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This Article explores the history of the accounting profession, expertise, and the administrative state. It explains how the government gradually grew to rely on expertise not only as a way to master the technical problems of the modern industrial world, but also to justify the expansion of the administrative state. In theory, the professions would provide a neutral source of value just as academics successfully undermined the courts' ability to perform this function. The Article argues that government policy toward business regulation and the accounting profession from the Progressive Era to the New Deal helped shape a profession that was deeply tied to its business clients. Using this history as a guide, this Article offers a unique perspective on two contemporary debates concerning the expert's role in governance. First, by tracing the roots of private governance in the early 20th century, this Article throws doubt on the grand claims made by the fashionable new "private governance" scholarship, announcing the imminent demise of the administrative state and the ascendance of private regulation. Second, in recounting the history of the accounting profession, which is marked by repeated attempts by the profession to gain federal recognition and strengthen alliances between the profession and business, this Article suggests a new way of assessing the recent efforts, embodied in the Sarbanes-Oxley Act of 2002, to restore a sense of independence to the profession.

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REBECCA ROIPHE*

I. INTRODUCTION

On a Thursday in 1933, Felix Frankfurter asked James Landis to come to Washington to help him draft the Federal Securities Act, promising that they would be back in Cambridge by the following Monday when Landis was scheduled to teach his next class.[1] Needless to say, Landis did not make it back in time. Instead, he camped out with Benjamin Cohen and Thomas Corcoran, two former Frankfurter students, in a room on the seventh floor of the Carlton Hotel in Washington, D.C.[2] J.P. Morgan and his staff, who had been summoned to testify at the Pecora hearings, were staying in a suite just above theirs.[3] As the reformer and the mogul made their way to and from the Capitol, they frequently met in the elevator. Landis mused that he "passed unnoticed, happy that our burrowing in the structure of that empire had no noticeable reverberations above."[4]

The New Deal government recognized the professions as a new constituency and a new class of rulers. Experts had played a role in governance for close to a century before the New Deal.[5] Even the early state railroad agencies depended on engineers and economists to gather information regarding rates and competition. They used this information in a rather modest effort to persuade the railroads to reduce rates or avoid disruptive competition. While the model for regulation remained limited throughout the 19th century, in the 1890s, a group of intellectuals began to attack party politics and promote a permanent governing body staffed

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[1] DONALD A. RITCHIE, JAMES M. LANDIS: DEAN OF THE REGULATORS 43 (1980).

[2] James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV 29, 39 (1959). Thomas Corcoran, born in Pawtucket, Rhode Island, received his LL.B. from Harvard in 1925. MICHAEL E. PARRISH, SECURITIES REGULATION AND THE NEW DEAL 59–60 (1970). After serving as a law clerk for Associate Justice Oliver Wendell Holmes, Corcoran worked in a law firm in New York where he specialized in corporate reorganization. *Id.* Benjamin Cohen, the son of a wealthy Jewish family from Muncie, Indiana, received his Ph.D. in economics from the University of Chicago in 1914 and his LL.B. from Harvard two years later. *Id.* He clerked for Judge Julian Mack on the United States Court of Appeals for the Second Circuit, worked for the United States Shipping Board during World War I and later became counsel for the American Zionists. *Id.* at 59. After the war, Cohen worked as a lawyer in New York, and like Corcoran, he specialized in corporate reorganizations. *Id.* at 60.

[3] Landis, *supra* note 2, at 39. The Pecora hearings, led by Ferdinand J. Pecora, were conducted by the Senate Committee on Banking and Commerce to investigate the causes of the Depression. *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL-STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 20–21 (1982).

[4] Landis, *supra* note 2, at 39.

[5] *See infra* Part II.A.1.

by professionals.[6] This vision did not emerge fully formed for decades to come, but World War I forced the government to rely increasingly on experts within private industry and the professions to coordinate the war effort.[7] In the decade of peace and prosperity that followed, government continued to rely on businessmen to govern.[8] After the stock market crash of 1929, however, everyone agreed that business could not be trusted to police its own behavior.[9] Regulatory agencies grew in size and stature, interfering in new and unprecedented ways in the market.[10] To reconcile the new invasion into the private realm with the older deference to business, New Deal reformers had faith in the value of professions not only for their technocratic expertise, but also as a neutral source of value, which derived not just from the scientific nature of their inquiry but also from their independent status.[11] The Securities Act of 1933 embodied this new faith in professionals by relying on, among others, the accounting profession—a body that stood, at least theoretically, between government and business.[12]

The accounting profession, however, had a somewhat checkered past. The professional association was plagued with internal strife from its inception in 1887.[13] Battles between the national and state professional bodies lasted for decades. Clamoring for recognition at the end of the 19th century, accountants tried to persuade the new governmental agencies of the virtues of their profession.[14] The government ignored the plea and allowed bureaucrats to do the accounting that was necessary to regulate business. When officials turned to the private realm, they consulted business itself not the professionals. Excluded from both the intellectual and practical efforts to coordinate the growingly complex capitalist system, the profession allied itself with business, defining its mission against government, rather than in a common pursuit of the public good. During the First World War, accountants finally won a degree of recognition.[15] The accounting profession helped the government mobilize business and

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[6] *See infra* Part II.A.1.

[7] *See generally* ROBERT D. CUFF, THE WAR INDUSTRIES BOARD: BUSINESS-GOVERNMENT RELATIONS DURING WORLD WAR I (1973).

[8] Robert D. Cuff, *Herbert Hoover, The Ideology of Voluntarism and War Organization During the Great War*, 64 J. AM. HIST. 358, 358–62 (1977).

[9] *See* RITCHIE, *supra* note 1, at 44; *infra* Part II.A.4.

[10] *See infra* Part II.B.4.

[11] *See infra* Part II.B.4.

[12] *See infra* Part II.A.4. The government relied on a group of professionals—accountants, lawyers, and investment bankers—which came to be knows as gatekeepers. This article explores accountants, one such group of professionals, as an example of this new reliance on experts to mediate between government and business.

[13] GARY JOHN PREVITS & BARBARA DUBIS MARINO, A HISTORY OF ACCOUNTANCY IN THE UNITED STATES: THE CULTURAL SIGNIFICANCE OF ACCOUNTING 31 (1998). *See infra* Part II.B.1.

[14] For an extensive discussion of this topic, see *infra* Part II.B.2.

[15] *See infra* Part II.B.3.

calculate the proper price for war contracts. "Public accountants," as they became known, swarmed to the help of the wartime government and people seemed to notice.[16] As soon as the war ended, however, the accountants retreated from the public realm. They took their newfound prestige and applied it to business rather than public service. Income tax returns, audits, and consulting work all turned the profession's eye away from government service toward business advising.[17] It was at this moment, and against this backdrop, that James Landis and his colleagues drafted the Securities Act of 1933, which required independent audits by public accountants of the financial statements of all companies offering securities to the public.[18]

Landis was a young reformer, one of Frankfurter's protégés. He was a legal realist and a New Deal liberal,[19] part of what came to be known as Roosevelt's "brain trust."[20] These two intellectual commitments are, at first glance, difficult to reconcile. The notion that legal doctrine is driven, in large part, by the subjective musings of individual jurists threatened to undermine the theoretical basis for the rule of law and with it the liberal state. Almost from its inception, democracy was considered dangerous: left to its own devices, the state would abuse its delegated powers and begin to erode personal security and property. In theory, the rule of law guards against this eventuality by constraining the state with mandates that transcend the whims of those charged with applying them. The rule of law would ensure that the government worked for the good of all, not the passions of the few.[21] Legal realists, however, carefully attacked and undermined the existence of such independent norms.[22]

Far from abandoning faith in the state, however, New Deal liberals like Landis called for a more significant role for the government. As one of the

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[16] "Public accountants" refers to those who do not work for a particular business but rather practice in a private firm. "Certified public accountants" are those who are certified to practice by their state. PREVITS & DUBIS MERINO, *supra* note 13, at 24–25.

[17] *See infra* Part II.B.3.

[18] *See infra* Part II.B.4.

[19] MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1870–1960: THE CRISIS OF LEGAL ORTHODOXY 169–72 (1992); Mark Tushnet, *Legal Scholarship: Its Causes and Cure*, 90 YALE L.J. 1205, 1207 (1981).

[20] RITCHIE, *supra* note 1, at 58.

[21] C.B. MACPHERSON, THE POLITICAL THEORY OF POSSESSIVE INDIVIDUALISM: HOBBES TO LOCKE (1962). Historians of the revolutionary period have discussed the development of the notion of the rule of law throughout the early period of the republic. *See, e.g.*, JOHN PHILLIP REID, CONSTITUTIONAL HISTORY OF THE AMERICAN REVOLUTION: THE AUTHORITY OF RIGHTS (1986); GORDON S. WOOD, THE CREATION OF THE AMERICAN REPUBLIC 1776–1787 (1969); Martin S. Flaherty, *History "Lite" in Modern American Constitutionalism*, 95 COLUM. L. REV. 523, 542–49 (1995); Larry D. Kramer, *Foreword: We the Court*, 115 HARV. L. REV. 4, 16–128 (2001). For a discussion of how the notion of the rule of law evolved in the late 19th and early 20th centuries, see HORWITZ, *supra* note 19.

[22] HORWITZ, *supra* note 19, at 3–7.

primary authors of the Securities Act of 1933, Landis defended the growth of the administrative state, declaring the obsolescence of judges as "jacks-of-all-trades and masters of none."[23] In championing the role of agencies, however, Landis and his colleagues had to provide a new source of legitimacy for government, a new justification for the liberal state. In the wake of the judge-based rule of law, they had to find a new guardian of the public good.

Landis, like many of his contemporaries, filled this void with objectivity, science and expertise, which would provide the ultimate justification for the administrative state. When the government collided with business, as Landis and J.P. Morgan's encounter nicely illustrates, expertise—a neutral and almost invisible force—would be able to mediate. Science would provide a necessary cushion between capital and labor, private acquisitiveness and the excesses of democracy. The Securities Acts of 1933 and 1934 provided for independent audits of financial statements.[24] And this made sense given that the accountants had an expert knowledge of financial reporting. The science of accountancy would constitute a neutral arbiter between the state and business, guarding against the excesses of democratic government while curbing the dangers of unrestrained self-interest in the market. Science and expertise would ensure that the government acted on behalf of the public good, rather than the captains of industry. In short, the neutrality of expertise justified the use of an independent profession in business regulation just as it did the administrative state generally.[25]

By generating a seemingly neutral source of value, expertise could provide a perfect theoretical basis for government expansion. The use of an independent profession, however, was not foreordained. Landis could have created a body of government accountants to regulate business directly. He could have employed the Federal Trade Commission (FTC), which enforced the antitrust acts, or the Securities and Exchange Commission (SEC), which was created by the Securities and Exchange Act of 1934, to monitor the issuance of securities and conduct audits of publicly traded companies. But he did not. The Securities Acts were enacted after the stock market crash of 1929. They were approved after Franklin Delano Roosevelt won the 1932 election in a landslide, but many people still harbored a distaste for large government, a fear of democratic excess and a suspicion that corruption would inevitably erode the conscience of our leaders. The accountancy profession provided a seemingly perfect compromise. Expertise combined with the profession's status as a private group would preclude—at least theoretically—the

[23] JAMES LANDIS, THE ADMINISTRATIVE PROCESS 31 (1938).

[24] Securities Exchange Act of 1934 § 10a(m)(3), 15 U.S.C. § 78j (2000).

[25] The government specifically declined to judge the merits of securities offerings. It relied, on the neutrality of accountants, among others, to do so instead. *See infra* Parts II.A.4, II.B.4.

corruption and inertia of an overgrown bureaucracy, while guarding against the self-interest of the market. Recognizing that private parties govern each other, Landis assumed that the distinction between the private and the public sphere would be blurred by this group that straddled the line between the two.

Faith in the professions, however, proved to be near-sighted at best. The securities laws pasted together faith in the expertise of the accounting profession with skepticism about the objectivity of those same professionals. The legislators themselves recognized that accountants were both the source of the problem and the solution, and they created a regulatory scheme that embodied that uneasy balance.[26] This ambivalence has survived today. The Sarbanes-Oxley Act of 2002, which regulates corporate governance and strengthens reporting obligations, is premised on the independence of the accounting profession while simultaneously expressing a doubt as to whether such a mythical creature exists.[27] It attempts to address the problem of accountants' lack of independence without removing their critical role in the regulatory process. The Act perpetuates the grave responsibility of independent audits, but simultaneously polices the profession so closely as to communicate that the accounting profession is not inherently independent.[28] At the same time, it imposes rules designed to instill an otherwise absent independence in the auditor.[29]

This Article has three related goals. First, it contributes to the understanding of the administrative state by analyzing how the New Deal government both depended on the technocratic skill of experts to govern and developed a related faith in the professions as a neutral source of value. The audit provision of the Securities Acts recognized the accounting profession and simultaneously transformed it into a semi-public association. The drafters of the Securities Act of 1933 attempted to create a hybrid, a body suspended between the public and private realms. They did so to preserve the distinction between a public and a private interest, relying on the profession to mediate between the two. Theoretically, the profession replaced courts as a guardian of the public good, a way of ensuring that experts in both government and business would work toward the common good. The profession, not the courts, would ensure that government would be insulated from the greed of the market and that

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[26] *See infra* Part II.B.4.

[27] *See* Jonathan Macey & Hillary A. Sale, *Observations on the Role of Commodification, Independence, and Governance in the Accounting Industry*, 48 VILL. L. REV. 1167, 1182–83, 1185 (2003) (describing the creation of the "Public Company Accounting Oversight Board").

[28] *See id.* (discussing the Sarbanes-Oxley reforms, and the limits on accountant's independence).

[29] *See id.* at 1182–86 (arguing that it is the internal structure of the large accounting firm that has contributed to the lack of independence in the profession).

capital would not be transformed into the tool of the politically powerful. Ideally, however, Landis imagined a world in which the public and the private would blur as experts and professionals suffused the ranks of both.

Second, this Article puts recent proposals to use private and semi-public bodies to regulate business in historical context.[30] This scholarship, known as "private governance" literature, echoes both the 1920s reliance on businesses to regulate themselves and aspects of New Deal regulation. By casting these arguments in historical context, this Article isolates what is, in fact, new about this scholarship and throws doubt on their proponents' claim to espouse a novel turn to private regulation. While the use of private and semi-public bodies has deep roots in the history of regulation, proponents of private governance have seemingly abandoned the faith in expertise of an earlier generation.[31] Thus, scholars suggest that we open the regulatory doors to anyone who might have some interest or knowledge about a problem and then devise new methods to ensure that the process results in policies that are in the public interest.[32] Ironically, many of these scholars rely heavily on professions and other expert associations, such as accrediting agencies, to ensure that the private participants in the regulatory process serve the public good. This history provides a cautionary tale, warning against any naked claim that professional associations will provide a check against private actions.

Finally, this Article illustrates that Landis's New Deal vision was built on an illusion (or a misplaced optimism) about professional independence. The accounting profession had come of age as the regulatory state itself was just emerging. Excluded from the realm of politics until the Great War, public accountants never truly developed a public ethic.[33] To the contrary, they distanced themselves from the government and aligned more closely with business as the Depression drew near.[34] The critical piece of this New Deal puzzle, professional independence, develops over time in relation to government policy; it cannot be created overnight by a wave of the legislative wand. This uncontroversial conclusion—that a public ethic

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[30] *See generally* Symposium, *New Forms of Governance: Ceding Power to Private Actors*, 49 UCLA L. REV. 1687 (2002); Symposium, *Public Values in an Era of Privatization*, 116 HARV. L. REV. 1212 (2003). *See also* Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267 (1998); Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV 543 (2000) [hereinafter Freeman, *The Private Role in Public Governance*]; Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. REV. 1 (1997) [hereinafter Freeman, *Collaborative Governance*]; Michael P. Vandenbergh, *The Private Life of Public Law*, 105 COLUM. L. REV. 2029 (2005).

[31] For a discussion of the collapse of the faith in expertise as a neutral source of value, see Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1669, 1676–93 (1975).

[32] Freeman, *Collaborative Governance*, *supra* note 30.

[33] Public ethic, in this article, refers not merely to a rhetoric concerning service but rather social norms within a profession that continually reinforce a sense that the goal of the profession is to serve and help develop a common good.

[34] *See infra* notes 327–31.

is built over time not by fiat—suggests a new way to look at recent rules that govern gatekeepers.

Part II of this Article reviews the intellectual context in which the securities laws were enacted, demonstrating both the increasingly entrenched reliance on the expert in general and the evolution of one such group of professionals, the accountants. With reference to the evolving role of the expert in the regulatory structure, it explains the development of the accounting profession throughout the late 19th and early 20th centuries, emphasizing the notion of independence both within the profession itself and by government regulators. Part III of the Article uses this history to analyze two contemporary debates concerning the role that the expert should play in governance, both in the regulation of business by accountants and in the regulatory scheme more generally.

II. BUILDING THE IRON CAGE[35]

Reliance on experts to govern is deeply ingrained in American history. After the Civil War, the government grew committed to minimal intrusions in the private life of individuals and the market.[36] Thus, experts played a quiet role, a supporting part in an (at least theoretically) unimportant plot. As the industrial economy matured in the late 19th century, regulation became more prevalent and the government grew to rely on expertise to master the problems of the modern industrial world.[37] Gradually, the state turned to the independent expert not only to meet the practical problems of the modern world, but also to fill a theoretic vacuum. This vacuum arose as lawyers, judges, politicians, and academics all questioned the role of the courts in ensuring the rights of all against the power of the few: both the market and politics were characterized by coercion.[38] The professions could ensure neutrality and accountability as the distinction between the private and the public began to blur. Thus, as government intruded more in the market and relied more on businesses to regulate themselves, professions would ensure that both private and public actors were working toward a common good. Because the profession was so young and because it competed with government officers, accountancy, unlike some of the other professions, did not gain recognition until well into the 20th century. The Securities Acts thus endowed a grave responsibility of

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[35] The sociologist Max Weber used the term "iron cage" to refer to a bureaucracy that has grown so complex that it imprisons the soul. MAX WEBER, THE PROTESTANT ETHIC AND THE SPIRIT OF CAPITALISM 181 (Talcott Parsons trans., 1958).

[36] WILLIAM J. NOVAK, THE PEOPLE'S WELFARE: LAW & REGULATION IN NINETEENTH-CENTURY AMERICA (1996).

[37] *Id.*; WILLIAM M. WIECEK, THE LOST WORLD OF CLASSICAL LEGAL THOUGHT: LAW AND IDEOLOGY IN AMERICA, 1886–1937 (1998).

[38] HORWITZ, *supra* note 19, at 33–65.

preserving the public good on a profession that had grown deeply tied to its business clients.

A. *Expertise and Regulation in American History*

This section analyzes the history of regulation, demonstrating how the state began to see expertise and ultimately the independent professions as the panacea for the ills of the industrializing world.[39] In the progressive era, a new professional elite promoted a plan for an administrative state.[40] While the proposal gained support among intellectual circles, it did not truly succeed for years to come. During World War I, the Wilson administration relied increasingly on both businessmen and professionals to persuade industry to serve the needs of a state at war.[41] With peace, the coordination of business efforts was quickly replaced with a conservative corporatism.[42] The government not only relied on business to regulate itself but delegated a certain amount of legislative power to organized trade groups.[43] Experts did not lose their prestige but they fled from government service.[44] Politicians relied on experts within the industries to govern themselves. Eventually, the New Deal implemented a new system in which state power would be divided among private, public, and semi-public experts—agencies, business, and professionals—who would work together to manage the chronically sick economy. Expertise would permeate the public and the private realm not just to solve the practical problems of industrial America but also to provide a neutral source of value, immune to the self-interest of the market and the corruption of party politics.

