

April 2008

## Too Close for Comfort: The Potential Dilemma Facing the Securities and Exchange Commission and the Public Accounting Oversight Board

David H. Roberts

Follow this and additional works at: <https://digitalcommons.pace.edu/plr>



Part of the [Securities Law Commons](#)

---

### Recommended Citation

David H. Roberts, *Too Close for Comfort: The Potential Dilemma Facing the Securities and Exchange Commission and the Public Accounting Oversight Board*, 28 Pace L. Rev. 495 (2008)

DOI: <https://doi.org/10.58948/2331-3528.1100>

Available at: <https://digitalcommons.pace.edu/plr/vol28/iss3/2>

This Article is brought to you for free and open access by the School of Law at DigitalCommons@Pace. It has been accepted for inclusion in Pace Law Review by an authorized administrator of DigitalCommons@Pace. For more information, please contact [dheller2@law.pace.edu](mailto:dheller2@law.pace.edu).

# Too Close for Comfort: The Potential Dilemma Facing the Securities and Exchange Commission and the Public Accounting Oversight Board

David H. Roberts\*

## Introduction

In the wake of major accounting scandals at such corporations as Enron and WorldCom, a number of proposals were introduced before Congress in an attempt to address the conditions that led to these scandals. Many of the proposals shared the common assumption that the past oversight of public accountants was inadequate.<sup>1</sup> Around that same time period, a number of high-ranking members of the Securities and Exchange Commission ("SEC") declared that the SEC would begin to move more aggressively in pursuing enforcement actions against both individual public accountants<sup>2</sup> and public accounting firms.<sup>3</sup> The former Chairman of the SEC, Harvey Pitt, stated that the SEC would step-up actions against public accountants accused of financial fraud and noted that there will be "a substantial increase in [the SEC's] involvement in the discipline process."<sup>4</sup> The former Director of the SEC's Enforcement Division, Stephen Cutler, stated that it was time to adopt a new

---

\* Associate at Goodwin Procter LLP; Northeastern University School of Law, 2004. I would like to thank Professor Dan Danielson and Professor Arthur Laby for their valuable insights and guidance. Also, special thanks to John Roberts and Ashley Mauldin for their tireless assistance.

1. MARK JINCKLING, CONG. RESEARCH SERV., RS21173, AUDITOR OVERSIGHT: PROPOSALS FOR A NEW REGULATOR 3 (Apr. 18, 2002).

2. Mike McNamee, *How the SEC Plans to Police Accountants*, BUSINESS WEEK, Jan. 18, 2002, available at [http://www.businessweek.com/bwdaily/dnflash/jan2002/nf20020118\\_0337.htm](http://www.businessweek.com/bwdaily/dnflash/jan2002/nf20020118_0337.htm).

3. Stephen M. Cutler, Director, Division of Enforcement, Sec. Exch. Comm'n, Remarks Before the American Institute of Certified Public Accountants (Dec. 12, 2002) available at <http://www.sec.gov/news/speech/spch121202smc.htm>.

4. McNamee, *supra* note 2.

enforcement paradigm, “one that *reverses* the current presumption against suing firms for an audit failure.”<sup>5</sup>

With the passage of the Sarbanes-Oxley Act (“SOX”), the SEC may seek to pursue a more aggressive enforcement policy regarding public accountants with new regulatory tools and machinery. However, a comparison of SOX and the regulations that were in place prior to the passage of SOX suggests little change in the SEC’s enforcement and remedial authority as it pertains to public accountants. The main effect of SOX seems to be a possible change in enforcement personnel.

An unintended consequence of the creation of dual authority in the SEC and the Public Company Accounting Oversight Board (“PCAOB”) to oversee public accountants is that an enforcement action by one of these parties may preclude or severely limit an enforcement action by the other. Congress could remedy this potential preclusion, however, if Congress does not act, the preclusion need not bar the SEC and PCAOB from attaining their regulatory goals regarding public accountants. Rather, the new regime of the SEC and the PCAOB taken as a whole should be able to cure past regulatory inadequacies given that a well funded PCAOB with strong oversight from the SEC can offer a heightened level of regulation.

Section I provides a brief summary of the role of public accountants and the regulatory regime for public accountants, including the enforcement power of the SEC, before and after the passage of SOX. Section II explores how under the current law the overlapping powers and authority of the SEC and PCAOB could lead to the actions of one precluding the actions of the other under the legal doctrines of collateral estoppel and res judicata. Finally, Section III suggests a potential Congressional remedy to this preclusion and discusses why the post-SOX system should nevertheless cure past inadequacies in the regulation of public accountants even if Congress chooses not to act.

---

5. Cutler, *supra* note 3.

## I. The Regulation of Public Accountants Pre and Post-SOX

### A. *The Role of Public Accountants*

A public accountant is an individual who furnishes accounting or auditing services for more than one client on a fee basis, while a certified public accountant (“CPA”) is one who has received from the proper board or commission a certificate qualifying him to hold himself out and practice as such.<sup>6</sup> Public accountants have a number of roles under the federal securities laws. One of their most significant roles, and the role that this Article focuses on, is auditing financial statements filed with the SEC.<sup>7</sup> The audit function is of critical importance given that public accountants provide assurance to investors that an issuers’ financial statements conform to generally accepted accounting principles (“GAAP”) and that the public accountants’ audits were performed in compliance with the standards of the PCAOB.<sup>8</sup>

### B. *Regulation of Public Accountants Pre-SOX*

Historically, regulation of the public accounting profession and enforcement of its standards of practice were largely dependent on the profession itself. The American Institute of Certified Public Accountants (“AICPA”), a private trade organization, essentially stood at the center of this self-regulation.<sup>9</sup> Members of the AICPA, who audited public companies, were required to join the Securities Exchange Commission Practice Section (“SECPS”) of the AICPA.<sup>10</sup> The SECPS would conduct inspections of its members under the “peer review” program, which was in place to ensure that audits of financial statements were being performed consistently with the profes-

---

6. 1 AM. JUR. 2D *Accountants* § 1 (2003).

7. Adopting Release, 63 Fed. Reg. 57164-01, 57165 n.13 (Oct. 26, 1998).

8. PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD NO. 2003-025, AUDITING STANDARD NO. 1, REFERENCES IN AUDITORS’ REPORT TO THE STANDARDS OF THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD at A-3 (Dec. 17, 2003).

9. U.S. GEN. ACCOUNTING OFFICE, NO. 02-411 THE ACCOUNTING PROFESSION: STATUS OF PANEL ON AUDIT EFFECTIVENESS RECOMMENDATIONS TO ENHANCE THE SELF-REGULATORY SYSTEM 6 (May 2002).

10. Sally S. Spielvogel, *Exploring The Sarbanes-Oxley Act: Will Government Intervention in the Public Accounting Profession Prevent Another Enron?*, 92 KY. L.J. 339, 347 (2003).

sion's standards.<sup>11</sup> AICPA members could be subject to enforcement actions from the AICPA for violations of the profession's standards.<sup>12</sup> The Public Oversight Board ("POB"), comprised of five public members, was in place to oversee the SECPS and to represent the public interest regarding the integrity of the audit process.<sup>13</sup> The former Chairman of the POB, Charles Bowsher, noted that this system of oversight had serious flaws, including the fact that the POB's funding was subject to control by the auditing firms through the SECPS.<sup>14</sup> In the past, the SECPS had gone so far as to cut off the POB's funding in order to curtail POB activities.<sup>15</sup>

Although the profession was largely self-regulated, the state boards of accountancy and the SEC also participated in the oversight of public accountants. State boards of accountancy, which grant CPAs their licenses, have the ability to revoke those licenses.<sup>16</sup> State boards of accountancy were not equipped to be a strong enforcement presence due to limited budgets and the lack of effective means to investigate allegations and impose disciplinary measures.<sup>17</sup> The SEC on the other hand has the authority to make and enforce both accounting and auditing rules.<sup>18</sup> From an enforcement perspective, due to a lack of resources, the SEC was often forced to pursue cases against only those public accountants responsible for the most egregious violations.<sup>19</sup> To put this lack of funding in perspective, in the year 2000, Enron spent \$25 million for audit services while the SEC's budget for 2000 was only \$368 million.<sup>20</sup> Hence, the cost of Enron's 2000 audit alone equaled nearly

---

11. *Id.*

12. *Id.* at 356.

13. U.S. GEN. ACCOUNTING OFFICE, *supra* note 9, at 8.

14. *Id.*

15. *Id.* at 7, 18-19.

16. George J. Benston, *The Regulation of Accountants and Public Accounting Before and After Enron*, 52 EMORY L.J. 1325, 1345 (2003).

17. U.S. GEN. ACCOUNTING OFFICE, *supra* note 9, at 26.

18. 15 U.S.C. § 77s(b) (2004); 15 U.S.C. §§ 77s(a), 78c(b), 80a-37(a) 77m(b) (2004).

19. David Hilzenrath, *Auditors Face Scant Discipline: Review Process Lacks Resources, Coordination, Will*, WASH. POST, Dec. 6, 2001, at A01.

20. JICKLING, *supra* note 1, at n.2.

seven percent of the SEC's budget, and Enron was just one of 17,000 companies that submitted filings with the SEC.<sup>21</sup>

Pre-SOX, most impartial observers would argue that there was a systemic problem with the disciplinary function of the public accounting industry's self-regulation, and that changes were needed.<sup>22</sup> In addition to the lack of proper oversight of the SECPS, limitations of the state boards of accountancy and lack of funding for the SEC, one of the main problems with self-regulation was that the AICPA was a toothless tiger. In the AICPA's enforcement capacity, the AICPA had never disciplined a major accounting firm as of 2002.<sup>23</sup> Also, fewer than one out of every five accountants who had been sanctioned by the SEC for unprofessional conduct were subjected to discipline by the AICPA.<sup>24</sup>

### C. *Regulation of Public Accountants Post-SOX*

Under SOX, Congress created the PCAOB, which for all practical purposes abrogated a number of the AICPA's responsibilities regarding public accountants that perform audits of publicly traded companies.<sup>25</sup> Post-SOX, all accounting firms that prepare or issue audit reports on U.S. public companies are required to register with the PCAOB<sup>26</sup> and as of April 18, 2008 there were 1,847 accounting firms registered with the PCAOB.<sup>27</sup> The duties of the PCAOB include, but are not limited to, conducting inspections of registered public accounting firms (successor to the SECPS's peer review process) and promulgating the professions audit and ethical standards.<sup>28</sup> The PCAOB is also responsible for bringing enforcement actions against

---

21. *Id.*

22. U.S. GEN ACCOUNTING OFFICE, NO. GAO-02-742R, THE ACCOUNTING PROFESSION: STATUS OF PANEL ON AUDIT EFFECTIVENESS RECOMMENDATIONS TO ENHANCE THE SELF-REGULATORY SYSTEM 1 (May 3, 2002).

