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The Political Economy of Corporate Financial Regulatory Legislation, 49 J. Marshall L. Rev. 679 (2016)

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THE POLITICAL ECONOMY OF CORPORATE FINANCIAL REGULATORY LEGISLATION

MICHAEL PATRICK WILT, J.D, LL.M.*

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I. INTRODUCTION

Businesses should consider the manner in which and the reasons why they lobby Congress. This is especially important when Congress is considering imposing new corporate financial regulations. Although white-collar crime and the regulation of the corporate world has come to the attention of congressional policymakers, especially following the Enron and Arthur Anderson scandal in 2001,¹ there is little scholarship on the connection between the passage of new corporate financial regulations by Congress and the political actions of businesses affected by those new laws. What did businesses want and how did they seek to persuade policymakers in Congress to adopt their view – and were they successful? While a theoretical understanding of why business interest groups are motivated to lobby are useful, historical accounts of their actions can serve as a valuable tool to

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1. Vikramaditya S. Khanna, *Corporate Crime Legislation: A Political Economy Analysis*, 82 WASH. U. L.Q. 95, 95 (2004).

guide future legislative strategies. What impact can a generalized community, e.g., big business interests, have on legislative direction? Do specific industries tend to benefit more than others from corporate financial regulatory legislation?

One recent major federal debate on corporate financial regulation occurred in 2002 following the Enron and Arthur Anderson scandal. Congress and the Bush administration created a Department of Justice special task force to investigate white collar crime and to reassure the American people that something was being done about the excesses of Wall Street and their impact on the economy.² Congress also passed the Sarbanes Oxley (SOX) law in 2002, with the goal of reigning in accounting fraud across the corporate world and granting the Securities and Exchange Commission greater power to regulate publicly traded companies.³

This legislation was not the government's first attempt at corporate financial regulation.⁴ Typically, the federal government passes corporate financial regulation as a reactionary measure to scandals involving corporate misconduct. As such, Congress seemingly passes a new, massive corporate financial regulatory bill every decade.⁵ These bills are typically enforced by DOJ or an administrative agency such as the SEC – or multiple agencies.⁶ Following the financial crisis of 2008, the Congress passed – and

2. President's Corporate Fraud Task Force, U.S. Department of Justice, www.justice.gov/archive/dag/cftf/.

3. Henry N. Butler & Larry E. Ribstein, *The Sarbanes Oxley Debacle: What We've Learned; How to Fix It*, AEI LIABILITY STUDIES 2006, www.aei.org/files/2006/03/13/20060308_ButlerRibsteinSOXDraft313.pdf.

4. *See, e.g.*, Financial Institutions Reform, Recovery, and Enforcement Act, 103 Stat. 183.

5. *See* Khanna, *supra* note 1, at 96. Khanna argues that “corporations and business interests are considered some of the most, if not the most, powerful and effective lobbyists in the country,” but then wonders why there has been an expansion in corporate criminalization (noting that there are over 300,000 federal regulatory offenses that are criminal in nature). *See also* Samuel W. Buell, *Is the White Collar Offender Privileged?*, 63 DUKE L.J. 823, 873 (2014) (“One might even argue that the symbiosis working against the criminal offender can be more powerful in the case of the corporate violator. It is not just mutually beneficial to legislators and executive-branch officials to be tough on corporate crime. It benefits firms too, because the focus on ex post punishment directs discussion about responses and remedies away from ex ante regulation. Accounts focused on bad apples and wrongdoers crowd out ones about systemic failure. Tough prosecution of individual miscreants strengthens the argument for leniency against firms themselves and their many “innocent” stakeholders. These approaches benefit large private institutions determined to hold down costs of doing business. And the perception of toughness benefits legislators, and executive-branch rulemakers and enforcers, who prefer to avoid blame for failing to prevent wrongdoing through regulation. It should not be surprising that the Bush administration from 2001 to 2009 had a record of both hostility to business regulation and aggressiveness in criminal prosecution of senior executives of large corporations.”).

6. Khanna, *supra* note 1, at 99-100.

the Obama administration has sought to vigorously enforce – regulations on Wall Street.⁷ Violations of these new laws can result in criminal penalties.⁸ While no high-level executive has been indicted for his or her role in the 2008 financial crisis,⁹ it is likely only a matter of time before a new financial scandal emerges and another law is deemed to be necessary. Another important consideration is the long-term impact of compliance and enforcement that these laws have on smaller business and the groups that stand to benefit from new, complex regulations.¹⁰ When the next corporate scandal emerges, business interests – and legislators who wish not to bend to their will – should look to the past as prologue.

This article will discuss corporate financial regulatory legislation and its enforcement at the federal level in light of interest group politics and will seek to develop a better understanding of how federal corporate financial regulatory legislation is enacted by examining legislative history. The goal of this article is to provide an overview of the legislative history of two important laws (the Foreign Corrupt Practices Act and the Sarbanes Oxley Act) and how interest group politics affected their passage. “Business” interests (in general) are different from the interests of the accounting industry, and both interest groups will be considered. Unlike most large corporations, the accounting industry, specifically, stood to benefit from additional regulation. Legislative history gives insight into the motivations of many groups, but can also show that some interest groups are more motivated than others to persuade policymakers to adopt their view – or at least, reject a less desirable policy position.

The article will proceed as follows: Part II examines the legislative and political history of the FCPA and SOX, their civil and criminal components, and how various interest groups approached the enactment of both laws. Part III will explain the different classical theories of regulation as defined in Richard Posner’s seminal article on the topic. Part IV will apply the interest group theory of regulation to the passage of both the FCPA and SOX. Finally, Part V will consider how the FCPA and

7. Tiffany M. Joslyn, *Criminal Provisions in the Dodd-Frank Wall Street Reform & Consumer Protection Act*, NEW FEDERAL INITIATIVES PROJECT, THE FEDERALIST SOCIETY, Dec. 10, 2010, www.fed-soc.org/publications/detail/criminal-provisions-in-the-dodd-frank-wall-street-reform-consumer-protection-act.

8. *Id.*

9. Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. OF BOOKS, Jan. 9, 2014, www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions/.

10. See Stephen Primack, *The Financial Impact of the Sarbanes-Oxley Act on Small vs. Large US Public Companies*, DEPT OF ECON., UNIV. OF CAL BERKELEY, (Spring 2012), <http://live.econ.berkeley.edu/sites/default/files/Primack.pdf>.

SOX have had a long-term effect on the business community, especially smaller businesses.

Ultimately, this article concludes that particular interest groups and their representatives, notably the accounting industry, influenced the scope and definition of these laws, but that the laws still passed because business interests were not united, homogenous, or incentivized enough to adequately oppose them or alter the direction in which the Congress chose to act. Two observations are derived from this analysis: the profession arguably most responsible for corporate accounting fraud – the accountants – was homogenous, well-coordinated, and strong enough to gain additional institutional protections for their profession, barriers to entry for potential competitors, and economic advantages through the passage of the FCPA and SOX. Moreover, these two laws are among the most worrisome on the books for corporate general counsel.¹¹ This suggests that corporate interest group lobbyists may not possess as much power to influence policy when political sentiment insists that “something must be done” to curb perceived business wrongdoing.

Additionally, the business community has felt a substantial negative impact from compliance with and enforcement of both the FCPA and SOX, in both a civil and criminal capacity. The relative effectiveness of “the business community” in shaping corporate regulatory legislation (or shielding themselves from it) appears to be greatly overestimated. When attempting to thwart new corporate financial regulations, the effectiveness of the general “business community” cannot compare to the efforts of those in favor of such regulation or who stand to benefit from it.

II. LEGISLATIVE HISTORY OF THE FOREIGN CORRUPT PRACTICES ACT AND SARBANES OXLEY

Congress involved itself in emerging corporate scandals several times during this nation’s history. Examples of this include the 1929 stock market crash, the savings and loan scandal of the early 1990’s, and the 2008 financial crisis. This article examines laws passed in response to two other financial scandals: the foreign bribery of the 1970’s and the corporate accounting and fraud of the early 2000’s. Congress passed two laws in response to these scandals: the Foreign Corrupt Practices Act and the Sarbanes Oxley Act. While each Act addressed separate instances of corporate malfeasance, they shared one core problem: heavy scrutiny of accounting practices from the media, Congress, and policymakers. In response to this increased scrutiny, both laws

11. FTI Journal, *The Legal Risks that Keep Directors and General Counsels Awake*, (Mar. 2013), www.fticonsulting.com/global2/critical-thinking/fti-journal/the-legal-risks-that-keep-directors-and-general-counsels-awake.aspx.

implemented additional requirements, reviews, and systems for corporate accounting practices, in a huge boon to the very industry most responsible for the very problems about which the country was worried. Additionally, outside of the accounting industry, strategy and opinion as to the need for and content of these laws was mixed, resulting in less effective opposition to and influence on the structure of both the FCPA and SOX. Interest group theory, as discussed in Part IV, predicts that the more organized and homogenous group – accountants – would triumph over the less organized and homogenous group, business in general.

