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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket No. 015

Proposed Rule On Procedures Relating To Subpoena Requests In Disciplinary Proceedings

Deloitte & Touche LLP is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Rule on Procedures Relating to Subpoena Requests in Disciplinary Proceedings*, PCAOB Rulemaking Docket Matter No. 015 (October 26, 2004).

INTRODUCTION

As the Board is aware, we support the goals of the Sarbanes-Oxley Act of 2002 (the "Act") in restoring investor confidence, as well as the Board's efforts, under the review of the U.S. Securities and Exchange Commission (the "SEC" or "Commission"), to develop rules that implement the Act faithfully. The current rule proposal is important, because the availability of subpoenas is necessary to ensure the completeness, accuracy and fairness of Board proceedings.

The Board's proposal seeks to implement Section 105(b)(2)(D) of the Act, in which Congress explicitly contemplated rules permitting the Board to request the Commission to issue

subpoenas in aid of Board proceedings. These subpoenas would be necessary to obtain information from individuals and entities who may not be subject to the direct authority of the Board. By contrast, registered public accounting firms and their associated persons are by definition subject to the mechanism of accounting board demands for documents in their control.

The Board began this implementation process in its Proposed Rules on Investigations and Adjudications. *See* SEC Release No. 34-49454, *Public Company Accounting Oversight Board: Notice of Filing of Proposed Rules Relating to Investigations and Adjudications*, 69 Fed. Reg. 15394 (Mar. 25, 2004). In its now-approved Rule 5424(b), the Board followed the general language of the statute and indicated that it may seek subpoenas from the Commission. In approving the Board's rules, the Commission suggested that the subpoena process presented a "potentially complex arrangement" and recognized, significantly, that the standards under which requests by respondents would be handled by the Board and the Commission presented potential due process concerns. *Id.* at n.7. The Commission stated that the subpoena process would not be available to the Board until it established rules that dealt with these issues. *Id.*

We believe that the current proposal includes important first steps in developing orderly procedures for requesting Commission subpoenas. We are concerned, however, that the proposal includes some terms that cannot be reconciled with the Board's statutory mandate to develop "fair procedures" for its investigations and disciplinary proceedings or the Commission's observations regarding due process concerns. Act, § 105(a); SEC Release No. 34-49454, 69 Fed. Reg. at n.7. The availability of subpoenas to a respondent, pursuant to fair procedures, is fundamental to the respondent's ability to gather the information necessary to its defense, and to ensuring the accuracy of Board disciplinary proceedings.

The availability of subpoenas is not just a mere matter of convenience for respondents; rather, it is indispensable to "fair procedures" in Board proceedings. Indeed, the Supreme Court has recognized, in some circumstances, that fairness principles can be violated if a respondent does not have adequate access to compulsory process of witnesses and documents important to its defense. *See, e.g., Washington v. Texas*, 388 U.S. 14, 17-19 (1967).[1] In contrast to these principles of fairness, the proposal appears to resolve many procedural issues in favor of expedited proceedings, and against the issuance of subpoenas and the obtaining of evidence that could be critical to a respondent's defense. Moreover, the proposal, coupled with existing limits in the Board's rules on discovery tools available to respondents, may impair the fairness and accuracy of Board proceedings in ways that should be of equal concern to the Board. Importantly, the proposed subpoena process will require the integrated involvement of the Commission, which is a government agency and which, therefore, must act in accordance with the strict procedural and other protections in the Constitution. Commission action must also satisfy the Administrative Procedure Act, and other federal statutes governing agency conduct, as well as the Sarbanes-Oxley Act. The final rule should therefore reflect these well-established principles of federal law.

We believe that the changes suggested below are essential to ensure that the subpoena procedures, and the Board's disciplinary proceedings generally, comport with the Act's requirement of "fair procedures" and also reflect well-established principles of constitutional and administrative law. The Commission clearly respects the Board's expertise in matters pertaining

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[1] In addition, Congress acknowledged in the Act that relevant and material information might be found in the hands of those whose disclosure can only be compelled by subpoena. Act, § 105(b)(2)(D).

to the Board's proceedings. That these suggested changes are considered carefully before the Board is thus very important to registered firms and their associated persons.

