THE CULPABILITY OF CORPORATE OFFICERS UNDER THE CLAWBACK PROVISION OF SARBANES-OXLEY IN A POST-*JENKINS* WORLD

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INTRODUCTION

"CEOs or other officers should not be allowed to profit from erroneous financial statements."[1] This simple tenet formed the foundation of President George W. Bush's call for greater accountability on the part of corporate officers following the collapse of Enron and the myriad of other accounting scandals uncovered at some of America's largest corporations in 2001 and 2002. Many of these scandals involved circumstances under which CEOs and CFOs of the offending company were either directly involved in the financial misconduct that was occurring or were inexcusably

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1. George W. Bush, *President's Ten-Point Plan to Improve Corporate Responsibility and Protect America's Shareholders*, REVISTAINTERFORUM.COM (June 30, 2002), http://www.revistainterforum.com/english/articles/063002eco_us.html.

ignorant of its existence.[2] Sarbanes-Oxley represented the Congressional response to these scandals and has been described as "the broadest package of federal disclosure and corporate governance legislation since the federal securities laws were first enacted in the late 1930s."[3]

Sarbanes-Oxley includes amongst its provisions several sections, which impose greater responsibilities upon corporate executives for their company's financial practices and permit civil and criminal penalties in the case of wrongdoing.[4] Section 304 is part of that regulatory package and requires CEOs and CFOs to reimburse their companies for certain bonuses, incentive-based compensation and stock profits if the company fails to comply with financial reporting requirements as a result of misconduct and thereafter issues an accounting restatement.[5] This section has sometimes been referred to as the "clawback provision" of Sarbanes-Oxley because it does not simply impose fines on corporate executives, but instead seeks to recoup previously earned compensation and stock profits.[6]

Since its inception, Section 304 has been the source of great debate amongst scholars, particularly with regard to whether a CEO or CFO must participate in the financial misconduct occurring within their company, or at least have knowledge of it, in order to invoke the obligation of reimbursement.[7] This debate was recently put to rest, at least for the time being, by the Arizona District Court's decision in *Securities and Exchange Commission v. Maynard L. Jenkins*.[8] The *Jenkins* court looked to the plain

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2. John Patrick Kelsh, *Section 304 Of The Sarbanes-Oxley Act Of 2002: The Case For A Personal Culpability Requirement*, 59 BUS. LAW. 1005, 1027 (2004) (describing the circumstances leading to the enactment of Sarbanes-Oxley, including the participation of corporate officers in fraudulent accounting schemes and insider trading, as well as the failure of other officers to recognize ongoing financial misconduct).

3. JOHN T. BOSTELMAN, THE SARBANES-OXLEY DESKBOOK, 2-2 (Practising Law Inst. 2008) (2003).

4. *See infra* notes 17-21, 26 and accompanying text.

5. 15 U.S.C. § 7243(a)(1)-(2) (2006).

6. *CEO Compensation in the Post-Enron Era: Hearing on S.R. 253 Before the Senate Comm. on Commerce, Sci., & Transp.*, 108th Cong. (2003) (describing for the first time Section 304 as a "clawback" for executive compensation). "Clawbacks" have generally been defined as a theory for recovering benefits that have been conferred under a claim of right, but that are nonetheless recoverable because unfairness would otherwise result. Miriam A. Cherry, *Clawbacks: Prospective Contract Measures In An Era Of Excessive Executive Compensation and Ponzi Schemes*, 94 MINN. L. REV. 368, 371-72 (2009).

7. *Compare* Kelsh, *supra* note 2, at 1010 (advocating a narrow interpretation of Section 304 whereby a CEO or CFO must have engaged in financial misconduct in order for their compensation to be clawed back), *with* Rachael E. Schwartz, *The Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive To Keep The Corporate House Clean*, 64 BUS. LAW. 1, 2 (2008) (opining that Section 304 should be invoked whenever there is an accounting restatement resulting from misconduct, regardless of whether the company's CEO or CFO participated in the misconduct or had knowledge of it).

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

language and legislative history of Section 304, as well as the larger statutory construct of Sarbanes-Oxley itself, and affirmatively held that knowledge of or participation in financial misconduct is not required in order to bring a CEO or CFO within the purview of the clawback provision.[9]

This note examines the implications of the *Jenkins* decision and its potential effect on future actions brought by the SEC under Section 304. Part I of this note discusses the circumstances surrounding the enactment of Sarbanes-Oxley and addresses the key provisions governing the financial disclosure obligations imposed upon corporations and their executives. Part II contains an in-depth analysis of the *Jenkins* decision, including insight into the underlying fraud alleged by the SEC, motions filed seeking the dismissal of the action and the ultimate decision of the Arizona District Court to allow the litigation to continue despite the absence of any allegations of individual misconduct by the defendant. Finally, Part III discusses the constitutional implications raised by the *Jenkins* decision and issues moving forward relating to the level of misconduct necessary to invoke the reimbursement obligation under Section 304.