A. Foreign Corrupt Practices Act of 1977

Congress enacted the Foreign Corrupt Practices Act of 1977 to prevent corporate bribery of foreign officials.¹² The Act contains three main provisions: a books and records requirement, an internal accounting requirement, and a prohibition on bribery of foreign officials. The law was enacted after revelations that American corporations were bribing foreign government officials across all industries, during a “morality oriented post-Watergate atmosphere” in the mid-1970’s.¹³ The revelations of “slush funds and secret payments by American corporations were stated to have adversely affected American foreign policy, damaged the image of American democracy abroad, and impaired public confidence in the financial integrity of American corporations.”¹⁴

Before the Congress began debating the relative merits of proposals on how to deal with bribery, it heard testimony on whether a problem with bribery actually existed and how it should be addressed.¹⁵ The U.S. Chamber of Commerce, while supporting voluntary disclosure (at the time, already provided for by law), opposed “new legislation... to confront the problems caused by questionable overseas payments.”¹⁶ The National Association of Manufacturers also opposed new law.¹⁷ However, legislators held the “prevailing view . . . that existing laws were deficient.”¹⁸ With

12. Michael V. Seitzinger, *Foreign Corrupt Practices Act (FCPA): Congressional Interest and Executive Enforcement*, CONG. RES. SERV. (Oct. 21, 2010), www.fas.org/sgp/crs/misc/R41466.pdf.

13. Mark Romaneski, *The Foreign Corrupt Practices Act of 1977: An Analysis of Its Impact and Uncertain Future*, 5 B.C. INT’L & COMP. L. REV. 405 (1982), <http://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=1567&context=iclr>.

14. Michael V. Seitzinger, *Foreign Corrupt Practices Act: CRS Report to Congress*, CONG. RES. SERV. (Mar. 3, 1999), www.fas.org/irp/crs/Crsfcpa.htm.

15. Mike Koehler, *The Story of the Foreign Corrupt Practices Act*, 73 OHIO ST. L. J. 929, 959 (2012).

16. *Id.*

17. *Id.* at 960.

18. *Id.*

this in mind, how did these business interests affect the passage of the FCPA?

Congress considered two competing options to remedy the apparent problem: a system of criminal prosecution for bribery and a system of reporting and disclosure.¹⁹ The Department of State supported the latter option, while the Carter administration supported a mixture of criminal prosecution and more stringent reporting and disclosure.²⁰ Ultimately, Congress chose a criminalization approach. Corporations may have preferred the criminalization approach over the reporting and disclosure system.²¹ Who were these groups and why would they support such a system? The Committee Report from the House of Representative's consideration of the bill explains the latter question quite succinctly:

Most importantly, though, criminalization is far less burdensome on business. Most disclosure proposals would require U.S. corporations doing business abroad to report all foreign payments including perfectly legal payments such as for promotional purposes and for sales commissions. A disclosure scheme, unlike outright prohibition, would require U.S. corporations to contend not only with an additional bureaucratic overlay but also with massive paperwork requirements.²²

The minority report opposed a criminalization approach, arguing:

We believe that legislation that cannot be effectively enforced will do little to deter payoffs. On the other hand, disclosure could be a very effective deterrent especially in combination with the other sanctions against such payments which exist in present securities, antitrust, tax and criminal law. We are concerned that the committee may have constructed a paper tiger which in the long run will do little to discourage conduct which we all believe has no place in the American business community.²³

Some argued that the existence of "criminal penalties for certain questionable payments would deter their disclosure and thus the positive value of the disclosure provisions would be reduced," and that both approaches could not be implemented at the same time.²⁴ Additionally, the Ford administration's task force on bribery was skeptical of enforcing criminal provisions.²⁵ Ultimately, the disclosure approach failed to gain traction and the

19. *Id.*

20. *Id.*

21. Khanna, *supra* note 1, at 115-20.

22. H. Rep. No. 95-640, at 5 (1977), www.justice.gov/criminal/fraud/fcpa/history/1977/houseprt-95-640.pdf.

23. *Id.* at 10.

24. Koehler, *supra* note 15, at 989.

25. *Id.*

criminalization approach was adopted due to its supposed efficiency and a lower compliance cost burden on business.²⁶

Those presenting testimony at the 1976 sub-committee hearings included “the American Association of Certified Public Accounts, public interest groups and the Bar.”²⁷ According to the Senate report on the bill, the American Bankers Association and the Securities Industry Association also presented testimony.²⁸ The most interesting opposition to the legislation came a year later, from the Chamber of Commerce and the National Association of Manufacturers, both of which opposed the proposed law.²⁹ Both organizations submitted statements for the Record in April 1977 opposing H.R. 3815, the Unlawful Corporate Payments Act of 1977.³⁰ This bill was eventually codified into law as the FCPA.³¹

In addition to the criminal penalties of the FCPA, the Act also included the books and records and internal control provisions, all of which are overseen by accountants and auditing professionals.³² Representatives testified in Congress on behalf of the accounting profession.³³ In 1976, the President of the American Institute for Certified Public Accountants (AICPA) testified at a hearing on corporate responsibility that the “increased interest and visibility has resulted in large part from a growing recognition of the importance of obtaining assurance regarding the reliability of corporate financial statements.”³⁴

Later in 1976, the Chairman of the AICPA’s Committee on SEC Regulations testified regarding foreign bribery, and the books and records provision of the pending legislation.³⁵ AICPA

26. *Id.* at 997, citing S. Rep. No. 93-114, at 10 (1977) (“Direct criminalization entails no reporting burden on corporations and less of an enforcement burden on the Government.”). “A disclosure scheme, unlike outright prohibition, would require U.S. corporations to contend not only with an additional bureaucratic overlay but also with massive paperwork requirements.” *Id.* at 997.

27. *Id.*

28. S. Rep. No. 95-114, at 2 (1977), www.justice.gov/criminal/fraud/fcpa/history/1977/senaterpt-95-114.pdf.

29. *Unlawful Corporate Payments Act of 1977: Hearing on H.R. 3815 Before the Subcomm. On Consumer Finance and Protection of the H. Comm. on Interstate and Foreign Commerce*, 95th Cong. 234-51 (1977) (statement of Chamber of Commerce of the United States and National Association of Manufacturers).

30. *Id.*

31. *Id.*

32. 15 U.S.C. § 78m(b).

33. See, e.g., *Corporate Rights and Responsibilities: Hearing Before the S. Comm on Commerce*, 94th Cong. 120 (1976) (statement of Wallace E. Olson and the American Institute for Certified Public Accountants).

34. *Id.*

35. Foreign Payments Disclosure: Hearing on H.R. 15481 and S. 3664 and H.R. 13870 and H.R. 13953, Before the Subcomm. on Consumer Protection and Finance of the H. Comm on Interstate and Foreign Commerce, 94th Cong.

supported the law, but stressed that previous instances of bribery were circumventions of “internal accounting controls,” not a reflection on the adequacy of those controls.³⁶ AICPA opposed requiring “adequate” internal accounting controls, but did support having the law require that the books and records of a corporate issuer of securities reflect its transactions and make it unlawful to falsify or circumvent the internal accounting controls.³⁷ Although AICPA failed to lobby against the “adequate” controls provision in the original bill, the word “adequate” was removed in the next decade through amendments to the FCPA.³⁸ Corporations are required to have internal accounting controls, which are sufficiently reasonable to assure that statements are accurate and true to this day.³⁹ Corporations and their financial staff, including accountants, are responsible for creating and enforcing these controls.⁴⁰ During the FCPA debate, the committee requested the AICPA’s response to the following question:

You indicate on page 4 that the internal accounting control provision could be counter-productive since lawyers would advise their clients not to seek suggestions from internal and outside auditors and others. Wouldn’t this more likely place an extra incentive on the issuer to seek third party advice as to the adequacy of his controls?⁴¹

To which the AICPA responded, in part:

I would conjecture that issuers might well turn more to the legal profession than to the accounting profession for advice as to compliance with a legislative requirement calling for an “adequate” internal control system. The outgrowth of this might well involve a checklist-type approach to the problem, or a general standardization of systems characteristics, developed by the legal profession, to guide issuers in ascertaining compliance with the new law. Constructive criticism of those with real insight into the intricacies of internal controls would neither be solicited nor welcomed in such a legalistic approach. The result would be, unfortunately, an attempt by companies to attain a system that meets a minimal legal

158 (1976) (statement of Thomas L. Holton and the American Institute for Certified Public Accountants).

