



## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 202

[Release No. 34-85437]

#### Public Company Accounting Oversight Board Hearing Officers

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission (“Commission”) is revising its regulations with respect to the method by which hearing officers of the Public Company Accounting Oversight Board (“Board” or “PCAOB”) are appointed and removed from office. Specifically, the Commission is adopting a rule expressly requiring that the appointment or removal of a PCAOB hearing officer be subject to Commission approval.

**DATES:** *Effective Date:* [insert date of publication in the Federal Register].

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#### SUPPLEMENTARY INFORMATION:

##### I. Background

The Sarbanes-Oxley Act of 2002, as amended (the “Sarbanes-Oxley Act” or the “Act”),<sup>1</sup> established the PCAOB to oversee the audits 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

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<sup>1</sup> 15 U.S.C. 7201 *et seq.*

the preparation of informative, accurate, and independent audit reports.<sup>2</sup> The Act vests the Commission with comprehensive oversight and enforcement authority over the PCAOB. It grants the Commission authority to, among other things, appoint and remove the members of the PCAOB, approve PCAOB rules and professional standards, and oversee the PCAOB's exercise of certain assigned powers and duties.<sup>3</sup>

Section 105 of the Sarbanes-Oxley Act authorizes the Board to investigate and, if necessary, initiate disciplinary action against registered public accounting firms and their associated persons.<sup>4</sup> Upon initiating such an action, the Board may hold a hearing to determine whether a registered public accounting firm or associated person committed, and should be disciplined for, any violation of the Sarbanes-Oxley Act, the securities laws, the Commission's rules, the Board's rules, or professional standards.<sup>5</sup>

The Sarbanes-Oxley Act directs the Board to promulgate rules governing its investigations and adjudications.<sup>6</sup> The Board has done so. As relevant here, those rules provide that once the Board has issued an order instituting proceedings, or after a registration applicant has requested a hearing, a hearing officer will be assigned to preside over the proceeding.<sup>7</sup> The hearing officer is granted "the authority to do all things necessary and appropriate to discharge his or her duties," including: issuing accounting board demands; receiving and ruling on the admissibility of evidence; generally "regulating the course of a proceeding and the conduct of the

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<sup>2</sup> 15 U.S.C. 7211(a).

<sup>3</sup> 15 U.S.C. 7211-7219.

<sup>4</sup> 15 U.S.C. 7215.

<sup>5</sup> *Id.* The Board is authorized to delegate the hearing function to an employee, pursuant to Section 101(f)(4) and (g)(2), 15 U.S.C. 7211(f)(4) & (g)(2).

<sup>6</sup> 15 U.S.C. 7215.

<sup>7</sup> PCAOB Bylaws and Rules, Section 5-Investigations and Adjudications, available at [https://pcaobus.org/Rules/Documents/Section\\_5.pdf](https://pcaobus.org/Rules/Documents/Section_5.pdf) (effective pursuant to SEC Release No. 34-49704, File No. PCAOB-2003-07, 2004 WL 1439833 (May 14, 2004)).

parties and their counsel”; holding pre-hearing and other conferences; ruling on motions; and preparing an initial decision.<sup>8</sup> The role of the PCAOB hearing officer thus closely resembles that of the Commission’s administrative law judges (“ALJs”).

On June 21, 2018, the United States Supreme Court in *Lucia v. SEC* considered a challenge to the method by which the Commission’s ALJs were appointed, holding that because the ALJs exercise “significant authority pursuant to the laws of the United States,” they are “Officers of the United States” who must be appointed in the manner prescribed by the Constitution’s Appointments Clause—by the President, a court of law, or head of a department, such as the Commission.<sup>9</sup> In so holding, the Court followed its earlier decision in *Freytag v. Commissioner*, in which it determined that, given the powers they exercise, special trial judges of the United States Tax Court are also constitutional officers.<sup>10</sup>

While PCAOB hearing officers are similarly vested with “the authority needed to ensure fair and orderly adversarial hearings,”<sup>11</sup> there are notable differences between the powers they exercise and those exercised by Commission ALJs and Tax Court special trial judges. Unlike the other adjudicators, for example, PCAOB hearing officers are not authorized to administer oaths or punish contemptuous conduct.<sup>12</sup> Moreover, to date, no court has held that PCAOB hearing

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<sup>8</sup> PCAOB Rule 5200(b); *see also* Guide to Proceedings Before a PCAOB Hearing Office, available at <https://pcaobus.org/Enforcement/Adjudicated/Pages/guide-to-proceedings-before-PCAOB-hearing-officer.aspx> (“A hearing on the merits before a PCAOB Hearing Officer is, in many respects, similar to a trial before a judge in state or federal court.”).

<sup>9</sup> 138 S. Ct. 2044, 2050-51 (2018); Art. II, § 2, cl.2.

<sup>10</sup> *Lucia*, 138 S. Ct. at 2053-54 (citing *Freytag v. Comm’r*, 501 U.S. 868 (1991)).

<sup>11</sup> *Lucia*, 138 S. Ct. at 2053.