We have organized our comments in the general order of their importance to preserving the fairness of Board proceedings.

I. THE BOARD SHOULD REMOVE THE THIRTY-DAY LIMIT ON COMMISSION ACTION

Proposed Rule 5424(c)(8) provides that the hearing officer shall deem the Commission to have denied a request for a subpoena if the Commission has not granted it within thirty days of the Board submitting the request. The Proposed Rule thus provides that the Commission may deny subpoena requests through taking no action at all. In the context of the Commission's heavy docket, access to important evidence will be jeopardized by the limited resources of a Commission whose attention will be drawn to competing responsibilities at a given moment. The thirty-day provision should be removed from the proposal.

By allowing a proceeding to go forward without giving the Commission an adequate opportunity to consider subpoena requests, the Board may be perceived as signaling to the Commission a relative lack of importance of those requests. If the Commission does not quickly address a request for the issuance of a subpoena, the thirty-day period may lapse unintentionally. Administrative agencies generally are required to explain their reasons for rejecting a proposal or other argument from the public, and courts generally have not allowed an administrative agency, through its inaction, to avoid that obligation. *See, e.g., Motor Vehicles Mfg. Ass'n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 34 (1983); *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 549-51 (1978). Accordingly, courts have overturned agency decisions as arbitrary and capricious when they do not show reasoned consideration of a public comment or petition. The Proposed Rule, by permitting an

administrative agency to resolve a petition by not addressing it, may unnecessarily create a risk of judicial reversal.

Moreover, the selection of a thirty-day period appears to be arbitrary. The Board has not explained the basis for a thirty-day rule – *e.g.*, by attempting to reconcile it with the period of time in which it can reasonably be expected that the Commission will respond to such requests. Notwithstanding an understandable interest in avoiding unnecessary delay in its proceedings, the Board must afford the Commission an opportunity to consider these requests for subpoenas. Indeed, to the extent that Commission consideration of subpoena requests "delays" Board proceedings, that delay is a function of Congress's decision not to grant the Board independent subpoena authority and to require a Commission decision on these matters. *See* Act, § 105(b)(2)(D). This congressional mandate should be recognized in the process for approving subpoenas.

The Board has established a wide range of procedures and standards for hearing officers and the Board to consider subpoena requests. Indeed, for a subpoena request to even be presented to the Commission, a respondent will have to persuade a hearing officer that it is seeking relevant information that bears on the respondent's opportunity to defend itself before the Board, and that the respondent has made a significant effort to obtain the information voluntarily; and the Board will have to concur in that assessment. It would undermine that process if the Commission were deemed to reject those findings by simply not considering a subpoena request within a prescribed time limit.

Proposed Change: Accordingly, Proposed Rule 5424(c)(8), enabling hearing officers to presume the denial of subpoena requests from the passage of thirty days, should be deleted from the final rule.

II. THE RULE SHOULD EXPLICITLY PROVIDE FOR IMMEDIATE REVIEW OF DENIALS OF SUBPOENA REQUESTS ON AN ADEQUATE RECORD

The Proposed Rule creates more burdensome procedures for granting requests than for denying them by insulating denials of requests from immediate review, and by requiring more detailed opinions for the granting of a subpoena request.

According to the Proposed Rule, if a hearing officer approves the request for a subpoena, the hearing officer must do so in writing and must "include a written description of the reasons for seeking the subpoena." Proposed Rule 5424(c)(5). The Proposed Rule would then require the hearing officer to submit the subpoena request and supporting materials to the Board for immediate review.

Unlike a request granted by a hearing officer, a request for a subpoena that is denied is not automatically subject to immediate Board review. Indeed, the Proposed Rule itself makes no mention of the review process in such circumstances. Instead, the commentary accompanying the Proposed Rule states that a review of hearing officer denials of subpoena requests will be subject to the same standard and timing of review as the vast majority of hearing officer decisions—*i.e.*, in most cases, only at the *end* of the proceedings. Although the Board's section-by-section analysis correctly notes that interlocutory review may be available pursuant to Rule 5461 (Release at A2-6), that Rule permits interlocutory review only in "extraordinary circumstances" and suggests that denials of subpoena requests will rarely be subject to immediate Board scrutiny.