36. *Id.*

37. *Id.*

38. See, e.g., Anti-Bribery and Books & Records Provisions of the Foreign Corrupt Practices Act, U.S. DEPT OF JUSTICE (July 22, 2004), www.justice.gov/criminal/fraud/fcpa/docs/fcpa-english.pdf.

39. 15 U.S.C. § 78m(b).

40. See, e.g., *Guide to Internal Control Over Financial Report*, Center for Audit Quality 7 (“While management structures vary, in many companies, the Chief Financial Officer or the Chief Accounting Officer and his or her staff have day-to-day responsibility for ICFR.”), www.thecaq.org/docs/reports-and-publications/caq_icfr_042513.pdf?sfvrsn=2.

41. Hearing before S. Comm., *supra* note 33, at 162.

standard rather than to attain the best system suitable to the circumstances.⁴²

Either seems plausible, but it is not unreasonable to speculate that both auditors and lawyers would be consulted as part of a corporate manager's due diligence in seeking the best advice. Why did the AICPA oppose including this provision? It professed to seek the "best system suitable" to the circumstances. Perhaps its motivation was pure, as public interest theory of regulation might suggest: regulation is primarily created to serve the best interests of society.⁴³ On the other hand, perhaps AICPA feared a loss of business to the lawyers, as the above response implies. The Congress ignored this fear and enacted the adequate internal accounting provision into law.⁴⁴

B. Sarbanes Oxley Act of 2002

The Sarbanes Oxley Act, colloquially known as SOX, is a complex law, considered to be the "most sweeping federal securities legislation since the original laws in 1933 and 1934."⁴⁵ In 2001 and 2002, there were mounting reports of corporate fraud and bad accounting practices at major corporations, such as Enron and WorldCom.⁴⁶ The law accomplishes several objectives including: increased internal monitoring, including certification of reports with criminal penalties for reckless certification by the CEO; protection of whistleblowers; a code of ethics for financial officers; increased independence of auditors and creation of an independent Public Company Accounting Oversight Board (PCAOB); new disclosure rules relating to firm structure, code of ethics, off-balance-sheet transactions; prohibition on loans to insiders; and, additional regulation of securities analysts to ensure that they are independent from firm investment banking activities.⁴⁷

In 2002, both houses of Congress considered several different bills relating to corporate accounting and governance practices and held multiple hearings in both the Senate committee chaired by Senator Paul Sarbanes and the House committee chaired by Congressman Michael Oxley. Oxley's less restrictive bill passed

42. *Id.* at 163.

43. *See infra* Part III.

44. Koehler, *supra* note 15, at 998 ("The prevailing view was that the criminalization approach embodied in S. 305 and H.R. 3815, along with supplemental books and records and internal control provisions that were agreed to in conference, represented the best legislative response to the foreign corporate payments problem.").

45. Butler, *supra* note 3, at 8.

46. *Id.*

47. *Id.* at 23.

the House in April 2002.⁴⁸ However, the Senate version sponsored by Sen. Sarbanes ultimately passed and most of its stronger provisions were agreed upon in conference committee.⁴⁹ President Bush signed the law on July 30, 2002, describing it as “the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt.”⁵⁰ Unlike the House bill, which included tougher criminal penalties and an accounting industry watchdog, the Senate bill also included “several more consequential corporate governance measures, including a prohibition on executive loans, requiring audit committee independence, and executive certification of financial statements” under penalty of law.⁵¹

Business interests did not entirely oppose passage of the law. Under the weight of intense media and political pressure, it was reasonable to expect that major corporations would be willing to do anything to move past the corporate accounting scandal. In any event, the larger firms knew that they had the resources to defend against and comply with any new law that may be passed by Congress.⁵² This knowledge could explain why the Business Roundtable did not oppose SOX.⁵³ Business Roundtable “represented big business,” and may have believed that letting the law pass would remove the spotlight from them as quickly as possible, a solid public relations move.⁵⁴ Firms may have supported or at least not vigorously opposed SOX because it appealed public opinion and was seen as largely symbolic.⁵⁵ Given the relatively few criminal prosecutions resulting from SOX, it is difficult to argue with the conclusion that it was symbolic, at least with regard to the criminal provisions.⁵⁶

The Chamber of Commerce did oppose the law, and argued that their membership is comprised of smaller firms, who were

48. See Richard A. Oppel, Jr., *GOP Bill on Auditing Clears House*, Apr. 25, 2002, N.Y. TIMES, www.nytimes.com/2002/04/25/business/gop-bill-on-auditing-clears-house.html.

49. See Roberta Romano, *Does the Sarbanes-Oxley Act Have a Future?*, 26 YALE J. ON REG. 229, 238 (2009) (“And when the bill that emerged from the conference committee was the Democratic Senate’s version, all but three House Republicans voted for it.”), <http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=1286&context=yjreg>.

50. Butler, *supra* note 3, at 13.

51. *Id.* at 22-23.

52. For a review of the literature on the cost differential between small and large firms, see, e.g., Suraj Srinivasan and John C. Coates IV, *SOX after Ten Years: A Multidisciplinary Review*, 28 ACCOUNTING HORIZONS 627 (2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2343108.

53. Butler, *supra* note 3, at 16.

54. *Id.*

55. *Id.* at 17.

56. Kevin Drawbaugh & Dena Aubin, *Analysis: A decade on, is Sarbanes-Oxley working?*, REUTERS, (July 30, 2012), www.reuters.com/article/2012/07/30/us-financial-sarbox-idUSBRE86Q1BY20120730.

less responsible for the accounting fraud and more likely to incur the significant costs in monitoring and compliance.⁵⁷ The Chamber represented a heterogeneous membership with no specific industry or even tier of market capitalization, ranging from small to large businesses.⁵⁸ The National Federation of Independent Business (NFIB), which primarily represented small, mostly privately held firms, also opposed the application of SOX on behalf of their members.⁵⁹ The President of the National Association of Manufacturers (NAM), Jerry J. Jasinowski, testified before Congress and while not explicitly endorsing the legislation, did say that Oxley's bill "provides the framework for the kind of reform – thoughtful balanced reform that we need."⁶⁰ However, Jasinowski urged against the creation of a "whole new set of laws" such as "measures which will do real harm; that is, to produce a lot of new legislation, new liabilities, try to reinvent the wheel."⁶¹ NAM was worried about "new liability provisions" and "increases in costs" for business.⁶² NAM did not testify before the Senate with regard to its more stringent bill,⁶³ and based upon these comments, likely would have opposed some of the bill.

Franklin D. Raines, then Chairman and CEO of Fannie Mae and Chairman of the Business Roundtable Corporate Task Force, testified that "some legislation and regulatory changes are necessary."⁶⁴ In its written submission, the Business Roundtable expressed a mix of concerns and support for the pending legislation, but also specifically expressed concern with any attempts to alter or repeal the PSLRA (Private Securities Litigation Reform Act).⁶⁵ The Business Roundtable "oppose[d] the provisions of other bills that weaken the protections of the PSLRA."⁶⁶ As Professor Khanna explains in his article, the increased civil liability of the kind feared by both the Business

57. Butler, *supra* note 3, at 16. See also Gail R. Chaddock, *Corporate Fraud Under Seige*, CHRISTIAN SCI. MONITOR (July 11, 2002), www.csmonitor.com/2002/0711/p02s02-uspo.html ("The Sarbanes bill will hand American corporations back to the trial lawyers for summary execution," said Thomas Donohue, President of the U.S. Chamber of Commerce).

58. Butler, *supra* note 3, at 16.

59. Karen Harned, *Congress Never Intended to Subject Mom-and-Pop Shops to Sarbanes-Oxley*, THE DAILY CALLER (Nov. 12, 2013), <http://dailycaller.com/2013/11/12/congress-never-intended-to-subject-mom-and-pop-shops-to-sarbanes-oxley/>.

60. *The Corporate Auditing, Accounting, Responsibility, and Transparency Act of 2002: Hearing on H.R. 3763 Before the H. Comm. on Financial Services*, 107th Cong. 106 (2002) (statement of Jerry J. Jasinowski), www.gpo.gov/fdsys/pkg/CHRG-107hhrg78501/pdf/CHRG-107hhrg78501.pdf.

61. *Id.* at 107.

62. *Id.* at 107.

63. Hearing Before S. Comm, *supra* note 33.

64. See Hearing, *supra* note 60, at 101 (Statement of Franklin D. Raines).

65. *Id.*

66. *Id.*

Roundtable and NAM, may have led them to express only lukewarm support for the host of accounting, auditing, and criminal provisions that ultimately were signed into law as SOX.⁶⁷ The Council of Institutional Investors, represented by its Executive Director Sarah Teslik, argued that it would be more beneficial to investors (and the economy as a whole) if management was put in jail rather than merely having the corporation fined.⁶⁸ It is not unreasonable to believe that investors would prefer increased individual corporate criminal sanctions to civil liability or corporate fines, which affect the bottom line of the company more than a manager being fired and sent to prison for fraud.