23. Lisa K. Buckser-Schulz, *Congratulations to Arthur Andersen: Why Self-Regulation of the Accounting Industry Doesn't Work*, 4 INSTITUTIONAL INVESTOR ADVOCATE 2 (First Quarter 2002), available at <http://www.blbglaw.com/publications/1Q02lisab.pdf>.

24. *Id.*

25. Sarbanes-Oxley Act of 2002, 15 U.S.C.A. § 7211(a) (West 2004).

26. *Id.* § 7212(a).

27. PCAOB.com, Registered Public Accounting Firms (2007), [http://www.pcaob.com/Registration/Registered\\_Firms.pdf](http://www.pcaob.com/Registration/Registered_Firms.pdf) (last visited Apr. 18, 2008).

28. 15 U.S.C.A § 7211(c).

those registered public accounting firms, and associated person thereof, that have violated the federal securities laws relating to the preparation and issuance of audit reports (including the rules of the SEC issued under SOX), rules of the PCAOB, provisions of SOX or professional standards.<sup>29</sup> SOX defines professional standards to include accounting principles, auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards.<sup>30</sup> The PCAOB can seek a number of disciplinary or remedial sanctions depending on the severity of the violation. Where there has been intentional or knowing conduct on the part of a public accountant, including reckless or repeated instances of negligent conduct, the PCAOB can seek to suspend or permanently revoke registration with the PCAOB; a suspension or bar of a person from further association with any registered public accounting firm; temporary or permanent limitation on the activities, functions, or operations of such firm or person; monetary penalties; censure; to require additional pro-

---

29. *Id.* § 7215(c)(4).

If the [PCAOB] finds, based on all of the facts and circumstances, that a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the [PCAOB], the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the [SEC] issued under this Act, or professional standards, the [PCAOB] may impose such disciplinary or remedial sanctions as it determines appropriate.

*Id.*

30. *Id.* § 7201(10). "Professional standards" is defined as follows:

- (A) accounting principles that are—
  - (i) established by the standard setting body described in section [19(b) of the Securities Act of 1933], as amended by [SOX], or prescribed by the [SEC] under section [19(a) of the Securities Act or section 13(b) of the Securities Exchange Act of 1934]; and
  - (ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and
- (B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards that the [PCAOB] or the [SEC] determines—
  - (i) relate to the preparation or issuance of audit reports for issuers; and
  - (ii) are established or adopted by the [PCAOB under section 103(a)], or are promulgated as rules of the Commission.

*Id.*

fessional education or training; or any other appropriate sanction provided for in the rules of the PCAOB.<sup>31</sup> Where there has been a single act of negligent conduct on the part of a public accountant, the PCAOB is limited to seeking monetary penalties; censure; additional professional education or training; and any other appropriate sanction provided for in the rules of the PCAOB.<sup>32</sup>

The SEC's authority over public accountants changed very little under SOX. The SEC still has the authority to make and enforce both accounting and auditing rules.<sup>33</sup> In its enforcement capacity, the SEC has the same two actions at its disposal as it did before SOX: administrative actions and injunctive ac-

---

31. 15 U.S.C. section 7215(c)(4)-(5) states that the PCAOB:

- (4) [M]ay impose such disciplinary or remedial sanctions as it determines appropriate, subject to applicable limitations under paragraph (5), including:
- (A) temporary suspension or permanent revocation of registration under this [title];
  - (B) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;
  - (C) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);
  - (D) a civil money penalty for each such violation, in an amount equal to—
    - (i) not more than \$100,000 for a natural person or \$2,000,000 for any other person; and
    - (ii) in any case to which paragraph (5) applies, not more than \$750,000 for a natural person or \$15,000,000 for any other person;
  - (E) censure;
  - (F) required additional professional education or training; or
  - (G) any other appropriate sanction provided for in the rules of the [PCAOB].
- (5) Intentional or Other Knowing Conduct—The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to—
- (A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or
  - (B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

15 U.S.C.A § 7215(c)(4)-(5).

32. *Id.*

33. *Id.* § 7202(c).



tions which are brought in federal court.<sup>34</sup> The SEC weighs a number of factors in determining whether to seek administrative or injunctive relief. Factors such as a severe violation of the federal securities laws and a lack of cooperation with the SEC's staff may cause the SEC to seek injunctive over administrative relief.<sup>35</sup>

Administrative proceedings against public accountants in professional discipline cases are brought by the SEC under Rule 102(e).<sup>36</sup> The SEC may bring proceedings under Rule 102(e) against a public accountant for not possessing the requisite qualifications; a lack of character or integrity; a violation of the professional standards; unethical or improper professional conduct; and willful violations of the federal securities laws.<sup>37</sup> Im-

---

34. Harvey L. Pitt, et. al., *"Court-ing Disaster": The Factors That Prompt the SEC to Seek Injunctive Relief*, 908 PLI/CORP 269, 272 (1995).

35. *Id.* at 271.

36. Norman S. Johnson & Ross A. Albert, *"Déjà Vu All Over Again": The Securities and Exchange Commission Once More Attempts to Regulate the Accounting Profession Through Rule 102(e) of its Rules of Practice*, 1999 UTAH L. REV. 553, 568.

37. 17 C.F.R. § 201.102(e) (2004) states:

- (1) *Generally.* The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter:
  - (i) Not to possess the requisite qualifications to represent others; or
  - (ii) To be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or
  - (iii) To have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.
  - (iv) With respect to persons licensed to practice as accountants, "improper professional conduct" under § 201.102(e)(1)(ii) means:
    - (A) Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or
    - (B) Either of the following two types of negligent conduct:
      - (1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.
      - (2) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.
- (2) *Certain professionals and convicted persons.* Any attorney who has been suspended or disbarred by a court of the United States or of any State; or any person whose license to practice as an accountant, engineer, or

proper professional conduct includes intentional or knowing conduct, including reckless conduct, and certain negligent conduct.<sup>38</sup> Negligent conduct encompasses a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which a public accountant knows, or should know, that heightened scrutiny is warranted or repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the SEC.<sup>39</sup> In Rule 102(e) proceedings,<sup>40</sup> the SEC can only seek to censure or to deny a public accountant the privilege of practicing before the SEC, it cannot seek monetary penalties.<sup>41</sup> In the past, the use of this rule by the SEC was not without controversy. Before Congress codified Rule 102(e),<sup>42</sup> there was some question as to whether the SEC had the authority to promulgate and enforce such a rule.<sup>43</sup>

Injunctive actions can be brought by the SEC against public accountants when they are engaged in or about to engage in any violations of the Securities Act of 1933 and the Securities and Exchange Act of 1934 and any rules promulgated thereunder, and for the rules of the PCAOB.<sup>44</sup> In injunctive actions, the SEC can seek an injunction against further violations of the federal securities laws and the SEC can also seek monetary penal-

---

other professional or expert has been revoked or suspended in any State; or any person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission. A disbarment, suspension, revocation or conviction within the meaning of this section shall be deemed to have occurred when the disbaring, suspending, revoking or convicting agency or tribunal enters its judgment or order, including a judgment or order on a plea of *nolo contendere*, regardless of whether an appeal of such judgment or order is pending or could be taken.

38. *Id.*

39. *Id.*

40. One point of note is that historically the SEC has not considered Rule 102(e) to be an enforcement remedy. Adopting Release, 63 Fed. Reg. 57164-01, 57170 (Oct. 26, 1998). This distinction has been seen as pretextual by a number of commentators. See Johnson & Albert, *supra* note 36, at 580; see also Leo F. Orenstein & Marc B. Dorfman, *A Rule Gone Bad: SEC No Longer Needs to Rely on Rule 102(e), but Can't Seem to Let It Go*, 23 LEGAL TIMES 46 (Nov. 20, 2000).

41. 17 C.F.R. § 201.102(e) (2004).

42. 15 U.S.C.A. § 78d-3 (West 2004).

43. S. REP. NO. 107-205, at 42 (2002).

44. 15 U.S.C.A. § 78u(t)(a) (West 2004); 15 U.S.C.A. § 78u(d)(1) (West 2004).

ties.<sup>45</sup> The SEC for the last few decades has been relying less on injunctive actions and more heavily on Rule 102(e) administrative actions, because the federal courts have made it increasingly difficult for the SEC to obtain injunctive relief.<sup>46</sup> These difficulties arose in large part from the U.S. Supreme Court's holding that *scienter* is an element of a violation for the following antifraud provisions amongst others: Section 10(b) of the Securities Exchange Act of 1934; Rule 10b-5, which was promulgated under Section 10(b); and Section 17(a)(1) of the Securities Act of 1933.<sup>47</sup>

## II. Unforeseen Consequences in the Creation of the PCAOB

It appears that the SEC intends that the newly created PCAOB's enforcement powers combined with the existing enforcement powers of the SEC will mean more firepower in the enforcement of the public accounting profession's standards. Prior to the passage of SOX, former SEC Chairman Pitt, in his written testimony to the United State Senate's Committee on Banking, Housing and Urban Affairs noted the following on the creation of an independent oversight board:

This private sector body would supplement our enforcement efforts, by adding a layer, or tier, of new regulation. There should be no misunderstanding. In the first instance, we, and our Division of Enforcement, will continue vigorously to investigate and pursue instances of illegal conduct. The SEC has had a successful history with two-tier regulation that involves the private sector. Such two-tier regulation has been largely successful with the brokerage industry.<sup>48</sup>

Subsequent to the passage of SOX, the SEC still appears intent on utilizing a two-tiered enforcement strategy. In De-

---

45. 15 U.S.C.A. § 78u(d)(1)-(3) (West 2004).

46. See Johnson & Albert, *supra* note 36, at 568 n.44.

47. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197-98 (1976) (requiring proof of *scienter* in private Section 10(b) and Rule 10b-5 actions); Aaron v. SEC, 446 U.S. 680, 701-02 (1980) (*scienter* required in governmental law enforcement actions under Section 10(b), Rule 10b-5 and Section 17(a)(1) but not under 17(a)(2) and 17(a)(3)).

