

BYLAW AND RULE AMENDMENTS TO
PROVIDE THAT THE PCAOB'S
APPOINTMENT AND REMOVAL OF ITS
HEARING OFFICERS ARE SUBJECT TO
COMMISSION APPROVAL

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PCAOB Rulemaking
Docket Matter No. 045

Summary: The Public Company Accounting Oversight Board (“Board” or “PCAOB”) is adopting amendments to its bylaws and rules to provide that the PCAOB’s appointment and removal of its hearing officers are subject to Securities and Exchange Commission (“SEC” or “Commission”) approval, and to make related clarifying and conforming changes.

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I. Summary

The Board’s duties under the Sarbanes-Oxley Act (“Act”) include (a) acting on registration applications of public accounting firms that prepare audit reports for issuers, brokers, or dealers¹ and (b) conducting disciplinary proceedings concerning, and imposing appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms.² In carrying out these duties, the Board may direct that a PCAOB hearing officer preside over a disciplinary or other proceeding.³ The Board’s authority to do so derives from Section 101(f)(4) of the Act, permitting the

¹ The PCAOB has oversight authority with respect to audits of brokers and dealers that are registered with the SEC. See Sections 110(3) and (4) of the Act, 15 U.S.C. 7220(3) and (4).

² See, e.g., Sections 101(c)(1) & (4), 102(c), 105(a) & (c)(1)-(3) of the Act, 15 U.S.C. 7211(c)(1) & (4), 7212(c), 7215(a) & (c)(1)-(3).

³ See, e.g., Sections 101(f)(4) and 101(g)(2) of the Act, 15 U.S.C. 7211(f)(4) & (g)(2); PCAOB Rules 5200 (Commencement of Disciplinary Proceedings), 5500 (Commencement of Hearing on Disapproval of a Registration Application).

Board, subject to Commission oversight under Section 107 of the Act, “to appoint such employees, accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation.” Section 101(g)(2) of the Act further authorizes that “[t]he rules of the Board shall, subject to the approval of the Commission . . . permit, as the Board determines necessary and appropriate, delegation by the Board of any of its functions to an . . . employee of the Board, . . . including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter.” In 2004, the Commission approved the Board’s proposed rules relating to investigations and adjudications, authorizing creation of the PCAOB’s hearing officer position.⁴

On June 21, 2018, the U.S. Supreme Court held in *Lucia v. SEC* that SEC Administrative Law Judges (“ALJs”) are inferior officers under the Appointments Clause of the U.S. Constitution and that, accordingly, SEC ALJs are required to be appointed by “the President, a court of law, or a head of department,” such as the Commission.⁵ Since the *Lucia* decision, the Commission has taken various actions, including issuance of an order reiterating its November 30, 2017 approval of the prior appointments of its ALJs by its staff as the Commission’s own under the Constitution.⁶ In light of the *Lucia* litigation, other federal government agencies have taken similar measures as to their ALJs or like officials, also out of an abundance of caution and for avoidance of doubt.⁷

⁴ See *Order Approving Proposed Rules Relating to Investigations and Adjudications*, SEC Rel. No. 34-49704, 2004 WL 1439833 (May 14, 2004).

⁵ 138 S. Ct. 2044, 2050-51 (2018).

⁶ See *In re Pending Administrative Proceedings*, SEC Rel. No. 34-83907, 2018 WL 4003609, *1 (Aug. 22, 2018).

⁷ See, e.g., USITC, *The Appointment of the Commission’s Administrative Law Judges for Section 337 Investigations*, 83 Fed. Reg. 45,678-01 (Sept. 10, 2018); FMSHRC, *Ratification Notice* (Apr. 3, 2018), available at www.fmshrc.gov/about/news/commission-ratification-notice; FDIC, *Resolution of Board of Directors* (July 19, 2018), available at <https://www.fdic.gov/news/board/2018-07-19-085152.pdf>; CFTC, *Ratification and Reconsideration Order, In re Pending Administrative Proceedings*, 2018 WL 1966116 (Apr. 6, 2018); Letter from Sec’y R. Alexander Acosta, Dep’t of Labor, to Hon. Paul R. Almanza, Admin. Law Judge, Dep’t of Labor (Dec. 21, 2017), available at https://www.oalj.dol.gov/PUBLIC/FOIA/Frequently_Requested_Records/ALJ_Appointments/Secretarys_Ratification_of_ALJ_Appointments_12_21_2017.pdf; FTC, *P130500 Federal Trade Commission Minute: Ratification of Appointment of Administrative Law Judge and Chief Administrative Law Judge* (Sept. 11, 2015), attached as Ex. A to FTC, *Order Denying Respondent LabMD*,