One group that effectively lobbied for and influenced the passage of SOX was the accounting industry. Judge Easterbook commented that:

The accounting profession is highly concentrated and has learned that it can get benefits at the national level. The Sarbanes-Oxley Act increased the amounts corporations pay for accounting services. Does it surprise you that, after multiple scandals showed that accountants were not very good at detecting or preventing fraud, new legislation required firms to purchase more accounting services? Why buy more of a low-quality good? But if you think in public-choice terms, it should not surprise you that accounting failures become a means by which resources are transferred from investors to accountants.⁶⁹

SOX's legislative hearings bear this conclusion out. It is true that the "more vocal business supporters of SOX were the accountants and others in the monitoring and consulting industry who audit, investigate, prosecute and defend fraud as well as prepare disclosure documents."⁷⁰ The fact that the accounting industry would benefit from increased compliance costs, regulation, and subsequent barriers to entry is not a surprise, and it should not be a surprise that SOX was an advantageous bill for the industry.

The business community did not vigorously oppose SOX, which, politically speaking, made sense. The Republican congressmen were in election-mode and may have been more willing to appear tough on crime than help protect business. Businesses were perhaps resigned to the fact that something was

67. See *infra* Part IV.

68. "[W]ill you be more deterred by thought that your company may be fined or by the thought you may go to jail?". *Accounting and Investor Protection Issues Raised by Enron and Other Public Companies: Hearing Before S. Comm. on Banking, Housing, and Urban Affairs, 107th Cong.* (statement of Sarah Teslik and the Council for Institutional Investors), www.banking.senate.gov/02_03hrsg/032002/teslik.htm.

69. Frank H. Easterbrook, *The Race for the Bottom in Corporate Governance*, 95 VA. L. REV. 685, 698 (2009).

70. Butler, *supra* note 3, at 16.

going to be done.⁷¹ If fighting against increased civil liability was the best outcome they could hope for, as Khanna argues,⁷² it appears they were successful.⁷³ The lack of a united front and one voice permitted political realities to dictate passage of the stronger Senate bill, as the clock ticked down on the election year.⁷⁴ The White House pressured a quick compromise, and there was a rush to support the harsher of the two bills in conference between the House and Senate.⁷⁵ With regard to SOX, it appears that

71. *Id.* at 14 (“Facing midterm elections in November, the party controlling the White House and identified with business stood to lose much more than the Democrats as the result of any public ire about the economy and corporate misconduct.”).

72. Professor Khanna has a conclusive take on interest group politics and the passage of the FCPA and SOX. Khanna concludes that “[c]orporate crime legislation may be the preferred response for some corporate interests because it satisfies public outcry while imposing relatively low costs on those interests, thereby avoiding legislative and judicial responses that are more harmful to their interests and sometimes deflecting criminal liability away from managers and executives and onto corporations.” Khanna focuses on the groups that would “normally oppose regulation” and argues that “these groups may often prefer corporate crime legislation of corporate civil liability.” The substitution thesis is simple: corporations and its managers prefer corporate crime legislation to civil liability because the costs are lower and the certainty is greater. Khanna acknowledges – as this article’s review of the legislative history of FCPA and SOX prove – that a smoking gun “memo” or “direct documentary evidence indicating that corporate interests ignored or supported corporate crime legislation in order to avoid increases in corporate civil liability.” Khanna argues that there is a “pattern” over time that has developed indicating lobbying activities and preferences of corporate interests. See Khanna, *supra* note 1, at 115-20.

73. However, some have argued that SOX actually did increase civil regulation and liability. “[I]t is worth pausing to observe that the Republican effort to divert legislative energy from civil regulatory to punitive criminal measures largely failed. Although legislators seeking a strong regulatory response to corporate scandals may not have gotten everything they wanted, they got most of it-and far more than either the House (and many Senate) Republicans or the White House would have preferred. Moreover, once the Republicans entered the competition to see who could create the toughest criminal sanctions, there was no turning back. The ironic result was that by adopting the White House diversionary strategy of focusing on criminal remedies, the Republican leadership, which originally sought relatively weak regulation and no additional criminal penalties for corporate wrongdoers, was ultimately obliged to accede to legislation containing both relatively strong regulatory remedies and potentially very punitive criminal provisions.” See Frank O. Bowman, III, *Our Encourager Les Autres? The Curious History and Distressing Implications of The Criminal Provisions of the Sarbanes-Oxley Act and the Sentencing Guidelines Amendments that Followed*, 1 OHIO ST. J. CRIM. L. 373, 402 (2004). Perhaps SOX’s civil regulatory provisions, coupled with the “punitive” criminal provisions, imposes greater costs in the long-run than a simple repeal or alteration of PSLRA would have imposed. If that is so, then Khanna’s argument with regard to less vigorous opposition to SOX would not hold water, unless business interests were either nearsighted or were confronted with a “pick your method of execution” choice.

74. Butler, *supra* note 3, at 18.

75. *Id.*

Republicans may have ignored business interests, but the interest groups themselves did not put up quite enough of a vigorous fight. Perhaps they believed that SOX was more symbolic, heavy on rhetoric but light on actual reform, such as repealing PSLRA or other securities laws that protected corporations, as some have argued.⁷⁶

III. INTEREST GROUP POLITICS DEFINED

Richard Posner's article, *Theories of Economic Regulation*,⁷⁷ applies simple concepts such as supply, demand, and cartel theory to help the reader understand how interest groups affect the regulatory decision-making process, from inception to enforcement. Before explaining the interest group theory of regulation, it is important to explain earlier theories of regulation that have since been called into question: public interest theory and capture theory.

A. Public Interest Theory of Regulation

Public interest theory is the original basis for regulation in this country.⁷⁸ The essential point of this theory is that regulators act in the best interests of the public when they see a problem with a market (such as a market failure), and that government regulation does not cost anything.⁷⁹ If there is a market imperfection, government can fix it.⁸⁰ Of course, we now know that government regulations do indeed have costs, and that those costs may be even greater than the cost of letting a market sort itself out.⁸¹

Additionally, perhaps the biggest problem with the theory is trying to determine what, exactly, is the public interest. As Posner points out, public interest theory fails to link the perception of the

76. See, e.g., Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And it Might Just Work)*, 35 CONN. L. REV. 915 (2003), http://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=1538&context=faculty_publications. But see Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1587 (2005) ("[T]he mandates are not costless (as one would expect legislation that is intentionally symbolic to be). In particular, compliance costs to meet the certification requirement appear to be considerable, especially for smaller firms."). Romano argues that the bill couldn't possibly be seen as merely symbolic, given its high compliance costs.

77. Richard A. Posner, *Theories of Economic Regulation*, 5 BELL. J. ECON. & MGMT. SCI. 335 (1974).

78. *Id.* at 335.

79. *Id.* at 336.

80. *Id.* at 336.

81. *Id.* at 336.

public interest to actual legislative action.⁸² Unless one hundred percent of the people all agree upon the public interest, it is possible that the “public interest” deemed by the majority may end up having a greater cost imposed on the minority than the benefit derived by the majority, resulting in a welfare loss.⁸³

Posner suggests that, perhaps due to collusion among politicians, there may be an opportunity for those politicians to impose their own views on society, and that this results in policies that are adopted based upon what the “public interest” is as conceived by those politicians.⁸⁴ But other theories may be more appropriate to explain regulatory action.

B. Capture Theory of Regulation

The capture theory of regulation is a far more cynical understanding of regulatory action. Essentially, as Posner describes it, interest groups seek to promote their own interests, often at the expense of the general public.⁸⁵ One formulation of the theory is that big business and capitalists control the institutions of society, including regulation, and that this benefits them.⁸⁶ Of course, as Posner rightfully points out, plenty of smaller interests and businesses benefit from regulation, rendering this view false.⁸⁷

The other more sophisticated version of capture theory is one formulated by political scientists. This version holds that regulatory agencies are, over time, captured by the very industries they regulate.⁸⁸ Posner makes several arguments against capture theory, arguing it is a hypothesis not backed by any real theoretical foundation.⁸⁹ First, he points out that more than just the industry itself can affect the agency.⁹⁰ Additionally, customers of the regulated industry would be in a position to also capture the agency.⁹¹ He also points out that an industry strong enough to capture an agency might be strong enough to prevent its creation in the first place, and that capture theory doesn’t explain how industries often procure and help create the agency from the beginning.⁹²

Perhaps the biggest flaw with capture theory is that it is not an analytical or predictive theory to explain regulatory outcomes. In agencies that regulate separate industries, which have

82. Posner, *supra* note 77, at 340.

83. *Id.* at 340.

84. *Id.* at 340-41.

85. *Id.* at 341.

86. *Id.* at 341.