I. SARBANES-OXLEY AND ITS RELEVANT PROVISIONS

A. The Act and the Impetus for Change

Sarbanes-Oxley was conceived in the wake of the accounting fraud uncovered at Enron, which left the company in ruins and its investors and employees with stock and retirement accounts that were virtually worthless.[10] Despite the overwhelming nature of this financial debacle, Sarbanes-Oxley was not rushed into law, but instead languished in congressional committees.[11] It would take the even more spectacular WorldCom collapse to prompt lawmakers to address the readily apparent need for greater corporate transparency and accountability.[12] Congress recognized that Enron and

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9. *Id.* at 1074-78; *See infra* Section III.

10. S. REP. NO. 107-146, at 3 (2002) ("Enron's sudden collapse left thousands of investors holding virtually worthless stock, and most Enron employees with a worthless retirement account. Pension funds nationwide, including state and union-owned pension funds, literally lost billions on Enron-related investments"); Kelsh, s*upra* note 2, at 1006 (stating that in many cases of corporate accounting fraud public investors were wiped out when news of financial misconduct broke, but officers and directors had profited by selling the issuer's stock while the company was perceived to be legitimate).

11. Roberta Romano, *The Sarbanes-Oxley Act And The Making Of Quack Corporate Governance*, 114 YALE L.J. 1521, 1557 (2005) (asserting that the perceived crisis situation and media frenzy created by the Enron collapse had lessened by April 2002 such that the version of Sarbanes-Oxley proposed for Senate approval would not progress).

12. *Id.* at 1557-58. When the WorldCom scandal broke on June 26, the political environment changed dramatically once again to one calling for emergency action. Roberta

WorldCom, as well as a multitude of subsequent high-profile accounting scandals, shook investor confidence to the core and left the public crying out for more effective regulation of big business.[13]

Congress responded to the public's concern by enacting what has been referred to as "the single most important piece of legislation affecting corporate governance, financial disclosure and the practice of public accounting since the Great Depression."[14] Sarbanes-Oxley was necessary in order to strengthen "corporate responsibility, accounting oversight and investor information" in an economic environment, which saw massive drops in the major stock indexes following the corporate accounting scandals.[15] The Act ushered in a new era of corporate responsibility aimed at protecting investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws.[16]

Sarbanes-Oxley contains eleven titles addressing various subjects including enhanced financial disclosures, external auditor independence, SEC authority and corporate fraud accountability.[17] Title III is entitled "Corporate Responsibility," and focuses on the duties of the corporation and its officers.[18] It requires that senior executives certify each annual or quarterly report filed in accordance with the Securities and Exchange Act of 1934.[19] Additionally, it forbids corporations from exercising improper influence upon independent auditors and places prohibitions upon the trading of securities by officers and directors during pension fund blackout periods.[20]

Romano, *Does Sarbanes-Oxley Have A Future?*, 26 YALE J. ON REG. 229, 237 (2009) (stating that the Senate took immediate action after the WorldCom scandal and limited the consideration of the bill that would ultimately become Sarbanes-Oxley by adopting a closure motion to restrict debate time and permissible amendments).

13. Frank Newport, *Iraq and al Qaeda, the Election, Bill Clinton, Big Business, Politicians*, GALLUP POLL NEWS SERVICE (June 22, 2004), http://www.gallup.com/poll/12109/iraq-qaeda-election-bill-clinton-big-business-politicians.aspx (noting that confidence in big business hit an all time low of 20% due to Enron, WorldCom, and other cases of corporate accounting fraud).

14. Jennifer K. Coalson, *The Sarbanes-Oxley Act of 2002: Are Stricter Internal Controls Constricting International Companies?*, 36 GA. J. INT'L & COMP L. 647, 654-55 (2008)(internal quotations omitted).

15. 148 CONG. REC. H1544-02, 1545 (daily ed. Apr. 24, 2002). Enron and the subsequent corporate scandals resulted in a dramatic drop in all major stock indexes, including a one-third drop in the value of the S&P 500 composite index from the previous year. S&P 500 Statistics, http://www.standardandpoors.com/home/en/us (last visited Sep. 19, 2011).

16. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

17. 15 U.S.C.A. § 7201 (West 2011) *et seq.*

18. 15 U.S.C. §§ 7241-7246 (2006).

19. 15 U.S.C. § 7241 (2006).

