

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FREE ENTERPRISE FUND, ET AL.,	:	Civil Action No. 06-0217
	:	
Plaintiff	:	June 29, 2006
	:	
v.	:	
	:	
PUBLIC COMPANY ACCOUNTING	:	3:00 p.m.
OVERSIGHT BOARD, ET AL.,	:	
	:	
Defendants	:	
.....	:

TRANSCRIPT OF MOTION HEARING
BEFORE THE HONORABLE JAMES ROBERTSON
UNITED STATES DISTRICT JUDGE

APPEARANCES:

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P R O C E E D I N G S

COURTROOM DEPUTY: This is Civil Action Number 06-217, Free Enterprise Fund, et al. versus Public Company Accounting Oversight Board, et al. Will counsel please identify themselves for the record?

THE COURT: The ones who are going to be speaking.

MR. LAMKEN: Jeff Lamken for the defendants, the Public Company Accounting Oversight Board, and the individual defendants.

MR. CARVIN: Michael Carvin for the plaintiffs.

MR. KATERBERG: Robert Katerberg for the United States.

THE COURT: You call this Free Enterprise Fund versus Public Company Accounting Oversight Board, but from where I sit it looks like Jones Day versus Baker Botts, which is possibly even a more interesting lineup.

Well, all of you in the courtroom are more schooled in these issues than I am, and I'm just going to sit back and listen to the argument. Who's going to present the motion to dismiss?

MR. LAMKEN: I will, Your Honor.

THE COURT: All right, sir. Start with your strongest argument, which would be what, standing?

MR. LAMKEN: I was going to start with the exclusive review mechanism and exhaustion of administrative remedies, sir.

THE COURT: Fine. Go ahead.

1 MR. LAMKEN: May it please the court, there appears to
 2 be no dispute that Sarbanes-Oxley establishes an exclusive
 3 statutory review mechanism, and there appears to be no dispute
 4 that plaintiffs could avail themselves of that mechanism to
 5 raise their constitutional claims and obtain review in the Court
 6 of Appeals; for example, seeking pre-enforcement review by
 7 challenging a board rule-making before the SEC, and challenging
 8 the SEC's resulting decision in the Court of Appeals, or
 9 post-enforcement following imposition of any sort of sanction.

10 The question here, or the principal question here, is
 11 whether, confronted with an ongoing formal investigation,
 12 plaintiffs may bypass that remedy by bringing what they deem a
 13 facial constitutional challenge to the board's authority. In
 14 our view the answer is no, for three related reasons.

15 The first is that each of the principles that animate
 16 the exclusive review mechanism and the necessity of the
 17 administrative exhaustion apply with force here notwithstanding
 18 the facial label. The first of those reasons is the need for
 19 the agency's expert interpretation of the statute and practical
 20 experience. In this case, plaintiff's claim of an excess
 21 delegation of authority to the board, its claim that the board
 22 exercises unchecked authority that violates separation of
 23 powers, and its claim that there's a violation of the
 24 appointments clause because the board's members are principal
 25 officers as opposed to inferior officers or mere employees who

1 must be appointed by the president, all turn on the claim that
2 the SEC --

3 THE COURT: Are you keeping up with this, Rebecca?
4 He's talking pretty fast.

5 THE REPORTER: I am so far, but it is fast.

6 MR. LAMKEN: I should slow down. My apologies.

7 THE COURT: Maybe it's just me that's not keeping up
8 with it.

9 MR. LAMKEN: Well, then, I ought to slow down for
10 certain.

11 Each of these claims turns critically on the
12 plaintiff's assertion that the SEC exercises insufficient
13 authority and control over the board's activities. One need
14 look no further than Section 6 of the complaint to see those
15 allegations. Repeatedly the SEC's supervision and oversight is
16 characterized as nominal, minimal, or limited. Those, in our
17 view, are dubious interpretations of the statute, but in any
18 event, are most directly and inappropriately directed to the
19 Securities and Exchange Commission first, because the Congress
20 has given the SEC authority to apply and interpret those review
21 and supervision and oversight provisions in the first instance.
22 It would be premature to decide that they're constitutionally
23 insufficient to give the SEC sufficient control over the board
24 before the SEC has actually told us what they mean.