48. Harvey L. Pitt, Chairman, Sec. Exch. Comm'n, Written Testimony Concerning Accounting and Investor Protection Issues Raised by Enron and Other Public Companies (Mar. 21, 2002), available at <http://www.sec.gov/news/testimony/032102tshlp.htm>.

ember of 2004, Susan Markel, the SEC's Division of Enforcement's Chief Accountant, stated that the PCAOB has not replaced the SEC in auditor enforcement cases.<sup>49</sup> Markel stated that the PCAOB's enforcement capabilities should be viewed as an addition, as opposed to an alternative, to SEC enforcement.<sup>50</sup> It should be noted that the PCAOB and SEC have yet to bring an enforcement proceeding against the same individual arising out of the same action, although the PCAOB has only brought a limited number of proceedings to date.<sup>51</sup>

If it is the PCAOB's and SEC's intention to act against the same public accountant, this combined firepower may never come to fruition. An unintended consequence of Congress granting the PCAOB enforcement authority virtually identical to the SEC's, may be that one might be precluded from litigating issues or claims already litigated by the other against the same public accountant. This preclusion would arise from the legal doctrines of collateral estoppel and res judicata.

Under the doctrine of collateral estoppel, the resolution by a court of an issue of fact or law necessary to its judgment precludes the relitigation of that issue in a subsequent suit, whether based on the same or a different claim.<sup>52</sup> Res judicata prevents the relitigation of any claim that was or that might have been brought in a prior action where there has been full consideration and a final decision in a prior proceeding.<sup>53</sup> Res judicata can be distinguished from collateral estoppel in that the application of the doctrine of res judicata necessitates an identity of the claim while the invocation of collateral estoppel does not. Therefore, even if a court were to find there was no identity of the claim, the defense of collateral estoppel may still be available. Although the recent trend in modern case law is to separate the doctrines of res judicata and collateral estoppel,

---

49. Wolters Kluwer Law and Business, *SEC Staff Reviews Accounting Projects and Enforcement at Recent Conference*, <http://business.cch.com/securities-Law/news/12-23-04.asp> (last visited Apr. 18, 2008).

50. *Id.*

51. As of the end of 2007 the PCAOB has brought 16 enforcement proceedings. Public Company Accounting Oversight Board, PCAOB Disciplinary Proceedings, [http://www.pcaob.com/Enforcement/Disciplinary\\_Proceedings/index.aspx](http://www.pcaob.com/Enforcement/Disciplinary_Proceedings/index.aspx) (last visited Apr. 18, 2008).

52. 47 AM. JUR. 2D *Judgments* § 487 (2008).

53. *Id.* § 473.

the literal meaning of *res judicata* is “matter adjudged,” which encompasses issue preclusion, and the term *res judicata* has in fact been used to indicate issue preclusion in a number of cases.<sup>54</sup>

As a result, the combined enforcement power of the PCAOB and the SEC, and the increased level of engagement promised by the SEC, could be restricted. For example, suppose both the SEC and the PCAOB wanted to bring an action against Mr. Smith, a public accountant, for his violation of the federal securities laws relating to the preparation and issuance of an audit report. As explained in more detail below, under collateral estoppel, the PCAOB in an enforcement proceeding or the SEC in both an administrative proceeding under Rule 102(e) and in an injunctive action could be precluded from relitigating issues that have already been litigated by the other against Mr. Smith. At the same time, under the doctrine of *res judicata*, the PCAOB in an enforcement proceeding or the SEC in both an administrative proceeding under Rule 102(e) and in an injunctive action could be precluded from relitigating claims that have been or could have been litigated by the other against Mr. Smith in the earlier action.

These potential restrictions of collateral estoppel and *res judicata* on PCAOB or SEC actions are important to the parties involved for a number of reasons. From the perspective of the PCAOB and the SEC, concurrent jurisdiction offers certain advantages. First, it may act as a greater deterrent for someone like Mr. Smith if he knows that he could potentially face multiple enforcement actions for a single violation. Also, if the PCAOB or the SEC were to bring a proceeding against Mr. Smith first and were unsuccessful, then the other party would still have a chance to obtain a ruling against Mr. Smith. From Mr. Smith's perspective, the concurrent jurisdiction of the PCAOB and the SEC represents a disadvantage. Mr. Smith could be faced with the additional time and expense it would take to defend himself in multiple enforcement actions. As a result of being faced with this potential loss of time and money in multiple actions, Mr. Smith may find it in his interest to just

---

54. *Id.* § 464.

settle these actions whether or not he has actually committed any wrongdoings.

### A. *Preclusive Effect*

Simply because the SEC is a government agency and the PCAOB was intended to be a non-profit corporation (it appears the PCAOB may in fact be treated as a government entity for certain purposes<sup>55</sup>) does not mean their decisions cannot have a preclusive effect. When an administrative agency such as the SEC, acting in a judicial capacity, resolves disputed issues of fact, which the parties had adequate opportunity to litigate, the courts have not hesitated to apply collateral estoppel or *res judicata*.<sup>56</sup> The question whether a PCAOB judgment can be preclusive has yet to be considered by the courts. However, a number of jurisdictions have held that judgments by non-governmental entities acting in a judicial capacity can be preclusive.<sup>57</sup> In order to determine whether doctrines of a PCAOB judgment can have a preclusive effect, it must be ascertained whether Congress intended for PCAOB judgments to have such an effect.

---

55. See *infra* Section II B.1.c.i.

56. *United States v. Utah Constr. & Mining Co.*, 384 U.S. 394, 422 (1966) (superseded by statute on other grounds); *Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 109-10 (1991) (holding that the suitability of administrative claim preclusion "may vary according to the specific context of the rights at stake, the power of the agency, and the relative adequacy of agency procedures"); *Jones v. SEC*, 115 F.3d 1173, 1178 (4th Cir. 1997) (assuming "that a prior SEC decision based on the NASD's disciplinary order would have preclusive effect to the same extent as any other agency decision where the agency acts in an adequately judicial capacity"); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1463-64 (2d Cir. 1996) (holding that *res judicata* was inapplicable, not because SEC administrative judgments are not preclusive, but because the suit based on fraudulent acts that occurred after filing of prior suit, even though acts were part of same pattern that formed basis of first suit).

57. *Boguslavsky v. Kaplan*, 159 F.3d 715 (2d Cir. 1998) (holding that under the doctrine of collateral estoppel investor was precluded from relitigating a number of issues previously litigated in a NASD arbitration hearing); *Jones*, 115 F.3d at 1178 (holding that the defendant could identify a final judgment on the merits entered by the NASD); *Olick v. Dippel*, 93 Fed. App'x 396 (3d Cir. 2004) (holding that it is well-settled law that a NASD arbitration panel is a court of competent jurisdiction for *res judicata* purposes); *Zandford v. Prudential Sec., Inc.*, No. 94-0036, 1995 WL 507169 (D.C. 1995) (holding that stockbroker was precluded from relitigating claims that could have been litigated in an earlier New York Stock Exchange ("NYSE") arbitration hearing).

The U.S. Supreme Court has noted that “where a common-law principle is well established, as are the rules of preclusion, the courts may take it as given that Congress has legislated with an expectation that the principle will apply except ‘when a statutory purpose to the contrary is evident.’”<sup>58</sup> This, however, does not require a definitive statement from Congress whereby Congress precisely articulates an intention to overcome the presumption’s application to a given statutory scheme.<sup>59</sup> Rules of plain statement and strict construction apply only to the protection of weighty and constant values, be they constitutional or otherwise.<sup>60</sup> The Court has held that the common law rules of administrative preclusion do not represent such weighty and constant values.<sup>61</sup> For example, in *Astoria Federal Savings and Loan Association v. Solimino*, the Court held that the statutory scheme of the Age Discrimination in Employment Act of 1967 implies that federal courts should not apply the doctrines of preclusion to state administrative findings.<sup>62</sup> The Court reasoned that while the statute does not expressly discuss the preclusivity of administrative findings, certain sections of the Age Discrimination in Employment Act make it clear that principles of preclusion do not apply. One section of the Age Discrimination in Employment Act provides that if a state has its own age-discrimination law, a federal plaintiff must pursue his claim with the responsible state authorities before filing in federal court.<sup>63</sup> Another section provides the deadline for filing Age Act claims after the termination of state proceedings.<sup>64</sup> The Court stated that “[b]oth provisions plainly assume the possibility of federal consideration after state agencies have finished theirs.”<sup>65</sup>

In the case of SOX, Congress failed to expressly or impliedly evince any intention of whether the rules of preclusion should apply to PCAOB proceedings. Congress never explicitly stated that it intended for the PCAOB and the SEC to be able to

---

58. *Astoria Fed. Sav. & Loan Ass’n*, 501 U.S. at 108 (quoting *Isbrandtsen Co. v. Johnson*, 343 U.S. 779, 783 (1952)).

59. *Id.*

60. *Id.* at 109.

61. *Id.*

62. *Id.* at 110.

63. *Id.*

64. *Id.*

65. *Id.* at 111.

bring an action against the same public accountant arising out of the same wrongdoing. SOX does state that nothing in that Act shall limit the ability of the SEC to take legal, administrative or disciplinary action against a public accountant.<sup>66</sup> However, it is unclear if this language was included in SOX to ensure that the SEC retained its ability to take actions against public accountants, or if it was meant to express that the SEC and PCAOB will be allowed to take an action against the same public accountant arising out of the same wrongdoing. Also, SOX states that “[t]he [PCAOB is required] to notify the [SEC] of any [PCAOB] pending investigation involving potential violations of the securities laws, and thereafter coordinate its [efforts] with [those] of the [SEC’s] Division of Enforcement as necessary to protect an ongoing [SEC] investigation.”<sup>67</sup> Once again this statement could be interpreted in various ways. Perhaps if Congress was contemplating multiple investigations, it was also considering multiple enforcement actions. On the other hand, this statement could also be interpreted that Congress simply did not want the PCAOB interfering with an SEC investigation. Lastly, there is some indication that Congress attempted to at least partially model the PCAOB after the securities industry bodies known as self-regulatory organizations (“SROs”). Historically, the courts and the SEC have held that actions by SROs, such as the National Association of Securities Dealers (“NASD”), did not inhibit the SEC’s own action.<sup>68</sup> This does not appear to imply that Congress intended for preclusion not to apply to PCAOB actions given that Congress could have modeled the PCAOB exactly after the NASD or NYSE but instead created the PCAOB with a number of notable differences.<sup>69</sup> None of these instances appear to evidence an implied statutory purpose to overcome the common law principle of preclusion as was found in *Astoria*.

---

66. 15 U.S.C.A § 7202(c) (West 2004).

67. 15 U.S.C.A § 7215(b)(4)(A) (West 2004).

68. *Jones v. SEC*, 115 F.3d 1173, 1178 (4th Cir. 1997); *Shearson, Hammill & Co., Exchange Act Release No. 34-7743*, 42 S.E.C. 811, 852 n.88 (Nov. 12, 1965); *Lile & Co., Inc., Exchange Act Release No. 34-7644*, 42 S.E.C. 664, 668 & n.13 (July 9, 1965).