20. 15 U.S.C. §§ 7242, 7244 (2006). A blackout period is broadly defined as any period during which the ability of participants or beneficiaries to direct or diversify assets credited to their accounts, or to obtain plan loans or distributions, is temporarily suspended,

Title III also requires that CEOs and CFOs reimburse their company for certain bonuses and stock profits if the company issues an accounting restatement due to material noncompliance with securities laws.[21] These provisions are intended to "enhance the direct responsibility of senior corporate management for financial reporting and for the quality of financial disclosures made by public companies."[22]

B. Section 302 of Sarbanes-Oxley

In order to fully understand the scope and application of the clawback provision, it is necessary to first discuss Section 302 of Sarbanes-Oxley. Section 302 requires that the principal executive officer and principal financial officer certify in each annual or quarterly report filed pursuant to the Securities Exchange Act that they have reviewed the report, that the report contains no false or misleading statements and that the statements made fairly present the financial condition of the issuer.[23] The signing officers must also certify that they are responsible for establishing and maintaining internal controls, have designed and evaluated the effectiveness of such controls and have presented in the report all conclusions about their effectiveness.[24]

Section 302 thus creates a statutory scheme whereby CEOs and CFOs must establish a system to bring to their attention financial misconduct occurring within the company and guarantee the veracity of the financial reports, which hinge on the reliability of internal controls.[25] Section 304 operates as the enforcement apparatus of this provision, requiring the

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limited, or restricted for more than three consecutive business days. BOSTELMAN, *supra* note 3, at 13-102.

21. 15 U.S.C. § 7243 (2006).

22. S. REP. NO. 107-205, at 2 (2002).

23. 15 U.S.C. § 7241(a) (2006).

24. *Id.* Section 404 of Sarbanes-Oxley requires management and an external auditor to report on the adequacy of the company's internal control over financial reporting. 15 U.S.C.A. § 7262(a) (West 2011). Specifically, management is required to produce an "internal control report" as part of each annual report affirming "the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting." *Id.* The report must also "contain an assessment, as of the end of the most recent fiscal year of the Company, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting." *Id.* This portion of Sarbanes-Oxley is considered the most costly to implement, as documenting and testing important financial manuals and automated controls requires enormous effort. Romano, *supra* note 12, at 240-41.

25. 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, 201 (2009) (summarizing the requirements set forth in Section 302 and opining that Congress intended that CEOs and CFOs establish safeguards to apprise them of misconduct occurring within their companies).

reimbursement of incentive-based compensation and profits on stock sales if the financial information in the issuer's annual reports must be restated as a result of misconduct.[26] Section 304 therefore works in concert with Section 302 to provide CEOs and CFOs with an incentive to be rigorous in their creation and certification of internal controls and actively investigate the financial practices within their company to ensure that no misconduct is occurring.[27]

C. Section 304 of Sarbanes-Oxley -- The Clawback Provision

Section 304 of Sarbanes-Oxley provides as follows:

> (a) **Additional Compensation Prior to Noncompliance with Commission Financial Reporting Requirements.**
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> 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--
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> (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
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> (2) Any profits realized from the sale of securities of the issuer during that 12-month period.
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> (b) **Commission Exemption Authority.**
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> The Commission may exempt any person from the application of subsection (a), as it deems necessary and appropriate.[28]

Through the enactment of this provision, Congress sought to hold CEOs and CFOs accountable for corporate misconduct that occurred on their watch and intended to prevent them from profiting while their

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26. 15 U.S.C. § 7243(a) (2006). Section 906 of Sarbanes-Oxley also provides for the enforcement of the certification requirements, mandating criminal penalties and imprisonment if an officer knowingly or willfully certifies false information. 18 U.S.C. § 1350(c) (2006).

27. List, *supra* note 25, at 201 (discussing the interplay between Sections 302 and 304 of Sarbanes-Oxley and the resulting "pressure" placed on CEOs and CFOs to seek out misconduct and ensure that the issuer's financial reports are accurate); SEC v. Jenkins, 718 F. Supp. 2d 1070, 1077 (D. Ariz. 2010).

28. 15 U.S.C § 7243 (2006).

companies were misleading the public.[29] Section 304's legislative history supports the notion that these requirements were to be imposed on corporate officers regardless of whether they had knowledge of the misconduct or participated in it. In creating Section 304, the House of Representatives and Senate debated two distinctly different corporate fraud reform bills.[30] The Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002 was passed by the House ("House Bill"), and directed the SEC to:

> Conduct 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.[31]

The SEC was authorized to adopt a rule requiring such disgorgement if it was deemed "necessary or appropriate in the public interest or for the protection [of] investors, and would not unduly impair the operations of issuers or the orderly operation of the securities markets."[32] In the event such a rule was adopted, the House Bill required the SEC to identify "the scienter requirement that should be used in order to determine to impose the requirement to disgorge."[33] Additionally, the House Committee on Financial Services explained that "if the Commission chooses to issue rules, . . . [it do so] only after providing safeguards and exemptions to ensure that such disgorgement is required only in cases where the Commission can prove extreme misconduct on the part of that officer or director."[34] Thus, the

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29. S. REP. NO. 107-205, at 25-26 (2002). The report of the Senate Committee on Banking, Housing and Urban Affairs ("Senate Report") states that Section 304 was proposed because "management should be held responsible for the financial representations of their companies" and was intended to prevent "CEOs or CFOs from making large profits by selling company stock, or receiving company bonuses, while management is misleading the public and regulators about the poor health of the company." *Id.*

30. *See* Linda C. Thomsen & Donna Norman, *Sarbanes-Oxley Turns Six: An Enforcement Perspective*, 3 J. BUS. & TECH. L. 393, 394 (2008) (discussing the legislative history behind the enactment of Sarbanes-Oxley and the nature of the bills passed by the House and Senate).