25 Second, even apart from the purely legal construction

1 of those mechanisms, the SEC has substantial experience with
2 similar provisions through which it exercises supervision and
3 control over self-regulatory organizations like the New York
4 Stock Exchange, like the National Association of Security
5 Dealers, which, like the board, can discipline their members and
6 create rules of conduct.

7 Through decades of experience with those similar review
8 provisions, the SEC has a unique practical insight to the sort
9 of relationship they establish, the degree of control, the
10 degree of independence that results. Absent channeling this
11 through the Securities and Exchange Commission, the Court would
12 not have a sufficient background to illuminate precisely how
13 these statutes operate in order to inform its view.

14 For example, in *Ticor*, Judge Edwards in his opinion
15 pointed out that even though it was a constitutional challenge
16 based on separation of powers grounds, the agency's application
17 could illustrate and illuminate the nature of the agency process
18 that was being challenged as unconstitutional. Similarly, in
19 *Morrison vs. Olson*, the Supreme Court, after describing the
20 statute in the abstract, said, a-ha, its actual application in
21 these instances illustrates how the statute works in practice.

22 The same is true here. Channeling through the SEC
23 would give that agency the opportunity to explain the nature of
24 the relationship and the degree of control the SEC exercises
25 over the board in practice based on its experience.

1 Third, in the context of an actual challenge, and
 2 confronted with a constitutional challenge to the SEC's
 3 oversight and control over the board, the claim that it is
 4 insufficient, the SEC would have the opportunity to articulate
 5 with greater precision than it has in the past precisely the
 6 nature of that control, and potentially to reconsider its views
 7 in order to ensure and avoid any constitutional challenges.

8 Which brings me to the second reason, which is the
 9 avoidance of constitutional issues. Congress in this case has
 10 given the SEC an unusual degree of authority over the board. In
 11 section 107(D)(1), for example, based on the public interest
 12 alone, the SEC can withdraw the board's enforcement authority
 13 entirely. The SEC also has authority to revisit the board's
 14 rules by its own rule-making, and it can approve or disapprove
 15 the board's rule-making processes.

16 To the extent plaintiffs suffer an injury at all, it is
 17 through the application of the board's rules and the board's
 18 sanctions that the SEC has authority to review. They should not
 19 be able to challenge those -- raise those injuries as injury in
 20 fact for a suit in this court before asking the SEC to exercise
 21 its authority to prevent those injuries, to exercise its
 22 authority under, for example, Section 107(D)(1).

23 And finally, there is the interference with the
 24 administrative processes. One of the principles that exists
 25 throughout the common law and through doctrines like

1 Younger Abstention is that individuals should not be able to
2 bring suits to prevent prosecutions or prevent investigations
3 because it interferes with the administrative process.

4 The exhaustion doctrine and the exclusive review
5 mechanisms reflect that principle here, and it's reflected in
6 cases of the DC Circuit which say that once you're subject to an
7 ongoing investigation or imminent enforcement proceeding, you
8 may not bypass the procedures that Congress has provided for you
9 to raise your challenge and instead bring an anticipatory
10 challenge in District Court. Instead you must await the
11 sanction, if one is imposed, and then challenge it afterwards,
12 or you may bring a rule-making challenge through the alternative
13 mechanism that Congress has established.

14 But in this case neither FEF nor Beckstead & Watts has
15 ever challenged any of the board's rules before the commission,
16 nor have they challenged any of the commission's approval of the
17 rules before the DC Circuit, which they would have the
18 opportunity to do if they chose to.

19 THE COURT: Well, back up a minute. Younger Abstention
20 is grounded in state/federal issues, deference to state court
21 systems and so forth.

22 MR. LAMKEN: That's true.

23 THE COURT: What kind of deference do I owe or does a
24 federal court owe to this kind of a body?

25 MR. LAMKEN: Well, to the Securities & Exchange

1 Commission, Congress has allocated to the agency in the first
 2 instance authority per the statute, but Younger Abstention
 3 actually applies in the federal context as well. There's a case
 4 called *Deaver vs. Seymour* from the DC Circuit that applies the
 5 Younger Abstention to preclude as a matter of fact separation of
 6 powers challenge against the independent prosecutor where
 7 there's an effort to keep the independent prosecutor from
 8 seeking or obtaining an indictment.