The ability of respondents effectively to defend against disciplinary proceedings may be undermined by the absence of immediate review of subpoena denials. Respondents may be forced to proceed entirely through a disciplinary proceeding lacking information that may be indispensable to their defense, and that can only be obtained by a subpoena. The availability of

review after the conclusion of proceedings provides little solace. The Board has specified that claims of error in disciplinary proceedings will be reviewed under a harmless error standard, which the respondent must satisfy. *See* Rule 5422. The harmless error rule is the most difficult to satisfy in discovery disputes. Due to the unavailability of the evidence requested, the respondents may not know what the discovered evidence would have been, or be able to demonstrate that the result of a proceeding would have been different had the evidence been obtained, thus potentially depriving respondents of any meaningful review of the subpoena denial.[2]

In addition, when a hearing officer denies a request for a subpoena, the Proposed Rule requires only that a hearing officer "issue a written denial of the application." Proposed Rule 5424(c)(5). There is no explicit requirement in the Proposed Rule itself that the hearing officer state the reasons for his denial at all. Indeed, the inclusion in the Proposed Rule itself of requirements for a written recommendation to grant a request may imply that such a requirement does not exist for a denial.[3] This difference will place respondents who seek review of their denials at a distinct disadvantage.

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[2] The Proposed Rule may have an additional, implicit effect. The more searching and immediate review to which decisions granting subpoenas – but not decisions denying subpoenas – are subject, may tip the scale against the request from the beginning. Hearing officers will be aware that decisions denying a request will be subject to limited, or perhaps effectively no, consideration by the Board. The disparity in review mechanisms, combined with an interest in avoiding any potential delay in the proceedings that may be occasioned by Board review, may discourage hearing officers from granting subpoena requests.

[3] The Release requires a hearing officer to issue a written opinion denying a request for a subpoena as well as for granting one. *See* Proposed Rule 5424(c)(5); Release at A2-5-6. But, as noted above, there is no requirement in the Proposed Rule text or the surrounding commentary establishing minimum standards of detail for the denial, as there is for the

[Footnote continued on next page]

Proposed Change: In order to create fair procedures, both acceptances and denials of requests for subpoenas should be subject to the same process and standard of immediate review by the Board. The Proposed Rule also should explicitly require that the decision to deny a subpoena request contain an explanation of the reasons for the denial, in order to allow for meaningful Board review.

III. HEARING OFFICERS SHOULD NOT HAVE UNSPECIFIED DISCRETION TO DENY SUBPOENA REQUESTS THAT OTHERWISE SATISFY THE RULE

According to Proposed Rule 5424(c)(4), a party seeking a subpoena must satisfy two standards. First, the applicant must show that the information "encompassed by the subpoena is not merely a matter of speculation." Proposed Rule 5424(c)(4)(i). Second, the applicant must show that the unavailability of the information requested may "bear on the Board's ability to provide a respondent with an opportunity to defend." Proposed Rule 5424(c)(4)(ii).[4] Even when these two standards have been met, however, the commentary to the Proposed Rule clearly provides that hearing officers still have residual discretion to deny the subpoena request. Release at page 4-5; *see also* Proposed Rule 5424(c)(4) (providing only that a hearing officer "*may* recommend" a grant when the predicate conditions are satisfied) (emphasis added).[5] As currently drafted, the grant of unspecified discretion not only eliminates any degree of certainty

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decision to grant. *Contrast* Proposed Rule 5424(c)(5) (requiring the hearing officer to include "a written description of the reasons for seeking the subpoena").

[4] Significantly, these standards alone exceed the showing required for issuance of a subpoena by the SEC's Rules of Practice. *See* 17 C.F.R. § 201.232. In fact, when the Board itself seeks the issuance of a subpoena by the Commission during an investigation, the Board need show only that the information is "relevant or material." Rule 5111(a).