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[39] William Nelson argues that the administrative state grew up as the ideal of protecting the minority from being overwhelmed by majoritarian self-rule receded. WILLIAM E. NELSON, THE ROOTS OF AMERICAN BUREAUCRACY, 1830–1900, at 1–2 (1982). For a consistent contemporary analysis of the birth of the administrative state as a response to industrialization and the extension of democratic impulses, see LANDIS, *supra* note 23, at 6–46.

[40] *See infra* Part II.A.4.

[41] *See infra* notes 80–87 and accompanying text.

[42] Corporatism is a political system in which the government gives legislative power to private groups. The groups or associations then assume a critical role in making decisions for the state. *See infra* Part III.A.4.

[43] Ellis Hawley, *Three Facets of Hooverian Associationalism Lumber, Aviation, and Movies, 1921-1930, in* REGULATION IN PERSPECTIVE: HISTORICAL ESSAYS 95 (Thomas K. McCraw Ed., 1981).

[44] In general, the word "expert" refers to anyone with special skill or knowledge gained from study or experience. This section seeks to illustrate how the term itself evolved throughout the last century. In the early period a businessman would be considered an "expert" in his field. By the New Deal, experts were those not simply with some technocratic skill but also with at least a claim to independence and neutrality. For a discussion of the development of objectivity in American history, see JAMES T. KLOPPENBERG, UNCERTAIN VICTORY: SOCIAL DEMOCRACY AND PROGRESSIVISM IN EUROPEAN AND AMERICAN THOUGHT, 1870–1920 (1986); PETER NOVICK, THAT NOBLE DREAM: THE "OBJECTIVITY QUESTION" AND THE AMERICAN HISTORICAL PROFESSION (1988).

1. *Regulation in the 19th Century*

In the early 19th century, the United States was governed by a patrician elite, comprised mostly of lawyers. By the middle of the century, the industrial economy matured and party politics displaced this uniquely American aristocracy. Small agencies with limited missions emerged to regulate railroads, and later public utilities.[45] These early agencies tended to gather information and use reports to persuade the regulated industry that it was in its interest to comply with government policy.[46] Experts took the helm in this limited capacity. By the 1870s, a new class of professionals joined progressive reformers to critique party politics and promoted a permanent bureaucracy staffed with experts instead.

In pre-Jacksonian America, the government comprised a class of professionals, a fairly stable patrician elite. As Alexis de Tocqueville observed, American lawyers, like European aristocrats, ruled with moderation and reflection.[47] These leaders largely assumed that government intervention in the economy was necessary to support growth.[48] Subsidies and land grants were all part of a political agenda, albeit a somewhat incoherent one. Government intervened in favor of the incipient industrial interests in order to prevent deleterious competition and promote growth. According to pre-classical ideology, the business corporation itself was a creature born to be regulated.[49]

By the time experts began to take significant part in governance, the prevailing political theory dictated a limited role.[50] Fueled by Andrew Jackson's egalitarian philosophy and Adam Smith's laissez-faire economics, classical liberalism despised government intervention.[51] Early classicists assumed that when the government acted, it did so on behalf of the powerful business interests.[52] The proponents of classical liberal thought favored a limited role for government, reasoning that if the

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[45] AVI HOOGENBOOM & OLIVE HOOGENBOOM, A HISTORY OF THE ICC: FROM PANACEA TO PALLIATIVE 6–8 (1976).

[46] THOMAS K. MCCRAW, PROPHETS OF REGULATION: CHARLES FRANCIS ADAMS, LOUIS D. BRANDEIS, JAMES M. LANDIS, ALFRED E. KAHN 1–57 (1984).

[47] 1 ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 290 (Henry Reeve trans., 1958).

[48] HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW: 1836–1937, at 11 (1991).

[49] *See id.* at 12; WIECEK, *supra* note 37.

[50] STEPHEN SKOWRONEK, BUILDING A NEW AMERICAN STATE: THE EXPANSION OF NATIONAL ADMINISTRATIVE CAPACITIES, 1877–1920, at 32 (1982). Not incidentally, by the 1820s, the legal profession was losing control over its membership. The expansion of the population on the one hand and the pressure for a more democratic politics on the other put strains on a profession defined by the informal ties of a small elite group of lawyers. *Id.* at 33.

[51] Classical legal theory and laissez-faire liberalism had myriad intellectual origins. For a thorough discussion of their sources, see Herbert Hovenkamp, *The Political Economy of Substantive Due Process*, 40 STAN. L. REV. 379 (1988).

[52] *Id.* at 321. *See also* WILLIAM NELSON, THE ROOTS OF AMERICAN BUREAUCRACY 1830–1900, at 152 (1982).

government remained neutral, the powerful and wealthy businesses would lose their greatest ally.[53] Competition would restore freedom and, to some measure, equality to the polity.[54]

In 1776, Adam Smith wrote that regulatory authority "would no-where be so dangerous as in the hands of a man who had the folly and presumption enough to fancy himself fit to exercise it."[55] It took a while to catch on, but 100 years later, most American judges[56] and political economists tended to agree.[57] The ethic of a self-regulating market where individuals acted in their own self-interest and the state remained a neutral arbiter prevailed—for a time. In this universe, regulation was seen as an aberration, a necessary evil, as classical liberal theory assumed that the market generally worked well.[58]

As the century drew to a close, however, the political economy of classical liberalism faltered. Society grew more interdependent and consumer markets for standardized products became larger and larger. Small and simple enterprises evolved into complex units forming what became known as "managerial"[59] or "corporate"[60] capitalism. The growing disparity in wealth, the obvious inequities in bargaining power, and the social struggles that resulted all shook the foundations of Adam Smith's laissez-faire state and exposed the inadequacy of courts to resolve the problems of the modern industrial world. Specifically, the economic panic of 1873 undermined the basic tenet of classicism that the market was benign and just.[61]

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[53] Hovenkamp, *supra* note 51, at 321; NELSON, *supra* note 52, at 152.

[54] HOVENKAMP, *supra* note 48; MCCRAW, *supra* note 46, at 10.

[55] ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, bk. 2, ch. 2 (Liberty Classics 1981) (1776). *See also* ALBERT O. HIRSCHMAN, THE PASSIONS AND THE INTERESTS: POLITICAL ARGUMENTS FOR CAPITALISM BEFORE ITS TRIUMPH (1977).

[56] Most judges in the late 19th century adhered to a judicial theory that embodied the political economy of classical liberalism. This jurisprudence is commonly referred to as "classical legal thought." Justice Stephen Field's jurisprudence provides a good example of this integration of classical liberal theory into legal discourse. Amidst increasing hostility, Justice Mahlon Pitney carried classical legal thought into the 20th century. *See, e.g.*, Coppage v. Kansas, 236 U.S. 1, 40–42 (1915) (Day & Hughes, JJ., dissenting). For a discussion of the definition of classical legal thought, see HORWITZ, *supra* note 19, at 3–31; WIECEK, *supra* note 37. For a discussion of the development of classical political economy in America in contrast to Britain, see Hovenkamp, *supra* note 51, at 402–10.

[57] Francis Wayland, Francis Bowen, and Henry Carey, among others, developed American classical political economy in the 19th century. *See* HOVENKAMP, *supra* note 48, at 36–41. By 1885, economists were developing anti-laissez-faire theories that would become popular several decades later. SKOWRONEK, *supra* note 50, at 132.

[58] *See generally* NOVAK, *supra* note 36.

[59] ALFRED D. CHANDLER JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977).

[60] JAMES LIVINGSTON, PRAGMATISM AND THE POLITICAL ECONOMY OF CULTURAL REVOLUTION, 1850–1941 (1994).

[61] The economic panic of 1873 was one of a series of depressions at the end of the century. It began in 1873 when a prominent Philadelphia bank Jay Cooke & Co. declared bankruptcy. This set off a number of other bankruptcies and culminated in the collapse of the American economy. The New York Stock Exchange closed for ten days, and 89 of the 364 railroads declared bankruptcy. *See* JAMES WILLARD HURST, THE LEGAL HISTORY OF MONEY IN THE UNITED STATES, 1774–1970 (1973).

The biggest failure in the American economy at the time was the railroad industry. After the Civil War, railroads transformed the United States. The country had been loosely tied together with broken down roads and waterways. As the geographic reach expanded westward, railroads provided the only way to connect producers, merchants, and consumers. But without federal coordination, railroads grew up in a haphazard way. States generally granted subsidies to privately-owned rail systems to promote growth. Soon, the railroads comprised a tangled mess of competing and overlapping routes.[62]

Early rate regulation largely occurred at the state level. With the exception of the Granger laws, which dictated fixed rates, regulation at this time was generally weak. Early railroad commissioners had faith that coercion was not necessary. With the proper information at their fingertips, they would be able to persuade the railroads to do what was best—knowledge and truth would prevail; progress would inevitably follow when the interests of all the affected groups were harmonized.[63] While their role was necessarily quite limited, experts began to take a part in governance.

As the century drew on, some state agencies took more active steps by setting maximum rates for public utilities.[64] As the state commissions and the Interstate Commerce Commission (ICC) were trying to impose order on the railroads, other companies just kept growing bigger. The great cartels began to emerge as businesses combined with their competitors through associations or mergers. Congress enacted the Sherman Antitrust

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[62] Robert L. Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189, 1197 (1986). Rate conferences were meetings among railroads to set rates and pooling agreements consisted of complex efforts to share equipment or traffic and fix the price accordingly.

[63] MCCRAW, *supra* note 54, at 1–57.

[64] *Id.* at 61–62; Herbert Hovenkamp, *Regulatory Conflict in the Gilded Age: Federalism and the Railroad Problem*, 97 YALE L.J. 1017, 1059 (1988). The Supreme Court essentially mandated that agencies determine rates by assessing the costs plus profit for the railroads, a system that required the expert service of accountants and statisticians. Ironically, in exercising its authority to determine the scope of regulation, the Supreme Court expanded the role of what would become its greatest competitor, the expert. In *Smyth v. Ames*, the Union Pacific Railroad challenged a Nebraska statute that set the maximum rates the corporation could charge for hauling freight. 169 U.S. 466, 470 (1898). The Court ruled that the state was entitled to fix rates but that it must ensure that the railroad receive a reasonable return on "the fair value of the property being used for the public." *Id.* *Smyth* came after a long line of cases in which the Court limited the power and discretion of the ICC. *E.g.*, ICC v. Cincinnati, New Orleans & Tex. Pac. Ry. Co., 167 U.S. 479 (1897) (rejecting the ICC's ability to set rates for railroads); ICC v. Alabama Midland Ry., 168 U.S. 144, 163–65 (1897) (retaining the ability of the courts to review de novo agency determinations regarding rate discrimination); United States v. Trans-Miss. Freight Ass'n, 166 U.S. 290 (1897) (rejecting the ICC's toleration of inter-railroad pricing agreements). For a discussion of the interaction between the ICC and the courts, see SKOWRONEK, *supra* note 50, at 152–60. For a contemporary account, see Paul J. Miranti, Jr., *The Mind's Eye of Reform: The ICC's Bureau of Statistics and Accounts and a Vision of Regulation, 1887–1940*, 63 BUS. HIST. REV. 469, 485 (1989) (citing CARL MCFARLAND, THE JUDICIAL CONTROL OF THE FEDERAL TRADE COMMISSION AND THE INTERSTATE COMMERCE COMMISSION, 1920–1930 (1933)).

Act in 1890 to address the problem. The solution was vague, and, perhaps as a result, the Department of Justice let the Act linger, bringing so few enforcement actions as to render the law virtually irrelevant.[65] The Sherman Act failed to address the central question of whether bigness was an evil in itself or only when used for unfair advantage. Culminating in *Standard Oil Co. v. United States*,[66] the Supreme Court opted for the latter and corporations continued to expand in size and power.[67] In this context, Theodore Roosevelt became President, and the collective voice of progressive reformers grew louder.

2. *The Progressive Era and the Idea of the Expert*

Progressive reformers of different stripes—labor reformers, women's rights activists, health care reformers to name a few—developed a new rhetoric at the turn of the 20th century, demanding government intervention in the economy. Reformers called for diverse and conflicting solutions to the social, political, and economic ailments of the day.[68] One thing that united the disparate group of reformers was the language of social efficiency and monopoly-bashing.[69] The diatribes against the concentration of power in the hands of the few had moved from the periphery—the populists, workers, and socialists—to the mainstream.[70] But the message was watered down in the process. As their name would indicate, the progressives were optimists. Most had faith that science, knowledge, and truth would harmonize conflicting interests and lead us happily into the modern era.[71]

Their theory of regulation may not have differed much from their predecessors, but the structure did. The progressives who promoted a new state were a special breed, a new intellectual and professional class that was beginning to gain some prominence in the late 19th century. The first professional societies emerged in the middle of the century—the American

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[65] MCCRAW, *supra* note 54, at 114.

[66] Standard Oil Co. v. United States, 221 U.S. 1, 57–61 (1911).

[67] WILLIAM LETWIN, LAW AND ECONOMIC POLICY IN AMERICA: THE EVOLUTION OF THE SHERMAN ANTITRUST ACT 117–28 (1965). Some historians have argued that the Sherman Antitrust Act ironically caused the mergers at the turn of the century. The first successful prosecutions under the Sherman Antitrust Act targeted "loose" combination or cartels. The Supreme Court overturned the first attempt to regulate "tight" combinations, or mergers, when it concluded that manufacturing is not commerce. Businesses inferred that they could avoid the reach of the law by merging rather than colluding. HOVENKAMP, *supra* note 48, at 242–43. More importantly, state corporate law failed to develop a policy regarding anti-competitive mergers. Both federal and state governments relied instead on the common law doctrine against contracts in restraint of trade. This doctrine was quite effective at policing agreements between firms but at the same time, it was agnostic about agreements within a single firm. *Id.* at 243.

[68] This is reflected in wage and labor legislation, municipal reform movements, and juvenile court proposals. RICHARD HOFSTADTER, THE AGE OF REFORM: FROM BRYAN TO F.D.R. 242 (1955).

[69] Daniel T. Rodgers, *In Search of Progressivism*, 10 REVS. AM. HIST. 113, 123 (1982).

[70] *Id.*

[71] *Id.*

Medical Association founded in 1847[72] and the American Bar Association in 1878[73]—amidst a great surge of voluntary associations in America.[74] In 1865, a small group of these reformers established the American Social Science Association, which provided organization for the emerging class of professional academics.[75] By the end of the century, states began to recognize the professions by enacting licensing laws and requiring examinations by new licensing boards.[76] In the first decade of the 20th century, law and medicine both began to develop their own codes of professional ethics.[77]

The growth in scope of the market rendered most transactions impersonal and thus unpredictable.[78] Experts, according to the progressives, could replace the local communities, which had previously monitored the market.[79] Many progressive reformers viewed expertise as the only way to restore morality to the market. Progressive reformers gradually developed a faith that bureaucratic organization, staffed by experts could coordinate the warring factions of the body politic and release the positive energy within the social organism.[80] Intellectuals condemned the despotism of the party machines and slowly but forcefully asserted that an apparatus run by professionals was the only solution.[81] Lawyers, economists, and social scientists joined the hue and cry against the corruption of party politics and championed an administrative structure, which, in E.L. Godkin's words, would possess "finish, efficacy, and

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[72] Maxwell H. Bloomfield, *Law: The Development of a Profession*, *in* THE PROFESSIONS IN AMERICAN HISTORY 40 (Norman O. Hatch ed., 1988).

[73] Ronald L. Numbers, *The Fall and Rise of the American Medical Profession*, *in* THE PROFESSIONS IN AMERICAN HISTORY, *supra* note 72, at 56.

[74] ROBERT H. WIEBE, THE SEARCH FOR ORDER: 1877–1920, at 117 (1967). The "organization synthesis" historians, as they came to be known, argued against a previous group of scholars who had viewed the professions as a sinister tool of capitalist interests. DAVID F. NOBLE, AMERICA BY DESIGN: SCIENCE, TECHNOLOGY, AND THE RISE OF CORPORATE CAPITALISM 44 (1977); Jerold S. Auerbach, *A Stratified Profession*, *in* LAWYERS' ETHICS AND THE PURSUIT OF SOCIAL JUSTICE: A CRITICAL READER 79, 79–80 (Susan D. Carle ed., 2005).

[75] THOMAS L. HASKELL, THE EMERGENCE OF PROFESSIONAL SOCIAL SCIENCE: THE AMERICAN SOCIAL SCIENCE ASSOCIATION AND THE NINETEENTH CENTURY CRISIS OF AUTHORITY 97 (1977); DOROTHY ROSS, THE ORIGINS OF AMERICAN SOCIAL SCIENCE (1991). While enacting barriers to entry into the professions, these groups simultaneously saw themselves as pioneers of liberal reform. *Id.*

[76] MAXWELL BLOOMFIELD, AMERICAN LAWYERS IN A CHANGING SOCIETY, 1776–1876, at 341 (1976).

[77] Susan D. Carle, *Lawyers' Duty to Do Justice: A New Look at the History of the 1908 Canons*, 24 LAW & SOC. INQUIRY 1, 6–7 (1999).

[78] *See* HOFSTADTER, *supra* note 68, at 224–25.

[79] WIEBE, *supra* note 74, at 129 (discussing the middle class's development of a new identity within the professions and their subsequent efforts to ameliorate the effects of the market).

[80] *See* Rodgers, *supra* note 69, at 117–18, 125.

[81] HOFSTADTER, *supra* note 68, at 257–59, 265; SKOWRONEK, *supra* note 50, at 43.

permanence."[82] As Woodrow Wilson explained in 1887, the country needs a "body of thoroughly trained officials serving during good behavior."[83] In the spirit of a whole generation of intellectuals,[84] Wilson insisted that governance must be separated from politics: "Bureaucracy can exist only where the whole service of the state is removed from the common political life of the people, its chiefs as well as its rank and file."[85] Turn-of-the-century intellectuals like Thorstein Veblen argued that the expert must take the helm because technology was critical to the future of the country.[86] Their message would not truly take root for decades to come.

As the intelligentsia was promoting a permanent bureaucracy, some historians argue that the professions served to maintain order amidst the conflict between capital and labor, which surged as a largely decentralized weak state attempted to tame the effects of corporate capitalism. Specifically, Robert Wiebe, Louis Galambos and others have suggested that by the end of the 19th century, change occurred primarily through the interaction of organizations—networks of hierarchical structures of authority both public and private.[87]

Despite the growing enthusiasm for expertise, the process took some time to emerge. In 1903, Roosevelt persuaded Congress to create a federal agency called the Bureau of Corporations.[88] Embodying the prevailing attitude toward regulation, the new unit consisted of lawyers and economists who studied and gathered information on the financial leviathans of the day.[89] The Bureau of Corporations, like the early state railroad commissions, expressed faith that knowledge, publicity, and education could persuade business to compete in an efficient and benevolent fashion.[90] Meanwhile, business kept getting bigger. The government used the Sherman Antitrust Act to restrict cartels, but both state corporation law and the federal government allowed most mergers to

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[82] SKOWRONEK, *supra* note 50, at 42 (quoting E.L. Godkin, *The Duty of Educated Men in a Democracy*, *in* PROBLEMS OF MODERN DEMOCRACY: POLITICAL AND ECONOMIC ESSAYS 199, 219 (1896)).

[83] Woodrow Wilson, *The Study of Administration*, 2 POL. SCI. Q. 197, 216 (1887).

[84] *See* SKOWRONEK, *supra* note 50, at 42.

[85] Wilson, *supra* note 83, at 217.

[86] *See* THORSTEIN VEBLEN, THE ENGINEERS AND THE PRICE SYSTEM 131–33 (1921).

[87] WIEBE, *supra* note 74, at 127–28; Louis Galambos, *The Emerging Organizational Synthesis in Modern American Business History*, 44 BUS. HIST. REV. 279, 280 (1970). This thesis came into some disrepute as social historians argued that individuals and disorganized groups had agency and effected historic change. Historians who adopt this critique either explicitly or implicitly are too numerous to catalogue. *See, e.g.*, GEORGE CHAUNCEY, GAY NEW YORK: GENDER, CULTURE, AND THE MAKINGS OF THE GAY MALE WORLD, 1890–1940 (1994); Regina G. Kunzel, *Fallen Women, Problem Girls: Unmarried Mothers and the Professionalization of Social Work, 1890–1945*, *in* FAMILIES BY LAW: AN ADOPTION READER 29, 32 (Naomi R. Cahn & Joan Heifetz Hollinger eds., 1994).