9 Similarly, the Alcee Hastings case, there's a
 10 separation of powers challenge to the judicial conference, or --
 11 yeah, the judicial conference, I believe, to prevent the
 12 investigation of Judge Alcee Hastings. And the DC Circuit again
 13 said, no, we're going to defer and wait for that investigation
 14 to be completed, because it will illustrate how this process
 15 works, it will provide greater guidance in terms of our
 16 determination of the constitutional issues, and plus the issue
 17 could potentially go away, avoiding the necessity of
 18 constitutional adjudication.

19 The second reason we believe that this case must be
 20 dismissed for failure to exhaust administrative remedies and
 21 failure to use the exclusive judicial review mechanism is that
 22 we do not believe that there is a freestanding facial challenge
 23 exception to exhaustion of administrative remedies. The cases
 24 on which plaintiffs rely break down into roughly two categories;
 25 first, cases where there is an express preclusion provision that

1 doesn't cover the particular case at issue. McNary was an
2 example of that, where it simply identified particular
3 individual challenges, that these challenges must be brought
4 through the mechanism established by statute, but didn't mention
5 the more expansive challenge that was before the Supreme Court
6 in that case.

7 The other category of cases is where you can't obtain
8 judicial review through the statutory review mechanism, and
9 therefore the mechanism is inadequate. We all presume that
10 Congress intends judicial review to be available; we therefore
11 presume that when judicial review would not be adequate or
12 available under this exclusive statutory review mechanism, that
13 Congress didn't intend for that to apply to the particular
14 claims, and they will allow plaintiffs in that circumstance to
15 bypass a brand new mechanism and bring the challenge by other
16 means.

17 And McNary, again, is an example of that, because the
18 Court was concerned that the actual mechanisms neither will
19 provide a sufficient record for the Court of Appeals to provide
20 review, nor would there be a meaningful opportunity to get the
21 claim in to the Courts of Appeals, because in order for the
22 alien to challenge the denial of his adjustment of status, he
23 would have to be caught and on the edge of being deported.

24 Third, consistent with the general principle that
25 there's no right to bring abstract constitutional challenges,

1 our view is it's consistent with the general rule that one does
2 not have a right to bring constitutional challenges to statutes
3 in the abstract. Any injury plaintiffs suffer in this case
4 arises from board's rules, which they must follow, or the
5 application of a sanction, but each of those actions is subject
6 to review at the SEC and then subject to judicial review in the
7 DC Circuit. Because this injury in fact arises out of an
8 application of the board's rules, it is reviewed by the SEC and
9 then the Court of Appeals, and indeed it arises from ones that
10 are stayed pending SEC review, we believe that those challenges
11 should be brought through the mechanism that Congress has
12 established.

13 If the Court has no questions, I'll reserve any
14 remaining time for rebuttal. Thank you, Your Honor.

15 THE COURT: You don't want to talk to me about
16 standing?

17 MR. LAMKEN: I would be happy to address standing if
18 you would like.

19 THE COURT: That's where I started.

20 MR. LAMKEN: Okay. My apologies for not getting to
21 where you started.

22 THE COURT: It's the great puzzle for district judges.
23 You never know how the Court of Appeals is going to come out, so
24 you have to teach me something about standing.

25 MR. LAMKEN: It is not exactly the most clear area of

1 law.

2 There are two challenges to standing that we have here.
3 The first is the challenge to FEF's standing to bring this
4 claim, because it does not articulate who its members are, which
5 regulations injure them, or the nature of their injuries. The
6 First Circuit case we cited in our brief indicates that those
7 are necessary elements to establish standing.

8 The contrary DC Circuit cases cited by plaintiffs
9 actually are situations where the DC Circuit was able to say
10 with absolute certainty that notwithstanding the failure to
11 identify the members who could bring -- who had standing and
12 that would have standing in their own right, notwithstanding the
13 failure to identify the injuries, the Court could say with
14 certainty that there was a member of the organization that was
15 capable of bringing this suit.

