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Recommended Citation

J. R. Fichtner, John Rozycki & Patrick Heaston, *The Unfulfilled Promise of Sarbanes-Oxley Section 304: A Call for Pervasive Enforcement*, 14 DePaul Bus. & Com. L.J. 49 (2015)

Available at: <https://via.library.depaul.edu/bclj/vol14/iss1/3>

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The Unfulfilled Promise of Sarbanes-Oxley Section 304: A Call for Pervasive Enforcement

J. Royce Fichtner, John Rozycki,** and Patrick Heaston****

I. INTRODUCTION

In the early 2000's, the financial markets were devastated by a series of highly publicized corporate accounting scandals¹ at companies such as Enron, Adelphia Communication, WorldCom, and Tyco.² A common thread among these scandals was the numerous instances where corporations had published glowing financial statements that materially overstated their true financial position.³ Corporate officers reaped the rewards of the overstated results by receiving large incentive-based bonuses while simultaneously selling their personal shares of stock in the company at higher-than-justified prices.⁴ Later, when corporations issued restatements that corrected the erroneous financial documents, shareholders watched the value of their shares plummet.⁵ In some instances the restatements triggered a total collapse of the corporation. By the spring of 2002, there was a pervasive push for a governmental response.⁶

In March of the same year, President George W. Bush issued a ten-point plan designed to improve corporate responsibility and help protect America's shareholders by providing better information to investors, making corporate officers more accountable, and developing a

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1. Mike Allen, *Bush Signs Corporate Reforms into Law; President Says Era of "False Profits" Is Over*, WASH. POST, July 31, 2002, at A4.

2. John Patrick Kelsh, *Section 304 of the Sarbanes-Oxley Act of 2002: The Case for a Personal Culpability Requirement*, 59 BUS. LAW. 1005, 1005-18 (2004).

3. *Id.* at 1005-06 (describing the era and citing numerous primary sources documenting the financial misstatements).

4. Kurt Eichenwald, *Enron's Many Strands: Executive Compensation; Enron Paid Huge Bonuses in '01; Experts See a Motive for Cheating*, N.Y. TIMES, Mar. 1, 2002, at A1; Gretchen Morgenson, *The King of Excess, and Other Standouts*, N.Y. TIMES, Dec. 29, 2002, at 3.1.

5. Kelsh, *supra* note 2, at 1006.

6. Allen, *supra* note 1, at A4.

stronger, more independent audit system.⁷ One of the key tenets of his plan was to make sure that “CEOs or other officers should not be allowed to profit from erroneous financial statements.”⁸ In April, the House of Representatives made the first attempt to achieve these goals by passing the Corporate and Auditing Accountability, Responsibility, and Transparency Act.⁹ While the Senate debated similar legislation, the drumbeat of corporate scandals accelerated.¹⁰ Adelphia announced that previously undisclosed loans and loan guarantees would necessitate an accounting restatement and WorldCom similarly announced that improper accounting measures would require a restatement of recent financial statements.¹¹ Reacting to the increasing media scrutiny, the Senate passed an even stronger bill that proposed profound and sweeping regulatory changes. The Senate’s version of the bill, the Public Company Accounting Reform and Investor Protection Act, better known as the Sarbanes-Oxley Act (“SOX”), passed both houses of Congress by an overwhelming majority and was signed into law by President George W. Bush in July of 2002.¹²

SOX created a “smorgasbord” of corporate governance rules, most of which were designed to enhance the reliability and quality of the information included in reports filed with the Securities and Exchange Commission (SEC) and prevent corporate and accounting fraud.¹³ These new rules were designed, in part, to make CEOs, CFOs, and auditors more accountable for erroneous financial reports.¹⁴ One section of SOX directly addressed the President’s goal of preventing CEOs and CFOs from profiting from erroneous financial statements.¹⁵ Section 304 created an explicit procedure to disgorge or claw

7. *The President’s 10-Point Plan: Improving Corporate Responsibility and Protecting America’s Shareholders*, WALL ST. J., March 6, 2002, available at <http://www.wsj.com/articles/SB1015460971646141720>.

8. *Id.*

9. *House Passes Bill to Change Regulation of Accounting Profession*, CPA LETTER, (June 1, 2002); see also H.R. 3763, 107th Cong. (Jan. 23, 2002) (engrossed House amendment).

10. Kelsh, *supra* note 2, at 1018.

11. *Id.*

12. The House voted 423-3 and the Senate voted 99-0. Kelsh, *supra* note 2, at 1007-08.

13. *Kogan v. Robinson*, 432 F. Supp. 2d 1075, 1077 (S.D. Cal. 2006); see *Carnero v. Boston Scientific Corp.*, 433 F.3d 1, 9 (1st Cir. 2006) (“The Sarbanes-Oxley Act . . . is a major piece of legislation bundling together a large number of diverse and independent statutes, all designed to improve the quality of and transparency in financial reporting and auditing of public companies.”).

14. Stephen C. Gara & Craig J. Langstraat, *The Sarbanes-Oxley Act of 2002: A New Ballgame for Accountants*, 34 U. MEM. L. REV. 73, 75-76 (2003).

15. S. REP. NO. 107-205, at 23 (2002) (“The bill therefore requires CEOs and CFOs to certify their companies’ financial reports, outlaws fraud and deception by managers in the auditing process, prevents CEOs and CFOs from benefitting from profits they receive as a result of misstate-

back a CEO or CFO's incentive-based compensation or ill-gotten stock gains when such profits were based on inflated financial statements that were later required to be restated to reflect the company's true financial position.¹⁶

When it was first signed into law, section 304 presented a strong stance against those who misrepresented their company's true financial position to the investing public. Its crisp language demanded swift reimbursement from those most likely to directly profit from the erroneous financial statements, without the burdensome issue of proving criminal fault. It also put the onus on the CEO and CFO to go beyond passive observation to actively search for potential sources of fraud and misconduct.¹⁷ Despite its strong stance, legal commentators warned that its broad and sweeping language left much room for judicial interpretation.¹⁸

Perhaps because of the uncertainty behind its broad and ambiguous language, the SEC ignored the deluge of financial restatements that occurred after SOX had been signed into law¹⁹ and waited five years to bring its first section 304 claim.²⁰ Private parties were not so timid. Numerous shareholder groups rushed to court with section 304 claims in an effort to disgorge bonuses and stock profits from CEOs and CFOs.²¹ None of these claims were successful because in each instance the ruling court determined that shareholders had no right to bring a section 304 claim.²² The SEC finally brought its first section 304 claim in 2007²³ and has since brought a handful of enforcement

ments of their company's financials, and facilitates the imposition of judicial bars against officers and directors who have violated the securities laws." (emphasis added)).

16. Sarbanes-Oxley Act of 2002 § 304(a), 15 U.S.C. § 7243(a) (2014).

17. Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Might Just Work)*, 35 CONN. L. REV. 915, 955-56 (2003).

18. See, e.g., Allison List, *The Lax Enforcement of Section 304 of Sarbanes-Oxley: Why is the SEC Ignoring its Greatest Asset in the Fight Against Corporate Misconduct?*, 70 OHIO ST. L.J. 195, 205-06 (2009).

19. Elaine Harwood & Laura Simmons, *The Tenth Anniversary of SOX: Its Impact and Implications For Future Securities Litigation and Regulatory Enforcement Activity*, BLOOMBERG BNA CORP. ACCOUNTABILITY REP., at 2 (July 13, 2012) (showing that the number of restatements filed by publically traded firms quickly rose from 163 in 2001 to 681 in 2006).

20. Gretchen Morgenson, *Clawbacks Without Claws*, N.Y. TIMES, Sept. 10, 2011, at BU1, available at <http://www.nytimes.com/2011/09/11/business/clawbacks-without-claws-in-a-sarbanes-oxley-tool.html>.

21. See, e.g., *In re BISYS Group Inc. Derivative Action*, 396 F. Supp. 2d 463, 464 (S.D.N.Y. 2005); *Neer v. Pelino*, 389 F. Supp. 2d 648, 648 (E.D. Pa. 2005).

22. *In re BISYS*, 396 F. Supp. 2d at 464; *Neer*, 389 F. Supp. 2d at 657.

23. Press Release, SEC, SEC Settles with Mercury Interactive and Sues Former Mercury Officers for Stock Option Backdating and Other Fraudulent Conduct (May 31, 2007), <https://www.sec.gov/news/press/2007/2007-108.htm> ("The Commission's first ever use of Section 304 of Sarbanes-Oxley – which allows the commission to seek the repayment of bonuses and stock sale

actions against carefully selected defendants. Now, more than thirteen years after it was first signed into law, there is a small number of court decisions that clarify some of its most conspicuous ambiguities. This paper will detail the most perplexing interpretation questions plaguing the statute and describe how a handful of court decisions have strengthened its potential for future enforcement. The paper will also highlight the lingering interpretation questions and predict how courts might resolve these issues in the future. It concludes with a criticism of the SEC's current trend of haphazardly enforcing section 304 and calls on the SEC for more systematic and pervasive enforcement.

II. THE STATUTE AND ITS AMBIGUITIES

Section 304 states, in its entirety:²⁴

304. FORFEITURE OF CERTAIN BONUSES AND PROFITS

(a) Additional compensation prior to noncompliance with commission financial reporting requirements. If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer for—

(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and

(2) any profits realized from the sale of securities of the issuer during that 12-month period.