[88] Rabin, *supra* note 62, at 1219.

[89] MCCRAW, *supra* note 54, at 80.

[90] Rabin, *supra* note 62, at 1219.

slip by.[91] Progressive reformers fought against big business. Drawing on a tradition that stretched back to Jackson, muckrakers like Louis D. Brandeis railed against the trusts warning that business had become so large that the nation's soul was in jeopardy.[92]

While the government was struggling with what to do about big business, Congress grew to accept a more expansive role for agencies such as the ICC. In 1906, for example, the Hepburn Act gave the Commission power to set maximum rates for railroads.[93] Perhaps because they considered railroads, unlike industry, to be "affected with a public interest,"[94] legislators were more willing to expand the role of the ICC while they still disagreed about whether there should even be an agency to oversee industry.[95] The public outcry against monopolies kept the issue alive nonetheless.[96]

As the new agencies grew, however, the courts jealously guarded their role in governing. In 1914, Wilson introduced two bills, one to amend the substantive antitrust laws and another to create a commission to regulate interstate trade.[97] The Federal Trade Commission Act delegated authority to a new commission to "investigate, publicize, and prohibit all 'unfair methods of competition.'"[98] Despite this grand mandate, the FTC got off to an inauspicious start.[99] Amidst a relatively severe economic downturn, the administration was reluctant to be perceived as anti-business and the agency languished under ineffectual leadership.[100] The Supreme Court emasculated the FTC even further. In *Federal Trade Commission v. Gratz*, the Court ruled that it was the role of the courts, not the Commission, to

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[91] *See* Morton Keller, *The Pluralist State: American Economic Regulation in Comparative Perspective, 1900–1930*, *in* REGULATION IN PERSPECTIVE: HISTORICAL ESSAYS, *supra* note 43, at 56, 69–70 (discussing the Supreme Court's Commerce Clause jurisprudence which effectively limited the reach of the Sherman Act to actual movement of products across state lines and did not include corporate consolidation per se).

[92] *See* LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 46–50 (1914); Rodgers, *supra* note 69, at 123.

[93] MCCRAW, *supra* note 54, at 62. For a discussion of the political debates leading up to the Hepburn Act and its predecessor the Elkins Act of 1903, see SKOWRONEK, *supra* note 50, at 250–51.

[94] *See* Rabin, *supra* note 62, at 1208, 1210.

[95] PARRISH, *supra* note 2; SELIGMAN, *supra* note 3.

[96] MCCRAW, *supra* note 54, at 61–62, 64–65; G. Cullom Davis, *The Transformation of the Federal Trade Commission, 1914–1929*, 49 MISS. VALLEY HIST. REV. 437, 438 (1963).

[97] MCCRAW, *supra* note 54, at 119.

[98] Davis, *supra* note 96, at 438. Prosecutions under the Sherman Act increased under Roosevelt and Taft, and Brandeis helped ensure that it was central to the presidential election in 1912. MCCRAW, *supra* note 54, at 110–11, 115. The initial bill supported a much weaker commission modeled on the early state railroad commissions. The purpose of this commission would have been to gather information rather than actively engage in determining unfair trade practices. *Id.* at 118.

[99] MCCRAW, *supra* note 54, at 125.

[100] *Id.* at 126–27.

determine what comprised an "unfair method of competition."[101] *Gratz* represented the growing hostility of the Court toward the incipient administrative state. Regulation in America had been largely a judicial function. The Court, still mired in classical legal theory, repeatedly invoked the doctrine that the executive had impermissibly undercut its authority to thwart the efforts of the new administrative tribunals.[102]

By the end of the first decade of the 20th century, there was a growing consensus that government would need to coordinate business activity, but the model did not stray too far from its roots in the early railroad regulatory commissions. Government was there to gather information, to persuade, and cajole. In industries with closer ties to the public, like the railroads and public utilities, state and even federal government would police the boundaries of acceptable behavior but within that wide swath, business was free to roam. The government began to recognize expertise as the means to this rather modest end and courts made sure that judges, not experts, defined their role in governing.

3. *World War I, the 1920s, and the Cult of the Expert*

During World War I, the government relied on experts to coordinate the war effort.[103] While Woodrow Wilson depended on experts to govern, the wartime government did not distinguish between business experts and the independent professions.[104] The government depended on the technocratic knowledge of both businessmen and the professions indiscriminately. It did not yet value the neutrality of expertise, unmoored from industry. The American government managed to coordinate industry and harness the economy without resort to a massive wartime bureaucracy.[105] Herbert Hoover, serving as head of the United States Food Administration, called for voluntary participation of civilians and businesses in the wartime effort, rather than mandating rationing, price fixing or production quotas.[106] With a masterful appeal to patriotism, the United States managed to persuade business to comply.[107] Using the model that dated to the early railroad commission, Hoover employed experts—both businessmen and professional—to write reports and urge

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[101] FTC v. Gratz, 253 U.S. 421, 427 (1920). For a review of Supreme Court decisions limiting the scope of the FTC's regulatory powers in the Progressive Era, see Rabin, *supra* note 62, at 1232–33. At the same time, the Court extended the reach of the Interstate Commerce Commission. *Id.* at 1233.

[102] The Court continued to use this theory to thwart regulatory efforts through the early New Deal. The last case that invoked the theory of executive delegation was *Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935). HORWITZ, *supra* note 19, at 223.

[103] CUFF, *supra* note 7, at 15.

[104] *Id. passim.*

[105] Cuff, *supra* note 8, at 358.

[106] *See id.* at 359, 369–70.

[107] *Id.* at 358.

business to conform to certain recommendations until business finally bowed to the government's agenda.[108]

The wartime attitude toward business drew on several Progressive Era proposals. As early as 1914, businessmen and politicians alike began to promote the ideal of association, organization, and industrial self-government.[109] In their view, the government should allow industries to form permanent associations to analyze and organize their activities.[110] These organizations would then function on their own without government supervision.[111] Administrators called for the extension of business efficiency to the national organism.[112] In other words, they believed that business was the most efficient organization and therefore, all political and social institutions should take business as their model.

Like most political economists of the time, Hoover believed that production was the key to progress. In order to increase production, private enterprises had to "rationalize" their systems. Essentially, he advocated the use of knowledge, hierarchy, and organization to maximize output and minimize waste.[113] The best way to achieve this result would be for businesses to form associations in discrete industries. Government would then actively assist in coordinating their effort to achieve rational and efficient order.[114]

Hoover and his aides preached a gospel of scientific management.[115] They called for economic rather than political government.[116] Politicians working through antitrust bureaus or regulatory commissions were necessarily inefficient and corrupt, but experts coordinating financial institutions—determining prices, production quotas, or wages—would be quite the opposite.[117] The professions saw the opportunity to gain the

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[108] *Id.* at 358–62.

[109] Hawley, *Three Facets of Hooverian Associationalism: Lumber, Aviation, and Movies, 1921–1930*, *supra* note 43, at 95, 98.

[110] MCCRAW, *supra* note 54, at 147. *See* HOVENKAMP, *supra* note 57, at 321–22 (discussing the trade association movement and the efforts of its leaders to convince the Supreme Court that the associations would help business avoid excess capacity and waste).

[111] MCCRAW, *supra* note 54, at 147.

[112] *Id.*

[113] By the turn of the century, many industrialists were adopting principles of "scientific management," also known as "Taylorism," after Frederick Winslow Taylor. WIEBE, *supra* note 74, at 151. Taylor argued that subdividing tasks would speed up production. It would create the greatest product and service with the minimum of cost and time. *See* CHANDLER, *supra* note 59, at 275–76. Hollis Godfrey, a Harvard educated engineer, applied the principles of Taylorism to prepare industry for war. He proposed forming a Council of National Defense that would gather information and persuade manufacturers to divide tasks so as to create the most efficient output for the wartime government. CUFF, *supra* note 7, at 27–29.

[114] Rabin, *supra* note 62, at 1237.

[115] Ellis Hawley, *Herbert Hoover, The Commerce Secretariat, and the Vision of an "Associative State," 1921–1928*, 64 J. AM. HIST. 116, 117 (1974).

[116] *Id.* at 126.

[117] ROSS, *supra* note 75, at 390–404.

status and recognition to which they had aspired for years.[118] Before America even entered the war, they seized the moment. In 1916, two prominent gynecologists and leaders of the medical profession, Franklin Martin and Franklin Simpson, formed the Committee of American Physicians for Medical Preparedness.[119] The new organization developed catalogs of the country's medical resources and created ties with the military to help prepare for war.[120] Not only did the professions court the government, the government also approached the professions.[121] For instance, Secretary of the Navy Josephus Daniels conferred with Thomas Edison in creating the Naval Consulting Board (NCB), a small body of inventors and engineers who would evaluate civilian and military inventions.[122] The board was ultimately led by the popular science hero Edison himself.[123] The NCB assessed the nation's capacity for munitions production by preparing a full inventory of industry.[124] It used this information to devise plans to increase that capacity and train each industry to produce the munitions that were most suited to its resources.[125] The NCB tried to convince business that private interest was aligned with public demand, that the traditional adversaries were, in fact, allies.[126]

In a very real way, the private and the public realm had begun to merge. The government needed the resources of the market to carry on a massive war effort and it used experts within industries to manage the new endeavor.[127] In establishing the Council of National Defense (the Counsel), Wilson took his cue from the NCB.[128] The Council's function was to investigate and make recommendations regarding railroad building, highway location, and the availability of military supplies.[129] The Council, comprised of government officials, soon appointed fourteen engineers, scientists, and businessmen to an Advisory Commission, which would determine how to mobilize industrial resources for war.[130]

Once the United States entered the war, government officials relied primarily on businessmen to build bridges between the state and the nation's economy.[131] Professionals continued to help but they did not occupy the center stage as they had hoped. By 1917, it was clear that the

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[118] CUFF, *supra* note 7, at 41.
[119] *Id.* at 13–14.
[120] *Id.* at 14.
[121] *Id.* at 16.
[122] *Id.* at 15.
[123] *Id.* at 15–16.
[124] *Id.* at 21.
[125] *Id.*
[126] *Id.* at 23.
[127] Cuff, *supra* note 8, at 358–59.
[128] *See* CUFF, *supra* note 7, at 25, 34.
[129] *Id.* at 36.
[130] *Id.* at 39.
[131] *See id.* at 94.

Council was too weak and ineffectual.[132] Bernard Baruch, the Wall Street tycoon, ultimately displaced the engineers and scientists, with his practical plan for dealing directly with industry leaders.[133] Wilson conceived of the War Industries Board (WIB) as a screen between private and public, insuring that private industrial power was accountable to public authority.[134] The WIB created a bureaucracy that was both public and private.[135] The public piece, however, was distinct from the regulatory infrastructure, staffed with volunteers from the private sector or "dollar-a-year men."[136] The private bureaus, like the war service committee, were chosen by industry associations but the line between private and public blurred as the government delegated regulatory authority to the private bureaus.[137] Throughout the war, professionals worked alongside businessmen in gathering information and coordinating the plans necessary to conduct the war.

Hoover carried his theory of regulation into the post-war era, but unlike many of his counterparts on the continent, he emphasized limits on government encroachment on economic liberty.[138] Bureaucracies were too often a sad mixture of incompetence and inefficiency. They jealously guarded their meager authority with little to show for it.[139] Government could advocate standardization, planning and rationality, which would guide private associations from bitter competition to progressive cooperation. The vision began to take form as trade associations grew and Hoover took the helm of the new Commerce Department to aid business in its self-government.[140] Government bureaus grew up to assist private associations in increasing efficiency. Even the FTC joined in, holding "trade-practice conferences" to help business groups rationalize their activities.[141] The experiment in associationalism, however, could not fully

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[132] *Id.* at 104.

[133] *See id.* at 145–46.

[134] *Id.* at 104.

[135] *See* SKOWRONEK, *supra* note 50, at 234.

[136] *Id.* at 236.

[137] Hawley, *supra* note 109, at 95, 98. Hawley argues that the 1920s did not constitute a return to laissez-faire liberalism, but rather the implementation of corporatist ideals developed during the First World War. *Id.* at 121.

[138] *See* Hawley, *supra* note 115, at 117–18.

[139] *See id.* at 126.

[140] *See id.* at 117–21. Hoover's initiatives met with some opposition from President Harding's Attorney General Harry Daugherty. Daugherty launched a new antitrust campaign targeting any trade association that looked like it might be fixing pricings or setting quotas on production. While Hoover did not endorse cartels, he had a much broader view of the proper role of a trade association. MCCRAW, *supra* note 54, at 148–49.

[141] MCCRAW, *supra* note 54, at 151. For instance, Hoover's Commerce Department helped to establish a quasi-public body called the Central Committee on Lumber Standards (CCLS) to assist the lumber industry, which had been depleting the natural resources it needed to persist. The CCLS was staffed by representatives of the lumber industry itself. For a time, it worked closely with the

withstand the great crash that was soon to come. After 1929, the temptation to fix prices and divide the market proved too great. The associationalist ideal receded but it did not disappear.[142]

4. *New Deal Regulation and the Professions*

Franklin Delano Roosevelt had the difficult task of creating an administrative tower from this babble. He inherited a problem that would plague generations to come: the government increasingly depended on experts within business but fundamentally distrusted their ability or inclination to serve public ends. The New Deal was united in the fairly uncontroversial position that there was something chronically wrong with capitalism.[143] While New Deal liberals may have shared that general conviction, there was no consensus on how to solve the problem. As Richard Hofstadter wrote, the program was "a chaos of experimentation."[144] The early New Deal was in no way ideologically bankrupt. To the contrary, it was a collection of a myriad of conflicting and complementary theories.[145] Thus, the fragmented New Deal responded to the immediate crisis with a combination of new and inherited ideas about regulation.[146] The early New Deal was created from several distinctly American threads. It echoed the system of national governmental planning developed during the First World War, while preserving Hoover's associational view of government intervention.[147] The intense new distrust of business, however, led New Deal architects to rely in a different way on the quasi-public bodies that developed under Hoover.[148] Associationalism and corporatism could not fully survive the great crash, but theories of regulation die a slow death.

Bits and pieces of Hoover's ideal survived and were written into New Deal reforms. Amidst the Great Depression, government could no longer rely solely on corporations to regulate themselves, but the theories of regulation extant at the time and popular opinion simply precluded massive

Commerce Department. The CCLS was ultimately able to help the lumber industry preserve resources for the future while lowering its costs. Hawley, *supra* note 109, at 103–07.

[142] MCCRAW, *supra* note 54, at 149; Hawley, *supra* note 115, at 108.

[143] *See* WILLIAM E. LEUCHTENBURG, FRANKLIN D. ROOSEVELT AND THE NEW DEAL, 1932–1940, at 34 (1963); JORDAN A. SCHWARTZ, THE NEW DEALERS: POWER POLITICS IN THE AGE OF ROOSEVELT (1993).

[144] HOFSTADTER, *supra* note 68, at 307.

[145] *See id.*

[146] The literature on the New Deal is obviously immense. For a useful overview of the historiography, see Thomas Ferguson, *Industrial Conflict and the Coming of the New Deal: The Triumph of Multinational Liberalism in America*, *in* THE RISE AND FALL OF THE NEW DEAL ORDER, 1930–1980, at 3, 5–7 (Steve Fraser & Gary Gerstle eds., 1989); Alonzo L. Hamby, *The New Deal: Avenues for Reconsideration*, 31 POLITY 665 (1999).

[147] Rabin, *supra* note 62, at 1244.

[148] *Id.*

government intervention into the economy.[149] The independent professions served to reconcile the associationalist ideology of regulation with the new thrust toward greater government control.

The first, and arguably the most significant, act of Roosevelt's administration was the National Industrial Recovery Act (NIRA) of 1933.[150] Using the trade groups that had grown up under Hoover's associationalist state, the NIRA went quite a few steps further by granting the President authority to approve standards of competition drafted by each of these industry groups.[151] From the beginning government, labor, and consumer representatives rarely participated, and the National Recovery Administration ultimately expressed the interests of business groups.[152] The NIRA was declared unconstitutional,[153] and while it was certainly not the only model for regulation during the New Deal, it starkly demonstrates, how older forms of regulation crept into the new measures.[154]

Roosevelt's program transcended its somewhat humble roots by acknowledging that government had an obligation to repair the economy. By 1933, most people agreed that the market was chronically sick and that government would have to intervene in some permanent way to make it better. Of course, no one could agree on how.[155] Labor felt sure that mass organization and collective bargaining would help. Businessmen advocated price and production controls. Some felt that raising wages and purchasing power would heal the ailing beast. Others were sure that curbing competition and ensuring profits would stimulate investment spending and fix the market.[156]

Amidst this cacophony, Felix Frankfurter, a close friend of Louis Brandeis, mentor to James Landis, and key architect of the New Deal, summed up a new view of the government's proper role and in turn, the part that experts would play in this new order. He wrote:

> The expert should be on tap, but not on top .... In a democracy, politics is a process of popular education—the task of adjusting the conflicting interests of diverse groups in the community and bending the hostility and suspicion and ignorance engendered by group interests toward a

[149] *See* ALAN BRINKLEY, THE END OF REFORM: NEW DEAL LIBERALISM IN RECESSION AND WAR 4–7, 17 (1995); LEUCHTENBERG, *supra* note 143, at 33–37.

[150] National Industrial Recovery Act, Pub. L. No. 73-67, 48 Stat. 195 (1933).

[151] LEUCHTENBERG, *supra* note 143, at 56–58.

[152] *See* Rabin, *supra* note 62, at 1244.

[153] Schechter Poultry Corp. v. United States, 295 U.S. 495, 541–42, 551 (1935); Panama Refining Co. v. Ryan, 293 U.S. 388, 433 (1935).

[154] *See* Rabin, *supra* note 62, at 1246.

[155] BRINKLEY, *supra* note 149, at 4–6; LEUCHTENBERG, *supra* note 143, at 22–35.

[156] *Rabin, supra* note 62, at 1246–47.

> comprehension of mutual understanding. For these ends, *expertise* is indispensable. But politicians must enlist popular support for the technical means by which alone social policies can be realized.[157]

Part of the reason why the ideology of the New Deal seems so elusive is that that ideology was to remain agnostic. While many of its architects had very specific views of what went wrong and how to fix it, the New Dealers did not commit to a political economy. They did not choose a philosophy on social welfare. But they did have a philosophy of sorts. Just as Hoover had used the government apparatus to enlist popular support for a cooperative war effort, the New Deal government would enlist popular support for goals defined in any given setting by the experts themselves. Politicians would articulate a broad social goal but experts would guide society to that end. Just as government experts persuaded business to serve the needs of a state at war, experts—in the mind of the New Deal architects—would train all conflicting interests to pursue a common goal, defined in each different context by the experts themselves. The dangers of democratic rule could be solved not by creating a technocratic government[158] but rather by using experts to train people to act for the common good. It was the government's role to ensure that the experts had sufficient authority and independence to work and that the people had sufficient faith and patience to allow them to do so.[159]

This is not to say that the New Deal simply extended the associationalism of the previous generation.[160] The early New Deal programs enacted a radical and unprecedented government control over trade practices.[161] Given the novelty of the New Deal, it is not surprising that Roosevelt was constantly hedging—matching every radical social welfare program with another designed to cater to business interests. Science and expertise would neutralize the tendency of political power to corrupt, solve the nation's economic woes, protect individuals, and serve to check the power of the executive. As James Landis remarked,

> If the doctrine of the separation of power implies division, it also implies balance, and balance calls for equality. The creation of administrative power may be the means for the

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[157] SELIGMAN, *supra* note 3, at 60 (quoting FELIX FRANKFURTER, THE PUBLIC AND ITS GOVERNMENT 161 (1930)).