69. *See infra* Section II.C.3.



## B. *Collateral Estoppel*

### 1. Administrative Actions Under Rule 102(e)

The SEC, in administrative actions against a public accountant or public accounting firm under Rule 102(e),<sup>70</sup> or the PCAOB in an enforcement action, may be precluded from relitigating issues already litigated by the other due to the legal doctrine of collateral estoppel. A number of authorities have articulated the following three prerequisites to the application of collateral estoppel in civil actions:

- 1) that the issue of fact or law was actually litigated in the prior litigation;
- 2) that the issue at stake must be identical to the one involved in prior litigation; and
- 3) that the determination of the issue in the prior litigation was a critical and necessary part of the judgment in the earlier action.<sup>71</sup>

In cases involving the government, there is a fourth requirement as well. There has to be a mutuality of parties for collateral estoppel to be applied against the government.<sup>72</sup>

---

70. The language of Rule 102(e) appears to pertain only to individual accountants. Rule 102(e) states that "The Commission may censure a person." 17 C.F.R. § 201.102(e)(1) (2006). However, the SEC has brought 102(e) actions against public accounting firms. *See In re Arthur Andersen LLP Respondent*, Release No. 34-44444 (June 19, 2001); *In re KPMG LLP*, Bryan E. Palbaum, CPA, John M. Wong, CPA, Kenneth B. Janeski CPA, David A. Hori, CPA Respondent, Release No. 34-50564 (Oct. 24, 2004). Also, when Congress codified Rule 102(e) it made it clear that it applied to registered public accounting firms and associated persons. *See* 15 U.S.C.A. § 78d-3 (West 2004). As a result, public accountants and public accounting firms will hereinafter be referred to as "public accountants."

71. *Deweese v. Town of Palm Beach*, 688 F.2d 731, 733 (11th Cir. 1982) (citing *Stovall v. Price Waterhouse Co.*, 652 F.2d 537, 540 (5th Cir. 1981)); *see also* RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1982) (defining issues preclusion as when an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or a different claim).

72. *Reich v. D.C. Wiring, Inc.*, 940 F. Supp. 105 (D.N.J. 1996) ("Although the facts of *Mendoza* naturally limited its holding to cases involving nonmutual offensive collateral estoppel, lower courts, in interpreting this holding, have generally concluded that its logic applies with equal force to cases involving nonmutual defensive collateral estoppel.") (citing *Hercules Carriers, Inc. v. Claimant State of Fla.*, 768 F.2d 1558, 1579-80 (11th Cir. 1985) (in case involving defensive estoppel, state agency was allowed to relitigate issues already lost by another agency of the same state due to the fact there was not a mutuality between the two agencies)); *Am. Fed'n of Gov't Employees, Council 214 v. Fed. Labor Relations Auth.*, 835 F.2d

a. *Prior Litigation of the Issue*

Regarding whether the issue was actually litigated in the prior litigation, it is assumed that, if the issues in question are identical, they will already have been litigated by the SEC in a Rule 102(e) proceeding or the PCAOB in an enforcement action. The PCAOB and SEC could not avoid collateral estoppel or res judicata simply by bringing actions simultaneously. When separate proceedings are brought simultaneously whichever judgment comes first would leave open the defense of collateral estoppel and res judicata in the other proceeding.<sup>73</sup> Therefore, in the case of Mr. Smith, even if the PCAOB and the SEC were to bring their proceedings simultaneously against Mr. Smith, either the PCAOB or the SEC would have to obtain its judgment first, resulting in the issues at stake being fully litigated.

b. *Identical Issues That Are Critical to the Judgment*

In regards to whether the issues at stake would be identical to the issues involved in the prior litigation, and whether these issues are a critical and necessary part of the judgment of the earlier action, enforcement proceedings brought by the PCAOB against public accountants would be brought to determine if there were any violations of the federal securities laws relating to the preparation and issuance of audit reports, rules of the PCAOB, provisions of SOX,<sup>74</sup> or professional standards.<sup>75</sup> With at least one exception, an SEC administrative proceeding under Rule 102(e) would be brought to make the same determinations.<sup>76</sup> One such exception, in which the issues may not be identical and collateral estoppel may not be applicable, is under Rule 102(e) where the SEC can bring an action against a public

---

1458, 1462 (D.C. Cir. 1987) ("Collateral estoppel will apply against the government only if mutuality of parties exists.").

73. *Sidag Aktiengesellschaft v. Smoked Foods Prod. Co., Inc.*, 776 F.2d 1270, 1275 (5th Cir. 1985) (citing *Montana v. United States*, 440 U.S. 147 (1979) (enforcing collateral estoppel against federal government where it had attempted to avoid preclusion by maintaining two simultaneous actions)).

74. It should be noted that any violation of SOX is considered a violation of the federal securities laws. 15 U.S.C.A. § 78c(a)(47) (West 2004).

75. *Id.* § 7215(c)(4).

76. 17 C.F.R. § 201.102(e) (2004).

accountant for *any* violation of the federal securities laws,<sup>77</sup> while the PCAOB can only bring an action for a violation of those federal securities laws relating to the preparation and issuance of audit reports.<sup>78</sup> Although SOX does not specifically state that the PCAOB can levy sanctions for a lack of integrity or character or for not possessing the requisite qualifications, as does Rule 102(e), those violations appear to be implicitly covered by its ability to levy sanctions for violations of professional standards.<sup>79</sup>

In Mr. Smith's case, the issues surrounding whether he violated the profession's standards, for instance, should be identical in both a PCAOB enforcement proceeding and an SEC proceeding under Rule 102(e). Also, the issues surrounding Mr. Smith's alleged violation would be a critical and necessary part of the judgment of the earlier action because those issues would be essential in determining whether Mr. Smith violated the profession's standards.

### c. *Mutuality of Parties*

In cases involving the government, the last element of collateral estoppel requires that a finding be made that there is mutuality between the parties. In order to meet this element, it must be shown that the SEC and the PCAOB are the same party or at least privies.<sup>80</sup>

---

77. *Id.*

78. 15 U.S.C.A. § 7215(c)(4) (West 2004).

79. The PCAOB has yet to set its final ethical standards and currently only has a modest amount of interim standards in place. However, on an interim basis the PCAOB has adopted the AICPA's Ethics Standards. ET section 102 states that in the performance of a professional service, a public accountant shall maintain objectivity and integrity, shall be free of conflicts of interest and shall not knowingly misrepresent facts or subordinate his or her judgment to others. ET § 102 (Jan. 12, 1988). Also, on an interim basis the PCAOB has adopted the AICPA's Auditing Standards Board's Statement of Auditing Standards No. 95, as in existence on April 16, 2003. CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, AU § 150 (AICPA 2002); Public Company Accounting Oversight Board Bylaws and Rules – Professional Standards Rule 3200T (Apr. 16, 2003). See AU § 150.02 (AICPA 2002) (stating that all audits shall be performed by a person or persons having adequate technical training and proficiency as an auditor).

80. *Blonder-Tongue Labs. Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 320-21 (1971).

i. *Same Party*

Congress set up the PCAOB as an independent entity in the form of a non-profit corporation, and there is some suggestion that it was intended to be autonomous.<sup>81</sup> However, at least for constitutional purposes, the Court has taken a formational and functional view of the question of whether a separate corporation, under the auspices of the government, is in fact part of the government. In *Lebron v. National Railroad Passenger Corporation*, the United States Supreme Court laid out a test to determine whether the National Railroad Passenger Corporation ("Amtrak") was a governmental entity for constitutional purposes.<sup>82</sup> The Court began by noting, "[t]hat the Congress chose to call [Amtrak] a corporation does not alter its characteristics so as to make it something other than what it actually is."<sup>83</sup> Therefore, it is not dispositive that SOX states that the "[PCAOB] shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act."<sup>84</sup> The Court in *Lebron* held that where the government creates a corporation by special law, for the furtherance of governmental objectives, and retains for itself permanent authority to appoint a majority of the directors, that corporation is part of the government and, therefore, is no different from the independent regulatory agencies such as the SEC.<sup>85</sup> The PCAOB appears to meet these criteria for the following reasons:

1. Congress created the PCAOB through a special law (SOX);<sup>86</sup>
2. the government objectives were clearly listed;<sup>87</sup> and

---

81. Congress had considered explicitly making the PCAOB part of the SEC. See JICKLING, *supra* note 1, at 3.

82. *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 393 (1995).

83. *Id.* at 393 (quoting *Cherry Cotton Mills, Inc v. United States*, 327 U.S. 536, 539 (1946)).

84. 15 U.S.C.A. § 7211(b) (West 2004).

85. *Lebron*, 513 U.S. at 398-400.

86. 15 U.S.C.A. § 7211(a) (West 2004).

87. *Id.*

3. the SEC retains for itself authority to appoint all the directors of the PCAOB.<sup>88</sup>

The case that the PCAOB is a government agency is even stronger than it was in *Lebron*, where the Court held that Amtrak was a government agency.<sup>89</sup> In *Lebron*, the directors of Amtrak were not removable by the President for cause per the explicit terms of the statute, and were not impeachable by Congress.<sup>90</sup> In the case of the PCAOB, the SEC can remove a director of the PCAOB for good cause shown before the expiration of the member's term.<sup>91</sup>

Government control was an important consideration throughout the *Lebron* decision.<sup>92</sup> In fact, a number of courts have held that the third prong in the *Lebron* test is whether the government has control over an entity, which would encompass a much broader range of factors than if one were to take a more literal reading of *Lebron*.<sup>93</sup> Under this interpretation of the third prong, whether or not the government could appoint the majority of an entity's directors would not be dispositive in determining whether the entity is part of the "government itself." Instead, the ability of the government to select directors is just one factor a court would consider in determining the govern-

---

88. *Id.* § 7211(e).

Donna M. Nagy argues that the PCAOB does in fact meet the criteria of a governmental agency as detailed in *Lebron* and could face a number of constitutional ramifications as a result. See Donna M. Nagy, *Playing Peekaboo With Constitutional Law: The PCAOB and its Public/Private Status*, 80 NOTRE DAME L. REV. 975 (2005).

89. *Lebron*, 513 U.S. at 400.

90. *Id.* at 398.

91. 15 U.S.C.A. § 7211(e)(6) (West 2004).

92. *Lebron*, 513 U.S. at 397 ("[t]hat Government-created and -controlled corporations are (for many purposes at least) part of the Government itself has a strong basis, not merely in past practice and understanding, but in reason itself").