87. Posner, *supra* note 77, at 341.

88. *Id.* at 341.

89. *Id.* at 342.

90. *Id.* at 342.

91. *Id.* at 342.

92. Posner, *supra* note 77, at 342.

conflicting interests, capture theory cannot explain how one outcome is chosen over another.⁹³ Moreover, even in one industry (for example, the airline industry and the Civil Aeronautics Board), there are competing interests within the industry.⁹⁴ Capture theory does not explain how one outcome is chosen over another, just that the Board is “captured” by the industry in some vague sense of the word.⁹⁵

Of course, Posner also suggests that there is a “good deal of evidence that the interests promoted by regulatory agencies are frequently those of customer groups rather than those of regulated firms themselves.”⁹⁶ The inability to account for many regulations that benefit customers over industry is a failure of “capture theory.”⁹⁷

C. Interest Group Theory of Regulation

The bulk of Posner’s focus is on what he calls the “economic theory of regulation,” which could also be called interest group theory of regulation. Unlike public interest theory, interest group theory abandons the notion of pure intentions in legislative and regulatory outcomes.⁹⁸ Like capture theory, the theory acknowledges that politically powerful groups may capture an agency, but it also acknowledges that these groups may not be the industry itself.⁹⁹ Additionally, the interest group theory applies the laws of supply and demand to regulation to help understand why economic regulation “serves the private interests of politically effective groups.”¹⁰⁰

Posner believes economic regulation is a product supplied to interest groups with a demand for the regulation.¹⁰¹ That is the economic theory of regulation in a nutshell. The theory is a predictive, analytical theory that helps explain why certain regulations are enacted, which groups benefit, and most importantly, why those groups – rather than others – benefited from the enactment of the regulation.¹⁰² Additionally, the theory applies to both regulation sought by industry and that thrust upon it.¹⁰³ Onerous regulations, such as criminal sanctions discussed in this article, also can be explained by the same theory that explains

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 342-43.

98. Posner, *supra* note 77, at 343.

99. *Id.* at 343.

100. *Id.* at 343.

101. Posner, *supra* note 77, at 344.

102. *Id.* at 343-44.

103. George J. Stigler, *The Theory of Economic Regulation*, 2 BELL. J. ECON. & MGMT. SCI. 3 (1971).

the beneficial regulation.¹⁰⁴ Additionally, the theory can also apply to regulations that are not just purely “economic” in nature. Posner insists that “criminal laws... affect economic welfare no less than the conventional forms of economic regulation, and it seems arbitrary to exclude them from the analysis.”¹⁰⁵ Therefore, examining corporate financial regulations that include criminal provisions passed by Congress – using legislative history – is ripe for analysis under Posner’s view.

IV. INTEREST GROUP IMPACT ON FEDERAL CORPORATE FINANCIAL REGULATORY LEGISLATION: DID BUSINESS HAVE AN IMPACT?

The SOX and FCPA case studies should begin with an understanding that merely showing that the laws benefited or negatively impacted certain groups does not prove the economic theory of regulation. As Posner puts it, this article must “demonstrate that the characteristics and circumstances of the interest groups were such that the economic theory would have predicted that they, and not some other groups, would obtain the regulation we observe them enjoying.”¹⁰⁶ It is clear after examining the FCPA and SOX that the particular characteristics and circumstances of the general business lobby and specifically the accounting profession, gravitated toward outcomes from both pieces of legislation that could be predicted by the interest group theory of regulation.

Posner argues that the economic theory can be used to “explain why we so often observe protective legislation in...the professions,” by which he means professions such as law, accounting, medicine, etc.¹⁰⁷ As demonstrated earlier in this article, the accounting profession was the target for reform in both SOX and FCPA, but actively supported and helped shape the debate over the internal controls, books and records, and other accounting features of SOX and the FCPA. The general business lobby, represented by trade associations such as the Chamber of Commerce, NAM, and the Business Roundtable, were less successful in lobbying against both laws, due to disunity and political pressure.¹⁰⁸ The economic theory of regulation predicts

104. *Id.* at 3.

105. Posner, *supra* note 77, at 353.

106. *Id.* at 352.

107. *Id.* at 347.

108. See, e.g., Joan MacLeod Heminway, *Rock, Paper Scissors: Choosing the Right Vehicle for Federal Corporate Governance Initiatives*, 10 FORDHAM J. CORP. & FIN. L. 225, 315 (2005) (“[a]mong the interest groups that may influence congressional deliberations are associations comprised of businesses with joint or overlapping rulemaking interests, industry or trade groups, professional associations, and other business interest organizations (e.g., the

why the accounting industry can be viewed as a winner from these laws and business, generally, as a loser. The economic theory may not predict why business would prefer criminal to civil liability, but it could predict that if politically powerful and influential, the business lobby should be able to shape pending legislation.

A. *The Business Community*

Some have characterized SOX as “emergency legislation,” where attention is diminished among legislators and opportunities for interest group influence are enhanced.¹⁰⁹ However, as previously mentioned in this article, the business community was divided over SOX, where the Business Roundtable (consisting of large corporate members) supported the law, while the Chamber of Commerce (with small-firms as members as well as large), opposed it.¹¹⁰ The Chamber of Commerce is politically powerful, but it has great diversity of views within its own membership. It is important to remember Posner’s caution that the “homogeneity of interests in the regulation in question” is key.¹¹¹ It is not surprising that the Chamber was politically weaker than the Business Roundtable in an environment where the political winds favored an immediate legislative fix. Larger corporations faced lower coordination costs and greater homogeneity of interest – escaping political pressure¹¹² and a public relations disaster¹¹³ – that creates incentives to have the legislation pass. The Chamber’s more diverse and numerous small-firm members did not have the same ability to speak forcefully with one voice. Additionally, SOX was not intended to affect small, privately-held firms.¹¹⁴ This explains why the Chamber’s membership lobbying efforts would be weaker.¹¹⁵ The economic theory of regulation predicts that an

Chamber of Commerce and the Business Roundtable.))”

109. Robert V. Adhieh, *From “Federalization” to “Mixed Governance” in Corporate Law: A Defense of Sarbanes-Oxley*, 53 BUFF. L. REV. 721, 728 (2005).

110. Romano, *supra* note 76, at 1564.

111. Posner, *supra* note 77, at 345.

112. See Romano, *supra* note 76, at 1567 (“[a]s a lobbyist for the Chamber of Commerce, which opposed the Senate bill, put it, “When the WorldCom scandal hit, it became, to me, a bit of a--a very different attitude and atmosphere, if not a political tsunami . . .”).

113. *Id.* at 1565 (“A further source of divergence between the positions of the Business Roundtable and the Chamber of Commerce may have been the accounting scandals’ concentration among the largest public corporations. Roundtable members may have thought that by supporting the legislative proposal perceived to be tougher on corporate crime and accountability, they would be distancing themselves in the public mind from scandal-tinged firms, a factor of little moment to smaller businesses.”).

114. See Harned, *supra* note 59.

115. *But see* Romano, *supra* note 77, at 1565 (“The different positions of the business umbrella organizations on the Senate bill can plausibly be explained by the disparity in expected compliance costs for the organizations’ members

entity such as the Business Roundtable, with deeper pockets, smaller numbers, and more homogeneous alignment of interests, would be able to affect the passage of the legislation more than the Chamber. The more homogenous and coordinated, the more likely a group is able to affect legislative action.

The analysis for the FCPA is different. Although they condemned foreign bribery, the business community took a fairly consistent stance against the need for new legislation. Once it became evident that legislation would occur, it appears that the business community withdrew from the debate over whether disclosure or criminalization would be a better choice. While Khanna argues that businesses would prefer the latter,¹¹⁶ the legislative history does not indicate which alternative businesses would have preferred Congress to enact.

While Khanna's theory is entirely plausible, the key question is why business interests were left on the sideline in the construction and debate over the FCPA? Business interests seem to have been in tacit agreement with much of the testimony in opposition to the criminalization approach: it would be ineffective and purely symbolic. Why oppose a law if it will not be enforced against you? A disclosure system was quickly abandoned during the legislative debate,¹¹⁷ leaving businesses a choice to remain silent or risk having the disclosure system incorporated into the criminalization approach, which was likely favored by politicians in order to appear tough on crime. Even if business interests were aligned, the economic theory of regulation would not predict that they get what they want – no new legislation addressing bribery – because there may be other circumstances, groups, or pressures that tilt the regulation landscape against them.¹¹⁸

regarding the accounting and certification measures: The small and medium-sized firms that are the membership base of the Chamber of Commerce were expected to find it far more costly to meet the proposed legislative mandates than large firms. Accordingly, the Chamber supported an amendment proposed by Senator Gramm to permit the new accounting regulator to exempt small businesses from the nonaudit services prohibitions (it was not enacted)).