[158] "Technocracy" refers to a world in which experts run the economy rather than private industry. In 1932, a group of engineers and scientists in America began to agitate for a technocracy. Inspired by Veblen's *The Engineers and the Price System* and led by a charismatic professional engineer named Howard Scott, the technocrats wanted to abolish private property and money in favor of a system in which a group of experts would organize distribution and consumption. WILLIAM E. AKIN, TECHNOCRACY AND THE AMERICAN DREAM: THE TECHNOCRAT MOVEMENT, 1900–1941 (1977).

[159] *See* LANDIS, *supra* note 23, at 60–62.

[160] *See* LEUCHTENBERG, *supra* note 143, at 61.

[161] *See, e.g.*, *id.* at 52–58.

> preservation of that balance, so that paradoxically enough, though it may seem in theoretic violation of the doctrine of the separation of power, it may in matter of fact be the means for the preservation of the content of that doctrine.[162]

Ultimately, Landis argued, experts would do what, in the minds of legal realists, the courts had failed so miserably to accomplish.[163] Not only would expertise solve the intricate problems of modern industrial America, it would police the boundaries of state power while ensuring the welfare of all.[164]

During World War I and the 1920s, the experts were the industry leaders themselves.[165] After the crash, the corporatist ideal simply could not hold. Industry could not be trusted to navigate the disaster. It could not be trusted to police itself, but, it seemed, the professions could. Divorced from politics and business, the professions stood poised to take control. Government turned to academics, engineers, doctors, social scientists, and professional accountants to fill the void. Landis explained that with the shift from a laissez-faire economy to a new form of "collectivism," the professions would play the critical role in reformulating the "postulates" upon which our society rests.[166] Landis listed workmen's compensation legislation and the recognition of collective bargaining as two signs that we had, indeed, abandoned the individualistic premises of an earlier generation.[167] He argued that lawyers had claimed a "monopoly over statecraft," by asserting that they were the only profession concerned with social problems. Landis insisted that "it was sheer egotism on the part of one profession to say that [it] and [it] alone could articulate such fundamental postulates of our society."[168]

In the course of recognizing the role of the professional in governance, Landis acknowledged that the distinction between private and public regulation was tenuous at best:

> The framing of principles of business management and operation, when done by private agencies, is ordinarily not

[162] LANDIS, *supra* note 23, at 46.

[163] *See supra* notes 19–25 and accompanying text.

[164] HORWITZ, *supra* note 19, at 213–46. Landis was not the first to articulate the idea that expertise would serve to restrain state power. The notion emerged throughout the early part of the century as progressive legal thought and legal realism discredited the role of the judiciary in defining coherent set of norms to limit the power of the state. *Id.* at 224.

[165] *See* Rabin, *supra* note 62, at 1238.

[166] James Landis, The New Responsibilities of the Professions in their Interrelationships with Business Management, speech before the Bureau of Personnel Administration (Mar. 30, 1939) (transcript available at the Library of Congress, James Landis Papers).

[167] *Id.*

[168] *Id.*

> reviewed by courts. But when a similar task is undertaken by an administrative agency juridical intervention becomes common. There is very little difference so far as these matters go between administrative agencies representing the government and an independent private agency such as, for example, the Stock Exchange. The Board of the U.S. Steel Corporation is a governing board just as much as a board appointed by the United States Government.[169]

Landis concluded that those private bodies should appoint professionals to guide their judgments. He suggested that "failure to admit such men has been responsible in part for the interference of government. And government has interfered to exercise powers very little different from those that business itself could have exercised."[170] In other words, private parties coordinating their own behavior is no different from government regulation, and if businesses would consult professionals to guide the process, there would be no need for bureaucrats. Thus, as Landis saw it, the administrative state was not hierarchical. Regulation was diffuse, falling upon private parties themselves just as much as government agents. Ideally, professionals would make sure that expertise suffused both business and government and develop "postulates" that served the public. Landis recognized that "professionals tend to be narrow in approach" due to their professional training but he felt confident that this would change, that professionals would assume the new responsibilities thrust upon them.[171]

B. *The History of the Accounting Profession*

Against this backdrop, the American accounting profession scrambled to catch up with the older professions. The profession struggled to gain legitimacy throughout the period prior to the New Deal. Despite modest gains in the Gilded Age and Progressive Era, the accounting profession failed to procure a role for itself in the incipient regulatory state. The profession finally won recognition in World War I, but rather than pursue that course, accountants allied with business during the Roaring Twenties. Government policy toward business regulation, expertise, and the accounting profession contributed to this course. While there were seeds of a public ethic in the profession's past, it was largely absent in the period immediately preceding the New Deal.[172] It was in this unfortunate context

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[169] *Id.*

[170] *Id.*

[171] *Id.*

[172] PREVITS & DUBIS MERINO, *supra* note 13, at 236. Historians tend to view the Securities Acts as an unprecedented recognition of the accounting profession by government. *See, e.g.*, *id.* at 274. This is, of course, true in that no prior law had required companies to obtain an independent audit from

that the Securities Act of 1933 formalized the role of the profession as an intermediary between business and government.

This section will review the development of the profession in America during the same periods discussed in the section on the history of regulation to understand how the profession grew up in relation to both the federal and state governments.[173]

1. *Accountants in the 19th Century*

The history of the accounting profession goes back to the 15th century in Europe, when bookkeepers began to use the double-entry system of debits and credits.[174] In 1494, Luca Pacioli wrote the first real treatise on accounting.[175] However sophisticated their methods, these early bookkeepers either worked part-time or were employed by a corporation.[176]

Public accountants, however, did not emerge in Britain until the mid-19th century.[177] As financial relations grew more complex, accounting, not surprisingly, became more sophisticated.[178] In the middle of the 19th century, Britain enacted a series of statutes, known as the Companies Acts, to regulate the expanding and mutating corporate forms.[179] In particular, the Joint Stock Companies Act of 1844 and the Companies Clauses Act of 1845 required all registered companies to obtain an audit from an independent accountant.[180] Many British accountants traveled to the States to monitor the growingly extensive investments, and some stayed on.[181] The system of railways in the United States, commonly known as the "octopus,"[182] created a need for internal auditing, and many railroads

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a public accountant. But in another—and I will argue—significant way, the government had grown to rely on accountants throughout the late 19th and early 20th centuries.

[173] The period before 1887 is obviously important to the development of the profession in the United States as is its roots in British accountancy. Sean O'Connor has developed an interesting thesis on the development of independence in the profession by tracing the development of the American profession in relation to Britain. Sean O'Connor, *Careful What You Wish For: How Accountants and Congress Created the Problem of Auditor Independence*, 45 B.C. L. REV. 741, 773–77 (2004).

[174] PREVITS & DUBIS MERINO, *supra* note 13, at 2–3.

[175] *Id. at* 3–4. *See also* JOHN L. CAREY, THE RISE OF THE ACCOUNTING PROFESSION: FROM TECHNICIAN TO PROFESSIONAL, 1896–1936, at 14 (1969). Double-entry bookkeeping is a system in which each transaction is recorded as both a debit and a credit. In other words, credit entries represent the source of financing while debit entries denote the use of that financing.

[176] During the colonial era, British accountants visited America to monitor the extensive trade between Britain and its colonies. CAREY, *supra* note 175, at 21.

[177] O'Connor, *supra* note 173, at 745.

[178] *Id.* at 746–47.

[179] *Id.* at 749.

[180] *Id.* at 749–50.

[181] CAREY, *supra* note 175, at 22.

[182] The term was coined by Frank Norris in a novel by that name to refer to the railroad with its tentacles reaching out in all directions. Frank Norris, *The Octopus, in* NOVELS AND ESSAYS (Viking Press 1986) (1901).

included audit reports in their statements to shareholders.[183] At the same time, the federal government was employing more accountants to master the growing complexity of the federal budget.[184] The accounting profession nonetheless remained fairly disorganized and underdeveloped in the United States.

The United States trailed behind England in its transition to a corporate economy and neither state nor federal law required audits until the New Deal. The first accounting association, the American Association of Public Accountants (AAPA), did not emerge until 1887 and it did not enjoy the public recognition of its counterpart in England.[185] Nor did it achieve the general recognition that other professions were beginning to secure in America. During the Gilded Age and Progressive Era, the accounting profession failed to secure any significant role for itself in the emerging structure of national economic regulation.[186]

The national organization limped to the end of the century. Public accountants were plagued with problems in their effort to acquire status as a profession. The national organization competed with state associations of Certified Public Accountants (CPA) for recognition. The first CPA law was passed in 1896 in New York.[187] Unlike law or medicine, the legislation did not restrict practice to license holders, but rather limited the use of the title "certified public accountant."[188] The New York law provided the model for other states.[189] As the state associations grew, they also grew suspicious of the AAPA with its ties to Great Britain and its elitist mien.[190] In 1902, the state societies formed a group called the Federation of Societies of Public Accountants.[191] A few years later the two organizations merged, temporarily quieting the competitive din.[192]

Meanwhile, financial reports were rare and those that existed were largely for the benefit of bankers rather than stockholders.[193] American corporations operated under a veil of secrecy that was considered both necessary and appropriate. It was not until the late 19th century that the public gradually started clamoring for more accountability. Unsurprisingly, it did so in the context of the railroads because the great

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[183] PREVITS & DUBIS MERINO, *supra* note 13, at 85.
[184] *Id.* at 95–96.
[185] *Id.* at 138–39; O'Connor, *supra* note 173, at 752.
[186] CAREY, *supra* note 175, at 45–47.
[187] *Id.* at 44.
[188] *Id.* at 43–45.
[189] *Id.* at 45.
[190] *Id.* at 50.
[191] PREVITS & DUBIS MERINO, *supra* note 13, at 191.
[192] CAREY, *supra* note 175, at 51–52.
[193] PREVITS & DUBIS MERINO, *supra* note 13, at 116.

railways acquired funding primarily through individual investments much earlier than other sorts of industry.[194]

The railroads were among the first clients of the early accounting firms in the United States.[195] Far from a voluntary effort to inform the investing public of the financial health of the railroads, mostly this was due first to state and then to federal regulatory efforts. Charles Francis Adams, Jr., a member of the Massachusetts Railroad Commission, catalogued the abuses inherent in the speculative financing of railroads in the 1860s and he was among the first to insist upon publicity in accounts.[196] As more and more state commissions required periodic reports, railroads began to employ public accountants to certify the correctness of their financial statements to their stockholders.[197]

2. *The Progressive Era Campaign for Recognition*

After the federal government stepped in, the local state regulations gave way to national control. The ICC's first chairman, Thomas M. Cooley, recruited the economist Henry Carter Adams to serve as its chief statistician. Sharing Charles Francis Adams's skepticism about the ability of courts to resolve the nation's industrial problems, the two expressed a faith, which would later gain widespread acceptance, that only experts could bring order and justice to the market.[198] To fulfill the agency's legislative mandate, Cooley and Adams set about devising a system of accounts.[199] They did so by consulting the experts. The ICC relied heavily on advice from the Association of American Railway Accountant Officers (AARAO), a private organization of railroad accountants.[200]

At the early stages, the ICC was largely involved in an effort to gather information about railroads.[201] During this period, Adams did not consult the AAPA.[202] He did not enlist their service, but rather turned to

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[194] *See generally* JOHN MOODY, HOW TO ANALYZE RAILROAD REPORTS (1912) (outlining railroad report analysis for an emerging investor class).

[195] *See* JAMES T. ANYON, RECOLLECTIONS OF THE EARLY DAYS OF AMERICAN ACCOUNTANCY, 1883–1893, at 20 (1925).

[196] Charles Francis Adams, Jr., *The Erie Railroad Row*, 3 AM. L. REV. 41 (1869). *See also* MCCRAW, *supra* note 54, at 17–25.

[197] *See generally* ANYON, *supra* note 195 (describing the role of the late 19th century accounting professional in America).

[198] Miranti, *supra* note 64, at 475–76.

[199] *Id.* at 476–78.

[200] *Id.* at 478–79. The railroad accountants, for instance, convinced the ICC that it was impossible to base regulation on a cost-of-service estimate—assessing the joint costs for railways in providing their service. *Id.* at 479. At the AARAO's urging, he switched to a value-of-service system instead, which evaluated worth through estimates of the amounts that particular classes of consumers were willing to pay. *Id.*

[201] *Id.* at 470.

[202] *Id.* at 476.

accountants within the businesses themselves to provide the information and the expertise necessary to render the data useful to the general needs of investors.[203] As the ICC gradually grew more aggressive in assessing the reasonableness of rates,[204] it relied even more heavily on railroad accountants to help standardize the accounting systems.[205] Meanwhile, the agency began to develop its own expertise, hiring a small crew of accountants, which expanded after the Hepburn Act of 1906 gave the ICC authority to set rates and prescribe uniform rules of accounting.[206]

The accounting profession seized the opportunity and attempted to secure a role for itself as the government expanded control over the railroad corporations. Prior to enactment of the Hepburn Act, A. Lowes Dickinson, the Secretary of the Committee on Legislation of the AAPA, wrote a letter to Senator Stephen B. Elkins regarding the proposed amendments to the Act to Regulate Commerce of 1887.[207] The bill included a provision for the examination of statements required by the Act to Regulate Commerce.[208] Dickinson argued that "examinations of accounts by politically appointed bodies are inefficient."[209] Public accountants, on the other hand, had developed an expertise in the private sector and could use that experience to conduct audits on behalf of the Commission.[210] He urged that "both the federal and state governments should recognize [public accountants] to the same extent that they have already been recognized by the commercial community and by the governments of other countries, particularly Great Britain."[211] At the same time, accountants were arguing for independent audits of all railroad reports.[212] An editorial published in the first volume of the *Journal of Accountancy*—the professional publication of the AAPA—recognized the potential for abuse when management begins to take control of a corporation without direct supervision by shareholders.[213] The editorial argued that public accountants—who are uniquely concerned about their

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[203] *Id.* at 480. The AARAO assisted the ICC in devising uniform formats for balance sheets so that investors could determine liquidity, solvency, and profitability.

[204] Miranti, *supra* note 64, at 480–85.

[205] *Id.* at 481.

[206] HOOGENBOOM & HOOGENBOOM, *supra* note 45, at 52–53.

[207] Letter from A. Lowes Dickinson to Stephen B. Elkins (Jan. 31, 1906), *reprinted in* the minutes of the Annual Meeting of the American Association of Public Accountants, 1 J. ACCT. 424, 433–34 (1906).

[208] *Id.* at 433.

[209] *Id.* at 433–34.

[210] *Id.* at 433.

[211] *Id.*

[212] Editorial, *The Public Accountant and Publicity*, 1 J. ACCT. 136, 136–37 (1905).

[213] F.A. Cleveland, *Advantages of an Independent Railway Audit to the Investor*, 1 J. ACCT. 386, 395 (1906).

reputation as professionals—are necessary to ensure against scandals.[214] But the profession was too young and the government unreceptive. The proposed amendments never found their way to the Senate floor and government mandated audits by independent public accountants remained a long way off.

The Act to Regulate Commerce provided for annual, monthly and special reports from railroad carriers and gave the ICC authority to prescribe uniform systems of accounts and inspect any accounts, records, or memoranda kept by the carriers.[215] The AAPA pleaded with the ICC to consult public accountants to design the forms of railroad reports.[216] In a letter to the agency, the AAPA claimed that, unlike the body of public accountants, the chief statistician of the ICC—Henry Carter Adams—was not an expert on recording transactions.[217] The tone of the letter was polite but firm. It is hard not to sense a certain bitterness in the letter, as the AAPA deferred to the expertise of "Professor Adams" in statistics, but stressed that he had no experience with accounts:

> While this association recognizes that Professor Adams' long experience in connection with railroad accounts and statistics has constituted him an authority on this subject . . . his knowledge has relation more to the statistics and the results to be obtained from books than to the devising of systems for recording original transactions.[218]

The agency responded politely, acknowledging its willingness to meet with the AAPA, but perhaps slightly condescendingly emphasized that it had already consulted its private counterpart, the American Association of Railroad Accountants (AARO).[219]

While public accountants did not receive the recognition they were looking for, the push and pull between the agency and the railroads and the agency and the courts initially forced the government to rely on accounting experts. Rather than turn to public accountants, the government relied on the accountants within the regulated industry. In a circular dated May 10, 1907, the ICC announced the form of the new railroad accounts, noting

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[214] *Id.* This would presage the thesis of Adolf A. Berle & Gardiner C. Means in *The Modern Corporation and Private Property*, published in 1933, which addressed the dangers of an entrenched management free from shareholder oversight.

[215] Act to Regulate Commerce of 1887, ch. 104, 24 Stat. 379.

[216] Letter to Hon. Martin A. Knapp, Chairman of the ICC, (Aug. 20, 1906), *reprinted in* the minutes of the Annual Meeting of the American Association of Public Accountants, 3 J. ACCT. 58, 75–76 (1906).

[217] *Id.* at 76.

[218] *Id.*

[219] *Id.* at 77. For a discussion of the rejection of the AAPA's suggestion that only qualified accountants be permitted to audit railroads, see AAPA YEARBOOK (1906).

that its aim was to cooperate with the carriers to perfect methods of accounting.[220] During the rate hearings, however, government regulators and railroad accountants assumed an adversarial relationship as railroads tried to defend their high rates to an incredulous audience.[221] Over the next several years, as the federal agency grew more sophisticated and Congress increased its breadth, the ICC began to integrate more accountants into the bureaucracy but it had difficulty finding individuals with knowledge of both accounting and railroad operations who were willing to enter the public sector.[222]

The need for uniform accounting standards would plague accountants for years to come, because without them critics would unsurprisingly accuse the profession of playing with different standards to achieve a desired result. Nonetheless, it was the government not the profession that provided the first systems of uniform accounting.[223] The Act to Regulate Commerce gave the ICC authority to prescribe uniform accounting methods.[224] While its initial attempts to standardize accounting procedure were controversial at best, throughout this period, it was the federal and state governments, not the profession, that pioneered the effort to standardize accounts.[225]

As government and industry worked out its complex relationship, the public accountants stayed on the sidelines.[226] While many audited the statements of railroads, they did not play a central role in devising policy and standards. In 1907, the ICC's chief statistician Henry Carter Adams spoke before the AAPA.[227] Perhaps in response to the slight he received a year earlier, he betrayed his own belief that public accountants had no special role in devising policy when he stated that issues of government control and political science "lie outside the sphere of discussion by an association of accountants."[228]

Similarly, as government tried to make sense of the massive mergers and combinations of the 1890's, it largely ignored public accountants. In 1898, Congress convened the Industrial Commission to hold hearings on combinations in restraint of trade.[229] Public accountants were not invited

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[220] Editorial, *New Interstate Commerce Commission Circular*, 4 J. ACCT. 150, 150 (1907).
[221] Miranti, *supra* note 64, at 481.
[222] *Id.* at 482.
[223] Arthur W. Teele, *Railroad Accounting in Relation to the 20th Section of the Act to Regulate Commerce*, 7 J. ACCT. 89 (1908).
[224] *Id.*
[225] *Id. See also* Roy Smith, *State Supervision Over Accounting Methods, Part IV: Supervision Over the Accounting of Public Service Corporations*, 8 J. ACCT. 419, 419–20 (1909).
[226] *See* Teele, *supra* note 223, at 89.
[227] Henry C. Adams, *Railway Accounting in its Relation to the Twentieth Section of the Act to Regulate Commerce*, 6 J. ACCT. 381, 382 (1908).
[228] *Id.* at 382.
[229] PREVITS & DUBIS MERINO, *supra* note 13, at 184.

to join.[230] The Commission issued a report urging the government to prevent the great combinations from deceiving the investing public.[231]

The AAPA was a national organization in name primarily.[232] Accountants were still scattered throughout their various state organizations and despite the merger, the AAPA remained small and disorganized.[233] It was nonetheless busy trying to claim professional status for its members. It did so, in part, by arguing that accountancy was a science.[234] As one speaker at the annual AAPA meeting in 1905 stated, "[a]ccounting is properly defined by Locke as 'a science of reason and common sense,' *which comprehends all* and is the keystone of professional existence."[235] An article in the first volume of the *Journal of Accountancy* emphasized that "accountancy to-day is peculiarly one of the most complex, definite and positive of the sciences. . . ."[236] Throughout the early years of the 20th century, accountants attempted to gain public recognition as a profession by invoking the scientific nature of their expert body of knowledge.[237] One prominent accountant even championed the profession by referring to H.G. Wells's prophecy that the future of the race lay with the scientists.[238]

The profession also sought legitimacy by declaring the centrality of accountants to national progress.[239] In the early years of the 20th century, accountants argued that they were essential to progress because the mastery of accounts was the only way to train business toward a "common purpose."[240] From this early period, the profession was attempting to carve a role for itself between business and government. The accounting profession would simultaneously guard against the self-interest of capitalism and the horrors of government control.[241] Countering the anti-monopoly movement, one lawyer argued that accountants and lawyers

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[230] *Id.*

[231] *Id.* at 185.