31. H.R. 3763, 107th Cong. § 12(a) (2d. Sess. 2002).

32. *Id.* § 12(b).

33. *Id.* § 12(b)(3). The U.S. Supreme Court has defined "scienter" as a mental state embracing "intent to deceive, manipulate, or defraud." Schwartz, *supra* note 7, at 6 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976)). The Court has also noted that every appellate court that has considered the issue has held that proof of reckless behavior, rather than intentional conduct, also suffices to meet the scienter requirement, though the circuits differ on the degree of recklessness required. *Id.* (citing Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 n.3 (2007)).

34. H.R. REP. NO. 107-414, at 44 (2002).

House Bill contemplated not only a scienter requirement, but also that the officer or director engage in extreme misconduct before the SEC could seek disgorgement.

By contrast, the Public Company Accounting Reform and Investor Protection Act of 2002 passed by the Senate ("Senate Bill") was much broader than its House counterpart.[35] This divergence was likely due to the myriad of financial misconduct uncovered at multinational corporations in the interim between the passage of the House Bill and the subsequent consideration of the issue by the Senate.[36] The Senate Bill contained none of the scienter or personal misconduct requirements articulated in the House's version of the bill,[37] and thus apparently sought to impose liability on CEOs and CFOs regardless of whether they were aware of the issuer's misconduct. Such an interpretation is supported by the fact that the Senate considered, but did not adopt, an amendment that would have limited Section 304 to officers and directors "with knowledge, at the time of the misconduct, of the material noncompliance of the issuer."[38] The Senate Bill was ultimately passed by Congress and signed into law by the President as Section 304 of Sarbanes-Oxley.

As the Senate Report describes it, Section 304 "requires that in the case of accounting restatements that result 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 results from misconduct."[39] This represents a significant departure from pre-Sarbanes-Oxley law, which permitted the disgorgement of compensation only where the defendant personally engaged in misconduct.[40] Now, however, the ability of the SEC to seek reimbursement regardless of the defendant's knowledge or participation in misconduct has been confirmed by the decision of the Arizona District Court in *SEC v. Jenkins*.[41]

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35. *Compare* S. 2673, 107th Cong. § 304 (2002), *with* H.R. 3763, 107th Cong. § 12 (2002).

36. Kelsh, *supra* note 2, at 1018 (describing Adelphia's massive restatement to account, the indictment of Tyco's former CEO for tax evasion, WorldCom's fraudulent accounting scheme, and the insider trading charges brought against Imclone's CEO as the precursors for the Senate's more aggressive disgorgement provision).

37. *See* S. 2673 § 304.

38. 148 CONG. REC. S6575-02 (daily ed. July 10, 2002) (statement of Sen. Cleland) (setting forth the text of amendments proposed for the Senate Bill).

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

40. List, *supra* note 25, at 204 (stating that the "inattentive liability standard" is a significant change from prior law allowing an individual's compensation to be targeted only if he or she engages in misconduct).

41. SEC v. Jenkins, 718 F. Supp. 2d 1070, 1078 (D. Ariz 2010).

II. *SECURITIES AND EXCHANGE COMMISSION V. JENKINS* -- THE FACTS, THE FRAUD AND THE DECISION

Maynard Jenkins served as CEO of CSK Auto Corp. ("CSK") between January 1997 and August 2007.[42] CSK is one of the largest retailers of automotive parts and accessories in the United States, operating 1,349 stores in 22 states.[43] As a retailer of automotive products, CSK purchases its inventory from various vendors and manufacturers, and derives a significant portion of its income from vendor allowances.[44] The allowances provide CSK with the financial support it needs to market vendor products and must be accounted for in its annual financial reports.[45] As CEO of CSK, Jenkins was responsible for the general management and supervision of the corporation and received a salary, bonuses and stock option grants.[46] He also signed the company's annual financial statements, including those for fiscal years 2002, 2003 and 2004.[47]

On May 2, 2005, CSK filed an accounting restatement, which adjusted its net income downward for the 2003, 2002 and 2001 fiscal years by $4.3 million, $5.5 million and $0.3 million respectively.[48] The restatement was signed by Jenkins, and corrected inaccuracies in the amount of reported vendor allowances resulting from what CSK characterized as "errors in

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42. *Id.* at 1072.

