

AMERICAN BAR ASSOCIATION  
Section of Business Law  
750 North Lake Shore Drive  
Chicago, Illinois 60611

April 26, 2004

Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Re: File No. PCAOB-2003-07

Members of the Commission:

On behalf of the Committees on Law & Accounting and Federal Regulation of Securities of the Section of Business Law of the American Bar Association (the "Committees"), we are writing to express our views with respect the proposed rules of the Public Company Accounting Oversight Board (the "Board" or "PCAOB") relating to the conduct of Board investigations and hearings. This letter was drafted by a task force composed of members of the Committees whose names are set forth below, and the Committee Chairs and task force members are available to discuss the matters discussed herein with the Commission and its Staff. The comments expressed in this letter represent the views of the Committees only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, they do not represent the official position of the ABA Section of Business Law, nor do they necessarily reflect the views of all members of the Committees.

General Observations

By letter dated August 21, 2003, the Committees provided detailed comments to the Board on its proposed rules governing investigations and enforcement hearings. In that letter, we began by commending the Board and its Staff for developing, within the rapid timeframe mandated by Congress in the Sarbanes-Oxley Act of 2002 (the "Act"), a comprehensive and generally well-balanced set of rules for the conduct of investigations and hearings. In particular, we noted that the proposed rules generally reflected a careful balancing of the need to protect the public and the rights of practicing accountants whose lives and livelihoods will be affected greatly by the Board's actions arising out of its investigations and disciplinary hearings.

In this letter, we have not repeated our prior comments, many of which were addressed by the PCAOB in its September 29, 2003 Adopting Release. Instead, our comments are limited to the one issue as to which the Commission specifically requested comment in publishing the PCAOB's proposed rules. This issue arises under proposed Rule 5424(b) and relates to the circumstances under which, at the PCAOB's behest, the Commission might issue a subpoena to require any person "to provide any testimony or produce any documents that the Board considers relevant or material to a Board proceeding."

### Specific Comments

In our view, the issuance of a "trial subpoena" to a non-party by the SEC in connection with a Board proceeding could be necessary in some situations to ensure that a respondent's right to a fair hearing is protected. We agree with the Commission's observation in its Proposing Release, however, that such a procedure would raise novel issues and should be undertaken only pursuant to additional, and carefully crafted, Board and Commission rules.

As we understand the proposed operation of the rule, the issue of whether the Commission might issue a subpoena in connection with a Board proceeding will arise only after the PCAOB staff has completed an investigation. During that prior investigation, the PCAOB staff may issue document demands to PCAOB-registered firms and their associated persons. To the extent the PCAOB staff wants to gather information from others, the Commission may issue investigatory subpoenas to facilitate the PCAOB investigation. During this investigation, the potential respondent has no information-gathering powers of its own and cannot compel production of documents or witnesses from third parties, even if such documents or testimony is crucial to a complete understanding of the auditor's actions.

After the investigation has been completed, and the PCAOB has instituted proceedings against a respondent, the respondent will have access to the documents obtained, and the testimonial record developed, during the investigation. In addition, the Board's proposed rules contemplate that the PCAOB may issue document demands to registered firms and their associated persons for additional documents or testimony in connection with the hearing itself, at the request of either the PCAOB staff or the respondent. The PCAOB itself, however, has no power to compel persons other than registered firms or their associated persons to appear before the Board. The PCAOB staff, however, will have had an opportunity to enlist the assistance of the SEC in developing the investigatory record.

In comparison, the respondent will not have had the same opportunity during the investigation (although the respondent presumably could request that the PCAOB staff seek an SEC subpoena to assist in developing the investigative record). Given the nature of the auditing function, it is likely that the audit client's documents and employees would be important sources of information for the respondent in presenting a defense. In addition, there may be other persons, in particular cases, who cannot be compelled by the

PCAOB to appear, but who may be important to the respondent's defense. If the investigatory record is not complete, a respondent's ability to develop and present such evidence during a hearing may depend upon the Commission's issuance of "trial subpoenas" for testimony or documents to non-parties. The Board's proposed Rule 5424(b), which would allow the Board, upon the application of any party or on its own initiative, to request that the Commission issue a subpoena, is reasonably intended to protect a respondent's right to a fair and balanced hearing in such situations.