116. See Khanna, *supra* note 1.

117. See Koehler, *supra* note 15, at 988-96.

118. At the time of the FCPA's passage, trust in business and government was low, and it isn't surprising that business would be generally ineffective in achieving its presumed goals in Congress. See, e.g., Romano, *supra* note 76, at 1611 (discussing business political power tied to public perception). ("Mark Smith has carefully demonstrated that when business unites behind legislation, labor tends to be united on the other side. As a consequence, if business "wins" it is because public opinion and election outcomes are tilting toward business's policy position and not because of financial leverage exerted by business over legislators. As Smith details, issues that unify business tend to be ideological (the issue separates liberals and conservatives), partisan (the issue separates Democrats and Republicans), and salient (the issue is highly visible to the public). Thus, Smith finds that in these issue contexts, direct resources or forms of power wielded by business (through campaign contributions and lobbying capacity) do not explain legislative outcomes, but

B. The Accounting Industry and Regulators

Understanding how and why SOX and the FCPA were passed must include an acknowledgement that the accounting industry (and its regulators) were at the forefront of shaping the debate in Congress. For example, with SOX, the Senate committee did not even hear from business interests, unlike the House, but it did hear from the accounting industry.¹¹⁹ The Senate committee focused on the accounting profession and heard from a large number of regulators and members of the accounting profession, such as the American Institute for Certified Professional Accountants.¹²⁰ Most of the witnesses for the Senate committee were associated in some way with the SEC.¹²¹ Ultimately, the Senate bill was the one adopted in most part by Congress.¹²²

The economic theory of regulation predicts such an outcome in both SOX and the FCPA, which also adopted many accounting and auditing reforms and strengthened the role of the SEC relative to its enforcement of internal monitoring. The theory demonstrates that the accounting industry and its regulators would stand to benefit from greater regulation and why the accounting industry would be more successful in shaping legislation. There are a few concepts from Posner's economic theory of regulation which apply: supply and demand for regulation; homogeneity of interests; coordination costs; cartelization as unfeasible or highly costly; barriers to entry; and the ability to charge supra-competitive prices. Each of these, as applies to the accounting profession and its regulators, will be discussed in turn.

1. Supply and Demand of Regulation

The accounting industry has the best of both worlds. Like the auto industry, its top players are concentrated, as discussed below. Like the legal world, the accounting industry is part of the

public opinion polls reflecting attitudes toward business and the partisan composition of elected lawmakers do." *Id.* at n.119.

119. See Romano, *supra* note 76, at 1570 ("...the composition of the witnesses differed across the chambers. Remarkably, the Senate committee heard no witnesses from the business community, in contrast to the House, even though business was an anticipated object of regulation and ostensibly among the potential beneficiaries of the legislation. The business community would, for instance, benefit from any improvement in the quality of auditing accomplished by legislation. Instead, the Senate was more focused on the accounting profession; it heard from a larger number of accounting industry regulators and members than did the House.").

120. *Id.*

121. *Id.* at 1568.

122. Oppel, *supra* note 48.

“professions,” as Posner describes those industries where cartelization is difficult but protective legislation is necessary.¹²³ Given the foregoing analysis regarding the supply of corporate criminal legislation by the Congress, which often includes accounting practices rules and regulations, the government is clearly willing and able to produce regulation for the accounting industry. The real question is: does the accounting industry have a demand for it? As the next few subsections indicate, there is little reason why the accounting industry would not at least be neutral or indifferent toward regulation, and very likely would (and has) benefited from erecting greater barriers to entry by making it more difficult for accounting firms to break into the top tier of public company accounting. This allows firms to charge higher prices as the firms they would be auditing have an even greater demand for their services following the passage of laws such as SOX and FCPA.¹²⁴

2. *Homogeneity of Interests*

It is important to distinguish the “Big 4” accounting firms from the rest of the industry.¹²⁵ Their interests are different from the “mom-and-pop” CPA shops in your hometown; the Big 4 of KPMG, Deloitte Touche Tohmatsu, Ernst & Young, and PricewaterhouseCoopers dominate the public company accounting market.¹²⁶ As such, they possess a greater interest in laws affecting accounting of publicly-held companies, like the FCPA and SOX, while smaller firms may not be. These laws will affect the Big 4 equally, as the laws do not target any one particular firm or practice in accounting done by one firm alone.

3. *Coordination Costs*

The four major accounting firms are interested in the same thing: accounting laws and regulations affecting publicly held companies. Four firms is a rather small number, and so long as the interests of other accountants outside of those firms are not brought into the discussion, it should not be difficult for the Big 4 to coordinate their public outreach to affect the policy debate regarding laws affecting the accounting industry. There is also less likely to be free-rider problems in an industry with only four major players.¹²⁷ Additionally, at least one study suggests that a small

123. Posner, *supra* note 77, at 347.

124. Easterbrook, *supra* note 69, at 698.

125. Accounting Services – Industry Facts and Trends, HOOVERS, www.hoovers.com/industry-facts.accounting-services.1299.html (last visited Aug. 25, 2016).

126. *Id.*

127. Posner, *supra* note 77, at 349.

increase of 50 points (on a scale of 0 to 10,000) in the Herfindhal-Hirschman Index (HHI), one of the primary modes of analyzing business concentration, would put the accounting industry in violation of antitrust guidelines.¹²⁸

4. *Cartelization is Unfeasible or Highly Costly*

While four firms dominate the market for public company accounting, actual cartelization would be unfeasible. Much like the legal profession, the accounting industry assesses rates for its services based on the client, the hour, the type of work involved, etc.¹²⁹ It is a highly skill-oriented profession dependent on the work of thousands of different certified professional accountants. The industry could not just set a price for its services, because there are so many of them.¹³⁰ If they set a price for one service, the firms could compete on other dimensions in other services. Fixing output would also be difficult for the same reason. Cartelization will usually not occur in an industry with low initial capital costs upfront, such as accounting, where all you need is a CPA, not an infrastructure or heavy machinery. Additionally, the accounting industry is highly regulated and monitored, making it unlikely that there could be a meeting of the minds for the Big 4 in terms of prices or output. They could, however, coordinate political outreach strategies without violating antitrust laws.¹³¹

5. *Barriers to Entry*

Smaller accounting firms face significant barriers to entry in the accounting industry with respect to accounting for public companies, the target for both the FCPA and SOX.¹³² Mergers in the 1980's and the dissolution of Arthur Andersen resulted in an oligopoly of the "Big 4" accounting firms.¹³³ As such, the industry

128. See Kalpana Pai & Thomas D. Tolleson, *The Capture of Government Regulators by the Big Four Accounting Firms: Some Evidence*, 13 J. OF APPL. BUS. & ECON. 83 (2012), www.na-businesspress.com/JABE/PaiK_Web13_1_.pdf.

129. See K. Sams, *How Much Should You Pay for an Accountant?*, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, Sept. 20, 2012, www.nfib.com/content/resources/management/how-much-should-you-pay-for-an-accountant-60944/.

130. For example, Deloitte offers many different services besides auditing. See *Audit*, DELOITTE, www2.deloitte.com/us/en/services/audit.html?icid=top_audit.

131. See, e.g., Noerr-Pennington doctrine: *E. R.R. Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127, 135 (1961); *United Mine Workers v. Pennington*, 381 U.S. 657, 670 (1965).

132. *Public Accounting Firms, Mandated Study on Consolidation and Competition*, GOV. ACCOUNT OFFICE, July 2003, www.gao.gov/assets/240/365/U.S.127239228.pdf.

133. *Id.*

is highly concentrated, ripe for cartel-like behavior. This analysis also considers the difficulty for attaining a license as a CPA, which further creates barriers to entry in the market for accounting in general.

6. *Supra-Competitive pricing*

Every public company needs an accountant, especially when they are dealing with billions of dollars every year and thousands of regulations and laws involving accounting practices. It is easier to set your price when there are only three other major competitors. Additionally, a highly-concentrated market with a very inelastic demand for the services might lead to increases in prices, as Easterbrook observed.¹³⁴

V. EFFECT OF FCPA AND SOX ON BUSINESSES

Both FCPA and SOX contain civil and criminal provisions, and both laws have proven to be substantially burdensome to business, particularly smaller businesses.¹³⁵ Unfortunately, these businesses possessed little influence in Congress during the debate over passage of these laws. While accounting firms may have benefited from the passage of the FCPA and SOX, other businesses did not. The consequences of rent seeking – using your resources to affect policy change to gain more resources, often at the expense of another, e.g., lobbying¹³⁶ – can negatively affect both those who lobbied for the rent as well as those who were in no position to organize an opposition, such as smaller businesses.