(b) Commission exemption authority. The Commission may exempt any person from the application of subsection (a), as it deems necessary and appropriate.

Subsection A explains when the statute is applicable. The crucial language of this section compels the CEO and CFO to reimburse the issuer if it “is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws.”²⁵

profits received by CEOs and CFOs where financial results are later restated – reflects the Commission's willingness to use all available remedies to deprive such senior officers of illicit gains.”).

24. 15 U.S.C. § 7243 (2014).

25. *Id.*

While section 304 appears succinct and straightforward, its sweeping language is plagued with latent ambiguities.

First, the statute does not clarify who is in charge of its enforcement. If the CEO or CFO does not willingly return the compensation or stock gains, then who can bring a claim to enforce section 304 – the board of directors, a shareholder via a derivative lawsuit, or the SEC?

Second, it does not specify whether section 304 imposes CEO and CFO disgorgement in all instances in which there is a misconduct-driven restatement, or whether it is contingent on proof that the CEO or CFO was personally involved in the misconduct.²⁶ Compounding the confusion in this area is the fact that the statute does not define the term misconduct, so interpreters are left to speculate whether its enforcement provisions are limited to circumstances where someone knowingly prepared erroneous financial statements or whether it also applies to circumstances where the mistakes could be attributed to mere carelessness.

Other questions revolve around the meaning of the phrase “required to prepare an accounting restatement.” If the company files a voluntary restatement, does section 304 apply? Or, does disgorgement extend to situations where the company has not yet filed a restatement? Could it be enough if the company is for some reason required to file a restatement?

The last half of subsection A describes the monies the CEO or CFO must actually return to the company. The disgorgement applies to any bonus or other incentive-based compensation received by the CEO or CFO during the twelve months following the issuance of the erroneous document.²⁷ It also applies to any profits realized by the CEO or CFO from the sale of any securities during those same twelve months.²⁸ Unfortunately, this section also contains several issues that are open to interpretation. There are legitimate questions as to what of the varying types of compensation must be returned to the company. For example, does the disgorgement provision apply to compensation that has been deferred? Another question concerns how to calculate the total amount for reimbursement for “any profits realized from the sale of securities of the issuer”²⁹ during the twelve-month period followed the erroneous statement. Specifically, is the disgorgement limited to securities initially acquired as a result of service to issuer or does it apply to all securities of the issuer, no matter when

26. Kelsh, *supra* note 2, at 1022-24.

27. 15 U.S.C. § 7243(a)(1).

28. *Id.* § 7243(a)(2).

29. *Id.*

or how they were acquired? A follow-up question concerns the mathematical computation of the profit earned. Section 304 provides no guidance on how the court should calculate the basis for the purpose of determining profits realized during the twelve-month period. Is it the original purchase price for the security or is it the value of the security immediately prior to the filing of the erroneous financial statement?

Subsection B gives the SEC the authority to exempt the disgorgement when “necessary and appropriate.”³⁰ This “prosecutorial discretion”³¹ section presents no interpretation problems. However, as demonstrated below, the unfettered authority, when coupled with the SEC’s aversion to use section 304 in all but the most blatant instances of misconduct, and sometimes not even then, has made exemption the rule, and the rare enforcement case the exception.

The following sections will address each of the above questions by looking to the legislative history that led to section 304, the SEC’s particular choice of when to pursue section 304 claims, and the district court rulings and appellate court decisions on those claims.

III. WHO CAN BRING AN ACTION TO ENFORCE A SECTION 304 CLAIM?

A plain reading of section 304 indicates that the company has a right to the bonuses, incentive-compensation and stock profits earned by a CEO or CFO during the twelve months after the erroneous financial statement.³² The language of the statute appears to be self-executing, simply stating that the CEO or CFO “shall reimburse the issuer” for these ill-gotten gains. It is extremely rare that a CEO or CFO would voluntarily return a bonus or turn-over any stock profits³³ and, regrettably, the statute does not specify who has the right to bring a legal claim to enforce the disgorgement. A review of the legislative history of the bill sheds some light on Congress’ original intent.

The House’s original plan for post-restatement disgorgements, which was markedly different than the mechanism codified into law in SOX section 304, merely directed the SEC to:

30. *Id.* § 7243(b).

31. Francine McKenna, *A Closer Look at Clawbacks*, (Oct. 23, 2011), <http://retheauditors.com/2011/10/23/a-closer-look-at-clawbacks/>.

32. *See Kogan*, 432 F. Supp. 2d at 1079 (“Section 304 creates a *right* in favor of issuers for reimbursement of certain bonuses and profits”) (emphasis in original); *Neer v. Pelino*, 389 F. Supp. 2d 648, 653 (E.D. Pa. 2005) (“Congress created a federal right in favor of issuers by specifying they would receive the proceeds of officers’ benefits”).

33. Aaron Elstein, *With Restatements on the Rise CEOs Could Face Payback Time*, WALL ST. J., April 9, 2002, available at <http://www.wsj.com/articles/SB1018302787767131400>.

[C]onduct an analysis of whether, and under what conditions, any officer or director of an issuer should be required to disgorge profits gained, or losses avoided, in the sale of the securities of such issuer during the six month period immediately preceding the filing of a restated financial statement on the part of such issuer.³⁴

This version gave the SEC the authority to choose to adopt a rule requiring disgorgement, with some conditions. First, any SEC rule requiring disgorgement had to “specify that the enforcement of such rule shall lie solely with the commission, and that any profits so disgorged shall inure to the issuer.”³⁵ Second, the House bill noted that if the SEC adopted a disgorgement rule, it must also “identify the scienter requirement that should be used in order to determine to impose the requirement to disgorge.”³⁶

None of this language made its way into SOX section 304. Instead of giving the SEC the option to issue a rule on disgorgement, Congress issued the rule itself. Notably, the specific details that the original house bill mandated be included in any potential SEC rule – that the SEC have the exclusive right to seek the disgorgement and that the SEC specify the scienter requirement for disgorgement – were not included in the version ultimately signed into law.³⁷ Because there is no statutory language directing who can bring an action to under section 304, this naturally begs the question: Can someone besides the SEC bring an action to disgorge the excess compensation and stock profits? Could the issuer, or a shareholder filing a derivative action on behalf of the issuer, pursue a section 304 claim? As explained below, courts interpreting the statute have answered these questions with a resounding “no.”

Not surprisingly,³⁸ there are no reported cases where a corporation has ever attempted to bring a section 304 claim against its current or former CEO or CFO. Therefore, there is no direct guidance on whether the issuer could pursue a section 304 claim to recover the bonus, incentive compensation, or stock profits. However, the question has been answered indirectly via the large number of shareholder groups that have attempted to bring section 304 derivative claims on behalf of their respective corporations.³⁹ In each claim, the defending

34. H.R. 3763, 107th Cong. § 12(a) (2002).

35. H.R. REP. NO. 107-414, at §12(b)(4) (2002).

36. H.R. 3763, at § 12(b)(3). Scienter is defined as a mental state embracing “intent to deceive, manipulate, or defraud.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976).

37. Nader H. Salehi & Elizabeth A. Marino, *Section 304 of SOX: New Tool for Disgorgement?*, N.Y. L.J., May 22, 2008.

38. Jesse Fried & Nitzan Shilon, *Excess-Pay Clawbacks*, 36 IOWA J. CORP. L. 721, 732 (2011).

39. *See, e.g.*, *Pedroli ex rel. Microtune, Inc. v. Bartek*, 564 F. Supp. 2d 683, 685-86 (E.D. Tex. 2008); *In re iBasis, Inc. Derivative Litig.*, 532 F. Supp. 2d 214, 223-25 (D. Mass. 2007); *Kogan*,

CEO or CFO argued that the case should be dismissed because section 304 does not contain an express private right of action.

The first case to squarely address this issue was *Neer v. Pelino*,⁴⁰ where a Federal District court utilized the United States Supreme Court's analysis in *Cort v. Ash*⁴¹ to determine whether section 304 contains a private right of action. The court explained that the "central inquiry" of the *Cort* test is "whether Congress intended to create, either expressly or by implication, a private cause of action."⁴² The *Neer* court noted that the text of section 304 does not expressly create a private cause of action.⁴³ The court then went on to look for an implied right of action, looking to other sections of the Act for guidance.⁴⁴ It pointed out that Congress created an express private right of action in SOX section 306, which makes it unlawful for directors or executive officers to trade any of the issuer's equity securities during a pension fund blackout period if those securities were acquired in connection with the director or executive officer's employment.⁴⁵ Section 306 specifies that if the issuer fails to bring an action to recover profits within sixty days of a request to do so, "an action . . . [under] this subsection may be instituted . . . by the owner of any security of the issuer in the name and in behalf of the issuer."⁴⁶ While both sections 304 and 306 provide for the issuer's reimbursement of ill-gotten gains, the court noted the obvious contrast. Section 306 expressly creates a private remedy with a specified statute of limitations, while section 304 does not.⁴⁷

432 F. Supp. 2d at 1082; *In re BISYS Group Inc. Derivative Action*, 396 F. Supp. 2d 463, 464 (S.D.N.Y. 2005); *Neer v. Pelino*, 389 F. Supp. 2d 648, 657 (E.D. Pa. 2005).

