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Sarbanes-Oxley and the Separation of Powers

On Monday, December 7, the Supreme Court began hearing arguments concerning Free Enterprise Fund v. Public Company Accounting Oversight Board (PCAOB).

While perhaps not as memorable as the "date which shall live in infamy," this case has been called the most important "separation of powers" case in 20 years by Judge Brett Kavanaugh, the dissenter in the 2-1 decision by the D.C. Circuit Court of Appeals that ruled for the PCAOB, prior to the case going to the Supreme Court for review).

For the first time in U.S. history, noted Judge Kavanaugh "we have an independent agency whose heads are appointed by, and removable only for cause by, another independent agency." And this was done deliberately to avoid the restrictions of the "separation of powers" doctrine.

In his public opposition to the bill (which later became the Sarbanes-Oxley Act, and set up the PCAOB board), Senator Phil Gramm (R-Texas), warned that this board will have "massive power, unchecked power, by design. We are setting up a board with massive power that is going to make decisions that affect all accountants and everybody they work for, which directly or indirectly is every breathing person in the country. They are going to have massive unchecked powers."

Yet Gramm later voted for final passage, along with 98 other Senators, on July 25, 2002.

The Chairman of the House Financial Affairs Committee Michael Oxley (a Republican from Ohio for 25 years) declared 12 days before Sarbanes-Oxley was signed into law, that the Board's governmental powers would be "extraordinary and maybe even beyond constitutional."

The powers of the board are breath-taking:

• Establishing professional audit standards (of accounting firms)

• Inspecting the engagements of these firms

• Investigating and bringing enforcement actions against those firms.

• Make law, including whatever rules "may be necessary or appropriate"

• Impose sanctions "as it determines appropriate"

• Lay its own taxes on publicly traded companies

• Appropriate such taxes as it sees fit by setting its own budget.

Even more remarkable, however, was the act's deliberate lack of accountability:

• The President cannot oversee the Board in any respect

• The Board is answerable only to another independent agency (The Securities and Exchange Commission)

• Board members can only be removed for (very narrowly-defined) “cause”,

• The act declares the Board to be a “private-sector, non-profit corporation”, and therefore off-limits from any Executive oversight.

• Salaries are set by the Board. (In 2008, PCAOB Chairman Mark Olson received $654,406, and the others on the board each received $531,995.)

Kavanaugh further notes the “world of difference between the legion of independent agencies and the PCAOB” with a structure “never [seen] before in American history”.

It aimed to give the Board “unchecked power, by design."

The Board therefore is the perfect and complete definition of tyranny: the combination of law-maker, law-enforcer, and law-interpreter, all “under one roof.”

The Cato Institute has filed a “friend of the court” (amicus curiae) brief with the Supreme Court, in which the key issue is set forth:

> The separation of powers lies at the heart of the governmental structure created by the Constitution. And in separating the powers of the federal government’s three branches, "the Founders consciously decided to vest Executive authority in one person, rather than several."

The Framers recognized [that] structural protections against abuse of power [are] critical to preserving liberty." And Presidential control over the use of executive power by federal agencies is indispensable to the good government that is liberty’s everyday safeguard.

In a brief filed by The Claremont Institute, their conclusion was equally clear:

> Our framers bequeathed to us a brilliant constitutional structure, designed to allow government to function within separation of power constraints that would at the same time prevent it from becoming tyrannical. The structure of PCAOB so clearly violates those most basic on constitutional constraints that it should be held to be unconstitutional.

Claremont went on to say:

> The fundamental problem with Sarbanes-Oxley and the PCAOB is a matter of first principles [emphasis added]. The government derives its power from the People: “Governments are instituted among Men, deriving their just powers from the consent of the governed.” (Declaration of Independence, paragraph 2, 1776).

The Constitution is based on a theory of original, and continuing, consent of the governed. In this Nation each sovereign governs only with the consent of the governed.

It is clear that Congress lost sight of this basic, fundamental truth in enacting Sarbanes-Oxley. Indeed, Congress went to great lengths to insure that the PCAOB was unaccountable to the people, granting it ‘massive powers’ that would be ‘unchecked’ by the political process.

By stripping the President of all power to remove the members of the PCAOB, Congress made them unaccountable to the Executive and thus unaccountable to the body politic. In creating this dangerous paring of power and lack of accountability, Congress all but assured that the PCAOB would run roughshod over public companies, small businesses, and shareholders without being held responsible for such conduct.

Further emphasis on this “first principle” was provided by the Amicus Curiae brief from the Mountain

States Legal Foundation:

> Because the legislative is the strongest and most ambitious of the branches of government, it requires more checks and balances, whereas the executive and the judicial branches require more protection. No blended power with the President should be implied, but, rather, it should be strictly construed. All efforts should be made not to allow the legislative branch to draw additional power to itself.
> How did this happen?

In early 2002, there was panic in the air. Enron had just imploded. The stock market had fallen off a cliff. And during consideration of this bill, WorldCom evaporated, devastating millions of investors.

As the Cato Institute summarized it in their brief:

> The panicked atmosphere on Wall Street caused a similar panic in the halls of Congress, with over-whelming pressure to do something — anything — to "restore investor confidence." The process in Congress is notable for the speed with which it occurred — and for the attendant lack of careful deliberation. In both houses, the legislation was considered within an unusually narrow time frame.

The House took only one day, for example, to consider the bill; and the Senate debate occurred under a cloture motion which restricted the time for legislative consideration and amendment.

And the predictable result?

Massive costs to the economy as businesses tried to navigate costly and ever-changing rules and regulations. According to a study by the Brookings Institute, these rules have cost nearly $1 trillion to implement. And yet, despite these huge costs, the new act did nothing to warn about the meltdown of mortgage-backed securities, or ponzi schemes like Bernie Madoff.

It's interesting to note that the case under review by the Supreme Court was brought initially by Brad Beckstead, the owner of a small Nevada accounting firm that had undergone a costly examination under PCAOB rules.

Photo of Sen. Paul Sarbanes and Rep. Mike Oxley: AP Images

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