The *Lucia* case did not involve a challenge to PCAOB hearing officers, only to SEC ALJs. Nor has any court, the Commission, or the Board adjudicated whether a PCAOB hearing officer is, like an SEC ALJ, an inferior officer under the Appointments Clause.⁸ Indeed, there are a number of differences between the position of an SEC ALJ and the position of a PCAOB hearing officer.⁹

Nevertheless, out of an abundance of caution, and to eliminate any uncertainty about the status of PCAOB hearing officers that might distract from the PCAOB's mission, including its important registration and disciplinary functions, the Board is adopting certain amendments to its bylaws and rules. These amendments modify the PCAOB's processes to appoint and remove its hearing officers to provide that such appointments and removals shall be subject to the approval of the Commission, a head of department under the Appointments Clause.

II. Description of the Amendments

The Board is adopting amendments to its bylaws and rules to provide that the PCAOB's appointment and removal of any PCAOB hearing officer are subject to Commission approval and to make related clarifying and conforming changes to the PCAOB's existing rules. Specifically, the Board is amending Article VI of its bylaws and PCAOB Rules 1001(h)(i), 5200, and 5402, as discussed below.

The amendments to Article VI of the bylaws and Rule 1001(h)(i), the language of which rule is changed to cross-reference the bylaw amendment, specify that the PCAOB's appointment and removal of any PCAOB hearing officer are subject to Commission approval. These changes are consistent with the Commission's broad authority to oversee the PCAOB under Section 107 of the Act¹⁰ and the Commission's

Inc.'s Motion to Dismiss, *In re LabMD Inc.*, No. 9357 (Sept. 14, 2015), available at <https://www.ftc.gov/system/files/documents/cases/150914labmdmotion.pdf>.

⁸ An attempt was made to challenge the constitutionality of a PCAOB hearing officer's appointment in *Kabani v. SEC*, but the court held that the argument had not been timely raised and was forfeited. 733 F. App'x 918, 2018 WL 3828524, *1 (9th Cir. Aug. 13, 2018).

⁹ For example, an SEC ALJ may administer oaths and affirmations; issue, revoke, quash, or modify subpoenas; issue protective orders; and punish contemptuous conduct; a PCAOB hearing officer does not have that authority. Compare 17 CFR 200.14(a)(1) & (2), 200.111(b), 180(a), 232(e), 322 with PCAOB Rules 5103, 5105, 5200(b)(1), 5424.

¹⁰ See Sections 101(c) & (f) and 107 of the Act, 15 U.S.C. 7211(c) & (f), 7217.

authority to “appoint . . . officers, attorneys, economists, examiners, and other employees” under Section 4(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78d(b).

As contemplated by these amendments, when the PCAOB’s Governing Board, as defined by the bylaws,¹¹ has reached a decision on the appointment or removal of any PCAOB hearing officer, that decision shall be submitted to the Commission for consideration. The proposed appointment or removal of a hearing officer by the PCAOB cannot be effectuated until Commission approval has been given. The Commission’s approval of a PCAOB hearing officer’s appointment will result in the hearing officer being appointed in the manner of an inferior officer for purposes of the Appointments Clause.¹²

The Board is also adopting certain clarifying and conforming amendments to its adjudications rules in light of the rule changes discussed above. Specifically, the Board is adding a new subsection to Rule 5200 to summarize the framework within which the hearing officer functions under the Act and the Board’s rules. That new subsection explains that all proceedings shall be presided over by the Board, which is the entity empowered to act on registration applications and to conduct disciplinary proceedings.¹³ Alternatively, the Board may order that the proceeding be conducted in the first instance by a hearing officer to whom the Board has, under certain conditions, delegated adjudicatory responsibilities.¹⁴ The new subsection makes even more explicit the