[232] *Id.* at 138–39.

[233] *Id.* at 138. At the turn of the century, the AAPA had fewer than 100 members, most of whom were English-born residents of New York City. *Id.*

[234] *E.g.*, Salutation of Frank Broaker, *reprinted in* the minutes of the Annual Meeting of the American Association of Public Accountants, 1 J. ACCT. 76, 86 (1905).

[235] *Id.*

[236] Cleveland F. Bacon, *The Accountant as an Expert Witness*, 1 J. ACCT. 99, 100 (1905).

[237] *See* Frank Broaker, *Accounting An Exact Science*, 1 J. ACCT. 328, 329 (1906); Editorial, *Accountancy and Economics*, 7 J. ACCT. 237, 237–38 (1909); David Kinley, *The Field of Accountancy*, 2 J. ACCT. 187, 190–92 (1906); James Logan, *The Importance of Scientific Accounting*, 6 J. ACCT. 276, 276–77 (1908); Seymour Walton, *The Relation of the Commercial Lawyer to the Certified Public Accountant*, 7 J. ACCT. 205, 205 (1909); *Technique in Accounting*, 2 J. ACCT. 54, 54 (1906).

[238] William Arthur Chase, *Our Critics*, 8 J. ACCT. 432, 438 (1909).

[239] F.A. Cleveland, *The Scope of the Profession of Accountancy*, 1 J. ACCT. 40, 55 (1905).

[240] *Id.*

[241] *Id.*

together would usher in progress, preventing a return to "the small and limited transactions of our forefathers."[242]

Accountants were not alone in viewing the expert as the means to social progress. Quoting Charles William Eliot, the President of Harvard University, one accountant claimed in 1909 that "[i]t is plain that the future prosperity and progress of American communities are hereafter going to depend much more than ever before on the large groups of higher trained men which constitute what are called the professions."[243] He concluded that the professions would supplant government as the leading force in modern America: "Political agencies are becoming secondary and subordinate influences. The real incentives and motive powers which impel society forward spring from those bodies of well-trained, alert and progressive men known as the professions."[244] Henry Clews, a prominent American financier, used civic republican rhetoric to argue that the country needed experts to ensure that corporations were trained to the public purpose.[245] He argued that corporations were invested with both public and private interest, but that managers were selfish.[246] Through corruption and moral decay, they inevitably lost sight of the common good.[247] Experts, however, trained to examine accounts could ensure that corporations served the public good, rather than the interest of the greedy and amoral managers.[248]

While other professions drew legitimacy by contrasting their expertise with the pretense of quacks and shysters, the accounting profession did so, in part, by discrediting the government's ability to do accounting work on its own.[249] The competition for public accounting, unlike law and medicine, came from the government itself. During Theodore Roosevelt's administration, accountants were already voicing concern that the government might generalize from its experience monitoring railroads and conduct audits of all corporations by itself.[250] The profession warned that corruption and inefficiency would ensue.[251] Public accountants insisted that it was their role, not that of bureaucrats, to audit the records of

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[242] Albert N. Eastman, *The Relation of the Public Accountant to the Lawyer*, 5 J. ACCT. 183, 184 (1907). *See also* John Alexander Cooper, *Professional Ethics*, 5 J. ACCT. 81, 94 (1907).

[243] Chase, *supra* note 158, at 438.

[244] *Id.* at 438–39.

[245] HENRY CLEWS, THE WALL STREET POINT OF VIEW 26, 29–30 (1900).

[246] *Id.* at 26.

[247] *Id.* at 26–27.

[248] *Id.* at 26–30.

[249] Sociologists have argued that professions develop by establishing a jurisdiction, from which they exclude everyone who lacks their special training or expertise. ANDREW D. ABBOTT, THE SYSTEM OF PROFESSIONS: AN ESSAY ON THE DIVISION OF EXPERT LABOR (1988). Michel Foucault has argued that the professions, or the disciplines, created new spheres of authority through the control of knowledge. *See* Jan E. Goldstein, *Foucault Among the Sociologists: The "Disciplines" and the History of the Professions*, 23 HIST. & THEORY 170, 175 (1984).

[250] Editorial, *Uniformity in Railway Accounting*, 3 J. ACCT. 36, 37 (1906).

[251] *Id.*

corporations.[252] They argued that regulation was inadequate because it did not require corporations to file reports audited by a qualified public accountant.[253] The profession repeatedly used the failures of the ICC as proof that the government was unqualified to audit accounts.[254] Accountants warned that a body of government inspectors was doomed to failure, a sure road to all the evils of socialism.[255] The inefficiency would ensure graft and corruption rather than morality in the marketplace.[256] By defining itself in contrast to the state, the accounting profession was already beginning to ally itself, at least rhetorically, with the efficiency of business against the corruption and wastefulness of government.[257]

Accountants not only claimed a special role due to the neutrality of their science and expertise, they also distinguished themselves from corrupt politicians.[258] During the Progressive Era, when public corruption received so much attention from reformers, accountants championed their independence from political influence.[259] As a 1913 editorial in the *Journal of Accountancy* put it, accountants doing public or corporate work "shall be qualified by ability and not by personal favor merely."[260] Independence, at the time, meant independence from political corruption just as much as, if not more than, freedom from the corrupting influence of the market.

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[252] *See, e.g.*, Editorial, *New York's Panic*, 5 J. OF ACCT. 58, 59–60 (1907).

[253] J.E. Sterrett, *Legislation for the Control of Corporations*, 9 J. ACCT. 241, 242–46 (1910). *See also* Roy Smith, *State Administrative Supervision Over Local Accounting*, 9 J. ACCT. 263, 263–67 (1910) (contrasting different state regulatory schemes, specifically in Indiana in 1909, and Idaho in 1905).

[254] Editorial, *The New Federal Incorporation Bill*, 9 J. ACCT. 279, 283 (1910). This editorial discusses a proposed bill for exclusive federal incorporation, which was never passed. Both Roosevelt and Taft advocated a system for federally chartered corporations. Neither one pursued the matter with enough enthusiasm to support federal legislation, thus the successive bills introduced in 1910, 1911 and 1912 all withered. Theodore H. Davis, Jr., Note, *Corporate Privileges for the Public Benefit: The Progressive Federal Incorporation Movement and the Modern Regulatory State*, 77 VA. L. REV 603, 624 (1991). *See also* Melvin I. Urofsky, *Proposed Federal Incorporation Legislation in the Progressive Era*, 26 AM. J. LEGAL HIST. 160, 165 (1982) (illustrating the arguments for federal, rather than state, regulation over corporations). The editorial comments, in relevant part:

> While there is no evidence in the text of the proposed law that it is the intention to create in the Bureau of Corporations a body of examining clerks who will themselves take up the audit of the accounts, rumors to that effect have become current, the tendency of the federal government to take up this class of work, for which it is in no way qualified and which can only be carried out at a great expense to the community, is shown by the extension in this direction of the activities of the Interstate Commerce Commission.

Editorial, *supra* note, at 283.

[255] John Alex Cooper, *Federal Relations: Advancement and Regulations of the Profession*, 15 J. ACCT. 1, 9 (1913).

[256] Robert H. Montgomery, *Federal Control of Corporations*, 14 J. OF ACCT. 272, 283 (1912).

[257] Editorial, *The Recognition of the Efficient*, 15 J. ACCT. 259, 260 (1913).

[258] *Id.* at 261.

[259] *Id.*

[260] *Id.* at 259.

The Taft administration did turn to public accountants in a limited way to help reform the federal bureaucracy.[261] In 1911, the President set up a Commission on Economy and Efficiency to introduce business methods to government, and appointed several leading accountants to the board.[262] Harvey S. Chase, a prominent member of the AAPA and municipal accounting expert, served on the Commission and drafted several reports on auditing problems.[263] Despite repeated pleas to be included in government regulatory bodies, however, public accountants did not become a permanent force in devising policy or reform.[264] In 1914, Robert H. Montgomery, the president of the AAPA, lamented that government commissions and departments were not staffed by public accountants.[265] The government ultimately chose to do without the service of the expert public accountants. This fact did not go unnoticed. In a speech before the annual convention of public accountants, one government lawyer noted that much of the government accounting work is done by economists or political scientists rather than accountants.[266] In comparing public to private accounting, he reasoned that public accounting serves a critical role in protecting individual welfare.[267] Rather than simply measuring profit and loss, accounting in government secures life and property.[268] "The problem of governmental accounting," he reasoned, "is especially difficult because of the far-reaching purposes and effects of governmental transactions."[269] He explained that governmental transactions involve the "protection of life and property," which "cannot be expressed in terms of profit and loss . . . ."[270] Thus, the professions began to develop a rhetoric in which expertise, not the courts, is critical to secure fundamental liberties by protecting the welfare of all.

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[261] PREVITS & DUBIS MERINO, *supra* note 13, at 178.

[262] *Id.*

[263] *Id.* at 178–79; Harvey S. Chase, *The National Budget on its Expenditure Side*, 15 J. ACCT. 397, 397 (1913).

[264] Edward L. Suffern, *The Contribution of the Accountant in Support of the Commission on Industrial Relations*, 13 J. ACCT. 401, 402–03 (1912). Suffern noted that in Great Britain, unlike in the United States, government not only consulted accountants, but also appointed them to prominent positions. In England, for instance, Sir William Plender, a public accountant, headed the Commission to Investigate Parliamentary Affairs. *Id.* *See also* Wilhelm Jensen, *Workmen's Compensation Act of Washington*, 14 J. ACCT. 380, 380 (1912) (lamenting fact that Workmen's Compensation Act was enacted without consulting public accountants).

[265] Robert H. Montgomery, *Report of the President*, 18 J. ACCT. 241, 241–42 (1914). *See also* Elijah W. Sells, *The Accounting Profession: Its Demands and Its Future*, 20 J. ACCT. 325, 329 (1915) (calling for a new field for public accountants in public office).

[266] George E. Frazer, *Who Can Qualify for Governmental Accounting*, 14 J. ACCT. 259, 263 (1912). Frazer spoke in his capacity as a member of the Wisconsin State Board of Public Affairs.

[267] *Id.* at 264.

[268] *Id.*

[269] *Id.* at 264–65.

[270] *Id.* at 264.

In the last years before World War I, the government took the first step toward regulating the accounting profession.[271] On November 10, 1914, the Federal Reserve Board issued Circular Number 13 regarding rediscounting of commercial paper.[272] The Federal Reserve used commercial paper as a basis for issuing currency, and the acceptability of the paper depended on the strength of the original maker.[273] To ensure the security of a loan, the Federal Reserve required a signed statement, a description of the business, a balance sheet, and a profit and loss statement.[274] The circular provided an exact method for characterizing the assets and liabilities.[275]

The following year, Edwin N. Hurley, the vice chairman of the FTC, began to preach the value of uniform systems of accounts.[276] As part of his plan, Hurley proposed "zone experts," government accountants who would be dispatched to particular geographic zones to help businesses prepare their accounts.[277]

The proposed FTC system of zone experts was a substitute for direct control of the industry: Hurley assured businessmen that his agency would not use "compulsory methods" but rather make experts available to business.[278] The AAPA disapproved of the proposal. An editorial in the *Journal of Accountancy* mocked the notion of government experts, invoking the specter of communism:

> Accountants will wonder whether they are to be an expert of "zone one" or "zone ten." Possibly the most fortunate will be rated as experts of all zones from the torrid to the frigid. . . . Looking down that long vista we can see struggling rows of manufacturers, merchants and business men clamoring for the advice and assistance of those fortunates [sic] upon whom the federal trade commission shall have bestowed the titulary encomium of "Z.E."[279]

The FTC and the accounting profession agreed that accountants could help regulate business without resorting to direct government control. They simply disagreed on where the accountants should come from: not surprisingly, the government proposed government accountants and the

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[271] Editorial, *Educating the Public*, 19 J. ACCT. 359, 359–60 (1915).
[272] *Id.*
[273] *Id.* at 359.
[274] *Id.*
[275] *Id.* at 359–60.
[276] Editorial, *In These Utopian Days*, 20 J. ACCT. 129, 129–30 (1915).
[277] *Id.*
[278] *Id.* at 130–31.
[279] *Id.* at 133.

AAPA championed the public accountant.[280] The zone experts never materialized but, in 1917, the Federal Reserve Board worked with the FTC and the AAPA's successor association, the American Institute of Accounts (AIA), to issue a pamphlet, *Uniform Accounting*, the first comprehensive set of accounting rules.[281]

Despite this modest success, the accounting profession focused less on securing a role for itself in government regulation as income tax laws created a new market for its services in the private sector.[282] While in 1895 the Supreme Court essentially declared the income tax unconstitutional,[283] the Sixteenth Amendment provided a new basis for such laws.[284] In 1909, Congress passed a corporate excise tax that generated both a great deal of business for accountants and significant controversy.[285] The income tax law of 1913 created a virtually endless supply of work for accountants.[286]

As accountants were trying to find a role for themselves in business and government, they continued to profess a devotion to high ideals, to public service, and to independence from business.[287] This fact in and of itself is rather unremarkable. All professions embrace a service ideal.[288] As early as 1906, one editorial in the *Journal of Accountancy* suggested

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[280] *Id.*

[281] PREVITS & DUBIS MERINO, *supra* note 13, at 230–32. In 1916, the AAPA reorganized, in part, due to pressure from a segment within the institution to lobby for federal licensing of accountants. *Id.* at 242. The resulting institution was renamed the American Institute of Accountants, but the suspicion of many certified public accountants that the AIA secretly wanted to undermine state control over the profession continued. *Id.*

[282] *Id.* at 182.

[283] Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1894). The decision held that the income tax was a direct tax that failed to conform to the rule of apportionment among the states. *Id.* at 587–88, 592. Because state by state apportionment of a tax on individual income was impracticable, the decision essentially precluded income tax laws.

[284] *See* U.S. CONST. amend. XVI. The Sixteenth Amendment, adopted in 1913, provided, "[t]he Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." *Id.*

[285] *See* PREVITS & DUBIS MERINO, *supra* note 13, at 181 (describing the 1909 corporate excise tax as a "highly profitable nightmare"); J.E. Sterrett, *An Open Letter on the Corporation Tax Bill*, 8 J. ACCT 456, 456–58 (1909). The government did not confer with public accountants before passing the act. *Id.* at 456. The law mandated that business revenue must be based on a cash rather than accrual basis. *See id.* at 457. Most accountants and businessmen considered the cash basis an imprecise measure of net income. *See id.* The cash basis for accounting dictates that a business should record income only when it receives cash or a check from its customer, and it should record an expense only when it actually pays a vendor. ANTHONY PHILLIPS ET AL., BASIC ACCOUNTING FOR LAWYERS 54 (4th ed. 1988). The accrual method requires that the business record income when the sale occurs, regardless of whether the payment has been made, and an expense when it receives a good or a service, even if it intends to pay at some later date. *Id.* at 53, 54.

[286] *See* PREVITS & DUBIS MERINO, *supra* note 13, at 182.

[287] *See, e.g.*, W.A. Chase, *The Profession of a Certified Public Accountant*, 2 J. ACCT. 194, 200 (1906); Editorial, *Burden of Prosperity*, 18 J. ACCT. 296, 297–98 (1914); Editorial, *Ethics of Accountancy*, 9 J. ACCT. 284, 284 (1910); J. Porter Joplin, *The Ethics of Accountancy*, 17 J. ACCT. 187, 189, 190 (1914); Robert H. Montgomery, *Professional Standards: A Plea for Cooperation Among Accountants*, 1 J. ACCT 28, 31 (1905); J.E. Sterrett, *Professional Ethics*, 4 J. ACCT. 407, 415–19 (1907); *Proceedings, Annual Meeting of the American Association of Public Accountants, Twentieth Annual Meetings*, 5 J. ACCT. 137, 138 (1907).

[288] Goldstein, *supra* note 249, at 174–75.

that public accountants should be hired by shareholders rather than management to ensure independence.[289] Like lawyers, accountants used the language of civic republicanism and even religious mission to assert their higher ideals.[290]

During the Progressive Era, accountants proclaimed the centrality of their profession to the future of the nation.[291] The efficiency movement, government reform, and increased regulation created a market for accountants' services, but the accounting profession was still in its infancy.[292] Unable to capitalize on the growing need for a uniform system of accounts and government service, public accountants largely squabbled amongst themselves as lawyers and economists in public offices took the helm.[293]

3. *A New Role in World War I and the 1920s*

During World War I, things changed. As business, labor, and government began to work together, accountants played a significant role in coordinating the effort.[294] During the war, the government entered into countless contracts with business for the purchase of munitions and supplies.[295] Government lawyers devised a cost plus profit measure for setting contract prices, which required public accountants to do the calculations.[296] For instance, Herbert G. Stockwell, a certified public accountant and member of the AIA (again, the successor organization to

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[289] Editorial, *Collateral Employment of Accountants*, 1 J. ACCT. 504, 505 (1906) ("Where the accountant is depending for his employment upon the favor of the managers whose work he is to scrutinize, he needs a robust moral sense to hew to the line without regard to the disposition of the chips."). Accountants repeated this suggestion that the American system should provide for shareholder election of accountants at least once. *See* Editorial, *Integrity of Investment*, 17 J. ACCT. 37, 40 (1914). This system would mirror that required by the British Companies Act. *See* O'Connor, *supra* note 173, at 743–44.

[290] *E.g.*, Eli Moorhouse, *The Mission of the Certified Accountant*, 13 J. ACCT. 266, 266, 269 (1912). Moorhouse argued that false or misleading statements not only destroyed the reputation of the accountant, but also his "own personal freedom of mind and conscience, if not actual freedom of body." *Id.* at 268. He continued that "[t]he certified accountant must thus endeavor to show that he is not merely a statistician nor even an interpreter of figures, but in the highest sense of the words a business physician and evangelist." *Id.* at 269. While accountants invoked the notion of "independence," a term associated with the civic republican tradition, they did so with far less frequency and far less oratory flourish than lawyers. *See* Robert W. Gordon, *The Ideal and the Actual in the Law*, *in* THE NEW HIGH PRIESTS: LAWYERS IN POST-CIVIL WAR AMERICA 51–67 (Gerard W. Gawalt ed., 1984) (discussing how lawyers, in the late 19th and early 20th centuries, sought idealized reform of their profession, yet despite their rhetoric, the profession continued to be subjected to scandals and corruption).

[291] *See* PREVITS & DUBIS MERINO, *supra* note 13, at 177.

[292] *See id.* at 177–78.

[293] CAREY, *supra* note 175, at 126–28.

[294] PREVITS & DUBIS MERINO, *supra* note 13, at 237. *See also* Editorial, *Accountants' Services in Wartime*, 23 J. ACCT. 364, 364–65 (1917).

[295] Editorial, *Government Contracts*, 23 J. ACCT. 450, 450 (1917).