In our view, the Commission should address several issues in considering the PCAOB's proposed rules in this area, including the SEC's statutory authority to issue such subpoenas and the procedures by which such subpoenas would be sought by the PCAOB. We address these in turn below.

As a preliminary matter, we note that the SEC's Proposing Release generally appears to assume that the Commission has statutory authority to issue subpoenas for testimony or the production of documents to third parties in connection with Board hearings, even when the subpoena recipients are not parties to the PCAOB proceedings. Neither the PCAOB's releases accompanying the proposal and Board adoption of Rule 5424(b) nor the SEC's Proposing Release, however, clearly identifies the sources of such authority.

In the context of Board proceedings, we believe that the Commission should construe its legislative authority in a manner designed to ensure that respondents (*i.e.*, registered public accounting firms or their associated persons) receive a fair hearing and are not deprived of an opportunity to present to the Board meaningful evidence that may bear upon the PCAOB's determination as to whether violations have occurred or sanctions should be imposed. Absent a clear statement by the Commission, however, as to its statutory power to issue such subpoenas, it is likely that some non-parties to a PCAOB proceeding would challenge the SEC's authority to act at the Board's behest. In our view, the likelihood of such challenges would be substantially reduced if the Commission were to identify clearly the statutory provisions that, in its view, authorize the SEC to issue trial subpoenas in support of a Board proceeding.

By way of example, we note that such provisions might include Section 105(b)(2)(D) of the Act, which clearly authorizes the SEC to issue subpoenas to any person in aid of an ongoing Board investigation and arguably empowers the Commission to issue subpoenas at the hearing stage, if the testimony or documents subject to the subpoena are "relevant or material" to the Board's prior investigation. In addition, Section 21(b) of the Securities Exchange Act of 1934 authorizes the Commission to issue subpoenas "[f]or the purpose of \* \* \* any other proceeding under this title." Insofar as Board hearings are brought pursuant to PCAOB rules that are approved by the SEC under Section 19(b) of the Exchange Act and subject to review by the full Commission, the SEC also might take the position that such hearings are "proceedings under this title" for Section 21(b) purposes.

In soliciting views on proposed Rule 5424(b), the Commission specifically invited comments on “any relevant distinctions between the functions of the PCAOB and those of self-regulatory organizations.” Both the PCAOB and self-regulatory organizations (“SROs”) such as the National Association of Securities Dealers, Inc. are charged with important responsibilities intended to protect investors in the nation’s securities markets. As a general matter, SRO procedures do not contemplate that the Commission will issue trial subpoenas at an SRO’s request in furtherance of SRO disciplinary hearings and the relevant statutes do not provide for such procedures. For several reasons, however, we do not believe that this factor should dissuade the Commission from issuing subpoenas in connection with hearings before the Board.

Although there are many similarities between the PCAOB and existing SROs, the PCAOB was created through a significantly more precise and structured statutory scheme that clearly contemplates the Commission’s extensive oversight over the Board’s activities. As noted above, in contrast to the statutory frameworks under which the SROs function, the Act specifically authorizes the SEC to issue subpoenas to third parties in furtherance of PCAOB investigations. In our view, the issuance of trial subpoenas by the Commission is consistent with the SEC’s oversight responsibilities with respect to the Board. In addition, the Board has specifically requested, in its proposed rules, that the Commission provide for the issuance of such subpoenas in appropriate circumstances and, as noted above, it appears that the SEC has the statutory authority to do so. Moreover, given the PCAOB’s unique focus on auditors of public companies, situations can be expected to arise with some frequency in which respondents will need access to testimony or documents from persons other than those directly subject to the Board’s jurisdiction in order to defend themselves in a Board proceeding. If the SEC were unwilling to exercise its broader authority to issue subpoenas in such circumstances, a respondent’s right to a fair hearing could be placed at serious risk.