40. 389 F. Supp. 2d at 657.

41. *Cort v. Ash*, 422 U.S. 66, 78 (1975). In *Cort*, the Supreme Court created a four-part test to determine "whether a private remedy is implicit in a statute not expressly providing one." The Supreme Court explained the four parts to the test as the following series of questions:

First, is the plaintiff "one of the class for whose especial benefit the statute was enacted," (citation omitted) that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? (citation omitted) Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? (citation omitted) And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law? (citation omitted).

Id.

42. *Neer*, 389 F. Supp. 2d at 653 (quoting *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575 (1979)).

43. *Id.*

44. *Id.* at 654.

45. *Id.* at 654-55 (citing 15 U.S.C. § 7244(a)(2)(B) (2002)).

46. *Id.*

47. *Neer*, 389 F. Supp. 2d at 655.

The court then went on to analyze the legislative history behind section 304 and noted that neither supporters nor opponents of the House's version of SOX wanted to create a private right of action under section 304.⁴⁸ It then analyzed the Senate Report behind SOX and concluded that the Senate never intended a private right of action because nowhere within the report did it mention a private right of action for section 304.⁴⁹ Because the court could find neither an express right of action in section 304 nor an implied private right of action in the legislative history of section 304, it ultimately dismissed the shareholders' claim.⁵⁰

The topic was also carefully addressed by the Ninth Circuit in the case of *In re Digimarc*, where the issue was once again whether to dismiss a derivative claim by shareholders under section 304.⁵¹ In this case the court also utilized the *Cort* analysis to focus on text and structure of the statute, as well as the entire statutory scheme, to determine whether Congress intended to provide shareholders with a private right of action.⁵² The plaintiff shareholders claimed that Congress must have implied a private right of action in section 304 because it had specifically disclaimed a private right of action in the immediately preceding section in SOX.⁵³ Specifically, the shareholders pointed the court to SOX section 303, which prohibits officers and directors from "tak[ing] any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant" for the purpose of creating disingenuous financial statements.⁵⁴ The shareholders argued that because section 303 specifically disclaims a private right of action, the lack of such a disclaimer in section 304 implies that Congress intended such a private right of action in section 304.⁵⁵ The court was unpersuaded, noting that one cannot prove congressional intent to create a private right of action merely "by pointing to other sections in [SOX] that expressly disclaim private enforcement."⁵⁶ The court also went on to note that section 304 contrasts with section 306, another nearby section that expressly gives the issuer a private right of action against officers or directors trading securities during a blackout

48. *Id.* at 655-56.

49. *Id.* at 657.

50. *Id.* at 657-58.

51. *See In re Digimarc Corp. Derivative Litig.*, 549 F.3d 1223, 1231-32 (9th Cir. 2008).

52. *Id.* at 1231.

53. *Id.* at 1232.

54. *Id.* at 1232 (citing 15 U.S.C. § 7242(a) (2014)).

55. *Id.*

56. *In re Digimarc Corp.*, 549 F.3d at 1232.

period.⁵⁷ Under the court's analysis, if Congress had intended to make section 304 enforceable via a private right of action, it could have done so as it had done in the nearby section 306. Ultimately, the Ninth Circuit firmly denied that there is any private right of action in section 304.⁵⁸

All reported decisions on this matter conclude that section 304 does not expressly or impliedly create a private right of action for shareholders of the issuer.⁵⁹ Absent any extraordinary decision on the matter by the United States Supreme Court, this issue appears to be settled. Only the SEC may bring a section 304 claim. While these decisions provide clarity, they also seriously undermine the usefulness of the statute. Neither the company,⁶⁰ nor its shareholders, can bring a section 304 claim to recapture unwarranted bonuses and stock sale profits. The SEC, on the other hand, can bring a section 304 claim, but there is little incentive to do so. Section 304 does not impose any type of criminal penalty and there is no possibility of monetary gain for the government or the SEC because any recovery is simply returned to the issuer.

IV. DOES THE CEO OR CFO HAVE TO PERSONALLY PARTICIPATE IN THE MISCONDUCT?

Arguably the most important aspect of section 304 – what is necessary for proof of disgorgement – is drafted in a way that is, at best, “inartful.”⁶¹ It states: “If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the issuer shall reimburse the issuer”⁶²

In its early attempts to apply section 304, the SEC did not force the judicial branch to interpret whether the CEO or CFO must be person-

57. *Id.* at 1233.

58. *Id.*

59. *See, e.g.,* *Pedroli ex rel. Microtune, Inc. v. Bartek*, 564 F. Supp. 2d 683, 685-86 (E.D. Tex. 2008); *In re iBasis, Inc. Derivative Litig.*, 532 F. Supp. 2d 214, 223-25 (D. Mass. 2007); *Kogan*, 432 F. Supp. 2d at 1082; *In re BISYS Group Inc. Derivative Action*, 396 F. Supp. 2d 463, 464 (S.D.N.Y. 2005); *Neer v. Pelino*, 389 F. Supp. 2d 648, 657 (E.D. Pa. 2005); *see also*, *In re Good-year Tire & Rubber Co. Derivative Litig.*, 2007 U.S. Dist. LEXIS 1233, at *23 (N.D. Ohio Jan. 5, 2007).

60. Rachael E. Schwartz, *The Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive to Keep the Corporate House Clean*, 64 *BUS. LAW.* 1, 2 (2008).

61. Matthew Boyle, *They Didn't Earn It - And Should Return It*, *FORTUNE*, May 11, 2006.

62. 15 U.S.C. § 7243(a) (2014).

ally involved in the misconduct.⁶³ The first section 304 enforcement actions were limited to situations where the CEO or CFO was clearly implicated in the alleged accounting misconduct⁶⁴ and section 304 was merely used as an additional mechanism to disgorge compensation from allegedly culpable individuals.⁶⁵

In 2009, the SEC brought its first disgorgement case where there was no evidence of any wrongdoing on the part of the CEO. The defendant in this case was Maynard Jenkins, the CEO of CSK Auto Corp (“CSK”).⁶⁶ CSK was a large automotive parts retailer that purchased its inventory from various vendors.⁶⁷ The accompanying vendor allowances were very significant to the company’s bottom line.⁶⁸ In 2004, CSK issued an accounting restatement adjusting its net income downward for 2003, 2002, and 2001 because of errors in the amount of previously reported vendor allowances.⁶⁹ CSK characterized these inaccuracies as “errors in estimation,” “imprecise estimates,” and “bookkeeping errors.”⁷⁰ That restatement failed to paint the true picture behind the reporting errors. It incorrectly characterized the errors as mistakes rather than fraudulent misstatements and it failed to write-off all the vendor allowance receivables that were known to be uncollectible at the time of the restatement.⁷¹ In 2007, CKS filed a second restatement, revealing instances of accounting fraud where the company had failed to write-off millions of dollars’ worth of uncollectible vendor allowances pursuant to Generally Ac-

63. Gretchen Morgenson, *Clawbacks? They’re Still a Rare Breed*, N.Y. TIMES, Dec. 29, 2013, at BU1.

64. William R. McClucas, Thomas W. White, Douglas J. Davison & Benjamin C. Brown, *SEC Wields the SOX 304 ‘Clawback Provision’*, LAW360, 1 (Dec. 6, 2010), https://www.wilmerhale.com/uploadedFiles/WilmerHale_Shared_Content/Files/Editorial/Publication/SEC%20Wields%20The%20SOX%20304%20%27Clawback%27%20Provision.pdf.

65. Emily Rockwood, *CEOs and CFOs Beware: Court Endorses SEC’s Aggressive Use of Section 304 of Sarbanes-Oxley To Clawback Compensation of Executives Who Did Not Engage in Misconduct*, CADWALADER, (Jan. 2, 2013), <http://www.cadwalader.com/resources/clients-friends-memos/ceos-and-cfos-beware-court-endorses-secs-aggressive-use-of-section-304-of-sarbanes-oxley-to-clawback-compensation-of-executives-who-did-not-engage-in-misconduct>.

66. SEC v. Jenkins, 718 F. Supp. 2d 1070, 1072 (D. Ariz. 2010).

67. Press Release, SEC, Complaint for Violations of Section 304 of the Sarbanes-Oxley Act of 2002, at 1-2 (July 22, 2009), <https://www.sec.gov/litigation/complaints/2009/comp21149.pdf>.

68. *Id.*

69. *Jenkins*, 718 F. Supp. 2d at 1072-73.

70. Press Release, Orrick, Memorandum of Points and Authorities in Support of Motion by Plaintiff Securities and Exchange Commission for Partial Summary Judgment Against Defendant Maynard L. Jenkins, at 5 n.4 (Sept. 17, 2010), <https://www.orrick.com/Events-and-Publications/Documents/3002.pdf>.