93. Nagy, *supra* note 88, at 1043 (citing *Sotack v. Pa. Prop. & Cas. Ins. Guar. Ass'n*, 104 F. Supp. 2d 471, 479 (E.D. Pa. 2000) (finding that an association of insurers is considered a state entity for constitutional purposes); *Jersawitz v. People TV*, 71 F. Supp. 2d 1330, 1338 (N.D. Ga. 1999) (holding that People TV is an agency of the city for constitutional purposes); *Becker v. Gallaudet Univ.*, 66 F. Supp. 2d 16, 20-21 (D.C. 1999) (holding that despite its congressional creation and governmental objectives, Gallaudet University is not an entity of the federal government for constitutional purposes); *Wilkinson v. Legal Servs. Corp.*, 27 F. Supp. 2d 32, 45 (D.C. 1998) (holding that LSC is an entity of the federal government for constitutional purposes); *Clark v. County of Placer*, 923 F. Supp. 1278, 1285 (E.D. Cal. 1996) (holding that nonprofit fair association is an entity of the county for constitutional purposes)).

ment's control over an entity along with other factors such as government funding,<sup>94</sup> government approval of rules or policies,<sup>95</sup> and governmental supervision.<sup>96</sup> A logical extension of the argument that a corporation is a government agency due in part to the control the government exerts, is that the corporation in question would be part of the government agency that is exerting the control. In this instance, the PCAOB would be part of the SEC given the SEC's control over the PCAOB. Not only does the SEC have control over appointing and removing the PCAOB's directors, it has oversight and enforcement authority over the PCAOB;<sup>97</sup> any final sanction imposed by the PCAOB may be reviewed by the SEC;<sup>98</sup> the rules promulgated by the PCAOB are subject to the approval of the SEC;<sup>99</sup> the PCAOB is required to submit an annual report (including its audited financial statements) to the SEC;<sup>100</sup> the budget of the PCAOB is subject to approval by the SEC;<sup>101</sup> the PCAOB is required to notify the SEC of any PCAOB pending investigation involving potential violations of the securities laws, and, thereafter, coordinate its efforts with those of the SEC's Division of Enforcement as necessary to protect an ongoing SEC investiga-

---

94. Nagy, *supra*, note 88, at 1043 (citing *Gorman-Bakos v. Cornell Coop. Extension*, 252 F.3d 545, 552-53 (2d Cir. 2001) (concluding in dicta that a state-created and state-funded agricultural cooperative was a state actor even though only two of its ten board members were appointed by the government)).

95. *Id.* (citing *Blount v. SEC*, 61 F.3d 938, 941 (D.C. Cir. 1995) (stating that the Municipal Securities Rulemaking Board's assertion that it was a private entity was "questionable" in light of the *Lebron* decision, despite the fact that the government no longer plays a role in appointing MSRB members; vacant seats are filled through a nomination committee composed of private individuals, with current Board members ultimately electing the committee's nominees)).

96. *Id.* (citing *Sotack*, 104 F. Supp. 2d at 478 (stating that the Commissioner of Insurance "has virtually limitless authority to supervise and regulate the PPCIGA at all times")).

97. 15 U.S.C.A. § 7217(a) (West 2004).

98. *Id.* § 7217(c)(3). This argument in no way means to suggest that because the federal courts can review a SEC decision, that the SEC should be considered part of the federal courts. This factor, viewed in conjunction with all the other listed factors, only adds to the argument that SEC is exerting control over the PCAOB and is not dispositive in and of itself.

99. *Id.* § 7211(g).

100. *Id.* § 7211(h).

101. *Id.* § 7219(b).

tion;<sup>102</sup> and if the PCAOB wants to obtain a subpoena it must request it from the SEC.<sup>103</sup>

If the SEC were to apply the requirements it uses to govern the consolidation of business entities for financial reporting purposes to the PCAOB, then it would have to consolidate the PCAOB into the SEC. Under GAAP, a parent company is required to consolidate all companies in which it has a controlling financial interest.<sup>104</sup> The SEC in its own Regulation S-X defines control to include "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise."<sup>105</sup> The SEC does not list specific criteria in determining when a less-than-majority owned entity should be consolidated.<sup>106</sup> Instead, the SEC notes that substance must be considered over form in determining an appropriate consolidation policy.<sup>107</sup> As a result, if the SEC were to apply its own rules and regulations regarding consolidation, and consider substance over form, it would have to consolidate the PCAOB into the SEC, given the control that the SEC exerts over the PCAOB.

One could argue that the PCAOB is no different than the NASD, which was held not to be the same party as or to be privies with the SEC by the Fourth Circuit in *Jones v. Securities and Exchange Commission*.<sup>108</sup> In *Jones*, a stockbroker contended that the NASD's prior disciplinary action against him precluded the SEC from bringing its own disciplinary proceeding.<sup>109</sup> Under the *Lebron* test, the NASD, unlike the PCAOB, is truly an independent corporation or SRO. Unlike the PCAOB, the NASD was not specifically created by the government under a special statute<sup>110</sup> and the government did not retain for itself

---

102. *Id.* § 7215(b)(4).

103. *Id.* § 7215(b)(2)(D).

104. FINANCIAL ACCOUNTING STANDARDS BOARD, FINANCIAL ACCOUNTING FOUNDATION, STATEMENT OF FINANCIAL ACCOUNTING STANDARD No. 94 (Oct. 1987).

105. Regulation S-X, 17 C.F.R. § 210.1-02(g) (2004).

106. *Id.* § 210.3A-02.

107. *Id.*

108. *Jones v. SEC*, 115 F.3d 1173, 1181 (4th Cir. 1997).

109. *Id.* at 1182.

110. An important distinction is that the NASD was created *under* the Maloney Act. 15 U.S.C.A. § 78o-3 (West 2004). The NASD was not created by the Maloney Act.

permanent authority to appoint a majority of the NASD's directors.<sup>111</sup> Also, although the SEC may review NASD proceedings,<sup>112</sup> unlike the PCAOB, the NASD is not required to submit an annual report (including its audited financial statements) to the SEC; the budget of the NASD is not subject to approval by the SEC; and the NASD is not required to notify the PCAOB of a pending investigation, and thereafter coordinate its efforts with those of the SEC's Division of Enforcement as necessary to protect an ongoing SEC investigation.<sup>113</sup> As a result, unlike the NASD, the PCAOB is so closely controlled by the SEC that not only may the PCAOB be a part of the government, it may be part of the SEC itself.

Even if a court finds that the PCAOB is part of the government and even more precisely that it is part of the SEC, the question remains whether the doctrine of collateral estoppel is required to be rooted in the U.S. Constitution.<sup>114</sup> The Court in *Lebron* held that, while Congress's description of Amtrak as an independent non-profit corporation is not dispositive of Amtrak's status as a governmental agency for constitutional purposes, it is dispositive for matters within Congress's control.<sup>115</sup> The Court noted that some of the matters that are within Congress's control include whether Amtrak is subject to statutes that impose obligations or confer powers upon Government entities, such as the Administrative Procedure Act and the laws governing Government procurement.<sup>116</sup> Furthermore, the Court stated that calling Amtrak a non-profit corporation can suffice to deprive Amtrak of sovereign immunity from a lawsuit.<sup>117</sup> The Court failed to note whether Congress calling an entity a non-profit corporation would be dispositive of that entity's status as a governmental agency in circumstances involving collateral estoppel. At least one lower court has held that an entity can simultaneously be a governmental entity for promissory estoppel purposes and not be a government entity

---

111. *Id.* § 78o-3(b)(4).

112. *Id.* § 78o-3(h)(3).

113. *Id.* § 78o-3.

114. As previously noted, the rules of preclusion are based in common law, not the Constitution. See *supra* Section II.A.

115. *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 392 (1995).

116. *Id.*

117. *Id.*



for constitutional purposes.<sup>118</sup> However, it is unclear based on that holding if an entity can be a governmental entity for collateral estoppel purposes as well.

ii. *Privity*

Given that there is an argument, albeit a somewhat attenuated one, that the SEC and the PCAOB are the same party, based on the relationship between the parties, there is an even stronger argument that SEC and PCAOB are at least privies. The Supreme Court has characterized privity as a “substantial identity” between parties.<sup>119</sup> In *United States v. ITT Rayonier, Inc.*, the Ninth Circuit found that the relationship between the United States Environmental Protection Agency (“EPA”) and the Washington Department of Ecology (“DOE”) was sufficiently close so that the EPA was collaterally estopped from relitigating an issue which had already been decided in a state enforcement action brought by the DOE.<sup>120</sup> In reaching that decision, the Ninth Circuit focused on the fact that the DOE and the EPA’s interests were identical in that they both acted to enforce the same pollution discharge permit.<sup>121</sup> With limited exception, the PCAOB and the SEC would be acting to enforce the same rules. As previously noted, all enforcement proceedings brought by the PCAOB against a public accountant would be brought to enforce the federal securities laws relating to the preparation and issuance of audit reports, rules of the PCAOB, provisions of SOX or professional standards and, for the most part, the same would be true in an action brought by the SEC in a proceeding under Rule 102(e).<sup>122</sup>

Even if the PCAOB is not found to be a government agency, collateral estoppel would still potentially apply per the Ninth Circuit’s analysis in *ITT Rayonier*. The Ninth Circuit in *ITT Rayonier* held that in some cases, “the relationship between governmental authorities as public enforcers of ordinances and private parties suing for enforcement . . . is close enough to pre-

---

118. *Paslawski v. Standard Mortgage Corp. of Ga.*, 129 F. Supp. 2d 793, 802 n.12 (W.D. Pa. 2000) (citing *Mendrala v. Crown Mortgage Co.*, 955 F.2d 1132, 1139 (7th Cir. 1992)).

119. *Chicago, R. I. & P. Ry. Co. v. Schendel*, 270 U.S. 611, 621 (1926).

120. *United States v. ITT Rayonier, Inc.*, 627 F.2d 996, 1003 (9th Cir. 1980).