43. Bloomberg Businessweek, *Company Overview – CSK Auto Corporation*, http://investing.businessweek.com/research/stocks/private/snapshot.asp?privcapId=27224 (last visited Dec. 1, 2011). CSK was founded in 1992 and is headquartered in Phoenix, Arizona. *Id.* It is a specialty retailer of automotive parts and accessories, operating under the Checker Auto Parts, Schuck's Auto Supply, Kragen Auto Parts, and Murray's Discount Auto Stores brand names. *Id.*

44. *See* Complaint for Violations of Section 304 of the Sarbanes-Oxley Act of 2002, *Jenkins*, 718 F. Supp. 2d 1070 (D. Ariz. July 22, 2009) (No. 09CV01510), 2009 WL 2350797, at *1-2 (describing the importance of vendor allowances to CSK and the effect of such allowances on the company's financial position).

45. *Id.* CSK accounted for vendor allowances by reducing its cost of goods sold. Thus, the more vendor allowances CSK earned, the lower its costs of goods sold, resulting in greater reported pre-tax income.

46. *See* 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 *7-8 (describing Jenkins's responsibilities as CEO and noting that he earned over $15 million in salary, bonuses, and other incentive-based compensation between 1997 and 2007, as well as 800,000 stock option grants).

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

48. CSK Auto Corporation Form 10-K (May 2, 2005), *available at* http://www.sec.gov/Archives/edgar/data/1051848/000095015305000964/p70502e10vk.htm; Memorandum of Points and Authorities in Support of Motion by Plaintiff Securities and Exchange Commission for Partial Summary Judgment Against Defendant Maynard L. Jenkins, *Jenkins,* 718 F. Supp. 2d 1070 (D. Ariz. Sept. 17, 2010) (No. CV-09-01510-PHX-GMS), 2010 WL 3693505, at *5 n.4.

estimation" and "imprecise estimates [and] bookkeeping errors."[49] Prompted by this restatement, CSK announced that it was postponing the release of its fourth quarter and fiscal 2005 financial results pending a special investigation by its Audit Committee relating to other potential accounting irregularities.[50]

On May 1, 2007, CSK filed a second accounting restatement, which revealed that the company had been engaged in accounting fraud by failing to write-off its uncollectible vendor allowances pursuant to Generally Accepted Accounting Principles.[51] By failing to write-off these allowances, CSK was able to overstate its pre-tax income by 47%, or $11 million, for fiscal year 2002, by 43%, or $34 million, for fiscal year 2003 - which allowed the company to report a profit instead of a loss for the year - and by 65%, or $21 million, for fiscal year 2004.[52] CSK's restatement disclosed that these fraudulent accounting practices were the result of actions directed by certain personnel within the company and an ineffective control environment, which permitted the recording of improper accounting entries and the inappropriate override of existing policies, procedures and internal controls.[53] CSK's chief financial officer, chief operating officer, controller and director of credits receivable were identified as the parties responsible

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49. Memorandum of Points and Authorities in Support of Motion by Plaintiff Securities and Exchange Commission for Partial Summary Judgment Against Defendant Maynard L. Jenkins, *supra* note 48.

50. CSK Auto Corporation Form 8-K (Mar. 27, 2006), Exhibit 99.1, *available at* http://www.sec.gov/Archives/edgar/data/1051848/000095015306000803/p72073exv99w1.htm. In addition to vendor allowance irregularities, the press release cited the investigation of a potential overstatement of approximately $27 million in CSK's in-transit inventory as well as other prospective inventory accounting inaccuracies as the reasons for postponing the release of its fourth quarter and 2005 financial results. *Id.*

51. CSK Auto Corporation Form 10-K (May 1, 2007), *available at* http://www.sec.gov/Archives/edgar/data/1051848/000095015307000933/p73759e10vk.htm. In the second accounting restatement, CSK acknowledged that it had restated vendor allowances in its 2004 Annual Report, but that it subsequently identified additional vendor allowances recorded in prior periods that had not been collected. *Id.* CSK admitted that, as a result of a lack of effective internal controls, it "did not detect or prevent the inappropriate override of established procedures related to: (i) the review and approval process for initial vendor allowance agreements; (ii) the monitoring of modifications to existing vendor allowance agreements; and (iii) the accuracy of recording of various vendor allowance transactions, including applicable cash collections and estimates." *Id.*

52. Plaintiff Securities and Exchange Commission' 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 (summarizing the extent to which CSK's failure to write-off uncollected accounts receivable impacted its pre-tax income).