71. *Jenkins*, 718 F. Supp. 2d at 1073.

cepted Accounting Principles (GAAP).⁷² In doing so, the company had overstated its pre-tax income by 47% in 2002, 43% in 2003, and 65% in 2004.⁷³ The restatement indicated that certain personnel were responsible for the improper accounting entries and that an audit committee investigation had revealed an ineffective control environment which allowed for the inappropriate override of existing procedures and internal controls.⁷⁴

The SEC filed civil complaints and criminal indictments against senior CSK officers implicated in the accounting fraud.⁷⁵ The SEC also filed a separate section 304 action against Jenkins, seeking to clawback the bonuses, incentive-based compensation, and profits he had realized from the sale of CSK stock during the period following the issuance of the 2002-2004 financial statements.⁷⁶ The SEC did not allege that Jenkins had personally participated in the accounting fraud or that he had any knowledge of the fraud.⁷⁷ Instead, the SEC alleged that officers had actually concealed the scheme from Jenkins.⁷⁸ Jenkins filed a motion to dismiss the section 304 claim, contending that the action was improper because section 304 requires proof of personal misconduct by the CEO.⁷⁹ He also argued that any claims of liability that did not involve his personal misconduct violated due process and imposed an impermissible penalty.⁸⁰

The importance of the outcome of this ruling cannot be overstated. Securities lawyers took notice of the SEC's bold move, and as one contemporary noted, if the district court allowed the SEC's claim to go forward, this would solidify section 304 as a "no fault" clawback."⁸¹ The district court's ruling was nothing short of a home-run for the SEC and the power of section 304. The district court denied the motion to dismiss, noting that there was no question that the

72. *Id.*; Press Release, SEC, CSK Auto Corporation Form 10-K, at 40 (May 1, 2007), <http://www.sec.gov/Archives/edgar/data/1051848/000095015307000933/p73759e10vk.htm>.

73. Plaintiff Securities and Exchange Commission's Opposition to Defendant Maynard L. Jenkins's Motion to Dismiss Complaint, Jenkins, 718 F. Supp. 2d 1070 (D. Ariz. Oct. 15, 2009) (No. CV-09-01510-PHX-GMS), 2009 WL 3377248, at *2.

74. CSK Auto Corporation Form 10-K, at 3 (May 1, 2007), <http://www.sec.gov/Archives/edgar/data/1051848/000095015307000933/p73759e10vk.htm>.

75. Jenkins, 718 F. Supp.2d at 1073; U.S. Securities and Exchange Commission, Litigation Release No. 20933A / March 6, 2009, <http://www.sec.gov/litigation/litreleases/2009/lr20933a.htm>.

76. Jenkins, 718 F. Supp. 2d at 1073.

77. *Id.*

78. *Id.*

79. *Id.* at 1074-75.

80. *Id.* at 1075-76.

81. Mark Schonfeld, *SEC's First Use of SOX "Clawback" Against Uncharged Executive*, GIBSON DUNN (July 27 2009), available at <http://www.gibsondunn.com/publications/pages/SECsFirstUseofSOXClawbackAgainstUnchargedExecutive.aspx>.

plain language of section 304 and the legislative history behind it subjects the CEO to disgorgement even if he or she was unaware of the misconduct leading to the erroneous financial statements.⁸² The court noted that “[w]hen a CEO either sells stock or receives a bonus in a period of financial noncompliance, the CEO may unfairly benefit from a misperception of the financial position of the issuer that results from those misstated financials, even if the CEO was unaware of the misconduct leading to misstated financials.”⁸³ The court pointed out that other securities laws already provide criminal and civil penalties for knowing misconduct by the CEO or CFO. Therefore, section 304 would be redundant if it also required evidence of personal misconduct.⁸⁴ The court also noted that the statute is designed to promote vigilance when it stated that “[s]ection 304 provides an incentive for CEOs and CFOs to be rigorous in their creation and certification of internal controls by requiring that they reimburse additional compensation received during periods of corporate noncompliance regardless of whether or not they were aware of the misconduct giving rise to the misstated financials.”⁸⁵ This vigilance is solidified by SOX section 302, which requires that the CEO and CFO certify that they are responsible for the existence, design, and operation of effective internal controls that provide assurances as to the accuracy of the company’s financial statements.⁸⁶ After the court denied his motion to dismiss, Jenkins eventually settled the case and agreed to return \$2.8 million in bonus compensation and stock profits that he received while the company was committing accounting fraud.⁸⁷

Two other federal district courts have followed *Jenkins*’ lead and found that the misconduct of the issuer, rather than direct proof of personal misconduct by the CEO or CFO, is the trigger for a section 304 claim.⁸⁸ While the decisions in these cases are compelling, it is important to note that none of these decisions constitute binding legal precedent. Neither the U.S. Supreme Court nor any of the circuit

82. *Jenkins*, 718 F. Supp.2d at 1075-76.

83. *Id.* at 1075.

84. *Id.* at 1077 n.2.

85. *Id.* at 1077.

86. *Id.* (citing 15 U.S.C. § 7241 (2014)).

87. *Former CEO to Return \$2.8 Million in Bonuses and Stock Profits Received During CSK Auto Accounting Fraud*, U.S. SECURITIES AND EXCHANGE COMMISSION (Nov. 15, 2011), <http://www.sec.gov/news/press/2011/2011-243.htm>.

88. *SEC v. Baker*, 2012 U.S. Dist. LEXIS 161784, at *13 (W.D. Tex. Nov. 13, 2012); *SEC v. Microtune, Inc.*, 783 F. Supp. 2d 867 at 886 (N.D. Tex. 2011) (“Section 304 contains no personal wrongdoing element”).

courts have ruled on this issue and there are some lingering arguments that the appellate courts might choose to address in the near future.⁸⁹

V. WHAT IS MISCONDUCT?

Section 304 is triggered by the need to issue a restatement⁹⁰ due to “misconduct.” Unfortunately, nowhere in SOX does Congress define the term “misconduct.”⁹¹ The full text indicates that the disgorgement provisions only apply when the restatement arises from misconduct that leads to material noncompliance with financial reporting requirements.⁹² Courts have not specified a uniform standard for the nature and degree of misconduct needed to maintain an action under section 304.⁹³ At most, one court stated “[t]he plain language of the statute indicates that the purpose of the Act is to punish ‘misconduct,’ not the mere decision to restate financial reports.”⁹⁴

Legislative history provides little insight. One early version of the bill passed by the House used the verbiage “extreme misconduct,”⁹⁵ but the extreme qualifier was not included in the Senate’s final version of SOX.⁹⁶ One might surmise that misconduct requires proof of scienter, which is defined as a mental state embracing “intent to deceive, manipulate, or defraud.”⁹⁷ The original bill passed by the House directed the SEC to “identify the scienter requirement that should be used in order to determine to impose the requirement to disgorge.”⁹⁸ However, the final version passed into law ultimately removed this language and left section 304 without any scienter requirement. A

89. In *Baker*, the defendant tried to leverage the Ninth Circuit’s language labeling section 304 actions as “equitable” disgorgements to argue that section 304 therefore requires proof that the CEO or CFO was actually engaged in the wrongdoing, as is generally required for a court to use its power to order an equitable disgorgement remedy. 2012 U.S. Dist. LEXIS 161784, at *18-19 (citing *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978)). The district court disagreed, finding that section 304 is a statutorily created cause of action specifically ordering disgorgement; it is not just a remedy fashioned by a court that is naturally bound to find some level of wrongdoing before crafting a remedy. *Baker*, 2012 U.S. Dist. LEXIS 161784, at *22. However, some commentators point out that this issue is still subject to dispute. Daniel R. Bryer, *The Culpability of Corporate Officers under the Clawback Provision of Sarbanes-Oxley in a Post-Jenkins World*, 12 J. BUS. & SEC. L. 1, 15-17 (2011).

90. FASB Accounting Standard Codification 250-10-20 defines a restatement as “The process of revising previously issued financial statements to reflect the correction of an error in those financial statements.”

91. Bryer, *supra* note 89, at 18.

92. 15 U.S.C. § 7243 (2014).

93. Bryer, *supra* note 89, at 18.

94. In re AFC Enter., 224 F.R.D. 515, 521 (N.D. Ga. 2004).

95. See *Neer v. Pelino*, 389 F. Supp. 2d 648, 656 (E.D. Pa. 2005).

96. *Id.* at 657.

97. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976).

98. H.R. 3763, 107th Cong. § 12(b)(3) (2002).

review of other securities laws under the Securities Exchange Act of 1934 reveals that this is not unique to section 304, as scienter is not required for some other types of actionable misstatements. For example, the U.S. Supreme Court has specifically found that the SEC need not prove scienter to establish a person's liability under sections 17(a)(2) and (3) of the Securities and Exchange Act, which prohibit a person in the offer or sale of securities from obtaining money or property by material misrepresentation or omission.⁹⁹

Because section 304 does not contain an explicit scienter requirement, and legislative history is silent on the issue, it is left open for speculation whether lesser conduct, such as mere negligent behavior,¹⁰⁰ would be enough to constitute misconduct under section 304. The SEC has not aggressively tested the boundaries of what constitutes misconduct. Instead, it has focused on situations where the misconduct was a clear violation of standard accounting practices and always rooted in deceit.¹⁰¹ Examples of cases where the SEC has alleged misconduct under section 304 include situations where companies overstated inventory values,¹⁰² falsified journal entries,¹⁰³ falsified timecards to achieve quarterly revenue and margin targets,¹⁰⁴ and improperly backdated stock options.¹⁰⁵ As this line of section 304 cases demonstrates, misconduct certainly includes conscious actions involving scienter. Nonetheless, the absence of any scienter requirement in the statute itself suggests that it could apply to lesser forms of misconduct, such as carelessness, as well. Dictum from one district court judge suggests that the SEC might win such a case. As stated by the court, “[s]ection 304 does not elaborate on what sort of misconduct is necessary, so the pay back remedy could be applied if any misconduct, however slight, leads to an accounting restatement.”¹⁰⁶ One

99. *Aaron v. SEC*, 446 U.S. 680, 697 (1980) (“It is our view, in sum, that the language of § 17 (a) requires scienter under § 17 (a)(1), but not under § 17 (a)(2) or § 17 (a)(3) [of the Securities Exchange Act of 1934]”); *SEC v. Universal Express, Inc.*, 475 F. Supp. 2d 412, 423 (S.D.N.Y. 2007) (“Scienter need not be proven, however to establish a violation of Sections 17(a)(2) and (3), 15 U.S.C. § 77q(a), which respectively prohibit a person in the offer or sale of securities from obtaining money or property by material misrepresentation or omission and from engaging in any act that operates as a fraud or deceit upon the purchaser.”).