As the Commission has suggested, however, its issuance of subpoenas in furtherance of Board hearings should be subject to additional, and carefully crafted, procedures jointly developed by the PCAOB and the SEC. In particular, we believe that the PCAOB should provide further guidance as to the circumstances under which it generally would honor a party’s request that the Board seek the issuance of a trial subpoena from the Commission. For example, such subpoenas presumably would be appropriately issued for relevant documents or testimony not already gathered in the investigatory process from the audit client or other third parties who provided information to the auditor during the course of the audit.<sup>1</sup> In addition, while the PCAOB has suggested that the decision whether to request that the SEC issue such a subpoena should rest solely with the Board, we believe that, in some circumstances, the Board’s refusal to seek a Commission subpoena would constitute an abuse of the PCAOB’s discretion that would jeopardize a party’s right to a fair hearing before the Board.

---

<sup>1</sup> Although it might present a somewhat awkward situation, there also might be circumstances where PCAOB or SEC staff members may be the most accessible sources of documents or testimony essential to a fair proceeding. It would be useful for the PCAOB to issue guidance as to how those requests would be handled.

We also believe that recipients of a subpoena pursuant to Rule 5424(b), and the parties to the Board proceeding, should have the ability to move to quash or modify a burdensome subpoena. Rule 232 of the Commission's Rules of Practice, which applies to SEC administrative proceedings and which the Commission has recently proposed to amend, provides a useful model. We further recommend that the SEC specify the person or persons at the Commission who would be authorized to issue, quash or modify subpoenas issued pursuant to a Board request under Rule 5424(b). In general, since these subpoenas would be issued after the PCAOB investigation has ended, we believe that the SEC should assign this function to an Administrative Law Judge, rather than to individual members of the Commission's Enforcement Staff. Such procedures, of course, should be in place by the time the Board begins to hold hearings involving particular registered firms or their associated persons.

We also understand that the SEC or others might be concerned that, under the Board's proposed rule, it may appear that the Commission is reviewing its own decisions if a party appeals a PCAOB decision and one of the grounds for appeal is that the SEC had declined to issue a requested trial subpoena (which, as noted, might cover documents in the Commission's possession or testimony from SEC employees).

In our view, however, these concerns should be alleviated by the fact that (1) under the PCAOB's proposed rule, the PCAOB will make the initial decision to request that the SEC issue a subpoena (i.e., respondents in PCAOB hearings could not make the requests directly to the SEC) and (2) the SEC could delegate responsibility for deciding whether the SEC will honor a PCAOB's request to administrative law judges. If the decision were delegated to an ALJ, and the ALJ were to make a decision not to issue a subpoena that the SEC later concluded was erroneous, the result would not seem significantly different from the situation in other administrative proceedings before the SEC, in which an ALJ makes a decision that the Commission later concludes is a grounds for modification or reversal of the ALJ's initial decision. The Commission is familiar with such situations; indeed, Rule 411 of the SEC's current Rules of Practice expressly provides that, in determining whether to grant a party's petition for review of an ALJ's initial decision, the Commission shall consider, among other things, whether "[a] prejudicial error was committed in the conduct of the proceeding" by the hearing officer.

We hope that these comments will be of assistance as the Commission completes its review of the Board's proposed rules governing the conduct of investigations and hearings. Members of our committees are available to discuss these comments. If you believe that such discussions would be helpful, please contact either of the undersigned.

Respectfully submitted,

Committee on Law & Accounting

/s/ Thomas L. Riesenbergs  
Committee Chair

Committee on Federal Regulation  
of Securities

/s/ Dixie L. Johnson  
Committee Chair

Drafting Committee:

David B. Hardison, Chair  
Paul H. Pashkoff  
Thomas L. Riesenbergs  
Dixie L. Johnson

ffdc02\johnsdi\324503.2