<sup>12</sup> *Compare, e.g.*, PCAOB Rules 5103, 5105, 5200(b)(1), 5424 (PCAOB hearing officers) with 17 CFR 200.14(a)(1) & (2), 200.111(b), 180(a), 232(e), 322 (Commission ALJs) and *Freytag v. Comm’r*, 501 U.S. at 881-82 (Tax Court special trial judges).

officers must be appointed as inferior officers under the Appointments Clause.<sup>13</sup> Nevertheless, to remove any doubt about the constitutional status of PCAOB hearing officers, the Commission hereby amends 17 CFR part 202, subpart A (Regulation P) to require that the Commission, acting as head of a department, must approve both the appointment and the removal from office of any PCAOB hearing officer before any such action may take effect.<sup>14</sup>

We believe this requirement is consistent with both the Constitution and the oversight and appointment authority Congress has granted the Commission. The Commission has the constitutional authority to both appoint and remove from office the inferior officers under its supervision.<sup>15</sup> Congress has also authorized the Commission to appoint inferior officers “necessary for carrying out its functions under the securities laws,” including those specified in the Sarbanes-Oxley Act.<sup>16</sup> Further, pursuant to the Sarbanes-Oxley Act, Congress has granted the Commission comprehensive oversight and enforcement authority over the PCAOB, and it has specified that the Board’s appointment of employees and its delegation of functions to such employees are subject to the Commission’s oversight.<sup>17</sup>

This power to appoint—or approve the appointment of—inferior officers carries with it the power to remove those individuals from office. As the Supreme Court has explained, “the power of removal from office is incident to the power of appointment,” and thus statutes vesting

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<sup>13</sup> While the Board is not a governmental entity for statutory purposes, it is “part of the Government’ for constitutional purposes.” *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477, 485-86 (2010).

<sup>14</sup> On December 20, 2018, the Board adopted amendments to its bylaws and rules (collectively, the “proposed amendments”) to provide that the PCAOB’s appointment and removal of hearing officers are subject to Commission approval. The PCOAB filed the proposed amendments with the Commission on January 29, 2019, and on February 11, 2019, the Commission published notice of this filing. See <https://www.sec.gov/rules/pcaob/2019/34-85090.pdf>.

<sup>15</sup> See *Lucia*, 138 S. Ct. 2044, 2051 & n.3; *Edmond v. United States*, 520 U.S. 651, 663 (1997); see also *Free Enter. Fund*, 561 U.S. at 513-14.

<sup>16</sup> 5 U.S.C. 4802(b) (citing 15 U.S.C. 78c(a)(47)); 15 U.S.C. 78d(b).

<sup>17</sup> 15 U.S.C. 7217(a); 15 U.S.C. 7211(f), (g).

heads of department with appointment authority are presumed to carry with them removal authority, absent language to the contrary.<sup>18</sup> Here, the relevant statutes provide no such restrictions.<sup>19</sup> Accordingly, the Commission may require that it approve both the appointment and the removal from office of any PCAOB hearing officer before any such action may take effect.

## II. Administrative Law Matters

The Commission finds, in accordance with the Administrative Procedure Act (“APA”),<sup>20</sup> that these revisions relate solely to agency organization, procedures, or practice and do not constitute a substantive rule. Accordingly, the APA’s provisions regarding notice of rulemaking, opportunity for public comment, and advance publication of the amendments prior to their effective date are not applicable. These changes are therefore effective on [insert date of publication in the Federal Register]. For the same reason, and because these amendments do not affect the rights or obligations of non-agency parties, the provisions of the Small Business Regulatory Enforcement Fairness Act<sup>21</sup> are not applicable. Additionally, the provisions of the Regulatory Flexibility Act,<sup>22</sup> which apply only when notice and comment are required by the APA or other law, are not applicable. These amendments do not contain any collection of information requirements as defined by the Paperwork Reduction Act of 1995.<sup>23</sup> Further, because the amendments impose no new burdens on private parties, the Commission does not

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<sup>18</sup> See *Keim v. United States*, 177 U.S. 290, 293–94 (1900); *Ex parte Hennen*, 38 U.S. (13 Pet.) 230, 259-60 (1839); *Power of the Secretary of the Treasury to Remove Inspectors of Hulls and Bollers*, 10 Op. Att’y Gen. 204, 207–09 (1862); *Tenure of Office of Inspectors of Customs*, 1 Op. Att’y Gen. 459, 459 (1821).

<sup>19</sup> See 5 U.S.C. 4802(b); 15 U.S.C. 78d(b); 15 U.S.C. 7217(a); 15 U.S.C. 7211(f), (g); see also *Free Enter. Fund*, 561 U.S. at 510 (Commission may remove members of the Board “at will”).

<sup>20</sup> 5 U.S.C. 553(b)(3)(A).

<sup>21</sup> 5 U.S.C. 804(3)(C).

<sup>22</sup> 5 U.S.C. 601 *et seq.*

<sup>23</sup> See 44 U.S.C. 3518(c)(1)(B)(ii); 5 CFR 1320.4.

believe that the amendments will have any impact on competition for purposes of Section 23(a)(2) of the Exchange Act.

### **III. Statutory Authority**

This rule is adopted pursuant to statutory authority granted to the Commission, including 5 U.S.C. 4802(b), Sections 4(b) and 23(a) of the Exchange Act, 15 U.S.C. 78d(b), and Sections 101 and 107 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7211, 7217.

### **List of Subjects in 17 CFR Part 202**

Administrative practice and procedure, Securities.

### **Text of Rule**

For the reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is amended as follows:

### **PART 202 – INFORMAL AND OTHER PROCEDURES**

1. The authority citation for part 202 continues to read in part as follows:

Authority: 15 U.S.C. 77s, 77t, 77sss, 77uuu, 78d-1, 78u, 78w, 78ll(d), 80a-37, 80a-41, 80b-9, 80b-11, 7201 *et seq.*, unless otherwise noted.

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### **Subpart A – Public Company Accounting Oversight Board (Regulation P)**

2. Section 202.150 is added to read as follows:

**§202.150 Commission approval of appointment or removal from office of Public Company Accounting Oversight Board hearing officers.**

The Commission shall approve both the appointment and removal from office of any hearing officer employed by the Public Company Accounting Oversight Board. No action by the Board proposing to appoint or remove from office a hearing officer shall be final absent

Commission approval.

By the Commission.

Dated: March 28, 2019.

Eduardo A. Aleman,  
Deputy Secretary.

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