100. *List*, *supra* note 18, at 207.

101. *Salehi & Marino*, *supra* note 37.

102. *SEC v. David H. Brooks*, Lit. Release No. 20345 (Oct. 25, 2007), <http://www.sec.gov/litigation/litreleases/2007/lr20345.htm>.

103. *Id.*

104. *SEC Charges Software Company in Silicon Valley and Two Former Executives Behind Fraudulent Accounting Scheme*, U.S. SECURITIES AND EXCHANGE COMMISSION (Sept. 24, 2014), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543035992>.

105. *SEC v. Microtune, Inc.*, 783 F. Supp. 2d 867, 871 (N.D. Tex. 2011).

106. *In re iBasis, Inc. Derivative Litig.*, 532 F. Supp. 2d 214, 224 (D. Mass. 2007).

legal commentator similarly noted that, “[a]t some level, every re-statement not caused by a change in accounting rules can be deemed to be a result of misconduct.”¹⁰⁷ Industry specific characterizations of misconduct in the accounting profession include descriptions such as acts carried out in the performance of a management accountant’s professional occupation that fall below the standard expected of a reasonably competent management accountant with specific listed examples of inadequate record keeping and incompetence.¹⁰⁸ While CEO’s and CFO’s might claim it is unfair to take bonuses and stock profits when there is no proof that anyone within the company intended to deceive the investing public, this interpretation would not conflict with the President’s original plan to make sure that key officers do not “profit from erroneous financial statements.”¹⁰⁹ Other securities laws impose civil or criminal penalties for intentional deceit;¹¹⁰ section 304 merely requires the CEO and CFO to return bonuses and stock profits that were attributable to incorrect financial measurements.

Eventually, the SEC may push the issue and begin to bring such section 304 actions. As noted by one former employee of the SEC enforcement division, prior to 2013 there were ongoing discussions within the SEC as to whether mere negligence was enough to trigger a section 304 disgorgement.¹¹¹ This same former employee predicted that the “next horizon” for section 304 cases would “be negligence-based cases without regard to fraud.”¹¹² In such cases the SEC could win disgorgement merely because the issuer did not have proper controls in place to prevent or catch any careless accounting. Even though this fits within the overall tenor of SOX enforcement under other sections of SOX, such as section 302, which mandates a set of internal procedures designed to ensure accurate financial disclosure,¹¹³ the current SEC leadership appears to have no desire to pursue such actions. Instead, SEC leaders still battle over whether they

107. Kelsh, *supra* note 2, at 1009.

108. See *What is Misconduct?*, CHARTERED INSTITUTE OF MANAGEMENT ACCOUNTANTS, <http://www.cimaglobal.com/Professional-ethics/Conduct/Misconduct/> (last visited Oct. 31, 2015).

109. *The President’s 10-Point Plan Improving Corporate Responsibility And Protecting America’s Shareholders*, *supra* note 7.

110. If a CEO is actually aware of misconduct that results in misstated financial statements, he or she may be responsible for civil and criminal penalties. See, e.g., 15 U.S.C. 78u(d), 18 U.S.C. § 1350; 17 C.F.R. § 240.10b-5; 17 C.F.R. § 240.13a-14.

111. David McCann, *More Clawbacks Likely In Store*, CFO, (May 23, 2013).

112. *Id.*

113. 15 U.S.C. § 7241(a)(4) (mandating that key officers are “responsible for establishing and maintaining internal controls” and “have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared.”).

should pursue claims against CEO's or CFO's who were not personally involved in blatant misconduct by their employees.¹¹⁴

VI. WHAT DOES "REQUIRED" MEAN?

Section 304 mandates that the CEO and CFO shall reimburse the issuer if the "issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws[.]"¹¹⁵ The use of the term "required" complicates the interpretation of this statute. It is unclear whether the term "required" compels the SEC to prove that the company was somehow compelled to file the restatement, instead of choosing to do so voluntarily. Another point of contention is whether the term "required" allows for section 304 disgorgement even if the company refuses to file a restatement.

There is a legitimate legal argument that the term "required" creates two categories of restatements: those that are required, or compelled, and those that are voluntary. Under this theory, the CEO or CFO would only be liable under a section 304 claim if there was proof that the "issuer [was] required to prepare an accounting restatement." Conversely, if the restatement was filed voluntarily, then the CEO or CFO would not have any section 304 liability. At least one court has tacitly recognized this distinction and broke the test down into two elements. In *SEC v. Shanahan*,¹¹⁶ the SEC brought an action against Michael Shanahan, the CEO of Engineered Support Systems, Inc., alleging multiple fraud and insider trading violations related to his personal involvement in backdating stock options and the corresponding concealment of material amounts of compensation paid to its top executives.¹¹⁷ The district court judge interpreted the rule by stating that the "ordinary, contemporary, common meaning of Section 304 is that, before penalties may be imposed, an issuer must be compelled or ordered to prepare a financial restatement and must actually file the restatement."¹¹⁸ Unfortunately, the court never considered the cir-

114. Kara Scannell, *Clawbacks Divide SEC: Aguilar Pushes Harder Line for Executives at Accused Firms*, WALL ST. J. (Aug. 7, 2010), available at <http://www.wsj.com/articles/SB10001424052748703988304575413671786664134>. The commissioners have split along party lines in cases involving CEOs or CFOs who did not participate in wrongdoing. Jesse Westbrook, *SEC Rift on When to Claw Back Bonus May Leave Policy in Limbo*, BLOOMBERG (Aug. 5, 2010), <http://www.bloomberg.com/news/articles/2010-08-06/u-s-regulators-said-to-debate-when-it-s-appropriate-to-claw-back-bonuses>.

115. 15 U.S.C. § 7243(a) (2014).

116. 624 F. Supp. 2d 1072 (2008).

117. *Id.* at 1075-76.

118. *Id.* at 1078.

cumstances in which a company would be required or compelled to prepare an accounting restatement because the court dismissed the section 304 claim for the reason that the company had never issued a restatement.¹¹⁹

While the *Shanahan* court provided no guidance as to how the SEC could prove that the issuer was ordered or compelled to file a restatement, other commentators have tried to fill in the gaps by speculating as to how courts might draw the line between a voluntary restatement and a required restatement. One hypothesized that a restatement would be categorized as “required” if there was evidence that the restatement was compelled by the company’s independent auditor.¹²⁰ Another posited that a restatement would be “required” if the SEC threatened an enforcement action unless there was a restatement or if the SEC refused to declare a registration statement effective under the Securities Act of 1933 unless there was a restatement of a previous financial statement.¹²¹

In two different cases, CFOs have seized upon this “required” language and argued their company’s restatements were “voluntary” and, therefore, negated any section 304 claim. In both cases the argument proved unsuccessful. In *SEC v. Jasper*, the SEC brought a civil enforcement action against the CFO of Maxim, alleging clear instances of accounting fraud through backdating options to employees.¹²² A jury found Jasper liable for, among other things, committing fraud by participating in a scheme to overstate his company’s net income, falsifying his company’s books and records, and aiding and abetting the company’s filing of materially false and misleading reports with the SEC.¹²³ The district court barred Jasper from serving as an officer or director of a publicly traded company for two years and imposed a civil penalty of \$360,000.¹²⁴ The court also ordered him, pursuant to

119. As described by the Government Accounting Office, “A financial statement restatement occurs when a company, either voluntarily or prompted by auditors or regulators, revises public financial information that was previously reported.” GAO, *Financial Statement Restatements: Trends, Market Impacts, Regulatory Responses, and Remaining Challenges* (Oct. 4, 2002), at 1 n.1, available at <http://www.gao.gov/assets/240/236067.pdf>.

120. See *Sarbanes-Oxley Requires Disgorgement of Bonuses and Profits in the Event of a Financial Reporting Restatement*, ALSTON + BIRD LLP SECURITIES LAW ADVISORY (Sept. 9, 2002), at 2, <http://www.alston.com/Files/Publication/22ed3b25-7502-4124-8008-6d2263fd9bbb/Presentation/PublicationAttachment/e795900f-85e2-43aa-ab8f-130100185b8b/Sarbanes-Oxley%20Requires.pdf>.

121. Stanton P. Eigenbrodt, *The Chilling Effects of Disgorgement and a Temporary Freeze: Sarbanes-Oxley Sections 304 and 1103*, JOURNAL REPORTS: LAW AND POLICY, at 2 (May 2004), available at http://www.gibsondunn.com/fstore/documents/pubs/Eigenbrodt_5_2004.pdf.