Following the passage of the FCPA, little was done to enforce its provisions.¹³⁷ However, businesses reported increased compliance costs and dissatisfaction with the clarity of the accounting provisions.¹³⁸ Today, enforcement of the FCPA has substantially increased, and the Department of Justice issued a 100-plus-page guidance document to businesses to assist in understanding the complexities of the law.¹³⁹ The SEC also

134. Easterbrook, *supra* note 69, at 698.

135. See Jason Bramwell, *Survey: Public and Private Company Audit Fees Went Up in 2013*, ACCOUNTING WEB, Oct. 2, 2014, www.accountingweb.com/practice/practice-excellence/survey-public-and-private-company-audit-fees-went-up-in-2013.

136. See Sandy Ikeda, *Rent-Seeking: A Primer*, *Foundation for Economic Education*, Nov. 1, 2003, <https://fee.org/articles/rent-seeking-a-primer/>.

137. Melissa Maleske, *The impact and continuing evolution of the FCPA*, INSIDE COUNSEL, May 22, 2013, www.insidecounsel.com/2013/05/22/the-impact-and-continuing-evolution-of-the-fcpa.

138. Government Accountability Office, *Impact of Foreign Corrupt Practices Act on U.S. Business*, Mar. 4, 1981, www.gao.gov/products/AFMD-81-34.

139. U.S. Department of Justice, *A Resource Guide to the U.S. Foreign*

increased enforcement of the books-and-records provisions of the FCPA, with a marked increase in enforcement actions since 2001.¹⁴⁰ In recent years, the SEC began enforcing the FCPA outside of the judicial system through the use of non-prosecution and deferred prosecution agreements.¹⁴¹ This includes substantial fines (tens of millions of dollars or more) for businesses that conduct business overseas.¹⁴² One study revealed that 63 percent of respondents, “who included corporate executives, investment bankers, private equity executives and hedge fund managers, say the FCPA and anti-corruption legislation have led to aborted or renegotiated deals such as M&A, joint ventures and distributor relationships.”¹⁴³ Businesses have struggled with the increased enforcement of the FCPA, its complex and uncertain interpretations, and the reality of doing business in an imperfect world where in some countries, one person’s corruption is another person’s standard business practice. With increased compliance costs and enforcement penalties, businesses are understandably on edge about the FCPA.

SOX similarly impacted business, especially small businesses. The National Federation of Independent Businesses has been a strong opponent of SOX and believes that the provisions in the law harm small businesses.¹⁴⁴ The government has sought to extend provisions of SOX (such as whistleblower protections) to companies that are not even publicly traded.¹⁴⁵ The Supreme Court affirmed this interpretation in a 2014 case.¹⁴⁶ Studies have shown that while the initial increased costs have generally declined for businesses as the law has aged, the impact of these costs has disproportionately fallen on small businesses.¹⁴⁷ For example, one study has shown that rules requiring independent, non-employee directors may be much more costly to small businesses, with small businesses paying nearly double

Corrupt Practices Act, Criminal Division, Jan. 16, 2015, www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf.

140. SEC Enforcement Actions: FCPA Cases, U.S. Securities and Exchange Commission, www.sec.gov/spotlight/fcpa/fcpa-cases.shtml.

141. See SEC Enforcement Actions: FCPA Cases, July 14, 2016, www.sec.gov/spotlight/fcpa/fcpa-cases.shtml.

142. *Id.*

143. Lisa Lacy, *The Rise and Rise of FCPA*, BUSINESS INSIDER, Mar. 24, 2011, www.businessinsider.com/the-rise-and-rise-of-fcpa-2011-3.

144. See Harned, *supra* note 59.

145. See *Lawson v. FMR LLC*, 134 S. Ct. 1158 (2014), www.supremecourt.gov/opinions/13pdf/12-3_4f57.pdf.

146. *Id.*

147. John C. Coates & Suraj Srinivasan, *SOX after Ten Years: A Multidisciplinary Review*, Harvard Law and Economics Discussion Paper No. 758, Jan. 12, 2014, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2343108.

compensation after SOX while larger businesses only marginally increased compensation.¹⁴⁸

Opponents of SOX claim that the law imposes rigid and inflexible rules and increased overhead costs, which disproportionately harm small businesses because smaller businesses have a greater percentage of their budget devoted to overhead.¹⁴⁹ The SEC's own study of financial executives' assessment of SOX five years after passage admits that the majority of respondents, particularly those in smaller firms, perceived the benefit-cost tradeoff for Section 404 internal control compliance to be negative.¹⁵⁰ Moreover, the costs of compliance with just that one section are estimated to be \$2.3 million on average and are seven times greater for smaller business than the costs imposed on larger firms.¹⁵¹

Proponents of the law have admitted that it is quite difficult to assess the actual costs and benefits of this type of regulation; despite six years of SOX being the law of the land, the financial crisis of 2008 still occurred.¹⁵² These unanswered questions raise the concern over "political entrepreneurs" shaping laws such as SOX rather than performance measurement and careful consideration.¹⁵³ While determining the role that SOX played in the financial crisis is beyond the scope of this article, it is important to remember that those in favor of passing SOX were adamant that its passage and greater government regulation would help to prevent future corporate financial scandals.¹⁵⁴

Both the FCPA and SOX have focused on financial reporting, and many in the accounting industry agree that these laws have improved how businesses follow accounting rules and practices – at least according to the Center for Audit Quality, one of the major

148. See Butler, *supra* note 3, at 43.

149. *Id.* at 53.

150. Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control over Financial Reporting Requirements 6, U.S. Securities and Exchange Commission, Office of Economic Analysis, Sept. 2009, www.sec.gov/news/studies/2009/sox-404_study.pdf. ("The majority of respondents to this section perceive the trade-off to be negative to varying degrees.")

151. Jon Berlau, *Republicans for Sarbanes-Oxley*, NATIONAL REVIEW, Nov. 29, 2011, www.nationalreview.com/article/284269/republicans-sarbanes-oxley-john-berlau.

152. Julia Hanna, *The Costs and Benefits of Sarbanes-Oxley*, FORBES, Mar. 10, 2014, www.forbes.com/sites/hbsworkingknowledge/2014/03/10/the-costs-and-benefits-of-sarbanes-oxley/2/#4c27a28c6a99. ("The big, unanswered question is whether SOX-related changes had any impact in the lead-up to the financial crisis. Did it make things better or worse?" says Srinivasan. "We don't know the answer to that.")

153. *Id.*

154. See, e.g., Hearing, *supra* note 60, at 133 (statement of Rep. Jan Schakowsky) ("The fact of the matter is we do not have the laws and procedures in place to protect common investors. If we don't take swift action, I have little doubt that corporate executives' greed and deception will victimize more people.").

lobbyists for the accounting industry.¹⁵⁵ SOX created the Public Company Accounting Oversight Board and ended a century of self-regulation for the industry.¹⁵⁶ With concerns about regulatory capture of financial regulators,¹⁵⁷ in particular those that regulate accountants, it is unclear whether ending self-regulation is necessarily a good thing. With the accounting industry dominated by four firms and already close to the antitrust limits, it is questionable whether regulators can do much in the future if another Arthur Andersen incident occurs.¹⁵⁸ Meanwhile, those accounting firms are protected from competition by the sheer burden of regulation now imposed on the accounting industry. Additionally, there is substantial concern over the “revolving door” between financial regulators and the regulated businesses, as well as concern over the Big Four accounting firm’s influence over their regulators.¹⁵⁹ Despite the central role that poor accounting practices played in the various “corporate scandals” that led to the passage of laws such as FCPA, SOX, and most recently, Dodd-Frank, the four major accounting firms are in a great position today, with responsibility for auditing more than 80 percent of large companies.¹⁶⁰

For those larger companies, the increased cost of compliance is simply a necessity worth spending time and money, and hiring

155. See PRNewswire, *Post-SOX Audit Quality Has Improved, Say Nation’s Audit Committee Members*, PRNEWswire, Mar. 18, 2008, www.prnewswire.com/news-releases/post-sox-audit-quality-has-improved-say-nations-audit-committee-members-56959567.html. Others have criticized the report as shoddy and the Center for Audit Quality as a “shell” for the accounting industry; see Thomas I. Selling, *Low Quality Stats from Center for Audit Quality*, THE ACCOUNTING UNION, Apr. 6, 2008, <http://accountingunion.typepad.com/theaccountingunion/2008/04/low-quality-sta.html>.

156. Paul Sweeney, *Sarbanes-Oxley – A Decade Later*, FINANCIAL EXECUTIVES INTERNATIONAL, July 2012, www.financialexecutives.org/KenticoCMS/Financial-Executive-Magazine/2012_07/Sarbanes-Oxley--A-Decade-Later.aspx#axzz3zVYpFqaA. (“Ernst & Young’s Brorsen sees creation of the PCAOB to police the auditing profession — coupled with corporate governance rules’ putting a public company’s board-level audit committee, rather than company management, in charge of the auditing process — as “the top two fundamental changes” brought about by the act. “It’s fair to say that the largest single impact of Sarbanes-Oxley was to end 100 years of self-regulation,” he says.”).