121. *Id.*

122. See *supra* Section I.C.

clude relitigation.”<sup>123</sup> Also, in *Montana v. United States*, the Court held that a prior judgment by the Montana Supreme Court against a government contractor, which brought the suit at the direction of the federal government, precluded the federal government from relitigating the issue.<sup>124</sup> In reaching its decision, the Court noted that there was mutuality between the federal government and the government contractor, given the control the federal government exerted over the original litigation.<sup>125</sup> In the case of the SEC and the PCAOB, their relationship is so close there is an argument that they are in fact the same party.<sup>126</sup> This closeness is a result of the control that the SEC exerts over the PCAOB, including the actual and perceived control the SEC will have over the PCAOB in its enforcement actions. The SEC has actual control over the PCAOB in its enforcement actions in that any final sanction imposed by the PCAOB may be reviewed by the SEC.<sup>127</sup> Also, if the PCAOB is unable to obtain testimony or documents on a voluntary basis, the PCAOB must request that the SEC issue a subpoena if it wishes to obtain the information.<sup>128</sup> There is also a perception of control, whether or not the SEC chooses to exert this control, given that the SEC has permanent authority to appoint and remove the PCAOB’s directors,<sup>129</sup> the budget of the PCAOB is subject to approval by the SEC,<sup>130</sup> and the PCAOB is required to notify the SEC of any PCAOB pending investigation, and thereafter coordinate its efforts with those of the SEC’s Division of Enforcement as necessary to protect an ongoing SEC investigation.<sup>131</sup>

This close relationship also helps distinguish the circumstances of the PCAOB and SEC from the holding in *Jones*. *Jones* is the case in which the Fourth Circuit held that the NASD and the SEC were not privies.<sup>132</sup> In reaching that deci-

---

123. *ITT Rayonier, Inc.*, 627 F.2d at 1003.

124. *Montana v. United States*, 440 U.S. 147, 162 (1979).

125. *Id.* at 155.

126. *See supra* Section II.B.1.c.i.

127. *See supra* note 98 and accompanying text.

128. *See supra* note 103 and accompanying text.

129. *See supra* notes 88, 91 and accompanying text.

130. *See supra* note 101 and accompanying text.

131. 15 U.S.C.A. § 7215(b)(4) (West 2004).

132. *See supra* note 108 and accompanying text.

sion, the Fourth Circuit held that the NASD's interests in prosecuting an enforcement action did not represent the same interest the SEC had in reviewing the NASD action and, therefore, the parties were not privies.<sup>133</sup> In this instance, the SEC's relationship with the PCAOB is more substantial than merely reviewing a PCAOB enforcement action.<sup>134</sup>

In determining whether two state government agencies were privies, the Eleventh Circuit in *Hercules Carriers* analyzed not only whether the agencies had similar interests but also whether the agencies had similar functions.<sup>135</sup> In determining whether the government agencies had similar functions, the Eleventh Circuit looked to the purpose of the agencies in bringing their actions.<sup>136</sup> It appears that the SEC acting under Rule 102(e) and the PCAOB in an enforcement action have the same functions in bringing actions against public accountants. The SEC acting under Rule 102(e) and PCAOB enforcement actions are in place to protect the interest of public investors in ensuring that they can have confidence in the integrity of the financial reporting process.<sup>137</sup> It appears that the PCAOB and SEC may or may not have similar functions if a court were to look to the broader purpose of the SEC and PCAOB as organizations. The primary mission of the SEC is to protect investors

---

133. *Jones v. SEC*, 115 F.3d 1173, 1181 (4th Cir. 1997).

134. It is unclear whether the Fourth Circuit would have reached the same conclusion in *Jones* if the SEC had brought an injunctive action against the broker, as opposed to administrative proceedings. Unlike in an administrative action, the SEC can bring an injunctive action for a violation of the rules of the NASD. 15 U.S.C.A. § 78u(d)(1) (West 2004).

135. *Hercules Carriers, Inc. v. Claimant State of Fla., Dep't of Transp.*, 768 F.2d 558, 1580 (11th Cir. 1985) (holding that the State of Florida Department of Professional Regulations and Department of Transportation were not considered privies given they had different functions and interests).

136. *Id.*

137. In passing an amendment to Rule 102(e) the SEC noted that it wanted Rule 102(e) to ensure that the SEC's "processes continue to be protected, and that the investing public continues to have confidence in the integrity of the financial reporting process." Amendment to Rule 102(e) of the SEC's Rules of Practice, 63 Fed. Reg. 57164-01, 57164-65 n.7 (Oct. 26, 1998). Similarly, the PCAOB was created to "to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors." 15 U.S.C.A. § 7211(a) (West 2004). Therefore, it appears that both Rule 102(e) and the PCAOB are in place to protect the interest of public investors in ensuring that they can have confidence in the integrity of the financial reporting process.

and maintain the integrity of the securities markets.<sup>138</sup> On the other hand, the PCAOB was created to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports for public companies.<sup>139</sup>

This analysis suggests that whichever entity receives a judgment first may preclude the other under collateral estoppel from relitigating issues already litigated in the earlier action. This is true given that the issues at stake in the SEC's administrative proceeding under Rule 102(e) should, for the most part, be identical to the issues involved in the PCAOB enforcement action and the determination of those issues in the prior litigation would be a critical and necessary part of the judgment in the earlier action. Also, it appears that the mutuality requirement is met given that the SEC and the PCAOB may be the same party or at least privies.

## 2. Injunctive Actions

The doctrine of collateral estoppel may also affect the PCAOB or the SEC's ability to litigate in instances where the SEC attempts to bring an injunctive action. Once again, it is assumed for the purposes of this Article that the issues in question, if the same, will already have been litigated by the SEC in an injunctive action or the PCAOB in an enforcement action and, therefore, the second prerequisite of collateral estoppel will be met.<sup>140</sup> As in the case where the SEC brings a Rule 102(e) proceeding, if both the SEC (in an injunctive action) and the PCAOB (in an enforcement action) were to bring simultaneous actions against Mr. Smith either the PCAOB or the SEC would have to obtain its judgment first resulting in the issues at stake being fully litigated.<sup>141</sup> Also, the fourth prerequisite is met, given that the SEC and the PCAOB may be the same party or at least privies.<sup>142</sup>

---

138. The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, <http://www.sec.gov/about/whatwedo.shtml#intro> (last visited Apr. 18, 2008).

139. See *supra* note 137 and accompanying text.

140. See *supra* Section II.B.1.a.

141. See *supra* Section II.B.1.a.

142. See *supra* Sections II.B.1.c.i. & II.B.1.c.ii.

Regarding whether the issues at stake would be identical to the ones involved in the prior litigation, and whether those issues were a critical and necessary part of the judgment of the earlier action, the PCAOB will have the power to bring proceedings against public accountants for violations of the federal securities laws relating to the preparation and issuance of audit reports.<sup>143</sup> Injunctive actions brought by the SEC against public accountants are brought in federal court under the federal securities laws.<sup>144</sup> Hence, it is assumed that the SEC would, at least in part, bring its injunctive action for the same violation of the federal securities law as the PCAOB. For instance, suppose both the PCAOB and SEC brought an action against Mr. Smith for certifying publicly filed financial statements that he knew, or was reckless in not knowing, were false in violation of Section 10(b) and Rule 10b-5. The issues surrounding his alleged violation of the federal securities laws should be identical in both a PCAOB enforcement proceeding and an SEC injunctive proceeding. Also, the issues surrounding Mr. Smith's alleged violation would be a critical and necessary part of the judgment of the earlier action because those issues would be essential in determining whether Mr. Smith violated the federal securities laws.

As a result, as in the case where the SEC brings an administrative proceeding, whichever entity receives a judgment first may preclude the other, under collateral estoppel, from relitigating issues already litigated in the earlier action.

### C. *Res Judicata*

The doctrine of collateral estoppel is not the only legal doctrine that may affect the PCAOB's or the SEC's ability to litigate when one or the other has already brought an action against the same defendant. The PCAOB in an enforcement proceeding or the SEC in an administrative proceeding under Rule 102(e) or in an injunctive action may be precluded from relitigating claims that have already been or could have been litigated by the other.

---

143. See *supra* note 29 and accompanying text.

144. See *supra* note 29 and accompanying text.

### 1. Administrative Actions Under Rule 102(e)

Under *res judicata*, the SEC in an administrative proceeding or the PCAOB in an enforcement proceeding could be barred from pursuing an action if the other had already brought an action against the same party. To establish a *res judicata* defense in a civil action, a party must demonstrate:

1. a final judgment on the merits in a prior suit;
2. an identity of parties or their privies in the two suits; and
3. an identity of the claim in both the earlier and the later suit.<sup>145</sup>

#### a. *Final Judgments and Identity of the Parties*

Regarding the first prerequisite, for the purposes of this Article it is assumed that there would have been a final judgment on the merits in a PCAOB enforcement proceeding or in an SEC administrative proceeding under Rule 102(e).<sup>146</sup> The SEC and the PCAOB appear to be the same party or at least privies, therefore, the third prerequisite may be met.<sup>147</sup> The remaining question is whether there is an identity of the claims in an SEC administrative proceeding brought under Rule 102(e) and a PCAOB enforcement action.

#### b. *Identity of the Claim*

In modern case law, the term “claim”<sup>148</sup> has been given varied application, depending largely on the facts in each case. In some cases, the application of the term depends on whether the evidence in the two cases is the same, in other cases on whether the actions involve the same subject matter or wrongful act.<sup>149</sup> In a situation involving both criminal and civil proceedings, the identity of claims fail given the varying burdens of proof re-

---

145. *Montana v. United States*, 440 U.S. 147, 153 (1979).

146. *See supra* Section II.B.1.a.

147. *See supra* Section II.B.1.c.

148. The term “claim” is often used synonymously with the term “cause of action.” *See* BLACK’S LAW DICTIONARY 247 (8th ed. 2004) (defining “claim” as “cause of action”).

149. *Nash County Bd. of Educ. v. Biltmore Co.*, 640 F.2d 484, 487-88 (4th Cir. 1981) (citing *The Haytian Republic*, 154 U.S. 118, 125 (1894); *Baltimore S.S. Co. v. Phillips*, 274 U.S. 316, 321, (1927); *Norman Tobacco & Candy Co. v. Gillette Safety Razor Co.*, 295 F.2d 362, 363 (5th Cir. 1961)).

quired.<sup>150</sup> In the case of the PCAOB and SEC, it appears there could be an identity of the claims when the PCAOB pursues an enforcement action and the SEC pursues an administrative proceeding against the same public accountant for the same violation. For instance, suppose the PCAOB and the SEC were both pursuing actions against Mr. Smith for his alleged violation of the profession's standards while he was conducting an audit. In this instance, the actions by the PCAOB and the SEC would both concern the same subject-matter, i.e., Mr. Smith's conduct during his audit. The two suits would also allege the same wrongful act, i.e., Mr. Smith's violation of the profession's standards. Given that the subject matter would be the same and the same wrongful act would be alleged, it is a logical assumption that the evidence presented would likewise be the same.<sup>151</sup>

Also, the identity between two claims that are intimately tied together will not fail simply because actions are based on different statutes.<sup>152</sup> Hence, the identity of the claims in this instance will not be destroyed in the *res judicata* context due to the fact that one action is based on SOX while the other is based on Rule 102(e).