122. *SEC v. Jasper*, 678 F.3d 1116, 1121 (9th Cir. 2012).

123. *Id.* at 1121-22.

124. *Id.* at 1122.

section 304, to reimburse the company for \$1.8 million in bonuses and profits from the sale of Maxim stock that he received during the period that he certified Maxim's false financial statements.¹²⁵

Jasper appealed, claiming that the jury decision was not specific enough to support a section 304 disgorgement because "the jury was never asked to consider whether Maxim was 'required' to restate its financials 'as a result of misconduct.'" ¹²⁶ Unfortunately, the Ninth Circuit did not address the issue of whether the SEC had to prove that the company was 'required' to issue the restatements. Instead, it dismissed the argument by noting that disgorgement was an "equitable" rather than a "legal" remedy and that "equitable" remedies do not necessitate a full jury trial to find all facts necessary for the action.¹²⁷

In *SEC v. Geswein*,¹²⁸ the CFO filed a motion to dismiss the section 304 claim on the basis that the SEC had failed to "allege that [the issuer] was 'required' to prepare an accounting restatement."¹²⁹ The magistrate judge swiftly dismissed this argument, simply noting that the issuer had issued a restatement and remarking that "[t]his court does not find that the word 'required' is limited to actions compelled by the SEC or another agency. 'A company may be 'required' to restate its financials in order to maintain proper compliance with GAAP.'" ¹³⁰ Under this judge's standard, the mere filing of the restatement so as to maintain proper compliance with GAAP would satisfy any requirement standard in section 304.

While the *Shanahan* decision and its dual requirement of proving both that the restatement was filed and that it was "required" to be filed still stands, the *Geswein* decision more accurately reflects the majority of the case law in this area. In practice, most courts simply overlook the term "required" and merely focus on whether there was a restatement.¹³¹ This interpretation may reflect Congress's true intent. The Senate Committee Report makes no mention of proof of a "re-

125. *Id.*

126. *Id.* at 1130.

127. *Jasper*, 678 F.3d at 1130.

128. 2011 U.S. Dist. LEXIS 111906, at *70 (N.D. Ohio Aug. 5, 2011) (reversed on other grounds).

129. *Id.*

130. *Id.*

131. For example, in *SEC v. Baker*, the district court stated that the SEC had pled the requisite elements of a section 304 claim and then discussed how each element had been satisfied. 2012 U.S. Dist. LEXIS 161784 at *9. The court made no reference to the term "required" or "compelled" when discussing the restatement. *Id.* The court only stated "[t]here is no question [the issuer] had to file restatements for the periods in question." *Id.* A fair reading of the context of this statement indicates that the court was content that the element was satisfied merely because the restatement was filed. *See id.*

quired” restatement when it described the bill in its Senate Report: “The bill requires that in the case of accounting restatements that results from material non-compliance with SEC financial reporting requirements, CEOs and CFOs must disgorge bonuses and other incentive-based compensation and profits on stock sales, if the non-compliance resulted from misconduct.”¹³² This interpretation is also practical because the decision to file a restatement is not made lightly. While companies may voluntarily file restatements pursuant to comments and suggestions from the SEC in a securities offering¹³³ or upon the advice of a new accounting firm,¹³⁴ companies will only do so if absolutely necessary because research has shown that restatements of financial statements result in a substantial loss of market value, decreases in expected future earnings, and increases in the firm’s cost of equity capital.¹³⁵ Because a corporation will not amend its financial statements unless it somehow believes it is absolutely necessary to do so, it is logical that courts have not devoted significant judicial energy towards determining whether the corporation was actually compelled to issue the restatement.

Another interesting interpretation of the term “required” is that it allows for section 304 claims even if the issuing company has refused to file a restatement. This argument is appealing because it would be too easy for a CEO to avoid personal liability if one only had to refuse to file a restatement and, as in the recent case of AgFeed Industries Inc., simply let the company fall into bankruptcy.¹³⁶ This argument first surfaced in *Teachers’ Retirement System of Louisiana v. Hunter*,¹³⁷ where the Fourth Circuit reviewed a district court decision that dismissed a shareholder derivative lawsuit based on allegations of intentional misconduct by key officers that led to misleading financial statements. In this case, the shareholders had brought a handful of claims under section 10(b) of the Exchange Act and Rule 10b-5 and

132. S. REP. NO. 107-205, at 26 (2002).

133. The SEC Division of Corporate Finance reviews selected financial statements and, on occasion, “suggests” that a company revise its financial statements. *See generally* Division of Corporation Finance, <http://www.sec.gov/divisions/corpfin/cffilingreview.htm#VPDVubHnacw> (last visited July 7, 2015).

134. JAMES REDA, STEWART F. REIFLER & MICHAEL STEVENS, *THE COMPENSATION COMMITTEE HANDBOOK* 196 (2014).

135. Paul Hribar & Nicole Thorne Jenkins, *The Effect of Accounting Restatements on Earnings Revisions and the Estimated Cost of Capital*, 9 REV. ACCOUNT. STUD. 337, 337-38 (2004); Zoe-Vonna Palmrose, Vernon Richardson & Susan Scholz, *Determinants of Market Reactions to Restatement Announcements*, 37 J. ACCOUNT. & ECON. 59, 59-60 (2004).

136. Complaint, SEC v. AgFeed Industries, Inc., at 7 (2014), <http://www.sec.gov/litigation/complaints/2014/comp-pr2014-47.pdf>.

137. 477 F.3d 162, 167 (4th Cir. 2007).

an accompanying section 304 claim.¹³⁸ The Fourth Circuit affirmed the dismissal of the § 10(b) and Rule 10b-5 claims because it found that there were inadequate allegations of misconduct and insufficient proof that the company had issued misleading financial statements.¹³⁹ The court then briefly addressed the shareholders' claim that section 304 damages were appropriate, due to numerous alleged GAAP violations in the financial statements, which the shareholders claimed "require[d]" the company to issue restatements, even though the company had never filed a restatement.¹⁴⁰ The circuit court specifically avoided ruling on the issue of whether a restatement must be filed in order to pursue a section 304 claim.¹⁴¹ Instead, the court pointed to the insufficient proof that the company had presented erroneous information in its financial reports and found that "the complaint does not adequately allege that any restatement is required."¹⁴²

In the aforementioned case of *SEC v. Shanahan*, a district court judge squarely ruled upon this issue and provided a definitive answer.¹⁴³ The SEC sought to use section 304 to claw-back incentive compensation payments and stock sale profits received by the CEO after the company had issued financial statements that concealed the backdated stock options.¹⁴⁴ The CEO filed a motion to dismiss the section 304 claim, noting that the issuer had never filed a restatement.¹⁴⁵ The SEC countered that section 304 does not explicitly require a restatement.¹⁴⁶ It argued that the text of the statute merely calls for disgorgement if the issuer is "required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws."¹⁴⁷ The SEC argued that because "Engineered Support's 2002 financial statement contained material errors, restatement was required under general accounting principles, and thus Section 304 applies."¹⁴⁸ The district court noted that the Eighth Circuit had never ruled on the issue of whether section 304 requires the actual

138. *Id.* at 168-69.

139. *Id.* at 183-84.

140. *Id.* at 188-89.

141. *Id.* at 189. (The court also specifically avoided ruling on whether a private right of action was available under section 304.) *Teachers' Retirement System*, 477 F.3d at 189.

142. *Id.*

143. *Shanahan*, 624 F. Supp. 2d at 1078.

144. *Id.*

145. *Id.* at 1077-78.

146. *Id.* at 1078.

147. *Id.* (citing 15 U.S.C. § 7243(a) (2014)).

148. *Shanahan*, 624 F. Supp. 2d at 1078.

filing of restated accounting reports.¹⁴⁹ The court then made a conclusory statement granting a motion to dismiss the section 304 claim, indicating that the “ordinary, contemporary, common meaning of section 304 is that, before penalties may be imposed, an issuer must be compelled or ordered to prepare a financial restatement and must actually file the restatement.”¹⁵⁰ The court did not provide detailed reasoning for this decision. Instead, it merely cited to a treatise, which stated that the company must file a restatement, and cited the Senate Report discussing section 304.¹⁵¹

These two cases constitute the full extent of any judicial analysis as to whether a restatement must be filed prior to a section 304 claim. Although one district court judge has ruled that a restatement is a precondition to a section 304 claim,¹⁵² the judge’s decision holds no precedential value and the lack of any substantial analysis in his decision provides little support for future jurists. On the contrary, the Fourth Circuit’s ruling on this issue suggested that a section 304 claim might be able to proceed absent a restatement, so long as the plaintiff could prove that a statement was for some reason “required.”¹⁵³ Although the Fourth Circuit ultimately decided that the shareholder plaintiffs had failed to adequately allege that a restatement was required under the circumstances of that case, it is likely that the SEC, with its extensive experience analyzing and commenting on corporate financial statements, could present a much more compelling argument that a section 304 claim is appropriate, even though the issuer never issued an accounting restatement.

In summation, there is no definitive answer as to how future courts will interpret the term “required” in the context of the SEC’s proof requirements for section 304 claims, but there are three possible scenarios.