¹¹ See Articles IV and VI of the PCAOB’s bylaws (stating that “[t]he Governing Board shall consist of those persons appointed thereto by the Securities and Exchange Commission, pursuant to Section 101 of the Act” and that “[t]he Chairman of the Governing Board . . . shall also be the President and Chief Executive Officer of the Corporation”). In *Free Enterprise Fund v. PCAOB*, 561 U.S. 477, 510 (2010), the Supreme Court held that PCAOB Governing Board members are inferior officers under the Appointments Clause.

¹² See *Free Enterprise Fund*, 561 U.S. at 512 n.13 (noting examples of precedents in which “[w]e have previously found that the department head’s approval [of the appointment of personnel] satisfies the Appointments Clause”).

¹³ See, e.g., Sections 101(c)(1) & (4) of the Act, 15 U.S.C. 7211(c)(1) & (4) (“the Board shall . . . register public accounting firms . . . [and] conduct . . . disciplinary proceedings . . .”) (emphasis added).

¹⁴ See Section 101(g)(2) of the Act, 15 U.S.C. 7211(g)(2) (permitting, under specified conditions, “delegation by the Board of any of its functions to an . . . employee of the Board, . . . including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter”).

manner in which current PCAOB rules, such as Rules 5200(b)(10), 5201(d)(2), 5204(b), and 5445, situate the hearing officer within PCAOB adjudication processes.¹⁵

Additionally, the amendments make clarifying and conforming edits to the heading of current PCAOB Rule 5200(b) and to the heading and text of PCAOB Rule 5402(b). Specifically, the words “appointment” and “appoint” in these current rules are replaced with “assignment” and “assign,” and current Rule 5200(b) is renumbered Rule 5200(c) and cross-referenced to new Rule 5200(b). These changes avoid any confusion between the actions of the Board and the Commission in appointing, and approving the appointment of, a hearing officer, and the PCAOB Secretary’s ministerial act of assigning a specific hearing officer to a specific proceeding pursuant to a Board order.

The above-described, targeted amendments seek to dispel any legal uncertainty arising from *Lucia* about the PCAOB hearing officer, who, as noted, may be tasked with presiding over a disciplinary or other proceeding. This will facilitate and make more efficient the Board’s performance of its duties under the Act to take “[a]ction on [a]pplications” for the “regist[r]ation [of] public accounting firms that prepare audit reports for issuers, brokers, and dealers”; to “conduct . . . disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms”; and to “enforce compliance with th[e] Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof.”¹⁶ These functions are part of the Board’s responsibility “to oversee the audit of companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports.”¹⁷

Moreover, additional benefits will flow from the amendments because the Appointments Clause serves an important public purpose. The Supreme Court has described the Clause’s requirements as “among the significant structural safeguards of the constitutional scheme,” “designed to preserve political accountability relative to important government assignments.”¹⁸ The Board has chosen to remedy any

¹⁵ The provision is also analogous to SEC Rule of Practice 110, 17 CFR 201.110.

¹⁶ See, e.g., Sections 101(c)(1), (4) & (6), 102(c), 105(a) & (c)(1)-(3) of the Act, 15 U.S.C. 7211(c)(1), (4) & (6), 7212(c), 7215(a) & (c)(1)-(3).

¹⁷ See Section 101(a) of the Act, 15 U.S.C. 7211(a).

¹⁸ *Edmond v. United States*, 520 U.S. 651, 659, 663 (1997).

uncertainty caused by *Lucia* by conforming the appointment and removal of its hearing officers to those requirements. Thus, the Appointments Clause’s benefits and protections are explicitly extended to respondents in PCAOB proceedings, and to the public more broadly.

III. Administrative Considerations

The amendments that the Board is adopting today are concerned solely with the administration of the PCAOB.¹⁹ In particular, they relate to the PCAOB’s employment relationship with its hearing officers, the PCAOB’s interaction with the Commission in the Commission’s performance of oversight of the PCAOB, and the clarification of the delegations of authority by the Board to PCAOB hearing officers. Therefore, the Board believes that public notice and comment in advance of adopting these bylaw and rule amendments is not required.