The identity between two claims will be destroyed, however, when the second claim is not capable of recovery in the first action.<sup>153</sup> Given that the identity between claims will be destroyed if the second claim is not "then capable of recovery" in

---

150. *Helvering v. Mitchell*, 303 U.S. 391, 397 (1938) (superseded by statute on other grounds) (holding that the difference in degree of the burden of proof in criminal and civil cases precludes application of the doctrine of *res judicata* in a civil suit based on a criminal case).

151. The Court has noted that "[r]es judicata not only bars relitigation of claims previously litigated, but also precludes claims that could have been brought in earlier proceedings." *Arizona v. California*, 530 U.S. 392, 424 (2000). Therefore, even if the SEC and PCAOB try to coordinate their actions so they are not bringing overlapping claims they would not be able to avoid *res judicata*. For instance, suppose the SEC decides to pursue an administrative action against Mr. Smith for his violation of the securities laws. In coordinating with the SEC, the PCAOB, instead of also bringing an action against Mr. Smith for his violation of the securities laws, decides to bring an action against Mr. Smith for his violation of the profession's standards. The PCAOB would still be barred under *res judicata* from litigating this claim, because the SEC could have brought a claim against Mr. Smith for his violation of the professions standards in the earlier action.

152. *Nash County Bd. of Educ.*, 640 F.2d at 489.

153. 47 AM. JUR. 2D *Judgments* § 536 (2007) (citing RESTATEMENT (SECOND) OF JUDGMENTS § 26).

the first action, then depending on the facts and circumstances there may not be an identity of all the claims in an SEC administrative proceeding under Rule 102(e) and a PCAOB enforcement action. In cases where the PCAOB brings an action where there was intentional or knowing conduct (including reckless conduct) or repeated instances of negligent conduct, the PCAOB can seek to levy fines, suspend or permanently revoke registration with the PCAOB, censure, require additional training or any other appropriate sanction provided by the PCAOB,<sup>154</sup> whereas the SEC under Rule 102(e) can only seek to censure or to deny the privilege of practicing before the SEC.<sup>155</sup> As a result, the order of the forums would be crucial.

If the first forum is an SEC administrative proceeding under Rule 102(e), the SEC would not be able to provide all the relief sought in the PCAOB proceeding. Both a suspension of registration with the PCAOB and the denial of the privilege to practice before the SEC effectively act as bar on a public accountant from preparing audit reports.<sup>156</sup> Therefore, if the SEC brought its administrative proceeding under Rule 102(e) first, the PCAOB would be restricted by *res judicata* from seeking a suspension of registration with the PCAOB, but it would not be restricted in seeking a number of other penalties including, but not limited to, monetary penalties.<sup>157</sup> If the order of the forums were reversed, *res judicata* would appear to apply, given that all the relief sought by the SEC would have been recoverable in the PCAOB proceeding.

In cases where the PCAOB brings an enforcement action for a single negligent act, the order of the forums would be irrelevant given the different relief that could be provided. The PCAOB can seek a monetary penalty, censure, require addi-

---

154. See *supra* note 31 and accompanying text.

155. See *supra* note 41 and accompanying text.

156. 17 C.F.R. section 201.102(f) defines practicing before the SEC to include: "The preparation of any statement, opinion or other paper by any attorney, accountant, engineer or other professional or expert, filed with the Commission in any registration statement, notification, application, report or other document with the consent of such attorney, accountant, engineer or other professional or expert." 17 C.F.R. § 201.102(f) (2004). 15 U.S.C.A section 7212(a) states that it "shall be unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer." 15 U.S.C.A § 7212(a) (West 2004).

157. See *supra* note 31 and accompanying text.



tional training or any other appropriate sanction provided by the PCAOB, but not a bar against practicing before the PCAOB.<sup>158</sup> In contrast, the SEC under Rule 102(e) can seek to censure or to deny the privilege of practicing before the SEC.<sup>159</sup> Hence, the identity between claims would be destroyed, since the second claim would not be capable of recovery in the first action.

Given the different remedies that can be provided in SEC administrative actions and PCAOB enforcement proceedings, depending on the order of the forums, *res judicata* may not apply if the claim was not capable of recovery in the earlier action.

## 2. Injunctive Actions

As in the case of administrative proceedings under Rule 102(e), the question of whether *res judicata* would be applicable in cases of SEC injunctive actions hinges on whether there would be an identity of the claims in an SEC injunctive action and a PCAOB enforcement action against the same public accountant.

Whether there would be an identity of claims can be demonstrated by an action against our fictitious accountant Mr. Smith. Suppose the PCAOB and the SEC were both pursuing actions against Mr. Smith for certifying publicly filed financial statements that he knew, or was reckless in not knowing, were false, in violation of Section 10(b) and Rule 10b-5. In this instance, the actions by the PCAOB and the SEC would both concern the same subject-matter, i.e., Mr. Smith's conduct while certifying the financial statements. The two suits would allege the same wrongful act, i.e., that Mr. Smith knew, or was reckless in not knowing that he prepared and certified publicly filed financial statements that were false, in violation of Section 10(b) and Rule 10b-5. Given that the subject matter would be the same and the same wrongful act would be alleged, it is a logical assumption that the evidence presented would also be the same.

However, as previously noted, the identity of two claims will be destroyed if the second claim is not "then capable of re-

---

158. See *supra* note 31 and accompanying text.

159. See *supra* note 41 and accompanying text.

covery" in the first action.<sup>160</sup> In this instance, the relief that the SEC can seek in injunctive actions would not mirror the relief that can be obtained in a PCAOB proceeding. The SEC in injunctive actions and the PCAOB in its enforcement actions can both seek monetary penalties.<sup>161</sup> The SEC in injunctive actions can also seek injunctions against future violations of the federal securities laws.<sup>162</sup> Whereas in a PCAOB enforcement proceeding, the PCAOB can additionally seek to have a public accountant deregistered from the PCAOB amongst other additional penalties.<sup>163</sup>

Given the different remedies that can be provided in injunctive actions and PCAOB enforcement proceedings, no matter the order of the fora, neither party would be completely barred under *res judicata* from seeking relief that was not available in the earlier action.

### 3. The NASD Comparison

The theory that *res judicata* may apply in instances where the PCAOB and the SEC both pursue actions against the same public accountant arising out of the same wrongdoing is not undermined by *Jones*. Recall that the Fourth Circuit in *Jones* held that that the SEC and NASD are not in privity with each other.<sup>164</sup> The Fourth Circuit also held that the defendant could not establish the second *res judicata* requirement, that the SEC's subsequent enforcement action was the same claim as the NASD's enforcement action.<sup>165</sup>

Regarding the second requirement, the Fourth Circuit held that, given the statutory schemes and the relationships between the parties, the NASD's enforcement actions were not under the same claim as the SEC's later enforcement action.<sup>166</sup> The court noted that the NASD order amounted to a final, internal NASD order sanctioning the defendant for violating the

---

160. See *supra* note 153 and accompanying text.

161. See *supra* notes 31, 45 and accompanying text.

162. See *supra* note 45 and accompanying text.

163. See *supra* note 31 and accompanying text.

164. See *supra* note 108 and accompanying text.

165. *Jones v. SEC*, 115 F.3d 1173, 1178 (4th Cir. 1997).

166. *Id.*

NASD's established rules.<sup>167</sup> The SEC's administrative proceeding on the other hand was designed not only to protect the integrity of the markets but also to vindicate the public interest, as determined by an agency of the government created by Congress to enforce the securities laws.<sup>168</sup> The Fourth Circuit also considered the fact that the SEC had more powerful authorizations than the NASD, including the right to seek injunctive relief.<sup>169</sup>

The holding of the Fourth Circuit in *Jones* may not be applicable to instances where the SEC and the PCAOB bring concurrent actions, given that the PCAOB and its enforcement proceedings do not appear to be analogous to the NASD and its enforcement proceedings.<sup>170</sup> The PCAOB, unlike the NASD, will not bring an action solely for violations of PCAOB promulgated rules. The PCAOB's enforcement proceedings and the SEC's administrative proceedings and injunctive actions, in most instances, would be brought to make the same determination. They would be brought to determine if there were any violations of the securities laws relating to the preparation and issuance of audit reports, rules of the PCAOB, provisions of SOX, or professional standards.<sup>171</sup> Also, the PCAOB, unlike the NASD, was specifically created by Congress and is arguably in privity with the SEC if not a part of the SEC itself.<sup>172</sup> Regarding the authorization, in certain circumstances it would be the PCAOB that has the greater authorization, and if the SEC were to bring an action after the PCAOB all the relief sought by the SEC would have been recoverable in the PCAOB proceeding. Where the PCAOB brings an action and there was intentional

---

167. *Id.* at 1180. It is unclear whether the Fourth Circuit would have reached the same conclusion in *Jones* if the SEC had brought an injunctive action against the broker, as opposed to administrative proceedings. Unlike an administrative action, the SEC can bring an injunctive action for a violation of the rules of the NASD. 15 U.S.C.A. § 78u(d)(1) (West 2004).

168. *Jones*, 115 F.3d at 1180.

169. *Id.*

170. The NASD was consolidated with the member regulation, enforcement and arbitration functions of the New York Stock Exchange in July 2007 creating the Financial Industry Regulatory Authority ("FINRA"). Program for Allocation of Regulatory Responsibilities, Exchange Act Release No. 34-56148, File No. 4-544 (Jul. 26, 2007).

171. See *supra* Section II.B.1.

172. See *supra* Section II.B.1.c.

or knowing conduct (including reckless conduct) or repeated instances of negligent conduct on the part of the public accountant, the PCAOB can seek to levy fines, suspend or permanently revoke registration with the PCAOB, censure, require additional training or any other appropriate sanction provided by the PCAOB;<sup>173</sup> whereas, the SEC under Rule 102(e) is limited to censure and denying the public accountant the privilege of practicing before the SEC.<sup>174</sup> Therefore, the holding by the Fourth Circuit in *Jones* may not be applicable to enforcement actions by the PCAOB and SEC, given that: the PCAOB unlike the NASD was specifically created by Congress; for the most part, the PCAOB will bring its enforcement proceedings for the same violation as the SEC; in some instances, the PCAOB will have greater authorization than the SEC; and the PCAOB and SEC appear to be privies, if not in fact the same party.