First, future courts might allow the SEC to pursue a section 304 claim even if the company did not file a restatement. Under this scenario, the SEC would need to prove that the issuer was required to file a restatement, but chose not to do so. This argument has sparked two reported decisions. In one, the Fourth Circuit Court of Appeals

149. *Id.*

150. *Id.*

151. *Id.* The citation to the Senate Report merely noted in a parenthetical citation that “legislative history indicates Congress contemplated the statute’s applicability only in terms of ‘accounting restatements that result from material non-compliance,’ rather than cases where there should have been an accounting restatement because of material non-compliance.” *Id.* (citing S. REP. NO.107-205, at 53 (2002)).

152. *Shanahan*, 624 F. Supp. 2d at 1078.

153. *Teachers’ Retirement System of Louisiana v. Hunter*, 477 F.3d 162, 189 (4th Cir. 2007).

avoided directly ruling on this issue, but did dismiss the case for failing to allege enough misconduct to “require” a restatement.¹⁵⁴ In the other, a district court judge expressly held that a restatement was required for section 304 liability.¹⁵⁵ Because this decision is not binding on other courts, there is no controlling precedent on this issue. It is difficult to predict whether future courts will allow section 304 actions without a restatement, but the SEC seems to be willing to press the issue. In 2014, the SEC filed a section 304 claim against a company that prepared a draft restatement, but filed for bankruptcy prior to the filing of the actual restatement.¹⁵⁶ Although this case has not sparked a reported decision, it appears that the SEC still believes that the term “required” serves as an exception to any actual restatement requirement. Future litigation in this area is likely.

In the second scenario, future courts might require that the SEC prove both that the company filed a restatement and that the restatement was somehow “required.” This standard has been addressed in a handful of federal district court decisions, but none provide any guidance as to how the SEC could prove that the restatement was “required.” At most, a magistrate judge ruled that filing a restatement to remain in compliance with GAAP standards was sufficient proof to satisfy the “required” element. However, this decision does not constitute binding authority.¹⁵⁷

This decision leads to the final scenario, where courts will effectively ignore the term “required” so long as the issuer filed a restatement. Because the stock market punishes issuers who restate prior financial results, it is likely that courts will find the mere act of restatement to be sufficient proof that the issuer was “required” to issue the restatement. Based on a review of all reported section 304 decisions, and the rarity in which the issue is even broached by the court, the authors find this to be the most likely scenario. As of the writing of this paper, the use of the term “required” provides virtually no obstacle to the SEC’s pursuit of a section 304 claim.

VII. WHAT COMPENSATION IS SUBJECT TO DISGORGEMENT?

Section 304’s disgorgement provision applies to “any bonus or other incentive-based or equity-based compensation received by [the CEO or CFO] from the issuer during the 12-month period following the

154. *Id.*

155. *Shanahan*, 624 F. Supp. 2d at 1078.

156. Complaint, SEC v. AgFeed Industries, Inc., at 7 (Mar. 11, 2014), available at <http://www.sec.gov/litigation/complaints/2014/comp-pr2014-47.pdf> (last visited Sep. 20, 2015).

157. *S.E.C. v. Geswein*, 2011 U.S. Dist. LEXIS 111906, at 70.

first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement.”¹⁵⁸ Enforcement questions still linger because there is no definition as to what it means to “receive” compensation under this statute. There is no dispute that if the CEO is awarded and accepts a cash bonus during the twelve-month window this would constitute receipt.

This was the case in *Jasper*, where the district court entered judgment disgorging the CFO of cash bonuses of \$207,466, \$646,447, and \$465,212 that were received during the fourth quarters of the years spanning 2003-2005.¹⁵⁹ Each of these disgorgements related back to an erroneous financial statement filed during the year of the bonus.¹⁶⁰ A more vexing question would be whether the receipt requirement would be applied to a cash bonus that accrued during the twelve-month period but was to be paid on a later date, outside the twelve-month period, under a deferral arrangement.¹⁶¹ Neither the courts, the SEC, nor legislative history provide any guidance on this subject, but it seems unlikely that the SEC would simply ignore these deferred payments. Otherwise this would be a simple loophole to avoid any possible future disgorgement actions.

Another question is whether the term “received” would apply to compensation awards that are subject to multi-year vesting requirements. For example, if the CEO or CFO was granted options to purchase stock at a future date that would lie outside of the twelve-month window, would the future exercise of those options be subject to disgorgement then? Similarly, there is no guidance on this issue. Until the issue is presented to a court for final ruling, CEOs and CFOs are left to speculate as to what types of compensation deferrals may or may not qualify for disgorgement.

VIII. HOW TO CALCULATE PROFIT FOR STOCK SALES?

Section 304’s disgorgement provision also applies to “any profits realized from the sale of securities of the issuer” during the twelve-month period “following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement.”¹⁶² This disgorgement provision is very important because at least one empirical study con-

158. 15 U.S.C. § 7243(a)(1) (2014).

159. *SEC v. Jasper*, 883 F. Supp. 2d 915, 932-33 (N.D. Cal. 2010).

160. *Id.* at 933.

161. *REDA ET AL.*, *supra* note 134, at 197.

162. 15 U.S.C. § 7243(a)(1).

firms that executives of firms accused of accounting irregularities were more likely to have exercised their stock options shortly after the occurrence of the irregularity.¹⁶³ However, the lack of detail in the disgorgement provision leads to more unanswered questions.

One question is whether the disgorgement is limited to securities initially acquired as a result of service to issuer or whether it applies to all securities of the issuer, no matter when or how they were acquired? A literal interpretation of the statute suggests that all transactions of securities of the issuer during the twelve-month period are susceptible to disgorgement, regardless of whether the securities were acquired as a result of service to the issuer. This is in stark contrast to SOX section 306(a), where the Act specifically limits the prohibition on selling securities during a pension plan blackout period to only those securities acquired by the director or executive officer in connection with his or her service as a director or executive officer.¹⁶⁴ Because section 304 contains no such limitation, it is likely that any security previously acquired by the CEO or CFO, which is then sold during the twelve-month period following the erroneous filing, would be subject to disgorgement, regardless of whether the CEO or CFO had purchased the stock on his or her own or whether it had been awarded by the company.¹⁶⁵

A second question pertains to the calculation of the amount of profit subject to disgorgement. In order to calculate the “profits realized from the sale of securities of the issuer,”¹⁶⁶ it is necessary to compare the sale price to the prior purchase price in a matching acquisition. Section 304 provides no limitation on the timing of the matching acquisition. Thus, the potential profit disgorgement could capture profits that accrued long before the filing of the erroneous report. For example, assume a CFO purchased 1,000 shares of com-

163. See Natasha Burns & Simi Kedia, *The Impact of Performance-Based Compensation on Misreporting*, 79 J. FIN. ECON. 35, 63 (2006) (finding that top managers of firms that experienced accounting irregularities and were subsequently subject to SEC enforcement actions had exercised their options in the misreported period on announcement day returns).

164. 15 U.S.C. § 7244 (2014).

165. To date, there is no direct ruling on this issue, partly because most section 304 cases have ended with a dismissal or settlement. The lone exception is *SEC v. Jasper*, which progressed all the way through a jury trial and court ordered disgorgement. In that case, the only security sales subjected to disgorgement were stock options exercised during the twelve-month period following the erroneous filing. The reported decision does not detail how the court arrived at the \$550,514 disgorgement for securities sales during the twelve-month period. However, a review of SEC filings during the pertinent period reveals that Jasper exercised his option to purchase 15,000 shares of company stock at the option price of \$14.0625 and sold them at \$50.7634 that very same day, for a profit of \$550,514. See SEC Form 4, Statement of Changes in Beneficial Ownership (Nov. 10, 2003), <https://www.sec.gov/about/forms/form4data.pdf>.

166. 15 U.S.C. § 7243(a)(2) (2014).

pany stock in 2005 at \$1 per share. The value of that stock rose consistently during the next ten years so that on January 1, 2015 the market value of that stock was \$8 per share. On January 2, 2015 the company files a statement with the SEC that contained erroneous information that materially misstated the company's financial position. The market price of the stock rose and on January 10, 2015 the CFO sold the stock for \$10 per share. A literal interpretation of section 304 suggests that the entire \$9 profit "realized from the sale of securities of the issuer"¹⁶⁷ would be subject to disgorgement. A CEO or CFO would surely argue that the entire gain is not subject to disgorgement; the only potential disgorgement would be an increase attributable to the erroneous information, which is \$2 in this example. This argument is bolstered by non-SOX disgorgement principles, where courts have disgorged only those securities profits attributable to the erroneous filing.¹⁶⁸ Consider the example of measuring the difference between the \$10 sale price on January 10, 2015 and the market price of the stock at a reasonable time after the public had been notified that the January 2, 2015 filing was erroneous. It is unclear what courts will use for the basis because almost every section 304 case has settled prior to a final court judgment. However, if courts were to find that negligence-based misconduct is sufficient for a section 304 disgorgement, it would seem inequitable to disgorge the entire profits gained on the stock sale, as illustrated by the \$9 example above.

