

PCAOB Amends Process for Appointing and Removing its Hearing Officers

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On January 29, 2019, the Public Company Accounting Oversight Board (PCAOB or “Board”) adopted amendments to its bylaws and rules that make the PCAOB’s appointment and removal of its hearing officers subject to the approval of the U.S. Securities and Exchange Commission (SEC).¹ This amendment comes in the wake of the Supreme Court’s 2018 holding in *Lucia v. SEC* that, because the SEC’s administrative law judges (ALJs) are “Officers” within the meaning of the Constitution’s Appointments Clause, the SEC’s commissioners (not staff) must appoint them.² The SEC took several steps in its own response to *Lucia*, including “ratif[ying] the appointments of the Chief Administrative Law Judge...and Administrative Law Judges...[and] reiterate[ing] [the SEC’s] approval of their appointments as [their] own.”³

This is not the first time the Board had to contend with a constitutional question regarding its structure. In *Free Enterprise Fund v. PCAOB*, the Supreme Court held that the Sarbanes-Oxley Act’s provisions making PCAOB Board members removable by the SEC only for good cause were inconsistent with the Constitution’s separation of powers.⁴ In this instance, the SEC and Board proactively insulated the Board’s hearing officers from the constitutional challenges addressed in *Lucia*.

By way of background, Board hearing officers hear two types of proceedings: (1) proceedings in connection with the Board’s disapproval of a public accounting firm’s application to register with the Board and (2) disciplinary proceedings to determine if registered public accounting firms or their associated persons violated applicable law, and, if so, whether they should be sanctioned.⁵ Both types of proceedings serve an important role in the Board’s oversight efforts.

The PCAOB (and SEC’s) relatively straightforward fix to the appointment and removal of the Board’s hearing officers allows the Board to remove a potential obstacle to its regulatory efforts. For example, it is not difficult to conjecture that, post-*Lucia*, parties facing the institution of a Board disciplinary proceeding may have resisted entering into settlements and raised challenges to the constitutionality of the Board’s former approach to hiring and removing its hearing officers on its own accord.⁶ Those concerns likely animated the amendment at issue even though, as the Board notes, no “court” and neither “the Commission, [n]or the Board has adjudicated whether a

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PCAOB hearing officer is, like an SEC ALJ, an inferior officer under the Appointments Clause.”⁷

In its release, the PCAOB also pointed out the benefits of requiring SEC approval of the hearing officers’ appointment since that approach allows for the hearing officer to be “appointed in the manner of an inferior officer for purposes of the Appointments Clause.”⁸ The PCAOB elaborated that the *Lucia* Court described the tenets of the Appointments Clause as “designed to preserve political accountability relative to important government assignments.”⁹ Also, unlike the risk of ongoing challenges to the status of SEC ALJs given that the *Lucia* Court did not address the question of their removal,¹⁰ the PCAOB’s amendment avoids that challenge by subjecting the removal of any Board hearing officer to SEC approval.¹¹

It is an open question whether the SEC will exercise greater oversight over the Board’s adjudication process through this new approach to the hearing officers’ appointment and removal. The SEC already exerts significant oversight over the Board’s enforcement process through, among other means, its review of any Board final decision in a disciplinary proceeding under a *de novo* standard.¹²

Several other questions remain as to how the PCAOB amendment will impact Board adjudications, including any Board final decision under SEC review. First, going forward, the Board will have to appoint hearing officers and submit them to the SEC for approval.¹³ The release does not indicate if that already has occurred or when the Board and the SEC may proceed with such appointments.

Second, to the extent respondents (in a timely manner) challenged the constitutionality of the hearing officer’s appointment and sought Board review of the hearing officer’s initial decision¹⁴, the Board likely will take a similar approach to the SEC and (as the Court required in *Lucia*) remand the proceeding to a different and properly appointed hearing officer.¹⁵ Or, following the SEC’s “alternative procedures” approach, the Board could offer the parties, upon mutual agreement, the option of staying with the original hearing officer after he or she is properly appointed under the Board amendment.

Similarly, respondents that made timely challenges to the constitutionality of the Board’s hearing officer and sought SEC review of a Board final decision in a disciplinary proceeding¹⁶ could also expect relief. In those instances, the SEC could remand their proceeding to the Board, which, in turn, would likely take the aforementioned approach. It will be worth keeping a close eye on how these potential remands and related reassignments work themselves out in the coming months.