157. Francine McKenna, *File Under Regulatory Capture: Deloitte’s “FiresideChats,”* FORBES, Aug. 22, 2011, www.forbes.com/sites/francine/mckenna/2011/08/22/file-under-regulatory-capture-deloitte-fireside-chats/#214636447263.

158. See Pai & Tolleson, *supra* note 128, at 90.

159. Charles Levinson, *Accounting industry and SEC hobble America’s audit watchdog*, REUTERS, Dec. 16, 2015, www.reuters.com/investigates/special-report/usa-accounting-PCAOB/.

160. Government Accountability Office, *Audits of Public Companies: Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action*, Jan. 9, 2008, www.gao.gov/products/GAO-08-163.

one of the four major accounting firms is a routine practice. For smaller businesses, however, the heavy burden of compliance may be a discouraging factor for some businesses that intend to launch an IPO and become a public company.¹⁶¹ President Obama's 2011 Job Council report notes that an unintended consequence of SOX was a decrease in IPO launches, particularly by smaller businesses.¹⁶² Smaller companies that are already public can struggle to keep up with increased auditing fees and compliance costs.¹⁶³

VI. CONCLUSIONS

There are important lessons to be drawn from the above analysis of legislative history and interest group politics and how corporate financial regulation evolved in Congress as a result of political interests. First, and most importantly, is the notion that certain types of interest groups, which are homogenous, concentrated, and have the ability to act collectively – such as the accounting profession – will have more success in crafting laws that provide significant advantages to the incumbents of their industry specifically. As applied to corporate financial regulatory legislation – at least through the lenses of the Foreign Corrupt Practices Act and the Sarbanes Oxley Act – it is clear that the accounting industry benefited tremendously from the passage of these laws because these laws created more work for accountants, especially the big four firms. The more paperwork and time accountants have to spend reviewing on behalf of a corporation, the better for the accounting profession. With both of these laws, auditing fees have increased, in many cases substantially, for those least able to afford compliance – smaller businesses.¹⁶⁴ Moreover, the accounting industry is now well protected by government regulators, as the cost of compliance with regulation is significant enough to decrease competition for the auditing business of major corporations.

Additionally, with a marked preference by the Department of Justice and the SEC for entering into deferred and non-prosecution agreements (especially in FCPA cases)¹⁶⁵ with

161. Martin Zwilling, *10 Reasons Why IPO Is No Longer A Good Startup Exit*, FORBES, Sept. 10, 2013, www.forbes.com/sites/martinzwilling/2013/09/10/10-reasons-why-ipo-is-no-longer-a-good-startup-exit/#7483d4cb23dd.

162. President's Council on Jobs and Competitiveness, *Taking Action, Building Confidence* 19, Interim Report, Oct. 2011, http://files.jobscouncil.com/jobscouncil/files/2011/10/Jobscouncil_InterimReport_Oct11.pdf.

163. See Bramwell, *supra* note 135; see also Al Ghosh & Robert J. Pawlewicz, *The Impact of Regulation on Auditor Fees: Evidence from the Sarbanes-Oxley Act*, Feb. 1, 2008, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1032642.

164. See Bramwell, *supra* note 135.

165. Gerald Martin, Jonathan M. Karpoff, D. Scott Lee, & James C. Cooper, *Foreign Corrupt Practices Act Enforcement, An Empirical*

publicly-held companies since the collapse of Enron and the successful but catastrophic prosecution of accounting firm Arthur Anderson,¹⁶⁶ the accounting profession has perhaps a little less to worry about today than they did early in 2002. Another major indictment could send the accounting industry into antitrust violations and would decrease the regulatory output of government if only three major firms were the target of regulation. With the requirements that executives sign all securities certifications and businesses follow strict accounting practices now over a decade old, there is little evidence to suggest that the accountants and their firms have been held more accountable for corporate fraud than before the passage of SOX. The Foreign Corrupt Practices Act has also proven to be a vigorously prosecuted law against the corporations themselves in the last decade, but at least one study suggests that investors care more about corporations lying on their securities statements (violating the books and records provisions) than the actual underlying alleged bribery itself.¹⁶⁷ Investors understand that business is done differently around the world, but cannot tolerate corporate managers deceiving them and the government on the company's financial statements. Corporate managers surely are aware of this, and are willing to invest heavily in compliance, auditing, and accounting systems, benefiting those particular industries through increased business and fees. If individual employees end up being prosecuted more than the company themselves, the corporation as an entity can breathe a sigh of relief.

Another lesson from interest group theory and corporate financial regulatory legislation is that business does not have one agenda or always present a united front. As Judge Easterbook put it:

To speak of "corporations" is to speak of the economy as a whole, and therefore to speak of a disorganized and ineffectual group--the target of small, concentrated, and therefore powerful adversaries. Businesses are at each other's throats (this is what competition in both product and political markets is about) and cannot collaborate to dominate the political process. Corporations that want to emit soot must fight off corporations that manufacture soot-control equipment. One hundred years ago corporate holdings were more

Examination of Enforcement Trends, SEARLE CIVIL JUSTICE INSTITUTE, Sept. 2012, www.masonlec.org/site/rte_uploads/files/FINAL%20FCPA%20REPORT%20PDF.pdf. The study finds that 75% of all FCPA enforcement actions have been resolved through these types of agreements since 2004.

166. David M. Uhlmann, *Prosecution Deferred, Justice Denied*, N.Y. TIMES, Dec. 14, 2013, at A23, www.nytimes.com/2013/12/14/opinion/prosecution-deferred-justice-denied.html?_r=0.

167. Gerald Martin, Jonathan M. Karpoff, D. Scott Lee, & James C. Cooper, *Foreign Corrupt Practices Act Enforcement, Economic Impact on Targeted Firms*, SEARLE CIVIL JUSTICE INSTITUTE, June 2014, [http://masonlec.org/site/rte_uploads/files/FCPA%20II%20Final%20\(6.4\).pdf](http://masonlec.org/site/rte_uploads/files/FCPA%20II%20Final%20(6.4).pdf).

concentrated; the House of Morgan and the Rockefellers could mobilize political power.¹⁶⁸

The divergence of opinion and strategy in approaching both the FCPA and SOX bears this out: unless “business” as a whole is united against some potential new law, various groups within “business” will have greater influence than others. Even an apparently united front, as seemed to be the case with the FCPA, will not override political circumstance or pressure from competing interest groups for provisions that favor their industry. That is the entire point of Posner’s interest group theory and the important lesson that applying law and economics scholarship to public policy decisions can teach us. Concentrated, motivated industries such as the accounting profession will have a strong incentive to band together and affect policy, while business in general will be unable to muster concrete, clear preferences that can be taken into account by members of Congress, especially when the political winds are blowing in the direction of changing public policy immediately.¹⁶⁹ With both the FCPA and SOX, corporate interests may have avoided even worse outcomes, as the substitution theory for corporations preferring criminal to civil liability demonstrates,¹⁷⁰ but that may be less a product of their influence than circumstances and political realities facing Congress at the time of passage. Moreover, the coupling of criminal provisions with massive new compliance and regulatory requirements, encumbered businesses in their own right and are more frightening today to corporate managers than the unlikely criminal indictment of a major corporation.

Ultimately, the biggest lesson from the legislative history of these two laws is that interest groups are not operating in a vacuum when it comes to corporate financial regulatory legislation. Even the accounting industry was subject to the tide of public opinion and the political environment it created, but it seems they made the most of it. What results may be a *fait accompli*, beyond any one person or group’s control. When Congress intends to act, it will often do so. The best that interest groups can hope for is to achieve an optimal outcome. It would be preferred that the outcome is one which will not come back to haunt them in an ironic twist, much as the FCPA’s strong criminal sanctions in lieu of disclosure has had for many corporations.

With both the FCPA and SOX, the impact of compliance on small businesses has been substantial, and the major business interests appearing before Congress in both of these debates may have failed to adequately represent those most likely to be harmed

168. Easterbrook, *supra* note 69, at 701.

169. *See, e.g.*, Hearing, *supra* note 56, at 14 (statement of James K. Glassman) (“...in times of scandal, emotions run high. And the urge to rush in with legislative remedies is understandable, but it should be resisted.”).

170. *See* Khanna, *supra* note 1, at 117.

by new regulation: small businesses. In future debates, corporate leaders should be careful what they wish for and what their lobbyists say or fail to say. If Congress is planning to do something, do not be so sure that your preferred outcome will be the one they choose and if they do, that it will work out to your benefit in the long run. There is risk in playing interest group politics, and the legislative history of the FCPA and SOX prove that businesses have much to lose and little to gain from new corporate financial regulation – unless they happen to be major accounting firms.