. Accounting Office Rep. No. GAO-03-339, *supra* note 35 at 4.

[161] *Id*. at i.

[162] *Id*. at 13–16.

as well. Yet the GAO found that no one, not even Pitt, knew of this information before the vote, because no commissioner was really in charge of the selection. Moreover, the SEC's chief accountant did not view this information as relevant and ''did not inform the SEC chairman or other commissioners about certain matters concerning Judge Webster.''[163] This is precisely the lack of accountability that the Framers sought to guard against through the Appointments Clause, and the Supreme Court was wrong to countenance such a messy appointment process.[164]

Conclusion

The Supreme Court's willingness to bend over backward to preserve as much of the Sarbanes-Oxley Act as it could—despite its serious constitutional flaws and massive cost to the economy and American business—is one more illustration that the Court is not ''pro-business.'' Nonetheless, the Court's ruling striking down the act's removal restrictions will promote government accountability in two ways: First, it will place the wasteful, red-tape-obsessed PCAOB more firmly under SEC control by enabling the SEC to fire PCAOB members at will. Second, it will strengthen the government's ability to get rid of high-ranking bureaucrats and lawyers who are intractable, headstrong, or mediocre. This strengthened accountability may improve financial regulation—and the U.S. economy—in the long run.

[163] *Id*. at 3.

[164] See Freytag, 501 U.S. 868, 904–05 (Scalia, J., concurring).