16 There are actually two particular challenges to
17 standing. The first is the challenge to both plaintiffs'
18 standing to challenge limitations on the SEC's authority to
19 select who will be members of the board. The statute provides
20 that the SEC, when it selects members of the board, can have two
21 and only two members of the accounting profession. That
22 challenge, if it can be brought, must be brought by the SEC
23 itself, since it's the SEC's authority and the SEC's discretion
24 that is being limited. The plaintiffs' claims suffer the usual
25 problem that third party standing claims suffer, which is that

1 they can't show that the other party, the SEC in this case,
2 would have acted differently absent the restriction on its
3 authority.

4 It is particularly problematic here in the context of
5 the plaintiffs' claim that the statute, to be constitutional,
6 had to put all of the authority in the hands of the SEC
7 chairman, as opposed to the SEC, because the SEC chairman in
8 this case voted in favor of each of the members of the board.
9 And therefore it seems to apparent to us, at least, that the
10 decision would not have been affected if the authority at a
11 certain point had been selected -- had been conducted
12 differently or established differently in the statute.

13 THE COURT: Does Beckstead & Watts have any better
14 claim of standing than the Free Enterprise Fund?

15 MR. LAMKEN: Beckstead & Watts doesn't have the
16 difficulty that Free Enterprise Fund does, in that it's not an
17 organization. For an organization to establish standing, it
18 must show that it has a member that would have standing to
19 challenge if it chose to do so, that the organization's purpose
20 is germane to the challenge that's brought, and finally, that
21 there's no indispensable plaintiff if the suit is brought on its
22 own behalf.

23 Where Beckstead & Watts -- excuse me. Where FEF's
24 claim as an organization falters here is on the first step. You
25 can't tell that it has a member that has standing to bring the

1 suit because it doesn't tell you who its members are or how they
2 are injured. Because Beckstead & Watts isn't an organizational
3 plaintiff, it doesn't have that difficulty. Thank you.

4 THE COURT: Thank you, sir. Does the government want
5 to be heard?

6 MR. KATERBERG: Thank you, Your Honor. Robert
7 Katerberg on behalf of the United States. We filed a statement
8 of interest in support of the board's motion to dismiss because
9 the issues that are raised implicate several key jurisprudential
10 principles that are of paramount importance to the
11 United States.

12 First among those is that Congress is entitled to
13 specify how and when legal challenges to regulatory authorities
14 and their actions may occur. The type of scheme that's at issue
15 here is certainly not unique to the SEC, to the board, or even
16 to the securities context. The United States Code, we would
17 submit, is replete with review systems like the one that's at
18 issue here, and indeed they are necessary to enable our
19 government to work effectively.

20 Second, Your Honor, there are key benefits that flow
21 from deferring judicial review until after the administrative
22 process is complete, and from centralizing judicial review in
23 particular courts that Congress selected. And counsel for the
24 board alluded to some of those a moment ago, but just to name a
25 few, they include having a crystallized record so that there

1 isn't just an abstract philosophical issue presented for the
2 Court's consideration; likewise, avoiding piecemeal litigation,
3 and, importantly, preventing litigation from being used as a
4 preemptive weapon to impede an ongoing investigation; third,
5 Your Honor, is the principle that important constitutional
6 questions like I think both sides would agree are presented here
7 should certainly not be decided unless and until necessary, and
8 not decided in the abstract.

9 Now, holding the plaintiffs in this case to the
10 exclusive statutory review mechanism in the Sarbanes-Oxley Act
11 and the securities laws serves each of these principles. First,
12 there can be no dispute that Congress made its choice apparent
13 here, because it simply adopted the framework that has been in
14 place for as long as we have had securities laws in this nation
15 and has been the vehicle for numerous challenges, including
16 facial constitutional challenges to the NASD, the National
17 Association of Securities Dealers, and to the SEC itself.
18 That's got to count for something.

19 Because Congress wasn't just making this up out of thin
20 air. They simply adopted the system that had long been in
21 place, and it can't be assumed that in the Sarbanes-Oxley Act
22 Congress intended to give public company accountants a
23 privileged status, greater judicial review rights than those
24 that are accorded to other types of industry participants, other
25 actors who are regulated under the securities laws by NASD or

