

Ruling in Sarbanes-Oxley upholds constitutional validity of act, attorneys say

By JACKIE NASH (Daily Reporter Staff Writer)

July 08, 2010

Despite making national headlines, the U.S. Supreme Court's recent ruling on the Sarbanes-Oxley Act, in *Free Enterprise Fund v. the PCAOB*, might be getting some attorneys and companies riled up for no good reason.

The Sarbanes-Oxley Act was enacted by Congress in 2002 to address bad accounting practices made apparent by several companies during the last decade, including Enron, WorldCom and Tyco International, which were all involved in some type of accounting fraud.

Among its many provisions, Sarbanes-Oxley created a five-member Public Company Accounting Oversight Board to oversee the auditors and accountants of public companies.

In June, the Supreme Court ruled that the PCAOB was unconstitutional due to the way its members were appointed. The 5-4 decision did not question the act's constitutionality as a whole, and found that it should remain a fully operative law.

Paul Hess, a corporate securities attorney and director at Kegler Brown Hill & Ritter, said many companies were hoping the high court would find the entire act unconstitutional, since the constitutionality of one part of the law was being scrutinized by the court.

"Many headlines and news reports about this case suggested or implied that the validity of the Sarbanes-Oxley Act, in its entirety, was at stake, because the provisions in the act were not severable; so if any provision in the act were to be ruled unconstitutional, the entire act would thereby be deemed to be unconstitutional," he explained.

He added that although only public companies are regulated by Sarbanes-Oxley, some private companies feel obligated to follow at least a portion of the act's provisions, so many companies were hopeful the act would be thrown out.

However, the high-court ruling "will not have any meaningful impact on companies, public or private, and will not affect the general validity of the Sarbanes-Oxley Act," Hess said.

"Despite receiving significant criticism over the years, in large part due to the high costs many public companies have incurred in order to comply with its provisions, the Sarbanes-Oxley Act remains intact without significant legislative change or successful judicial challenge ... Sarbanes is here to stay."

Hess added that although the ruling was very technical, it will prevent bad board appointments from remaining on the board if the federal government decides the board would work more efficiently without those individuals.

He explained that members of the PCAOB are appointed by the Securities and Exchange Commission for a term, and before the ruling, could only be removed by the SEC when there was cause. This cause stipulation was viewed by the high court as a violation of the Constitution's separation of powers clause, he added.

Now, "if someone on the (PCAOB) is anti-business, and they want to replace him with someone who is more pro-business, they will be able to. ... It gives a means to the political process to get more involved," Hess said.

"The Supreme Court, while striking down a provision that prevented the SEC from removing members of the PCAOB at will, not only upheld the establishment and constitutionality of the PCAOB, but confirmed that the Sarbanes-Oxley Act remains 'fully operative as a law' with these tenure restrictions excised."

Hess said the biggest lesson to be learned from the recent frenzy surrounding the ruling is that if Sarbanes-Oxley is looked at again, its constitutionality will be evaluated section by section, not as a whole.

"(This ruling) will make it very difficult in the future for anyone to question the constitutional validity of the Sarbanes-Oxley Act," he said.

Todd Kegler, chair of Kegler Brown's Mergers & Acquisitions Department, agreed that the costs and burdens of Sarbanes-Oxley are here to stay.

"Most of the public companies we work with would not mind seeing a little less government regulation and administrative expense, but this ruling will not accomplish that," Kegler said. "It just reinforces the legality and constitutionality of the Sarbanes-Oxley Act."

Barry Melancon, president of the American Institute of CPAs, said the ruling is a win for investors and accounting professionals, some of whom were fearful that the ruling would do away with the act entirely.

"The decision effectively fixes the constitutionality of the PCAOB by making board members subject to 'at will' removal by the SEC, and therefore, the president," Melancon said.

"It sustains the continued function of both the PCAOB and Sarbanes-Oxley. As such, the court rejected a transparent attempt to undermine the post-Enron reforms that have served our financial markets well."