[5] In addition, the Release states that a hearing officer should deny the request if a respondent did not exhaust avenues of voluntary compliance. *See* Point V.

provided by the two conditions for issuance of a subpoena, but fails to provide any standard to guide the hearing officer in the exercise of that discretion. The respondent's ability to defend against Board charges should not be subject to such unguided discretion. *See, e.g., SEC v. Chenery Corp.*, 318 U.S. 80, 89-95 (1943) (explaining the circumstances under which fundamental fairness requires rules rather than *ad hoc* decisionmaking).

Such a discretionary denial by a hearing officer could easily result in an unfair hearing for respondents. By definition, the hearing officer's residual discretion only comes into play when a respondent has first demonstrated that the subpoena is requesting potentially relevant and material information, and that such information could have a material impact on the respondent's case and ability to prepare a proper defense. Thus, when a hearing officer uses residual discretion to deny a subpoena request, that decision would be made despite those findings. The denial of such a request, in those circumstances, cannot readily be squared with Congress's mandate that the Board provide "fair procedures" to the respondent. Act, § 105(a).

Prospectively, respondents will face great uncertainty regarding the subpoena process because, even if they make the required showings, they might still be denied the opportunity to subpoena the information. The standards elaborated in Proposed Rule 5424(c)(4) will not determine a hearing officer's decision, and respondents will have difficulty in anticipating what discretionary factors hearing officers may consider. Hearing officers could use their discretion to deny subpoena requests in order to expedite proceedings and move on to other issues, knowing that any possible Board review will be far off and deferential. Because, as noted above, there is no requirement that hearing officers explain their decisions to deny subpoena requests, the Board would not have a record to evaluate the reasons for the discretionary denial.

With the two conditions specified in Proposed Rule 5424(c)(4), there is no need to grant hearing officers further discretion to deny subpoena requests. If the final rule continues to grant such discretion to hearing officers, respondents could easily find themselves without adequate information with which to defend themselves, particularly if such denials are not subject to prompt interlocutory review.[6]

Proposed Change: The Proposed Rule should explicitly require that a hearing officer grant a subpoena request if the two requirements of Proposed Rule 5424(c)(4) are met. If the Board continues to desire to give hearing officers the discretion to deny subpoena requests even when those requirements are satisfied, at a minimum the Proposed Rule should explicitly subject such denials to interlocutory review.

IV. THE PROPOSED RULE'S STANDARD FOR GRANTING SUBPOENA REQUESTS AFTER THE SUBPOENA REQUEST DEADLINE JEOPARDIZES THE FAIRNESS OF DISCIPLINARY PROCEEDINGS

The Proposed Rule requires the hearing officer to set a date for the parties to submit applications for issuance of a subpoena. Any application made after the deadline set by the hearing officer "shall be disfavored and shall not be granted except in unusual circumstances." Proposed Rule 5424(c)(2). This strict standard for granting subpoena requests after the deadline established by the hearing officer may not provide for the wide range of circumstances in which a respondent must make additional subpoena requests in order to be afforded an opportunity to

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[6] Even if the Board does not accept our proposal to allow for immediate interlocutory review of *all* denials of subpoena requests (see above), interlocutory review should be automatically granted, at a minimum, for denials on "discretionary" grounds. Of course, the value of interlocutory review would depend on another change—that the hearing officer be required to explain his decision so that the Board may distinguish discretionary denials, which occur even when the two requirements of Proposed Rule 5424(c)(4) have been met, from denials when the two requirements have not been met, thus allowing the Board to evaluate the stated basis for the denial.

defend its interests, especially where unexpected developments in the proceedings have created a reasonable and legitimate need for the information.