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

for the accounting fraud, and were charged with civil and criminal violations of the securities laws based on their misconduct.[54]

The SEC filed suit against Jenkins under Section 304 of Sarbanes-Oxley seeking to clawback more than $4 million in bonuses, incentive-based compensation and profits realized from the sale of CSK stock during the 12 month period following the issuance of CSK's 2002, 2003 and 2004 financial statements.[55] The action was predicated upon the pervasive accounting fraud occurring at CSK during Jenkins's tenure, and the multiple accounting restatements filed as a result of that fraud.[56] The complaint specifically noted the scheme engaged in by certain CSK executives to hide millions of dollars in uncollectible vendor allowance, but did not contain any allegations that Jenkins participated in the accounting fraud or that he was even aware that such fraud was occurring.[57] Despite Jenkins's lack of participation or knowledge, the SEC asserted that he was required to reimburse CSK his incentive-based compensation as well as the profits realized from his sale of CSK securities between May 5, 2003 and May 2, 2005.[58]

Jenkins moved to dismiss the SEC's suit against him, contending that the allegations contained in the complaint were insufficient to state a cause of action for violations of Section 304.[59] He asserted that Section 304 requires proof of personal misconduct on behalf of the defendant before reimbursement may be sought, and that such allegations were admittedly lacking in the instant case.[60] Jenkins argued that the legislative history of Section 304 confirmed that Congress intended to require both personal wrongdoing and a causal connection between the amounts to be reimbursed

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54. *See* SEC v. Fraser, CV 09-0443-PHX-GMS (D. Ariz. 2009); United States v. Fraser, CR 09-372 PHX SRB LOA (D. Ariz. 2009).

55. Complaint for Violations of Section 304 of the Sarbanes-Oxley Act of 2002, SEC v. Jenkins, 718 F. Supp. 2d 1070 (D. Ariz. July 22, 2009) (No. 09CV01510), 2009 WL 2350797, at *4. During the 12-month periods following the issuance of CSK's 2002, 2003, and 2004 financial statements Jenkins received over $2 million in compensation from CSK in the form of bonuses and other incentive-based and equity-based compensation and realized over $2 million in profits from the sale of CSK securities. *Id.*

56. *Id.* at *16 (describing the suit against Jenkins as being predicated upon: (1) CSK's material non-compliance with financial reporting requirements under the securities laws; (2) the resulting fraudulent financial statements for fiscal years 2002, 2003, 2004; and (3) the accounting restatements that were issued for those fiscal years).

57. *Id.* at *1 (noting that most of CSK's senior officers were engaged in accounting fraud, but failing to assert that Jenkins had any involvement in that wrongdoing beyond certifying the fraudulent financial statements).

58. *Id.* at *3.

59. *See* Notice of Motion and Motion by Defendant Maynard L. Jenkins to Dismiss the Complaint; Memorandum of Points and Authorities in Support Thereof, *Jenkins*, 718 F. Supp. 2d 1070 (D. Ariz. Sept. 15, 2009) (No. CV-09-01510-PHX-GMS), 2009 WL 3028005, at *5 (relying on Fed. R. Civ. P. 12(b)(6) in seeking dismissal of the SEC's complaint).

60. *Id.* at *1-2.

and the misstated financials.[61] He pointed specifically to Congressional reports which repeatedly referred to Section 304 as providing for "disgorgement," and argued that "disgorgement" is an equitable remedy designed to deprive a *wrongdoer* of unjust enrichment.[62] Jenkins also contended that the SEC's attempt to clawback his bonus compensation and stock profits without proof that he even had knowledge of the financial fraud occurring at CSK raised serious constitutional concerns.[63] Specifically, he argued that the imposition of Section 304 liability upon an innocent person violated due process and imposed an impermissible penalty.[64]

The district court denied Jenkins's motion to dismiss, holding that Section 304 does not require specific misconduct by the issuer's CEO or CFO in order to seek reimbursement of their bonus compensation and stock profits.[65] The court looked first to the text of the statute, which specifies that the reimbursement obligation is triggered if an issuer has 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."[66] The court noted that the issuer here is a corporation, which acts through its officers, agents or employees and is liable for the actions of such persons acting within the scope of their agency.[67] Thus, the court held, the plain language of the statute indicates that the misconduct of any corporate officers, agents or employees is sufficient to trigger the reimbursement obligation, regardless of whether the CEO and CFO are aware of their company's noncompliance with securities laws.[68]

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61. *Id.* at *4-5.

62. *Id.* at *17-18 (citing SEC v. First Pac. Bancorp., 142 F.3d 1186, 1191 (9th Cir. 1998); SEC v. Blatt, 583 F.2d 1325, 1335 (5th Cir. 1978) ("[t]he court's power to order disgorgement extends only to the amount with interest by which the defendant *profited from his wrong doing*") (emphasis added)).

63. Notice of Motion and Motion by Defendant Maynard L. Jenkins to Dismiss the Complaint; Memorandum of Points and Authorities in Support Thereof, *supra* note 59.

64. *Id.* at *10-11. Jenkins also asserted that Section 304 is a remedy to be imposed against wrongdoers, and not a standalone basis for liability. *Id.* at *14-16. In support of this proposition Jenkins relied primarily upon *In re* Digimarc Corp. Derivative Litig., 549 F.3d 1223 (9th Cir. 2008), which held that Section 304 does not create a private cause of action. Notice of Motion and Motion by Defendant Maynard L. Jenkins to Dismiss the Complaint; Memorandum of Points and Authorities in Support Thereof, *supra* note 59, at *16.