One final question arises as to the timing of the onset of the twelve-month period. If an improper figure is initially reported in one time period, and then restated again in a subsequently filed document, does the twelve-month window restart when the second document is filed or does the period only extend as far as twelve months from the date of initial filing? This precise question was addressed in the case *SEC v. Mercury Interactive LLC*.¹⁶⁹ In this case, the SEC sought section 304 damages based on the issuer's failure to properly record and report back-dated stock options granted in the second quarter of 2002.¹⁷⁰ Those expenses were not properly recorded in the August 2002 quarterly report filed with the SEC and the expenses related to those second quarter 2002 option grants were also not reported in subsequent SEC filings.¹⁷¹ The SEC argued that each subsequent failure

167. *Id.*

168. See Schwartz, *supra* note 60, at 15 n.95 (citing *SEC v. Unioil*, 951 F.2d 1304, 1306-08 (D.C. Cir. 1991) (Edwards, J., concurring)).

169. 2009 U.S. Dist. LEXIS 83719 (N.D. Cal. Sept. 15, 2009).

170. *Id.* at 18-20.

171. *Id.* at 19.

to report those expenses started a new twelve-month clock from which the disgorgement penalty should apply.¹⁷² The district court disagreed, finding this interpretation implausible.¹⁷³ It concluded that the beginning of the twelve-month clock is the first time this error was improperly recorded, not each subsequent filing restating the same error.¹⁷⁴

IX. CONCLUSION

When SOX was signed into law, President Bush proclaimed that it would protect investors by “improving the accuracy and reliability of corporate disclosures” through “tough new provisions to deter and punish corporate and accounting fraud and corruption” that would “ensure justice for wrongdoers, and protect the interests of workers and shareholders.”¹⁷⁵ Section 304 was written as a self-executing statute, where disgorgement of bonuses and stock profits would follow a restatement of financial information based upon misconduct. The only exception to this disgorgement rested with the SEC, which was granted the right to exempt a CEO or CFO when “necessary and appropriate.”¹⁷⁶

Soon after it was signed into law, companies began issuing restatements at an alarming rate.¹⁷⁷ CEOs and CFOs ignored section 304, perhaps waiting to see whether the SEC would enforce the disgorgement. For more than five years, it did not. Eventually, the SEC brought a handful of enforcement actions. In the meantime, however, exemption became the rule and the rare enforcement case became the exception. Intuitively, section 304 should have reduced the gross number of restatements and percentage of companies issuing restatements because it created a very tangible incentive for more vigilance from the top of the company. However, the opposite occurred. Even though the total number of exchange-listed firms has declined since SOX was signed into law, the total number of financial restatements filed today far exceeds the numbers that came before SOX. In 2001,

172. *Id.* at 20-21.

173. *Id.* at 21.

174. *Mercury Interactive LLC*, 2009 U.S. Dist. LEXIS 83719 at 20-21. Ultimately, the court dismissed the SEC’s claim because “the SEC ha[d] not identified adequately a ‘first public issuance or filing’ sufficient to identify a twelve-month period” for which the defendants would be obligated to reimburse bonuses and stock gains. *Id.* at 21.

175. George W. Bush, *Statement on Signing the Sarbanes-Oxley Act of 2002*, (July 30, 2002), THE AMERICAN PRESIDENCY PROJECT, <http://www.presidency.ucsb.edu/ws/?pid=64514>.

176. 15 U.S.C. § 7243(b) (2014).

177. Harwood & Simmons, *supra* note 19, at 2 (showing that the number of restatements filed by publicly traded firms quickly rose from 163 in 2001 to 681 in 2006).

the year preceding SOX, there were 7,921 exchange-listed firms and 163 of those firms, or roughly 2 percent, issued accounting restatements.¹⁷⁸ Ten years later, in 2011, there were only 5,552 exchange-listed firms, but 499 of those firms, or roughly 9 percent, issued restatements.¹⁷⁹ Despite the vast increase in the sheer number of restatements and the increasing percentage of firms filing restatements, the SEC has pursued only a handful of section 304 claims since SOX was signed into law thirteen years ago. Most of these enforcement actions were merely additional claims attached to more serious criminal charges and quite a few of these claims were eventually dropped or settled by the SEC.¹⁸⁰

However, now that recent court decisions have clarified some of section 304's more troublesome ambiguities, the time for diffidence is over. A growing number of courts have confirmed that the SEC can disgorge improperly awarded bonuses and indecorously earned stock profits without the burdensome task of proving misconduct on the part of the CEO or CFO. Despite the lingering questions surrounding the definition of misconduct and the extent of the monies susceptible to disgorgement, the SEC has shown that it can be used as a crude, but effective, weapon to compel CEOs and CFOs to return bonuses and stock profits that were based on inaccurate information. For example, when the SEC filed a section 304 action against the CEO of Diebold Inc. in 2010, he quickly settled the case and agreed to reimburse \$470,016 in cash bonuses, 30,000 shares of stock, and stock options for 85,000 shares of stock, even though there was no evidence he was shown to be personally involved in the misconduct.¹⁸¹ The SEC forced a similar settlement in 2011 with the CEO of Beazer Homes, even though he was not personally involved in the misconduct.¹⁸² More recently, in the spring of 2015, top officers at SABA software also quickly settled a similar case where there was no proof of personal involvement in the misconduct.¹⁸³

178. *Id.*

179. *Id.*

180. McKenna, *supra* note 31.

181. SEC v. Diebold, Inc., Sarbanes-Oxley Act Release No. 21543 (June 2, 2010), <https://www.sec.gov/litigation/litreleases/2010/lr21543.htm>.

182. Robbie Wheelan & Joann S. Lublin, *Beazer CEO Will Give Back Incentive Pay in Settlement*, WALL ST. J. (Mar. 4, 2011), <http://www.wsj.com/articles/SB10001424052748703300904576178694027276166>. Without admitting any wrongdoing, McCarthy agreed to reimburse Beazer almost \$6.5 million in cash bonuses and stock sale profits as well as numerous units of restricted stock granted during the twelve months after the erroneous filing. *Id.*

183. Mary P. Hansen, *SOX Section 304 Enforcement at the SEC's Whim?*, LAW360 (February 20, 2015, 11:17 AM ET), <http://www.law360.com/articles/623125/sox-section-304-enforcement-at-the-sec-s-whim>.

Unfortunately, these examples of proactive enforcement are rare. Internal wrangling among the SEC commissioners¹⁸⁴ suggests that the majority of the commissioners seem content to abdicate their role as enforcers of section 304. For example, in the “London whale” scandal, there was clear misconduct and a subsequent restatement that reduced reported income by \$459 million, yet the SEC made no attempt to disgorge the bonuses or stock profits from the CEO or CFO.¹⁸⁵ In another highly-publicized case, the SEC did not seek disgorgements from top executives at Dell, Inc., even though the company itself admitted that restatements were required because of improper accounting adjustments that “appear to have been motivated by the objective of attaining financial targets.”¹⁸⁶ In other cases where a section 304 disgorgement appears obvious, the SEC inexplicably chose to use its prosecutorial discretion to exempt large portions of collectible monies.¹⁸⁷

The SEC’s unwillingness to use section 304 in all but the most egregious circumstances, and even then sometimes haphazardly deciding not to enforce it against certain individuals,¹⁸⁸ has betrayed the sense of security it was supposed to have created for investors. Because private parties cannot enforce section 304, the public should be able to rely on the SEC to consistently bring these types of actions so that exemptions once again become the exception. Failure to sufficiently do so decreases the faith of the general public in the efforts of companies and the SEC to ensure financial reporting accuracy. Unless the SEC begins to consistently use this section 304 against all companies that issue restatements because of misconduct, the provision’s original

184. Scannell, *supra* note 114; Westbrook, *supra* note 114.

185. Francine McKenna, *The SEC’s AgFeed Complaint: No Restatement Means No Sarbanes-Oxley Clawback*, RE: THE AUDITORS (Mar. 23, 2014), <http://retheauditors.com/2014/03/23/the-secs-agfeed-complaint-no-restatement-means-no-sarbanes-oxley-clawback/>; John C. Coffee, Jr., *In the Wake of the Whale, What’s Changed?*, The CLS Blue Sky Blog, (Oct. 10, 2013), <http://clsbluesky.law.columbia.edu/2013/10/10/in-the-wake-of-the-whale-whats-changed/>.

186. Francine McKenna, *Guest Lectures at Stanford Graduate School Business*, RE: THE AUDITORS (Feb. 22, 2014), <http://retheauditors.com/2014/02/22/guest-lectures-at-stanford-graduate-school-business/>.

187. Morgenson, *supra* note 19, at BU1 (discussing cases against Navistar and Diebold Inc.); see Francine McKenna, *Huron Consulting, Its Executive and PwC; All’s Well that Ends Well*, RE: THE AUDITORS (Jul. 23, 2012), <http://retheauditors.com/2012/07/23/huron-consulting-its-executives-and-pwc-alls-well-that-ends-well/> (discussing Huron Consulting Group, Inc.).

188. See Rockwood, *supra* note 65 (“[T]he SEC does not appear to have applied section 304(a) in a consistent manner from which anyone could glean any guidance – choosing to pursue zealously the compensation of some clearly non-culpable executives while giving a pass to other, equally non-culpable executives. The result has been a hodge-podge enforcement of section 304.”).

intent to ensure that CEOs and CFOs do not profit from erroneous financial statements will never be realized.¹⁸⁹

189. List, *supra* note 18, at 218-19.