The Proposed Rule's standard of allowing subpoena requests after the cut-off date – only in "unusual circumstances" – goes far beyond the standard for similar requests in the civil litigation context. For a civil litigant to secure an enlargement of time on a discovery order, he need show only just cause or that the request is being sought due to excusable neglect. *See* Fed. R. Civ. Pro. 6(b). Indeed, a leading treatise has noted that these lesser standards for enforcing the time limits of discovery deadlines "appear[s] to reflect a desire for flexibility in the administration of the time requirements for discovery." 1 James Wm. Moore et al., Moore's Federal Practice ¶ 6.06[4] (3rd ed. 2000). The federal rules recognize that as a case proceeds, the parties gain a better understanding of what information would be useful to present their arguments and will better be able to submit requests for specific types of information. The "unusual circumstances" standard announced by the Proposed Rule unnecessarily risks cutting off the opportunity for respondents to develop their case properly.

The potentially prejudicial effect of the cut-off date will be exacerbated by the unavailability of prehearing depositions to the respondent. *See* Rule 5425; *see also* Letter of Deloitte & Touche LLP on the PCAOB's Investigations and Adjudications Rule (Aug. 19, 2003) at 40-41 ("In effect, the proposal creates a discovery system that will not provide for a vigorous adversarial process to test the accuracy of evidence—it would permit the Board significant advance preparation and leave the respondent to hear witness testimony for the first time at the hearing."). One way civil litigants prepare their case is by questioning witnesses in advance of trial and identifying relevant evidence. But respondents in the Board's proceedings may not secure the presence of witnesses for purposes of discovery prior to the hearing, and must rely

heavily on subpoenaed documents to prepare their case. If the proposed deadline is too strictly enforced, however, respondents may be unsuccessful even in gathering such documents. The limitation could jeopardize not only the fair chance for respondents to defend themselves, but also the accuracy of determinations made by the Board, because the complete evidentiary record will not be available to it.[7]

Proposed Change: The standard for subpoena requests should be modified to allow late-filed requests where the facts and circumstances demonstrate that the information requested may be necessary to allow the respondent a fair opportunity to defend itself in the proceeding. Fairness would be served by acknowledging reasonable exceptions to the deadline, for example, when the subpoena is needed to obtain evidence revealed close to or after the deadline.

V. ENCOURAGING HEARING OFFICERS TO DENY SUBPOENA REQUESTS BECAUSE THE INFORMATION MAY BE "REASONABLY AVAILABLE" WITHOUT LEGAL COMPULSION MAY UNFAIRLY LIMIT RESPONDENTS' ABILITY TO GATHER EVIDENCE

In the commentary accompanying the Proposed Rule, the Board states that hearing officers may deny subpoena requests when evidence is "reasonably available" through requests to a third party for voluntary disclosure. Release at 3-4. This language effectively creates an additional test for granting a subpoena request – a test that the Board acknowledges is not

[7] As we have commented previously, the Board already has limited respondents' ability to engage in discovery in the following ways: (1) allowing the withholding by the Board of substantive categories of documents from respondents, (2) not requiring that a log of documents withheld by the Board be given to respondents, and (3) prohibiting respondents from compelling the deposition of witnesses for purposes of discovery prior to the hearing itself. *See* Letter of Deloitte & Touche LLP on the PCAOB's Investigations and Adjudications Rule (Aug. 19, 2003) at 34-42.

codified in the Proposed Rule. This additional test ignores the realities of adversarial proceedings.[8]

The "reasonably available" test does not reflect the time necessary for any "voluntary compliance" efforts to occur, or the strategic considerations that may limit the willingness or ability of respondents to seek or obtain voluntary compliance. Taken to its logical conclusion, the Board's "reasonably available" comment places an unfair burden on respondents to show that they have vigorously pursued available avenues of securing evidence by voluntary means. Similar documents may be in the hands of multiple entities, some of which are more difficult to reach than others. Many times, important evidence is being held by entities with an adversarial relationship to a respondent and who will not readily agree to release voluntarily information that may be necessary to a respondent's case (and possibly detrimental to their own interests). An entity initially may agree to provide documents, but may be slow to respond, interpret respondents' requests narrowly, or may – after much delay – provide no documents or only a small subset of documents from the initial request and claim compliance.[9]

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[8] Neither can such a "reasonably available" requirement be found in the Commission's regulations regarding subpoenas. *See* 17 C.F.R. § 201.232. In addition, the fact that the requirement is not found in the rule itself is cause for concern because the Board does not articulate with sufficient clarity the standard for hearing officers to use in determining whether evidence is "reasonably available."