IV. Text of the Amendments

For the reasons discussed above, the Board is amending Article VI of the bylaws and Rules 1001(h)(i), 5200, and 5402 as follows:

BYLAWS

* * * *

ARTICLE VI OFFICERS

* * * *

¹⁹ The statutory basis for the proposed amendments is Title I of the Act. Specifically, Section 101(f)(2) of the Act empowers the Board, subject to Commission oversight under Section 107 of the Act, “to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act.” Section 101(f)(4), as discussed, empowers the Board, subject to Commission oversight under Section 107 of the Act, to appoint personnel. Section 101(g)(1) directs the Board, “subject to the approval of the Commission . . . [to] provide for the operation and administration of the Board, the exercise of its authority, and the performance of its responsibilities under th[e] Act.” And Section 101(g)(2) permits the Board, “subject to the approval of the Commission,” to delegate its hearing functions within the PCAOB. Furthermore, the amendments directly relate to statutory duties of the Board and purposes for its establishment that are discussed above.

6.3. Powers of the Chief Executive Officer.

* * * *

- (d) Furthermore, notwithstanding any other provision of these bylaws, the appointment or removal of any hearing officer shall be made by the Governing Board and shall be subject to the approval of the Securities and Exchange Commission.

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RULES

SECTION 1. GENERAL PROVISIONS

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Rule 1001. Definitions of Terms Employed in Rules.

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(h)(i) Hearing Officer

The term “hearing officer” means a person, other than a Board member or staff of the interested division, appointed in accordance with Article 6.3 of the Board’s bylaws to preside at hearings.

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SECTION 5. INVESTIGATIONS AND ADJUDICATIONS

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Part 2 — Disciplinary Proceedings

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Rule 5200. Commencement of Disciplinary Proceedings

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(b) Presiding Official

All proceedings shall be presided over by the Board or, if the Board orders, by a hearing officer.

(c) Assignment of a Hearing Officer

Subject to Rule 5200(b), as soon as practicable after the Board has issued an order instituting proceedings, or after a registration applicant has requested a hearing pursuant to Rule 5500(b), the Secretary shall assign a hearing officer to preside over the proceeding and shall serve the parties with notice of the hearing officer's assignment. Subject to Rules 5402 and 5403, the hearing officer shall have the authority to do all things necessary and appropriate to discharge his or her duties. The powers of the hearing officer include, but are not limited to, the following—

* * * *

(d) Separation of Functions

The staff of the Division of Enforcement and Investigations may not participate or advise in the decision, or in Board review of the decision, in any proceeding in which the Division of Enforcement and Investigations is the interested division, except as a witness or counsel in the proceeding. Any other employee or agent of the Board engaged in the performance of investigative or prosecutorial functions for the Board in a proceeding may not, in that proceeding or one that is factually related, participate or advise in the decision, or in Board review of the decision, except as a witness or counsel in the proceeding. A hearing officer may not be responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions for the Board.

(e) Consolidation of Proceedings

By order of the Board or a hearing officer, proceedings involving a common question of law or fact may be consolidated for hearing of any or all the matters at issue in such proceedings. The Board or the hearing officer may make such orders concerning the conduct of such proceedings as it deems appropriate to avoid unnecessary cost or delay. Consolidation shall not prejudice any rights under these Rules and shall not affect the right of any party to raise issues that could have been raised if consolidation had not occurred. For purposes of this Rule, no distinction is made between joinder and consolidation of proceedings.

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Rule 5402. Hearing Officer Disqualification and Withdrawal

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(b) Assignment of a Replacement Hearing Officer

Upon withdrawal of a hearing officer, or in the event that a hearing officer is incapacitated or is otherwise unable to continue to serve after being assigned, the Secretary will assign a replacement hearing officer. To ensure fairness to the parties and expedite completion of the proceeding when a replacement hearing officer is assigned after a hearing has commenced, the replacement hearing officer may recall any witness or may certify familiarity with any part or all of the record.

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On the 29th day of January, in the year 2019, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

January 29, 2019