[296] *Id.* at 450, 450–52. *See also* Editorial, *How Best to Serve*, 26 J. ACCT. 38, 39 (1918).

the AAPA), organized the food administration in each state to determine fair margins of profits for businesses that handle foods.[297]

The AIA met with the Naval Consulting Board and the Council of National Defense to determine how best to serve the war effort.[298] Members served on the General Munitions Board, coordinating the acquisition and purchase of emergency supplies.[299] Despite their growing importance, one accountant, C.C. Waters, lamented that his profession was not playing an even greater role in preparing the nation for war.[300] Comparing the accountant with the corporate lawyer, Waters suggested that this might be the fault of the accountants themselves, who were obsessed with profit rather than "public service."[301] He insisted, however, that this focus was misguided, oddly dissonant with the real purpose of accounting: "[s]ound accounting principles are like the principles of international law. They are designed to protect the rights of the weaker against infringement by the stronger."[302] Thus, Waters set a place for the profession alongside the courts by claiming that it is uniquely suited to protect the interests of the minority against the majority.

Further, Congress passed various tax laws during the war to meet the unprecedented need for revenue.[303] Unlike previous years, the government consulted accountants to aid with the war effort.[304] In fact and perhaps as a result of the profession's newfound prominence, the commissioner of Internal Revenue, William H. Osborn, invited accountant Homer S. Pace to help reorganize the Bureau.[305]

The war ushered in a new era. The accounting profession had gained prominence and national recognition through its contribution to the war effort.[306] As a new decade brought peace and prosperity, accountants championed their new prominence.[307] But they retreated from public service. After the war, when the FTC proposed a plan for the registration of accountants, the AIA emphatically opposed the proposal, arguing that having the government identify those who qualified as an expert would inevitably devolve into inefficiency and corruption since "[e]very congressman from the backwoods and the plains would have a constantly

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[297] Herbert G. Stockwell, *Accountants and the Food Administration*, 26 J. ACCT. 250, 250–52 (1918).

[298] Editorial, *Accountants and the War*, 24 J. ACCT. 112, 112 (1917).

[299] *Id.* at 112–13.

[300] *See* C.C. Waters, *Public Accountants and Industrial Preparedness*, 23 J. ACCT. 445, 445–46 (1917).

[301] *Id.* at 447, 448.

[302] *Id.* at 448.

[303] *See* PREVITS & DUBIS MERINO, *supra* note 13, at 255; Editorial, *Genuine Service*, 27 J. ACCT. 270, 270 (1919).

[304] *See* PREVITS & DUBIS MERINO, *supra* note 13, at 237; Editorial, *supra* note 303, at 270–71.

[305] Editorial, *supra* note 303, at 271.

[306] *See* Editorial, *As We Advance*, 32 J. ACCT. 203, 203 (1921).

[307] *See, e.g.*, *id.*

increasing number of friends 'back home' seeking the prestige of federal registration."[308]

Throughout the 1920s, the AIA was plagued with internal strife. State societies of public accountants united to form a competing national group, the American Society of Certified Public Accountants.[309] The leadership of the profession was embattled and it lacked a national voice.[310] The AIA continued to profess high ideals, struggling with the rhetoric and its practical application.[311] In this new rhetoric, professions were still the key to progress and freedom but the meaning of both terms had changed. They now denoted a kind of humane individualism.[312] In the new zeitgeist, the professions would seek to prevent businessmen from becoming wealthy "through fraud upon the humble," which would in turn, they argued, benefit the country as a whole.[313]

During the Roaring Twenties, the discourse of public accountants moved further away from talk of a public ethic.[314] As the twenties wore on, more and more trade groups developed their own uniform systems of accounts.[315] Regulated industries worked with government regulators to refine these accounting rules.[316] Just as the FTC largely abandoned its aspirations as regulator in favor of a new role as business adviser, so too public accountants assisted businesses gather information on costs to help control competition voluntarily.[317]

Accountants began to criticize the idea of independent audits as Hoover's associationalist state emerged.[318] In the early twenties, the AIA

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[308] Editorial, *Federal Registration of Accountants*, 29 J. ACCT. 301, 301 (1920).

[309] PREVITS & DUBIS MERINO, *supra* note 13, at 242–43.

[310] *Id.* at 242–46.

[311] The articles appearing in the Journal of Accountancy on ethics are countless. *See, e.g.*, Herbert F. French, *Professional Ethics*, 36 J. ACCT. 81, 81–82 (1923); Carl H. Nau, *The Aims of the Institute*, 31 J. ACCT. 321, 322–25 (1921); Bernard Rose, *Responsibility of Auditors*, 35 J. ACCT. 335, 335–37 (1923); *Report of the President of the American Institute of Accounts*, 34 J. ACCT. 241, 245–46 (1922).

[312] This vision was expressed by a former justice of the Supreme Court for the District of Columbia before the annual meeting of the AIA in 1923. *See* J. Harry Covington, *Some Professional Obligations*, 36 J. ACCT. 417, 417–20 (1923); *see also* Editorial, *Legislative Draftsmen Needed*, 40 J. ACCT. 112, 112 (1925) (arguing that all laws ought to "protect . . . the sanctity of individualism").

[313] *See* Covington, *supra* note 312, at 419.

[314] *See infra* notes 327–36 and accompanying text.

[315] *See, e.g.*, Chester R. Union, *Uniform Accounting in the Textile Industry*, 29 J. ACCT. 104, 105 (1920) (arguing that a uniform accounting system would benefit the textile industry). A uniform system of accounts referred to a standardized format and set of classifications to guide businesses within a particular type of industry in the presentation of financial statements. Anthony B. Manning, *Advantages of Uniform Accounting*, 28 J. ACCT. 113, 113–16 (1919). The belief was that this sort of standardization would allow government regulators or anyone else interested in financial statements to compare the financial position and operational performance of different businesses within one industry. *Id.* at 116–18.

[316] *See id.* at 113–16; Union, *supra* note 315, at 104–10.

[317] PREVITS & DUBIS MERINO, *supra* note 13, at 239.

[318] *See id.* at 249–50.

still argued that the government should require independent audits of all public corporations.[319] Some continued to suggest that the United States adopt the British system, in which shareholders elect the auditor.[320] However, as it encountered a deaf ear in government, the profession turned its attention to bankers, attempting to persuade them that it was in their interest to require independent audits of all financial statements.[321]

In the years following World War I, Congress passed increasingly complex tax schemes and accountants helped businesses prepare their taxes.[322] Many of these accountants became lobbyists on their clients' behalf, arguing, for example, that the tax burden was too high.[323] In fact, the profession gained the greatest recognition in this new field of tax accounting.[324] To the great approval of the profession, the Treasury Department ultimately required that all accountants that practiced before it abide by the ethical rules designed by the AIA.[325] Accountants lobbied for a board for taxpayer appeals. The AIA argued that members of the board should be lawyers, accountants, economists, and businessmen, and it complained bitterly when civil servants from the Treasury Department won most of the appointments instead.[326]

Having failed to secure a role for themselves in government or through federal recognition, accountants refashioned themselves as business consultants and aides to management.[327] As one accountant concluded, accountants should not become too involved in politics: if the profession were to become too intimately involved in politics, it would not be able to remain "non-partisan."[328] In an article that reads like an etiquette book of

[319] *See* Editorial, *Displacing the Auditor*, 32 J. ACCT. 128, 128 (1921) (emphasizing the need for an "impartial accountant" to act as a liaison between businesses and the public).

[320] *Id.* at 128–29.

[321] John Raymond Wildman, *Certified Financial Statements as a Basis for Credit*, 30 J. ACCT. 161, 164–68 (1920).

[322] *See* Elijah W. Sells, *Why Not Lessen the Evils of Present Taxation?*, 32 J. ACCT. 161, 161–62 (1921).

[323] Editorial, *Proposed Tax Legislation*, 37 J. ACCT. 109, 109–10 (1924).

[324] *See* Sells, *supra* note 322, at 161. Elijah Sells, a prominent leader in the profession, stated, "[b]usiness is the very lifeblood of the nation." *Id.* at 162.

[325] *See* Editorial, *Ethics in Tax Practice*, 37 J. ACCT. 35, 35 (1924). The Treasury Department Circular 230 stated that any conduct inconsistent with the AIA codes of ethical conduct would justify rejection of an application to practice before the Treasury Department and also warrant revocation of such registration. *See* Carl H. Nau, *Growth of Professional Ethics*, 37 J. ACCT. 1, 8 (1924).

[326] Editorial, *Board of Tax Appeals*, 38 J. ACCT. 205, 205 (1924); Frank Lowson, *Federal Tax Board of Appeals*, 37 J. ACCT. 183, 183–86 (1924).

[327] *See* Editorial, *Accounting and Good Management*, 37 J. ACCT. 37, 37 (1924); A.R. Erskine, *Importance of Accounting to Management*, 38 J. ACCT. 107, 107–08 (1924) (noting that the accounting profession had primarily only been recognized by the state governments, but that accountants were now very valuable to businesses). As they aligned more closely with their clients, the AIA began to argue for a privilege that would render communications between accountants and their clients confidential. *See* Editorial, *Communications Must be Confidential*, 39 J. ACCT. 134, 134 (1925); Editorial, *Privileged with a Vengeance*, 38 J. ACCT. 46, 46–47 (1924).

[328] J. Arthur Marvin, *Public Service of the Public Accountant*, 37 J. ACCT. 187, 190 (1924) (also arguing that accountants should become more involved with serving the public by helping the government "solve their taxing and accounting problems").

the period, J. Hugh Jackson suggested that the primary role of the accountant was to assist management: "an accountant can often guide but seldom drive."[329] The most important attribute, he continued, was "personality," or, to be more specific, "[h]abits of speech, dress, and personal tidiness."[330] A good accountant was "pleasing to those with whom he comes in contact," and his fundamental goal was to make himself liked.[331]

In 1926, Arthur Andersen—the prominent accountant and founder of the accounting firm of the same name—developed a plan to implement the ideal of the accountant as business advisor.[332] He argued that accountants should constantly look for "newer and broader fields of service to business management."[333] In a prophetic moment, Anderson envisioned accountants consulting in all matters of business. He concluded: "It is in bringing a balanced view to bear upon the problems of the undertaking and in assisting management in matters of business analysis that the accountant will have [the] greatest opportunities . . . ."[334] The service ideal of the profession evolved from devotion to the common good to submission to the will of management.[335] To be fair, at the time, the two were thought to be consistent if not the same.[336]

As accountants grew more dependent on business and more closely aligned with management, the AIA demanded federally mandated audits by independent accountants, which they had shunned only years earlier.[337] The irony did not go unnoticed at the time. Herbert C. Freeman, a public accountant, argued for independent audits, reasoning that accountants should restrict themselves to serving the investor.[338] Otherwise, accountants cannot get recognition "as a distinct class in the business community, vested with quasi-judicial functions, if they are known in point of fact to have affiliations of a closer character in certain directions which

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329 J. Hugh Jackson, *Accountancy as a Profession: What Opportunities Does it Offer for a Professional Career?*, 40 J. ACCT. 161, 166 (1925).

330 *Id.* For a discussion of the cultural shift in focus from character—traits of self-restraint and morality—to personality—an emphasis on appearance and affability, see WARREN I. SUSMAN, CULTURE AS HISTORY: THE TRANSFORMATION OF AMERICAN SOCIETY IN THE TWENTIETH CENTURY 271–85 (1984).

331 *Id.*

332 *See* Arthur Andersen, *The Accountant's Function as a Business Advisor*, 41 J. ACCT. 17, 18–21 (1926).

333 *Id.* at 17.

334 *Id.* at 21.

335 *See* Jackson, *supra* note 329, at 165.

336 *See id.* at 165–66 (noting that whether or not an accountant acts as a public accountant or works individually with one business, the accountant is providing a useful social service).

337 *See* A. Lowes Dickenson, *Publicity in Industrial Accounts: With a Comparison of the English and American Methods*, 38 J. ACCT 254, 254–62, 265–74 (1924); Editorial, *The Next Step*, 38 J. ACCT. 366 (1924).

338 Herbert C. Freeman, *Some Thoughts on Modern Tendencies*, 39 J. ACCT. 361, 362–66 (1925).

render them, in turn, more or less dependent cogs in the economic machine."[339]

Others, however, disagreed with Freeman, arguing that a good accountant inevitably renders business advice in the course of an audit.[340] Accountants were not the only ones to notice the tension between their practical function as business advisors and the need for independent audits. Many critics condemned accountants for conducting poor audits, rubber-stamping the wishes of management and justifying their findings with vague and imprecise accounting rules.[341] Commercial bankers and academics led the assault.[342] It is not surprising that commentators perceived the tension at this point in history, because an accountant's role as business advisor was becoming more fundamental just as demands for independent audits were increasing.[343]

Perhaps the most important attack on the profession came from William Z. Ripley, a professor of political economy at Harvard.[344] In 1926, Ripley published a series of articles in the *Atlantic Monthly*, which were later collected and published in a book, *Main Street and Wall Street*.[345] Ripley explained that with the advent of popular ownership of corporations, "Main Street and Wall Street have come to cross one another at right angles."[346] Extending this metaphor, he warned that the lack of transparency in accounts casts a dark shadow over that intersection, all but ensuring a collision.[347] He continued to lament the current state of accounting, characterized by deceptive practices.[348] Some companies issued balance sheets and no income statement.[349] Others failed to charge for depreciation or obscured the distinction between capital and income.[350] Ripley spent page after page chronicling the mockery that corporate disclosures had become.[351] He concluded by praising those industries that voluntarily enforced transparency and the New York Stock Exchange for

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339 *Id.* at 366.

340 W.C. Heaton, *Development of Modern Practice*, 40 J. ACCT. 108, 108–09 (1925).

341 *See* Miranti, *supra* note 64, at 456.

342 *Id.*

343 WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET (1927). *See also supra* notes 327–36 and accompanying text.

344 John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 38 (2001).

345 RIPLEY, *supra* note 343 (1927).

346 William C. Ripley, *Stop! Look! Listen: The Shareholder's Right to Adequate Information*, 138 ATLANTIC MONTHLY 380, 380–81 (1926).

347 *Id.*

348 *Id.*

349 A balance sheet provides a snapshot of a company's financial condition at a particular moment in time. It includes assets, liabilities and net worth. An income statement, on the other hand, shows a company's worth—sales, expenses, and net profit—for a given period of time. BARTON E. FERST & STANLEY D. FERST, BASIC ACCOUNTING FOR LAWYERS 29–30, 89 (3d ed. 1975).

350 Ripley, *supra* note 346, at 386–88.

351 *Id.* at 381–94.

its rigorous listing requirements.[352] But Ripley recognized those reforms could go only so far.[353] The panacea in Great Britain had been the independent audit, conducted at the expense of the corporation but under the supervision of the shareholders.[354] Ripley, however, did not suggest that the British system be transplanted to the United States.[355] He concluded instead that in America the FTC should conduct audits of all corporations sold to the public.[356] Without drawing too much attention to his premise that American public accountants were too docile for the job, Ripley alluded to the "American practice of subserviency of the audit to management."[357]

In an address at the annual meeting of the AIA, George O. May, a leader of the profession, responded to Ripley's allegations.[358] He began, remarkably, by acknowledging that perhaps auditors had not done all that they could do to ensure transparency.[359] He then denounced Ripley's conclusion that the government should assume responsibility for audits and developed a strategy for addressing the problem.[360] He suggested that the New York Stock Exchange should take the lead by setting clear obligations for the auditor and developing distinct standards for balance sheets and income statements.[361] Ultimately, May joined with prominent businessmen, government leaders, and educators to sponsor research through the Social Science Research Council aimed at determining specific solutions to the problem of inadequate corporate transparency.[362] May chaired this committee, shaping the agenda of the group and by 1928, the majority of members favored limited government regulation.[363]

Operating under the new threat of government control, the accounting profession began to actively seek another solution. The AIA approached the New York Stock Exchange proposing a joint effort to develop minimum disclosure standards.[364] The Exchange initially declined, concerned that some companies would choose to be listed on another exchange rather than face such scrutiny.[365] Despite its initial failures, the

[352] *Id.*
[353] *Id.*
[354] *Id.* at 396–97.
[355] *Id.* at 390.
[356] *Id.*
[357] RIPLEY, *supra* note 343, at 143.
[358] George O. May, *Corporate Publicity and the Auditor*, 42 J. ACCT. 321, 321 (1926).
[359] *Id.*
[360] *See id.* at 323–24.
[361] *Id.* at 324.
[362] Miranti, *supra* note 64, at 457.
[363] *Id.* at 458.
[364] CAREY, *supra* note 175, at 163.
[365] *See id.* at 163–64; *see also* PARRISH, *supra* note 2, at 40–41.

AIA continued to push for voluntary cooperation by industry combined with stock exchange regulations rather than government mandated audits.[366] As one editorial put it, "American accountants have always championed the cause of business in opposition to excessive interference by government authorities, and [the profession] would not be inclined to change [its] position merely because [its] practice might be augmented by a paternalistic innovation."[367]

During this period, the courts were slow to recognize the massive power of the auditor and the tendency for abuse. During the 1920s, the law offered very little protection to vulnerable third parties, such as investors.[368] The political economist A.A. Berle noted that courts viewed accountants as neutral and would not question accounting practices.[369] In 1931, Justice Cardozo, who was then serving on the New York Court of Appeals, issued an opinion largely confirming that view.[370] He insisted that accountants could be held liable to third parties only for gross negligence tantamount to fraud.[371] In *Ultramares Corp. v. Touche*, the plaintiff, who lent money to a company on the basis of its fraudulent financial report, sued the accountants for certifying the statement.[372] In rendering his opinion, Cardozo analogized to the negligent manufacture of chattel, musing about whether he could recognize an injury that rested on "the explosive power resident in words."[373] He determined that a court could not hold accountants liable to the investor for negligence but concluded that such sloppiness could be used as evidence of fraud: "Even an opinion, especially an opinion by an expert, may be found to be fraudulent if the grounds supporting it are so flimsy as to lead to the conclusion that there was no genuine belief back of it."[374] Despite his somewhat conservative holding, Cardozo gave judicial voice to the growing consensus that accountants had a special power and a special obligation to the public, and that harm could result from words that were buttressed by the reputation of a professional. The only ones to disavow this position seemed to be the accountants themselves.[375]

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[366] CAREY, *supra* note 175, at 164.

[367] Editorial, *A Statutory Audit?*, 47 J. ACCT. 134, 134–35 (1929).

[368] A.A. Berle, *Management Power and Stockholders Property*, 5 HARV. BUS. REV. 424, 424–32 (1927).

[369] PREVITS & DUBIS MERINO, *supra* note 13, at 272 (citing Berle, *supra* note 368, at 428).

[370] *See* Ultramares Corp. v. Touche, 174 N.E. 441, 442, 445 (N.Y. 1931).

[371] *Id.* at 449.

[372] *Id.* at 443. The AIA filed an amicus brief in the case, arguing that there should be no liability where there is no privity of contract. Editorial, *Institute's Brief on Privity of Interest*, 50 J. ACCT. 88, 88–97 (1930).

[373] *Ultramares Corp.*, 174 N.E. at 445.

[374] *Id.* at 447.

[375] *See infra* Part II.B.4.

4. *New Responsibility in the New Deal Order*

It was at this inauspicious moment that the accounting profession won its greatest victory—federal recognition. Immediately before the Great Crash, the Federal Reserve Board asked the AIA to revise the accounting procedures published in 1928 and issued the new version as *The Verification of Financial Statements*.[376] In the midst of the economic crisis, accountants used this pamphlet as a bible, claiming that it would ensure fair audits, while simultaneously protecting accountants from unfair liability.[377] As long as they stuck to the rules, no one could blame them for a faulty audit.[378] Throughout the late twenties and early thirties, the vast majority of corporations chose to have their annual reports audited by independent accountants.[379] Finally, in 1933, the New York Stock Exchange announced that all public companies listed on the exchange must submit to independent audits.[380]

Efforts at self-regulation could not deter the new administration, as President Roosevelt considered securities regulation among his greatest priorities.[381] And once again, as in the Progressive Era, the federal government did not consult accountants in drafting the laws that might affect them.[382] Initially, Roosevelt assigned the bill to Samuel Untermyer, counsel for the Pujo "Money Trust" hearings in 1912.[383] Despite his good intentions, Untermyer's draft constituted nothing more than a refurbished version of an old proposal for Post Office supervision of stock and bond sales.[384] Roosevelt then delegated responsibility to Huston Thompson, a former FTC chairman, to draft a new version.[385] While Untemyer's

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[376] Editorial, *Verification of Financial Statements*, 49 J. ACCT. 44, 44 (1930).