[9] In addition, because the Board regulates foreign public accounting firms, Board investigations may often turn on documents that are in the possession of non-registrants outside of the United States, and on testimony by foreign citizens not always subject to the Board's authority. These situations present additional problems of subpoena fairness and accuracy in Board proceedings. Requests for voluntary compliance in these circumstances may often require custodians to evaluate whether production is compliant with foreign law, and thus result in only a belated rejection of that request, or limited responsiveness under restrictive foreign privacy laws.

Voluntary compliance is not an adequate substitute for a subpoena. Without a subpoena, respondents would be unable to secure documents from third parties that are unwilling to give them up. A third party could easily evade or half-heartedly comply with a respondent's "voluntary" request and, at the end of the day when significant relevant evidence had not been produced, respondents would be left *without legal recourse* to obtain the information and may be severely hampered in their ability to defend themselves. Although it is undoubtedly the case that some third parties will provide full and complete disclosure in response to "voluntary" requests, respondents do not know in advance which entities will be so willing to comply, and, indeed, will not know until after the production whether an entity has complied.

The problem inherent in the "reasonably available" commentary is magnified by the interaction of that commentary with the proposed deadline procedure for subpoena requests. If a respondent seeks voluntary compliance, the respondent may learn that complete compliance is not forthcoming only after the deadline has lapsed, leaving the respondent with no ready means to secure the information.

Proposed Change: The "reasonably available" standard should be deleted from the final rule and any accompanying commentary.

VI. THE PROPOSED RULE NEEDS TO INCLUDE SUBPOENA ENFORCEMENT PROCEDURES

A subpoena is only as effective as the enforcement powers that support it. The Proposed Rule, however, is silent on how Board requested subpoenas will be enforced against recalcitrant third parties. The final rule should specify how the Board or the respondent can seek the enforcement of a Commission-issued subpoena.

If the Board will be required to call upon the Commission to initiate proceedings to enforce a subpoena on the Board's behalf, the Proposed Rule should include procedures codifying that process. Such rules could require simply that a respondent submit a request to a

hearing officer that a subpoena be enforced. The hearing officer, after deciding that the subpoena has not been responded to properly and needs to be enforced, would forward the request and any necessary materials to the Board. Upon receipt of the materials from the hearing officer, the Board would then petition the Commission to seek enforcement of the subpoena. Alternative approaches could be reached, with Commission agreement, that would be even simpler, and provide for a more direct interface between Board and Commission procedures. Such provisions would remove uncertainty from the inevitable situation in which a third party refuses to comply with a subpoena.

Moreover, there is already a mechanism in the Commission rules for one potential situation involving the enforcement of a subpoena that should be reflected in the Board's final rule. When the recipient of Commission subpoenas files a motion to quash, the Commission generally calls for an opposition brief from the party on whose application the Commission issued the subpoena. *See* 17 C.F.R. § 201.232(e)(1). The Proposed Rule should explicitly provide that Board respondents will be afforded the ability to respond to a motion to quash in accordance with the Commission's rules.

Proposed Change: The Proposed Rule should include procedures for the Board to request that the Commission exercise its subpoena enforcement powers, and should allow respondents the opportunity to respond to a motion to quash filed by a subpoena recipient.

CONCLUSION

The Board should consider making substantial changes to the Proposed Rule. The proposal is insufficiently protective of the common interest, shared by the Board and the regulated community, in securing the information necessary for fair and accurate Board disciplinary proceedings.

We would be pleased to discuss these issues with you further. If you have any questions or would like to discuss these issues further, please contact Robert J. Kueppers at (203) 761-3579 or Eric H. Fisher at (212) 492-4020.

Very truly yours,

/s/ Deloitte & Touche LLP

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