65. SEC v. Jenkins, 718 F. Supp. 2d 1070, 1074 (D. Ariz. 2010).

66. *Id.* (citing 15 U.S.C. § 7243(a) (2006)).

67. *Jenkins*, 718 F. Supp. 2d at 1075. (citing *In re* Am. Int'l Grp., Inc. v. Greenberg, 965 A.2d 763, 802, 823 (Del. Ch. 2009)).

68. *Jenkins*, 718 F. Supp. 2d at 1075. The court also took the opportunity to distinguish Digimarc Corp., 549 F.3d 1223, stating that the Ninth Circuit merely held that Section 304 did not create a private cause of action and did not address whether Section 304 provides a stand-alone basis for imposing liability nor that the statue applies only to wrongdoers. *Id.*

The court found that the statutory title of Section 304 – "Additional Compensation Prior to Noncompliance with Commission Financial Reporting Requirements" – reinforced the notion that Congress sought to recapture compensation paid during any period of non-compliance, regardless of whether the CEO was personally aware of or participated in the financial misconduct.[69] The court noted that when a CEO either sells stock or receives a bonus in the 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.[70] The court concluded that under such circumstances, it is not irrational to require that such compensation amounts be repaid to the issuer.[71]

The court looked next to the larger statutory scheme behind Sarbanes-Oxley, and noted that Section 302 of the Act requires an issuer's CEO and CFO to certify each annual or quarterly report of the company.[72] Section 302 also requires the CEO and CFO to certify that they are responsible for the existence, design and operation of effective internal controls that provide assurances as to the accuracy of the issuer's financial statements.[73] The court held that Section 304 works in concert with this provision, providing an incentive for CEOs and CFOs to be rigorous in their creation and certification of internal controls by requiring the reimbursement of compensation received during periods of corporate non-compliance, regardless of whether or not the officer was aware of the misconduct giving rise to the misstated financials.[74]

Finally, the court found that the legislative history of Sarbanes-Oxley supported the notion that Section 304 did not require misconduct or knowledge of misconduct on the part of an issuer's CEO or CFO in order to trigger reimbursement.[75] The court noted that the House and Senate passed different versions of Sarbanes-Oxley, and that the Senate Bill did not mention scienter or require misconduct on behalf of the officers.[76] By contrast,

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69. *Jenkins*, 718 F. Supp. 2d at 1075.
70. *Id.*
71. *Id.*
72. *Id.* at 1076-77 (citing 15 U.S.C. § 7241 (2006)).
73. *See supra* Part II.B.
74. *Jenkins*, 718 F. Supp. 2d at 1077. The court also noted that if a CEO is actually aware of misconduct that results in a financial misstatement, the CEO may be subject to additional civil and criminal penalties. *Id.* at 1077 n.2 (citing 15 U.S.C.A. § 78u(d) (West 2011); 18 U.S.C. § 1350 (2006); 17 C.F.R. § 240.10b-5 (2006); 17 C.F.R. § 240.13a-14 (West 2011)). The court stated that because these other securities laws already provide civil and criminal penalties for knowing misconduct, interpreting Section 304 as covering situations where CEOs and CFOs were unaware of any misconduct avoids redundancy with existing securities laws. *Id.*
75. *Jenkins*, 718 F. Supp. 2d at 1077.
76. *Id.* at 1078; *see supra* notes 35, 37.

the House version of Sarbanes-Oxley directed the SEC to identify an appropriate scienter requirement and sought to impose liability only in the case of extreme misconduct on the part of an officer.[77] In light of the incongruity between these proposed statutory provisions, and the fact that the Senate's version was ultimately enacted into law, the court held that a cause of action may be stated under Section 304 without allegations that the defendant engaged in misconduct or had knowledge of the issuer's non-compliance.[78]

III. Implications of the *Jenkins* Decision and Interpretive Issues Moving Forward

A. Constitutional Concerns Raised by *Jenkins*

The court's decision in *Jenkins* unquestionably raises concerns relating to the constitutionality of holding a corporate officer personally liable for misconduct in which he was uninvolved. The Fifth and Fourteenth Amendments guarantee due process, and have been interpreted as imposing "substantive limits 'beyond which penalties may not go.'"[79] The U.S. Supreme Court has held that due process is violated when a penalty is "grossly excessive" in relation to the government's interests in punishment and deterrence.[80] Additionally, the Eighth Amendment provides that "[e]xcessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishment inflicted."[81] The Supreme Court has held that "a punitive forfeiture violates the Excessive Fines Clause if it is grossly disproportional to the gravity of the defendant's offense."[82] Similarly, in interpreting the prohibition against cruel and unusual punishment, the Supreme Court has stated that "the Eighth Amendment does not require strict proportionality between crime and sentence," but precludes "extreme sentences that are 'grossly disproportionate' to the crime."[83]

The Supreme Court thus consistently holds that where a gross discrepancy exists between the offense and punishment, a constitutional violation has occurred. Despite this limitation, however, courts have imposed liability upon corporate officers in the absence of personal misconduct under theories such as the "responsible corporate officer

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77. *Jenkins*, 718 F. Supp. 2d at 1077-78; *see supra* note 33-34 and accompanying text.