[377] *See* Editorial, *Standards to Protect Profession*, 49 J. ACCT. 45, 45–46 (1930).

[378] Editorial, *Standards Also Assist Good Business*, 49 J. ACCT. 46, 46–47 (1930).

[379] SELIGMAN, *supra* note 3, at 48. A survey conducted by the New York State Society of Certified Public Accountants concluded that in 1931, 83% of all companies listed on the New York Stock Exchange had their annual reports audited by an independent public accountant. Roger Barton, *Independent Audits for Investors*, 56 J. ACCT. 91, 94 (1933).

[380] *See* PREVITS & DUBIS MERINO, *supra* note 13, at 273.

[381] SELIGMAN, *supra* note 3, at 52.

[382] *See id.* at 52–53.

[383] *Id.* at 51. Arsène Pujo, a United States Congressman, was the chair of the Committee on Banking and Currency in 1912 when he received permission to investigate the Money Trust. Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1213 n.72 (1999). After a spectacular interrogation of J.P. Morgan by the committee's counsel, Samuel Untermeyer, the Commission concluded that a few men had gained an unhealthy control of the nation's money and credit. Jerry W. Markham, *Accountants Make Miserable Policemen: Rethinking Federal Securities Laws*, 28 N.C. J. INT'L L. & COM. REG. 725, 735 (2003). This investigation helped usher in the Federal Reserve Act of 1913 and the Clayton Antitrust Act the following year. SELIGMAN, *supra* note 3, at 51.

[384] SELIGMAN, *supra* note 3, at 51–52.

[385] *Id.* at 50, 52.

proposal was too mild, Thompson's draft proved too drastic. Among other things, the bill would have empowered the FTC to determine whether an issuing company was unsound or insolvent, a scheme that was almost universally condemned.[386] The notion that the federal government would pass on the soundness of securities was too radical a form of government control. The specter of socialism loomed large.[387] Perhaps the greatest problem with the bill was that it was self-enforcing. While it gave substantial authority to the FTC to revoke an issue, Thompson's draft was fairly short and simple, demonstrating his faith in legislative solutions rather than creative administration.[388] Thompson's bill was, nonetheless, introduced in Congress.[389]

Not only did the administration fail to recruit the help of accountants to design the bill, but the profession was also strangely absent from the congressional hearings.[390] Perhaps, the AIA feared that any public appearance would draw attention to the accounting scandals that had been unearthed by Ferdinand Pecora's investigation of stock exchange practices.[391] Or, maybe the professional organ still held hope that cooperation with the New York Stock Exchange would derail the federal regulatory efforts.[392] As the Thompson bill moved through Congress, the AIA did not so much as make an appearance.[393] Only Colonel Arthur H. Carter, managing partner of the accounting firm Haskins & Sells, testified before the Senate Banking Committee on behalf of the New York State Society of Certified Public Accountants.[394] Carter praised the Thompson bill, but argued that public accountants should be responsible for auditing financial statements, not a crew of federal agents.[395]

During his testimony, Carter and Senator Barkley engaged in the following somewhat comical, somewhat predictable exchange regarding the relationship between the public accountant and the company's chief accountant, or the controller:

Senator Barkley:	You audit the controllers?
Mr. Carter:	Yes, the public accountant audits the controller's account.

[386] *Id.* at 54, 56.

[387] Opposition to the bill also focused on the liability provision, which provided for recovery only from promoters, directors and officers. *Id.* at 56.

[388] PARRISH, *supra* note 2, at 51.

[389] SELIGMAN, *supra* note 3, at 53.

[390] CAREY, *supra* note 175, at 183.

[391] *See supra* note 3 (describing the Pecora hearings).

[392] *See* CAREY, *supra* note 175, at 182–83.

[393] *See id.* at 183.

[394] *Id.* at 184–85.

[395] *See id.* at 185.

Senator Barkley:	Who audits you?
Mr. Carter:	Our conscience.[396]

The Senator seemed bewildered. Carter argued that the government simply could not do the job—it was too inefficient and clumsy.[397] Senator Reynolds then took up the topic. He pressed Carter about why the government could not do the audit by itself, especially if it were to hire the auditors from the New York Society of Public Accountants itself.[398] Carter replied, "I do not think the type of men who are in the public practice of accountancy would leave their present practice to go in the government employ."[399] Reynolds responded, "if it were sufficiently remunerative they would."[400] Carter had to agree.[401] Thompson's bill was criticized from all sides. Banking, business, and most of the senators considered it too radical.[402]

Although professional accountants had not helped draft the Thompson bill, Roosevelt called in a different sort of professional for the next round. James Landis, who at the time was a professor at Harvard Law School, represented a new wing of the Democratic Party, the quasi-professional academic expert. Fueled with optimism about the power and flexibility of the administrative framework, Landis remained suspicious of the businessman's capacity to serve as the guardian of the public good.[403] The "brain trust" version of the securities laws differed from its failed predecessors in providing for independent non-government audits of all financial statements. Far from embracing a blind faith in the profession, Landis's version extended broad liability to the accountants and other professionals who lent their names to the financial report.[404] According to Landis, Thompson's bill suffered from a fundamental misconception of the nature of regulation.[405] Thompson assumed that corporations and directors issued securities, so the government could prevent abuse by disciplining those same corporations and directors.[406] Landis understood that modern business and financial activities already involved a series of interacting

[396] *Securities Act: Hearings on S. 875 Before the Comm. on Banking and Currency*, 73d Cong. 1 (1933) (statement of Col. A. H. Carter), *reprinted in* 2 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND THE SECURITIES ACT OF 1934, at 58 (J.S. Ellenberger & Ellen P. Mahar, eds., 1973).

[397] *See id.*

[398] *Id.* at 58–59.

[399] *Id.* at 59.

[400] *Id.*

[401] *Id.*

[402] PARRISH, *supra* note 2, at 53, 56.

[403] *Id.* at 57, 60–61.

[404] The Act imposed liability, but gave defendants the right to the affirmative defense, for which they bore the burden of proof, that they had exercised due diligence. SELIGMAN, *supra* note 3, at 70.

[405] *See* PARRISH, *supra* note 2, at 63 (indicating that Landis's April 10 proposal was a "new departure" and that the Thompson bill's major defect was its conception of regulation).

[406] *Id.*

functions of various professional and private groups, such as the New York Stock Exchange and investment bankers.[407] He understood that these private bodies already "regulated" each other.[408] To have any impact, the legislation would have to reach each of these interrelated groups.[409] Unlike Thompson, Landis's version delegated broad authority to the FTC. His mentor Frankfurter had argued that this sort of legislation would prevent evasion and encourage creative administration.[410] The new version sailed through both houses. On May 27, the Securities Act of 1933 was passed into law.[411]

It is not entirely clear why Landis and his colleagues advocated the independent audits, even if coupled with the strong liability provision. In the nation's experience thus far, the government agency, the ICC, had conducted audits itself.[412] The most likely explanation is that the drafters of the new securities act were aware of the reality captured by Colonel Carter. The government would have had a hard time recruiting a core of trained experts large enough to audit all publicly traded corporations, as public accountants simply would not have given up their lucrative private practice to become federal agents.

But, there must have been something more, because that point should have been apparent to Thompson as it was to Carter and Landis. Landis was a student of Frankfurter and a Brandeis clerk.[413] Brandeis's tenet that big business was bad had distilled over time, but the theory at its core survived.[414] Landis was the administrative state's strongest ally,[415] but he was also wary of power, skeptical of the concentration of authority in any one place.[416] The legislation he proposed therefore, created another circle of influence, a check on government and a check on business—a miniature system of checks and balances designed to ensure the liberty and security of individuals in the modern industrial world.[417] Landis did not believe that the accounting profession was inherently more independent than

[407] *Id.* (noting that the Frankfurter group, of which Landis was a member, understood this general principle).

[408] *See id.*

[409] *Id.*

[410] *Id.* at 62 (citing Felix Frankfurter, *The Task of Administrative Law*, 75 U. PENN. L. REV. 614, 616, 618, 620 (1927)).

[411] PARRISH, *supra* note 2, at 66, 69–70.

[412] *See supra* note 215 and accompanying text.

[413] MCCRAW, *supra* note 54, at 156–57.

[414] *See* NELSON LLOYD DAWSON, LOUIS D. BRANDEIS, FELIX FRANKFURTER, AND THE NEW DEAL 14–17, 21, 24 (1980) (describing Brandeis' distaste for bigness and noting that Frankfurter himself grew to dislike bigness, but to a lesser extent than his mentor); DONALD A. RITCHIE, JAMES M. LANDIS: DEAN OF THE REGULATORS 24 (1980) (noting that Landis too had inherited this dislike of bigness).

[415] *See, e.g.*, Louis L. Jaffee, *Foreword* to LANDIS, *supra* note 23, at vii, vii.

[416] RITCHIE, *supra* note 1, at 24.

[417] LANDIS, *supra* note 23, at 1–5, 11–12.

government experts.[418] He did not have any more faith in the accountant than he did in the bureaucrat, but he did have faith in expertise and in the power of legislation to direct that expertise, thus the strong liability provision.[419] And so, he tried to foster an independent profession, a check on business and a check on government. He tried to give birth to a new legislative creature.

The profession was not so pleased with its reincarnation. Rather than celebrate their new prestige, accountants expressed horror at the Act's liability provisions.[420] The federal recognition in the form of the mandated audits seemed to pass almost unnoticed. The professional journal did not highlight accountants' new responsibility, but focused almost exclusively on the unprecedented liability.[421] To everyone's surprise the rest of the decade witnessed a new détente. The second securities act made moderate changes to the liability provisions of the first, and Joseph P. Kennedy, the chairman of the Securities and Exchange Commission (SEC), and James Landis, its influential new commissioner, proved both sympathetic to business and willing to defer to the accounting profession.[422]

The era of good feeling, however, was short-lived. The securities acts created an odd dynamic, an adversarial relationship between accountants and government coupled with a theoretic partnership between the two against business. Unsurprisingly, it was the former that survived. The legislation was grafted onto a profession that had allied with business over the course of a decade, a profession whose public ethic never emerged fully formed. There were moments in the history of the profession when accountants seemed to court the government, loudly asserting its devotion to the public good, but they were largely scorned. The government never truly accepted the accountant into its ranks. The profession never became a permanent force within the new regulatory state except perhaps with regard to taxation where the profession clearly represented business interests rather than the public.

III. CONTEMPORARY APPROACHES TO THE EXPERT ROLE IN GOVERNANCE

In the immediate wake of legal realism, New Deal liberals justified the administrative state by virtue of its reliance on expertise, not courts or

[418] *Id.* at 40–42, 98–100.

[419] *Id.*; James Landis, *Significance of Administrative Commissions*, 12 IND. L.J. 471, 475 (1937).

[420] SELIGMAN, *supra* note 3, at 72.

[421] Fredrick B. Andres, *The Public Accountant and the Investing Public*, 57 J. ACCT. 55 (1934); Editorial, *Liability of Auditors*, 86 J. ACCT. 86 (1934); George O. May, *The Position of Accountants Under the Securities Act*, 57 J. ACCT. 9 (1934); Nicholas Waterhouse, *Liability of Auditors*, 57 J. ACCT. 92 (1934).

[422] CAREY, *supra* note 175, at 194–95; MCCRAW, *supra* note 54, at 179, 188–89.

politicians. Expertise would ensure that regulation served the public good rather than any particular interest. Landis did not, however, envision a technocracy. He believed that experts would suffuse both business and government. They would serve politicians and businessmen, guiding both toward a better world. Landis never forgot that power, even in the hands of experts, corrupts. His intellectual ties to Frankfurter and Brandeis were not so attenuated that he lost sight of the value of smallness, the virtue of competition. Landis believed that private businesses would learn to consult professionals who would help them regulate themselves. The government would actually shrink as groups of private and semi-public actors took the helm.

The purpose of requiring independent audits as part of the Securities Act of 1933 was to divide power among groups—business, government, and accountants—so they would constitute checks, one upon another. The Securities Act attempted to create another zone of power, separating what might otherwise concentrate in the hands of the government or of business itself. Landis's faith in expertise, however, was not completely blind. He knew that public accountants were fallible. He was doubtless aware of the numerous accounting scandals recounted before the Senate Committee on Banking and Commerce during the Pecora hearings. After all, those hearings were taking place at the same time he was drafting the Securities Act. Perhaps, Landis felt that the severe liability provisions would ensure that accountants did their part. He certainly believed that the huge public responsibility bestowed on the profession would inspire a sense of civic obligation. The Securities Act of 1933, however, grafted this new responsibility on a profession that had never developed a true public ethic and, in the previous decade, had grown deeply tied to its business clients. The mere fact of the new responsibility and the fear of liability could not change this historical context.

This section uses the history of regulation and the accounting profession to suggest a new way of looking at regulation in general and the accounting profession in particular. It is fashionable to argue that private and semi-public bodies should have a greater role in regulation. This Article suggests that the reliance on private and semi-public bodies to govern is not as new or innovative as some of these scholars suggest. To the contrary, this sort of arrangement is as old as the regulatory state itself. Landis explicitly analyzed the trend toward private regulation in the early stages of the New Deal and relied on experts, in part, because unlike courts, they could supervise private regulation. The contemporary private governance literature dispenses with expertise—which has been long since discredited[423] as justification for administrative agencies, but ironically still relies, at least at times, on the professions to ensure that regulation serves a

[423] *See* Stewart, *supra* note 31, at 1702–03, 1711.

public purpose.[424] By unearthing the historical roots of the private governance literature, this Article helps illuminate what is in fact new about the scholarship. A series of articles, each examining a different instance of how private parties govern, is useful not because it announces a new trend, but rather because it helps us assess whether this sort of regulation by private bodies is desirable in a given area and if so, what means we can use in that particular context to ensure that those private bodies are serving the public rather than a particular private interest.

Second, this section suggests a new way of looking at the regulation of gatekeepers—the modern-day professionals who serve investors by preparing or certifying corporate disclosures. To serve the function intended by Landis and his successors,[425] the accounting profession must be independent. It cannot be subsumed by business or politics. The history of the accounting profession suggests that independence is not simply a personal quality of individual professionals but denotes an ethic that is developed over time. Government attitudes toward business regulation and the profession can have a profound effect on the ethic of the profession as a whole. By bestowing special status on the accounting profession, the Securities Act of 1933 attempted to create a professional association suspended between business and government.[426] Of course, to do so, the legislators had no choice but to rely on the existing professional association. But, the professional body, which had been struggling to define itself for half-a-century was not so easily converted. The profession's identity developed over time in a slow give-and-take with government. By suggesting that the social norms of a profession are responsive to government regulation, the history of the profession offers a new way to look at the independence rules of the Sarbanes-Oxley Act of 2002.

A. *Private Governance*

The flurry of articles proclaiming a crisis in the administrative state has reached a heightened pitch. The most recent trend, known as "private governance," proposes a return to a more decentralized private regulatory structure.[427] While proponents of private governance are diverse, they

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[424] Freeman, *Private Role in Public Governance*, *supra* note 30, at 586, 615. *See generally* Vandenbergh, *supra* note 30 (detailing the influence of private entities on public regulations).

[425] *See supra* Part I.

[426] *See* Irina Shirinyan, *The Perspective of U.S. Securities Disclosure and the Process of Globalization*, 2 DEPAUL BUS. & COM. L.J. 515, 553 (2004).

[427] *See* John F. Duffy, *The FCC and the Patent System: Progressive Ideals, Jacksonian Realism and the Technology of Regulation*, 71 U. COLO. L. REV. 1071 (2000) (recognizing that recent critiques of the administrative state involve a turn to the private realm and critiquing the effort "to redeem government with idealized institutions that they lionized with heroic rhetoric"); Freeman, *Collaborative*

seem to share a commitment to certain premises and certain values. For one, the private governance scholars envision a world in which private and public power blend. They embrace the increased role that private parties play in the regulatory structure and urge delegating more public functions to private individuals and shrinking government control. In this new private governance model, the government will rely more and more on negotiation between public and private parties and on agreements between private parties. These scholars advocate a smaller role for courts and traditional modes of constraining agency action.[428]

Private governance scholars recognize that turning to private parties to regulate and dispensing with traditional checks on agency discretion leaves a bit of a vacuum. Who or what will ensure that private parties are acting on behalf of the public good rather than their own private interests? Scholars seem to frame this as a question of "accountability."[429] What is really at issue, however, is how to make this system serve the public rather than a private interest. Some suggest that the market will ensure that regulation works properly.[430] Others propose that government include terms in contracts entered into with private parties that require them to live up to certain standards.[431] Some scholars argue that by providing every interested party with information, and making sure that everyone has a role in the decision-making process, we will ensure that the public interest is served.[432] Still others suggest that semi-public groups like private accrediting bodies and professions will guide private behavior.[433]

The private governance literature proclaims that privatization (or "publicization," to use Jody Freeman's term)[434] is a fundamental shift from the New Deal approach. For instance, one private-governance scholar goes so far as to characterize the New Deal as "a paradigm shift in the American polity."[435] She suggests that "in the context of world war and economic depression, law was conceptualized as national, top-down, and sanctioned.

Governance, *supra* note 30; Jody Freeman, *Extending Public Law Norms Through Privatization*, 116 HARV. L. REV. (2003) [hereinafter Freeman, *Extending Public Law Norms*]; Freeman, *The Private Role in Public Governance*, *supra* note 30; Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342 (2004); Gillian Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367 (2003); Michael J. Trebilcock & Edward M. Iacobucci, *Privatization and Accountability*, 116 HARV. L. REV. 1422 (2003). This list is in no way a comprehensive account of all private governance scholars but it does provide a summary of some aspects that these scholars share.

428 *See* Alfred C. Aman, Jr., *Globalization, Democracy, and the Need for a New Administrative Law*, 49 UCLA L. REV. 1687, 1688–90 (2002).

429 *See, e.g.*, Edward Rubin, *The Myth of Accountability and the Anti-Administrative Impulse*, 103 MICH. L. REV. 2073 (2005).

430 Trebilcock & Iacobucci, *supra* note 427, at 1423–24, 1447.

431 Freeman, *The Private Role in Public Governance*, *supra* note 30, at 587.

432 Aman, *supra* note 428, at 1709; Dorf & Sabel, *supra* note 30, at 319–20; Freeman, *Collaborative Governance*, *supra* note 30, at 22.

433 *See* Freeman, *The Private Role in Public Governance*, *supra* note 30, at 614.