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¹ See Bylaws and Rule Amendments to Provide that the PCAOB’s Appointment and Removal of Its Hearing Officers Are Subject to Commission Approval, PCAOB Release No. 2019-001 (Jan. 29, 2019) at 3–6. [hereinafter, “*PCAOB Release*”]. The PCAOB made clarifying and conforming changes to its bylaws and rules. See *Bylaws of the Public Company Accounting Oversight Board Pursuant to the Provisions of Title I of the Sarbanes-Oxley Act of 2002*, Article VI, PCAOB, <https://pcaobus.org/Rules/Pages/Bylaws.aspx> (last visited Feb. 25, 2019); *Section 5. Investigations and Adjudications*, PCAOB, https://pcaobus.org/Rules/Pages/Section_5.aspx (last visited Feb. 25, 2019), PCAOB Rules 1001(h)(i), 5200, and 5402. The amendments became effective upon their filing with the SEC on January 29, 2019. See Notice of Filing of and Immediate Effectiveness of

Proposed Bylaw and Rule Amendments to Provide that the Board's Appointment and Removal of Hearing Officers Are Subject to Commission Approval, Exchange Act Release No. 34-85090, File No. PCAOB-2019-01 (Feb. 11, 2019).

² See *Lucia v. SEC*, 138 S. Ct. 2044, 2062 (2018). For further discussion about the *Lucia* decision, see also Securities Litigation Alert, *Government Agencies Face Uncertainty After Supreme Court Rules That SEC ALJs Must Be Appointed*, Akin Gump Strauss Hauer & Feld LLP (June 25, 2018), <https://www.akingump.com/en/news-insights/government-agencies-face-uncertainty-after-supreme-court-rules.html>.

³ Order, Securities Act Release No. 10536, Exchange Act Release No. 83907, Investment Advisers Act Release No. 2993, Investment Company Act Release No. 33211, 2018 SEC Lexis 2058 at 1 (Aug. 22, 2018).

⁴ *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010).

⁵ See PCAOB Release at 1, n. 2 (citing Sarbanes-Oxley Act of 2002 §§ 101(c)(1) & (4), 102(c), 105(a) & (c)(1)-(3), 15 U.S.C. 7211(c)(1) & (4), 7212(c), 7215(a) & (c)(1)-(3)); PCAOB Rules 5200 and 5500.

⁶ See *Kabani & Co., Inc. v. SEC*, 733 F. App'x 918 (9th Cir. 2018) (dismissing arguments regarding the constitutionality of the PCAOB's hearing officers for failure to raise it in a timely matter). On February 22, 2019, *Kabani* filed a cert petition with the United States Supreme Court arguing that the Ninth Circuit improperly denied their claim for failure to identify the Appointments Clause as their basis. See *Kabani & Co., Inc. v. SEC*, 733 F. App'x 918 (9th Cir. 2018), *petition for cert. filed*, (U.S. Feb. 22, 2019) (No. 18-1117).

⁷ See PCAOB Release at 2–3. The Board proposed these amendments to remove “any uncertainty about the status of PCAOB hearing officers that might distract from the PCAOB's mission...” See *id.* at 3.

⁸ See *id.* at 4.

⁹ See *id.* at 5 (citing *Edmond v. United States*, 520 U.S. 651, 662–63 (1997)).

¹⁰ See, e.g., *Lucia*, 138 S. Ct. at 2044.

¹¹ See PCAOB Bylaws Article VI; PCAOB Rule 1001(h)(i).

¹² See 15 U.S.C. § 7217(c)(2) (stating that Exchange Act §§ 19(d)(2) and 19(e)(1) “shall govern the review by the Commission of final disciplinary sanctions imposed by the Board”); S.W. Hatfield, C.P.A. and Scott W. Hatfield, C.P.A., SEC Rel. No. 66930 at 2 (July 3, 2013) (affirming the Board's decision after a *de novo* review).

¹³ See PCAOB Rule 1001(h)(i); PCAOB Release at 8. The Board hired its Chief Hearing Officer under the Board's former approach to employing a hearing officer. See *PCAOB Names Marc B. Dorfman as Chief Hearing Officer*, PCAOB (Oct. 23, 2013), https://pcaobus.org/News/Releases/Pages/10232013_HearingOfficer.aspx.

¹⁴ See PCAOB Rule 5460.

¹⁵ Under the Board's amendment to its Bylaws, the Board could also preside over any proceeding, without relying on a Board hearing officer's participation. See PCAOB Rule 5200(b) (“All proceedings shall be presided over by the Board or, if the Board orders, by a hearing officer.”). It is unlikely the Board would take that approach now that any appointment and removal of a Board hearing officer under these amendments would make, going forward, a *Lucia*-based challenge largely moot. See *id.*

¹⁶ See 15 U.S.C. § 7217(c)(2).