### III. Regulating Public Accounts With or Without Congressional Action

It appears that the SEC or the PCAOB may be severely limited in bringing actions where one or the other has already brought an action against the same defendant. Given that the PCAOB was created for the sole purpose of regulating public accountants, it seems a logical inference to expect that the SEC would defer to the PCAOB and allow it to adjudicate matters first. If the SEC chooses to allow the PCAOB to bring its actions ahead of the SEC, one limitation the SEC may face is that it will be barred under the doctrines of collateral estoppel from relitigating issues, in administrative actions and in injunctive proceedings, that were already litigated by the PCAOB.<sup>175</sup> The second limitation the SEC could face, is that it may also be barred under *res judicata* from relitigating claims, in administrative actions and in injunctive proceedings, that were litigated or could have been litigated by the PCAOB.<sup>176</sup> Although the SEC may never be completely barred under *res judicata* from relitigating claims in injunctive proceedings, given that there are a number of remedies that are not recoverable in a

---

173. See *supra* note 31 and accompanying text.

174. See *supra* note 41 and accompanying text.

175. See *supra* Sections II.B.1. & II.B.2.

176. See *supra* Sections II.C.1 & II.C.2.

PCAOB enforcement action,<sup>177</sup> the reason the SEC in recent years had been relying so heavily on Rule 102(e) administrative actions is that federal courts have made it increasingly difficult for the SEC to obtain injunctive relief.<sup>178</sup> Also, if a number of issues were already decided against the PCAOB in an earlier action, collateral estoppel could make the question of whether *res judicata* applies less significant.

#### A. *Congressional Action*

Congress could choose to intervene in an attempt to remove the restrictions of collateral estoppel and *res judicata*. Congress could simply amend SOX to state that collateral estoppel and *res judicata* do not apply to the PCAOB and SEC where one or the other has already brought an action against the same defendant.<sup>179</sup>

Congress could also choose to work within the parameters of the doctrines of collateral estoppel and *res judicata*. If Congress chooses this path, it could amend SOX so that there is no question that the PCAOB and the SEC are neither the same party nor privies. In order for the PCAOB to no longer be considered part of the government, or more importantly part of the SEC, under the *Lebron* test Congress would have to strip the SEC of its ability to appoint the PCAOB's directors and grant that responsibility to some nongovernmental body or bodies.<sup>180</sup>

Given the interrelatedness of the SEC and PCAOB, it is unclear how far Congress would have to go in amending SOX to ensure that the PCAOB and the SEC are not privies. Due to the fact that the NASD and the SEC were held not to be privies in *Jones*,<sup>181</sup> perhaps the NASD can be used as a litmus test or baseline for Congress in determining required revisions to SOX. If Congress decides to use the NASD as its model for the PCAOB, along with stripping the SEC of its ability to select and remove the PCAOB's directors, Congress would also have to

---

177. See *supra* Section II.C.2.

178. See *supra* note 46 and accompanying text.

179. See *supra* note 58.

180. It seems unlikely that Congress would act on one of the other two prongs of the *Lebron* test, given that such an action would require Congress to either dis-solve the PCAOB or make the government objectives more vague. See *supra* notes 86-89.

181. See *supra* note 108 and accompanying text.

take away the SEC's ability to control the PCAOB's budget, and no longer require that the PCAOB coordinate its pending investigations involving potential violations of the securities laws with the SEC.<sup>182</sup> Based on the guidance in *Jones*, Congress would not have to strip the SEC of its ability to review sanctions imposed by the PCAOB.<sup>183</sup>

*B. Achieving Regulatory Goals Without Congressional Intervention*

If Congress chooses not to act, and the SEC chooses to defer to the PCAOB despite all of the potential restrictions, this does not necessarily mean that the SEC and PCAOB would not be able to meet the regulatory interest of SOX. Acting in a coordinated manner, a strong and vibrant PCAOB, with oversight from the SEC, could meet the goals of SOX as it pertains to the regulation of public accountants.

Pre-SOX public accountants performing audits of financial statements filed with the SEC were essentially self-regulated. This self-regulation was for the most part left to an ineffective AICPA,<sup>184</sup> which was overseen in part by a non-independent POB.<sup>185</sup> The SEC also participated in the regulation, but it only had the resources to bring enforcement actions for the most egregious violations.<sup>186</sup> Post-SOX, the SEC, acting through an appropriately aggressive PCAOB, has the opportunity to remedy these problems that previously existed with the AICPA and an under funded POB and SEC.

Adequate resources to carry out its mandate should not be an issue for the PCAOB given that it receives its funding directly from accounting firms, through registration and annual fees, and from public companies in the form of mandatory "ac-

---

182. See *supra* Section II.B.1.c.i. Such a reduction in the oversight capabilities of the SEC may not be acceptable to Congress, given that in the legislative history to SOX, Congress noted that strong SEC oversight of the PCAOB was important because it assures that the PCAOB's policies are consistent with the administration of the federal securities laws, protects the rights of accounting firms and individuals subject to the PCAOB's jurisdiction, and it allows the public an important forum for commenting on PCAOB rules relating to auditing, quality control, and related standards. S. REP. No. 107-205, at 12 (2002).

183. See *supra* note 133 and accompanying text.

184. See *supra* notes 22-24 and accompanying text.

185. See *supra* notes 14,15 and accompanying text.

186. See *supra* notes 18, 19 and accompanying text.

counting support fees.”<sup>187</sup> There is a large incentive for companies to pay these accounting support fees. No registered public audit firm can sign an unqualified audit opinion, or issue a consent to an issuer’s financial statements, if that public company has past-due annual payments to the PCAOB.<sup>188</sup> For the fiscal year 2006, the SEC approved a budget for the PCAOB of \$128 million.<sup>189</sup>

Although the SEC may not always directly bring enforcement actions, this does not mean that the SEC, independent of the PCAOB, will simply be a bystander in the enforcement process. In this new enforcement paradigm, the SEC will oversee the PCAOB and has the opportunity to ensure that the PCAOB is acting appropriately in its enforcement capacity. Former SEC Chairman, William O. Douglas, once noted that in the government’s oversight of self-regulatory organizations the “government would keep the shotgun, so to speak, behind the door, loaded, well-oiled, clean, ready to use but with the hope that it would never have to be used.”<sup>190</sup> Perhaps the SEC’s oversight of the PCAOB will take a similar form, except given the control the SEC exerts over the PCAOB, the SEC’s shotgun might be brandished out in the open. In order to ensure the PCAOB is performing its duty as required by SOX, the SEC has the power to sanction the PCAOB if it is not diligent in performing its duties and the SEC also has the option of removing the directors of the PCAOB.<sup>191</sup>

Congress did not just provide the SEC with sanction power, it also ensured that the SEC would receive the funding and information the SEC would need for proper oversight of the PCAOB. As of 2006, Congress has increased the SEC’s budget by 90 percent since 2002 from \$466 million<sup>192</sup> to \$888 million.<sup>193</sup>

---

187. 15 U.S.C.A. § 7219(c)(1) (West 2004).

188. PCAOB Rule 7103(b) (2004).

189. PCAOB BUDGET, FISCAL YEAR 2006 (2006), *available at* [http://www.pcaob.com/About\\_the\\_PCAOB/Budget\\_Presentations/2006.pdf](http://www.pcaob.com/About_the_PCAOB/Budget_Presentations/2006.pdf).

190. WILLIAM O. DOUGLAS, *DEMOCRACY AND FINANCE* 82 (James Allen ed., 1940).

191. 15 U.S.C.A. § 7217(d) (West 2004).

192. U.S. GEN. ACCOUNTING OFFICE, *PRELIMINARY OBSERVATIONS ON SEC’S SPENDING AND STRATEGIC PLANNING*, GAO-03-969T (2003), *available at* <http://www.gao.gov/new.items/d03969t.pdf>.

193. U.S. SEC. AND EXCH. COMM’N, *FISCAL 2007 CONGRESSIONAL BUDGET REQUEST* (2006), *available at* <http://www.sec.gov/about/secfy07budgetreq.pdf>.

Also, SOX requires that the PCAOB provide the SEC with the information that the SEC will need to monitor the PCAOB's enforcement actions. The PCAOB is required to notify the SEC of any PCAOB pending investigation involving potential violations of the securities laws, and thereafter, coordinate its efforts with those of the SEC's Division of Enforcement.<sup>194</sup> Importantly, this sharing of information will not result in the loss of the information's status as confidential and privileged in the hands of the PCAOB.<sup>195</sup> After its review of the information, the SEC will have the opportunity to decide whether it would rather let the PCAOB bring the suit or to bring the suit itself.<sup>196</sup>

The SEC may choose to bring a suit in the place of the PCAOB for a number of reasons. For instance, the SEC may want to utilize rule 102(e) as it has previously to explain the application of professional standards for accountants.<sup>197</sup> In the past, the SEC's guidance to accountants on particular aspects of the audit function in 102(e) proceedings was often more extensive than those issued by the profession's standard-setting bodies.<sup>198</sup>

There are also some advantages to the SEC bringing certain actions in the place of the PCAOB. The PCAOB can only seek monetary penalties, censure, require additional professional education or training, and any other appropriate sanction provided for in the rules of the PCAOB when there has been a single instance of negligent conduct.<sup>199</sup> The PCAOB cannot seek temporary or permanent revocation of registration with the PCAOB for a single instance of negligent conduct.<sup>200</sup> In contrast, in Rule 102(e) proceedings for improper professional conduct, the SEC may bar an individual from tempora-

---

194. 15 U.S.C.A. § 7215(b)(4) (West 2004).

195. *Id.* § 7215(b)(5).

196. It is unclear if Congress intended, by forcing the PCAOB to coordinate its efforts with those of the SEC's Division of Enforcement, that the SEC would be able to decide whether it brings an action in the place of the PCAOB. However, given the control the SEC exerts over the PCAOB, it can be assumed that the SEC would be able to decide whether it would rather let the PCAOB bring an action or to bring the action itself.

197. Daniel L. Goelzer & Susan Ferris Wyderko, *Rule 2(e): Securities and Exchange Commission Discipline of Professionals*, 85 NW. U. L. REV. 652, 666 (1991).

198. Johnson & Albert, *supra* note 36, at 600.

199. *See supra* notes 31-32 and accompanying text.

200. *See supra* notes 31-32 and accompanying text.



rily or permanently appearing or practicing before the SEC due to a single instance of highly unreasonable conduct that results in a violation of applicable professional standards.<sup>201</sup>

### Conclusion

Without Congressional action, the regulation of public accountants might not take the form that the SEC intended because of the potential restrictions that the doctrine of collateral estoppel and *res judicata* could pose. However, even without Congressional action, past regulatory inadequacies may still be cured through a vibrant PCAOB that is closely governed by the SEC.

---

201. See *supra* notes 37-39 and accompanying text.