434 Freeman, *Extending Public Law Norms*, *supra* note 427, at 1285.

435 Lobel, *supra* note 427, at 344.

The New Deal regulatory model sought to consolidate formerly dispersed powers into the newly founded expert regulatory agencies and to direct economic and social activities at the national level."[436] In fact, the New Deal was not so simple; its authors were not so naïve. James Landis, for example, like the private governance scholars, recognized that the theoretic distinction between private and public bodies was more fictional than real.[437] He too felt that regulation by private bodies was no different than regulation by government officials.[438] He too considered the problems of concentrating power in a politically-appointed body and recognized that private parties regulate themselves to a great extent regardless of theoretical commitments to the contrary. He too worried that agencies staffed with experts might not serve the public as they should.[439] And because the architects of the New Deal did not believe that judicial review was the appropriate means of constraining agency discretion, Landis thought to use the public accounting profession to prevent factions, creating new checks and balances to fill the void left by courts and judges.[440] He imagined a world in which government would constrict as private parties all consulted professionals whose expertise would guide them toward the common good.[441]

That said, the private governance model does not replicate the regulatory schemes that came before it. Most importantly, contemporary scholars have, at least on the surface, abandoned the faith in expertise that animated the early New Deal.[442] The current vision of collaboration and private regulation involves not just experts, but almost everyone. Teachers, land owners, and police associations might be part of a private governance system, something which would have seemed alien to Landis seventy years ago, involving every interested party in the design and implementation, monitoring, and oversight of rules.[443] Without the justification of expertise, the literature on private governance suggests alternate forms of accountability. The market, expanded participation in rule-making, private law, or a renewed commitment to professional bodies might help ensure that the vast and complex private interactions serve public rather than private ends.[444]

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[436] *Id. See also* Vandenbergh, *supra* note 30, at 2035–37.
[437] *See supra* notes 165–71 and accompanying text.
[438] *See supra* notes 165–71 and accompanying text.
[439] *See* LANDIS, *supra* note 23, at 98–100; *supra* notes 165–71 and accompanying text.
[440] *See* HORWITZ, *supra* note 19, at 216–17.
[441] *Supra* Part II.A.
[442] Stewart, *supra* note 31, at 1682–83.
[443] Freeman, *The Private Role in Public Governance*, *supra* note 30, at 548.
[444] *See supra* notes 430–33 and accompanying text.

Highlighting what is new about the literature helps to evaluate it. Landis recognized and analyzed the reality of private regulation in 1933. By arguing that this part of their theory is revolutionary, the private governance scholars distract from what is, in fact, new about their scholarship. By exploring the details of how private parties regulate themselves in different contexts, private governance scholars are beginning to develop an eclectic theory of accountability. They are beginning to observe that in each regulatory situation, it is appropriate to take different measures to ensure that the administrative state is working well. At times, it will be appropriate to rely on professional associations;[445] at others, the market will ensure the correct result.[446] Depending on the context, the government might control private regulation by adding terms to a contract[447] or in other instances, it might involve more voices in the rule making process.[448] The nature of presidential, congressional, or judicial oversight of agency decisions might change once we acknowledge the role that private parties play in any given situation.[449] It is important, as a result, to do exactly what the private governance literature is doing: understand how regulation works, including how private parties govern each other, in each regulatory context.[450]

Evaluating how private parties or semi-public associations govern each other involves certain dangers that require a detailed, and most importantly historical, understanding of each different context. As the title of this Article implies, just as different scholars and commentators have had different views at different times about which branch of government is the most dangerous,[451] so too with professions. The accounting profession is the villain of the early 21st century but other professions may well take its place.

Of course, in this light, private governance literature begs the question of how to determine what accountability means once we have resigned ourselves to the fact that no one body—whether the courts or the market or professionals—has a monopoly on defining a transcendent public good.[452] Perhaps, the private governance literature exposes a modern predicament:

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[445] *See* Freeman, *The Private Role in Public Governance*, *supra* note 30, at 610.

[446] *See* Trebilcock & Iacobucci, *supra* note 427, at 1424, 1447.

[447] *See* Freeman, *The Private Role in Public Governance*, *supra* note 30, at 634–35 (discussing the checks on private prisons due to their contractual relationship).

[448] *See* Freeman, *Collaborative Governance*, *supra* note 30, at 30–31 (suggesting a "collaborative regime" to facilitate agency accountability).

[449] Vandenbergh, *supra* note 30, at 2036–37.

[450] For a particularly good example of this sort of fine-tuning to develop new mechanisms of accountability and transparency suited to the private parties involved, see Cristie Ford, *Toward a New Model of Securities Law Enforcement*, 57 ADMIN. L. REV. 757, 758–62 (2005).

[451] *Compare* ALEXANDER M. BICKEL, THE LEAST DANGEROUS BRANCH: THE SUPREME COURT AT THE BAR OF POLITICS (1975), *with* Martin H. Flaherty, *The Most Dangerous Branch*, 105 YALE L. J. 1725, 1727–31 (1996) (discussing the migrating nature of this accusation).

[452] *See* Rubin, *supra* note 429 at 2121–22 (criticizing the use of the term "accountability" to denote legitimacy); Stewart, *supra* note 31, at 1712–13.

once we recognize that there is no one ascertainable public good, we are forced to be pragmatic in our approach. Abandoning the hope for an overarching theory to justify the administrative state, we can still explore each situation and choose from an eclectic mixture of theories, some old and some new, to ensure that regulation works as well as it can.[453]

B. *Regulating the Gatekeepers*

Relying on professions may not always be misplaced but the professional status of key players is certainly no guarantee that we will achieve what is best for society. Rather, for professions to serve the public good, they must be independent. Drawing on the rhetoric of civic republicanism, the professions in America have always aspired to a high ideal. They have justified their role by proclaiming their independence from both government and industry.[454] Like the citizen in the civic republican polity, the professional would suppress his own self-interest in pursuit of the common good. Independence was not something that could be created by government mandate. Quite the contrary, it was a necessary prerequisite to participation in the public sphere.[455] While it is true that the rhetoric of professional ethics is just that, rhetoric, the reality of an independent profession is necessary to make Landis's scheme make sense. The profession cannot constitute a separate check on government and business unless it occupies a space in between.

Recent scandals, like the collapse of Enron, WorldCom, and Global Crossing, have proven that liability provisions and any analogous efforts to punish individual wrongdoers, no matter how extreme, might not accomplish this ultimate goal. This is not to say that we should abandon efforts to increase enforcement and stiffen penalties but rather that such efforts alone might not create an independent profession that will serve to diffuse state and market power. In fact, common sense would suggest that excessive liability provisions simply reinforce the public consensus that the

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[453] Michael Dorf and Charles Sabel use pragmatism in a very different way. They conclude that a pragmatic approach to government would involve what they call "democratic experimentalism," in which Congress states broad objectives without specifying the means of achieving these ends and various local communities are encouraged to find local solutions to the problem. Dorf & Sabel, *supra* note 30, at 343.

[454] *See* Gordon, *supra* note 290, at 60–61.

[455] Historians and lawyers have argued about the relative importance of civic republicanism at the time of revolution. For a review of this debate, see Flaherty, *supra* note 21, at 590; Daniel T. Rodgers, *Republicanism: The Career of a Concept*, 79 J. AM. HIST. 11 (1992). While most historians agree that the importance of republicanism as an animating political theory had waned by the turn of the eighteenth century, this article examines republicanism as a discourse—a way of understanding the role of the individual and the community—rather than its importance as a political theory. Republican rhetoric emerges in different contexts throughout American history. *See, e.g.*, Gordon, *supra* note 290, at 52–53, 56 (describing the views of the legal profession toward a republican polity throughout history).

profession is not to be trusted, that it cannot act independently of the business interests it represents.

In 2002, in response to the recent accounting scandals, Congress passed the Sarbanes-Oxley Act.[456] The Act protects shareholders and investors by regulating corporate governance and policing financial disclosures. In particular, the Act contains provisions designed to regulate gatekeepers.[457] The Sarbanes-Oxley Act repeats the exact irony of the 1933 Act—a reliance on a profession that is deemed, in the same legislative utterance, unreliable. That is, the Act perpetuates our reliance on public accountants while simultaneously imposing new constraints on the profession. Born of a distrust of accountants, it tightens the screws and sharpens the punishment of individual accountants while relying on the profession to preserve the public good. In this respect, it is no different from the Securities Acts of 1933.

At the same time, the Sarbanes-Oxley Act implements some significant changes. These provisions, known as the independence rules, are designed to dissociate accountants from business interests, to create new incentives for individual accountants to resist the temptation to serve management blindly.[458] While this is, no doubt, an important goal, the history of the profession suggests that the problem is deeper, not residing with individual accountants but with the profession as a whole. Independence is not merely a state of mind of individual accountants but also the result of a public ethic that a profession develops over time in relation to the government and the public. Legislation itself cannot transform a profession that has become the right hand of management into a tool of the public overnight. By pointing to how government exclusion of the profession contributed to its development as business advisor, the history of the accounting profession suggests that the best way to encourage such radical change will be to design regulation that helps create a public ethic among accountants.[459] Unless legislation is aimed at reforming the profession as a whole, we are at risk that individual accountants, even if their incentives are structured in individual

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[456] Sarbanes-Oxley Act of 2002 Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of titles 11, 15, 18, 28 and 29 U.S.C.).

[457] The literature on the role of gatekeepers in the corporate scandals of the early part of the decade is growing. *See, e.g.*, John C. Coffee, *Understanding Enron: "It's About the Gatekeepers, Stupid,"* 57 BUS. LAW. 1403 (2002); Jonathan Macey & Hillary A. Sale, *Observations on the Role of Commodification, Independence, and Governance in the Accounting Industry*, 48 VILL. L. REV. 1167 (2003). Some conclude that our reliance on professionals has been misplaced. Jill E. Fisch & Kenneth Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097 (2003).

[458] Sarbanes-Oxley Act § 103(b).

[459] Some scholars have argued that we abandon the entire structure of reliance on public accountants. Peter K.M. Chan, *Breaking the Market's Dependence on Independence: An Alternative to the "Independent" Outside Auditor*, 9 FORDHAM J. CORP. & FIN. L. 347, 351–54 (2004); Lawrence A. Cunningham, *Choosing Gatekeepers: The Financial Statement Insurance Alternative to Auditor Liability*, 52 UCLA L. REV. 413, 415 (2004).

transactions to be independent of the business interest they represent, will still fail to exercise the requisite neutrality.

Title II of the Sarbanes-Oxley Act contains provisions that are designed to create auditor independence.[460] When analyzing the wisdom of these provisions, commentators should focus not simply on empirical evidence regarding individual market incentives, but also on their ability shape the environment in which accountants operate such that the accounting profession could ultimately crawl out from under the control of management. If these provisions succeed in meeting this goal, the profession could develop the public ethic that it so desperately lacks.

For example, Section 201 of the Sarbanes-Oxley Act restricts audit companies from providing certain non-audit services to their clients.[461] These services include financial information system design and implementation, appraisal or valuation services, actuarial services, internal auditing services, investment banking services, legal and expert services unrelated to the audit, and brokerage services.[462] The provision provides a stark deviation from historic practice, as Arthur Anderson himself, as early as 1926, championed the idea of the accountant as business adviser.[463] He listed all sorts of consulting services that an auditor could provide to render him indispensable to his client.[464] The rationale behind reversing this trend, which Anderson evidently did not appreciate, is that the large fees from non-audit services compromise auditor independence by giving accountants incentive to acquiesce in managers' misconduct.[465]

Professor Roberta Romano has criticized these provisions, based on her examination of empirical studies concluding that "audit quality—and hence auditor independence—is not jeopardized by non-audit services."[466] The flaw in this criticism, however, is that she elides the independence of an individual auditor in the course of an individual transaction with the independence of the profession as a whole. Romano assumes that independence denotes the state of mind of the individual audit partner or the members of the audit team.[467] The provision of non-audit services, however, might not directly correlate with the decline in audit quality in an audit engagement. It might not necessarily compromise the integrity of the individual auditor, but it seems likely that it promotes a relationship

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[460] Elliot J. Weiss, *Some Thoughts on an Agenda for the Public Company Accounting Oversight Board*, 53 DUKE L.J. 491, 497 (2003).

[461] Sarbanes-Oxley Act § 201.

[462] For the rules designed to implement this new prohibition, see 17 C.F.R. § 210.2 (2005).

[463] Andersen, *supra* note 332, at 17.

[464] *Id.*

[465] Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521, 1533–34 (2005).

[466] *Id.* at 1537.

[467] *Id.*

between the client and the auditor, which, over time, contributes to a professional identity as business adviser rather than public servant. By altering the nature of the relationship between client and auditor, the statutory scheme can possibly contribute to independence by shaping the future of the profession.[468]

Another way in which the Sarbanes-Oxley Act seeks to ensure auditor independence is to mandate the rotation of lead and concurring audit partners every five years.[469] SEC rules implementing this section also limit other partners to a seven-year rotation period.[470] Again, the rotation requirement is aimed at individual accountants not the development of the profession as a whole. It presumably helps deter a close relationship between an accountant and his client that might lead an individual auditor into temptation to act improperly.[471] But it is hard to imagine how this provision will help instill a public ethic among accountants. In fact, this rule could be counterproductive as well. The rule assumes that auditors cannot and should not be trusted. While that may be the case at this particular juncture, a rule that so explicitly writes the distrust into the law seems to undermine the development of professional independence rather than encourage it. It is hard, for instance, to imagine such a rule applying to lawyers; it simply seems anathema to the lawyer's role as a professional. By treating accountants as less than a profession in such an obvious way, the rule threatens to fulfill the prophecy. It is a constant reminder to both the public and the accountant himself that the system does not trust him; that we assume that left to his own devices he will be lured into corruption by management.

In addition to mandating individual auditor rotation, the Sarbanes-Oxley Act also requires the SEC to investigate and report on the value of going so far as to require firm rotation.[472] Proponents have argued that firm rotation would both weaken the tie between an auditor and his client and encourage more conservative accounting, given that the accounting would eventually be reviewed by a new firm of accountants.[473] While this provision would treat the profession as unreliable in a very public way, it also fosters the sort of self-regulation that is supposedly critical for professional independence.[474]

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[468] Coffee, *supra* note 457, at 1404–05.

[469] Sarbanes-Oxley Act § 203.

[470] Regulation S-X, § 2-01 (C)(6), 17 C.F.R. § 210.2 (2006).

[471] Whether it does even this remains to be seen. *See* Macey & Sale, *supra* note 457, at 1168 (arguing that this regulation could potentially backfire since partners within a firm will be forced to compete more vigorously for clients and fees).

[472] Sarbanes-Oxley Act § 207.

[473] Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And it Just Might Work)*, 35 CONN. L. REV. 915, 951–52 (2003).

[474] *See* W. Bradley Wendel, *Nonlegal Regulation of the Legal Profession: Social Norms in Professional Communities*, 54 VAND. L. REV. 1955 (2001).

Beyond enacting such "auditor-independence" provisions, the Sarbanes-Oxley Act also creates a quasi-governmental body, the Public Company Accounting Oversight Board (PCAOB), to set auditing standards and review and discipline auditing firms.[475] Whereas under the Securities Act of 1933, government, business, the accounting profession, investment banks, and lawyers would theoretically work as checks on each other, this new board essentially adds another layer to Landis's structure. The PCAOB serves as an additional check, a new organization of experts to regulate a profession that has grown too deeply tied to its business clients to ensure that power does not concentrate too dangerously in business or in government.

The Act significantly deprives the accounting profession (the American Institute of Certified Public Accountants or AICPA) of the ability to dictate auditing standards and delegates the responsibility to the new PCAOB. In fact, only two of the five members of the PCAOB can be certified public accountants.[476] Unlike the rotation rules, the new board is a structural change directed at the entire profession, rather than merely individual participants. It might serve to refocus the profession on public service by engaging accountants in a partnership with the SEC, which has historically been more focused on transparency in the markets and service to the public.

In some ways, Landis was prescient and in others he seems quite naïve. He predicted the growing importance of private parties in governance but he also believed that by directing the professions attention toward this newly acquired public purpose, he could train them to serve a public good. He understood that power corrupts and designed a system in which professional experts would provide another check on that power, but he did not fully comprehend that expertise itself was susceptible to such corruption. If we are to ensure some degree of legitimacy in a system in which, as Landis observed, private parties govern each other then we will likely have to rely on experts to some extent. We should not, however, do so without being mindful of historical context. Before we imbue a profession or expert body with some critical responsibility, we should examine it in both its present capacity and its past to understand whether it will be able to provide an independent check on market forces. Otherwise, we might find ourselves, as we now do with regard to public accountants, relying on a profession that is inherently unreliable.

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[475] Sarbanes-Oxley Act §§ 101–09.
[476] *Id.* § 101(e).

IV. CONCLUSION

In the wake of the *Lochner* era, the demise of economic substantive due process effectively undermined the Court's role in regulating the economy. Legal Realists had revealed that judges were doing the same things as legislators, but they were doing it poorly. They were making policy decisions without any of the expertise or information necessary to do so. But, if the judiciary was no longer responsible for defining the laws in this realm, who was? Frankfurter, Landis, and his colleagues responded that experts within the new administrative state would take over this responsibility. Experts were valuable not just for their technocratic knowledge but also for their neutrality. They would develop rules based on cold hard facts that would govern the governors. The judicial rule of law no longer sufficed but practical solutions derived from expert knowledge would create "postulates"—as Landis put it—that would police the boundaries of state action and the limits of freedom. While Landis had a great and almost religious faith in science, he inherited his mentors' suspicion of power and he attempted to diffuse that power by creating, or recognizing, quasi-public bodies to mediate between business and government. Government would not fully regulate business and business would not run government. Instead, the two would engage in a dialogue mediated by the supposedly independent accounting profession. The profession, at least theoretically, would ensure that party politics and business self-interest gave way to the common good.

In *The Least Dangerous Branch*, Alexander Bickel famously began a debate concerning the accountability of the judicial branch.[477] Modern commentators have borrowed this phrase to describe, and critique, the administrative state.[478] Born of a desire to replace, or mitigate, the power of the courts with the neutrality and expertise of administrative agencies, the administrative state too has been criticized, most recently in the private governance circles, as suffering from similar flaws. These scholars have argued that courts should sit on the sidelines, and that private actors should take their place among the bureaucrats. They have argued that we should reconceive accountability, view it in terms of a dialogue, a system of checks, between different private, public, and quasi-public groups. But what these scholars overlook, in their quest to empower private and quasi-public bodies within the administrative state is that their idea is not new; in fact, reliance on the quasi-public accounting profession, among other private actors, was a cornerstone of the Securities Act of 1933.

Of course, the accounting scandals of the past five years suggest that the accounting profession—initially viewed as an antidote to the

[477] BICKEL, *supra* note 451.

[478] *See* Barry Friedman, *The Birth of an Academic Obsession: The History of the Countermajoritarian Difficulty, Part Five*, 112 YALE L.J. 153, 159 (2002).

judiciary—has not proven itself to be up to the task of replacing courts as the neutral arbiters of the laws regulating business; some might say they were no less dangerous. In fact, as history shows, the accounting profession was never up to the task that Landis proposed for it. Landis's administrative scheme relied on an independent profession to occupy a space in between the public and the private in order to mediate between the two. The accounting profession, however, had grown so deeply tied to its business clients that it has failed as the independent voice it was expected to be.

Where does the history of the accounting profession leave us? Some may argue for an extreme approach, that public accountants should cease to play a significant role in the regulation of business, and should be replaced by a class of bureaucrats, government-employed accountants. Others might argue for the placement of strong constraints on accountants, coupled with strict oversight. The Sarbanes-Oxley Act of 2002, like the 1933 Act, clearly hews closer to the latter approach.

But the wisdom of the measures adopted by Sarbanes-Oxley must be measured with an eye towards history. As Landis hoped, the accounting profession can provide a buffer between government and business only if it is a true profession, independent of both. And short-term attempts to ensure the independence of accountants—independence understood as the independence of particular accountants from particular business interests during particular representations—through measures such as firm and accountant rotation may have a drastic unintended effect. That is, such measures, born of a distrust of accountants, may create a self-fulfilling prophecy that will undermine the professional ethic of accountants, and thus undermine the true independence of the accounting profession, understood as its capability to serve neither business nor government interests. The history of the accounting profession shows both the elusiveness and the necessity of striving to meet this goal.

That said, another moral of the historical story is that government regulation has an effect on the identity of the profession. Legislative attempts to steer the profession in one direction or another might well accomplish the desired goal. Scholars of legal ethics tend to view the debate in stark terms: either we regulate the profession through the traditional means or we defer to communal norms within the profession.[479] The history of the accounting profession belies this assumption. If regulations are directed at the profession as a whole, rather than individual members, they might well contribute to shaping the norms or ethic of a profession.

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[479] Wendel, *supra* note 473, at 1956–69.