78. *Jenkins*, 718 F. Supp. 2d at 1078.

79. TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443, 453-54 (1993) (quoting Seaboard Air Line R. Co. v. Seegers, 207 U.S. 73, 78 (1907)).

80. BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 568 (1996).

81. U.S. Const. amend. VIII.

82. United States v. Bajakajian, 524 U.S. 321, 334 (1998).

83. Harmelin v. Michigan, 501 U.S. 957, 1001 (1991) (Kennedy, J. concurring).

doctrine."[84] In *U.S. v. Dotterweich*,[85] the Supreme Court held that the president of a pharmaceutical company was liable under the Federal Food, Drug and Cosmetics Act of 1938 ("FFDCA") for distributing adulterated and misbranded drugs, despite the lack of any proof that he had knowledge of the violations or participated in the acts constituting the basis for the violations.[86] The Court stated that although the defendant did not actually engage in wrongdoing, he had a responsibility in relation to the situation due to his position of control such that vicarious liability could be imposed.[87] Subsequently, in *U.S. v. Park*,[88] the Supreme Court found the president of a grocery firm liable for violations of the FFDCA despite the fact that he did not personally participate in any wrongdoing.[89] In rendering this decision, the Court rejected the defendant's argument that he had delegated his responsibilities to a subordinate, holding that liability may be predicated upon an officer's failure to prevent a prohibited act.[90]

These principles of corporate responsibility have been expanded upon greatly since *Dotterweich* and *Park* and have been applied by courts in a variety of cases including securities fraud,[91] consumer fraud,[92] antitrust violations[93] and tax violations.[94] While scholars contend that these cases do not impose the same "absolute vicarious liability" contemplated by Section

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84. Randy J. Sutton, *"Responsible Corporate Officer" Doctrine or "Responsible Relationship" of Corporate Officer to Corporate Violation of Law,* 119 A.L.R.5th 205 (2004). Under the responsible corporate officer doctrine corporate officers are subject to both civil and criminal liability for corporate violations of statutes affecting public welfare even where the officer did not personally participate in the wrongdoing, so long as the officer was in a position of responsibility that allowed the officer to influence corporate policies and activities and the corporate officer had a responsible share in the furtherance of the transaction that the statute outlawed. *Id.*

85. United States v. Dotterweich, 320 U.S. 277 (1943).

86. *Id.* at 285.

87. *Id.* at 280-81.

88. United States v. Park, 421 U.S. 658 (1975).

89. *Id.* at 677-78.

90. *Id.* at 672-73.

91. Wittenberg v. Gallagher, No. 01-0168, 2001 WL 34048121, at *1 (Ariz. Ct. App. Nov. 20, 2001) (holding president of investment company personally responsible for violations committed by broker employee).

92. State *ex rel*. Miller v. Santa Rosa Sales and Mktg., Inc., 475 N.W.2d 210, 219-20 (Iowa 1991) (holding corporate president personally liable for fraudulent purchase scheme perpetuated by employee).

93. Monarch Mktg. Sys., Inc. v. Duncan Parking Meter Maint. Co., No. 82-C-2599, 1986 WL 3625, at *1 (N.D. Ill. Mar. 13, 1986) (holding officer liable under Sherman Antitrust Act for improper corporate transaction).

94. Purcell v. United States, 1 F.3d 932, 936 (9th Cir. 1993) (rejecting corporate president's argument that he had delegated taxation related duties to subordinate and finding him personally liable for violations of the Internal Revenue Code).

304,[95] there can be no doubt that the propriety of holding an officer accountable for the misconduct of corporate employees has been judicially scrutinized and upheld by courts throughout the country. Furthermore, given the fact that several of these decisions were handed down by the Supreme Court, it appears that the constitutionality of imposing such vicarious liability upon corporate officers is assured, at least for the moment. Interestingly, commentators have also asserted that Section 304 does not actually impose "vicarious" liability at all and, therefore, does not implicate any constitutional concerns.[96] This view is based upon the notion that "the clawback does not impose liability for the 'misconduct' that led to the restatement, but for the CEO's or CFO's own failure to prevent, or at least detect and put a stop to, the misconduct."[97]

Regardless of whether Section 304 can be seen as imposing liability vicariously based on the misconduct of corporate employees, or directly for an officer's failure to implement effective internal controls, the court's decision in *Jenkins* appears to be on solid constitutional footing. The Supreme Court in *Dotterweich* and *Park* imposed liability upon CEOs and CFOs without regard to their knowledge or participation in misconduct based on the larger responsibility these officers owe to their corporations and the public at large.[98] A similar theme underlies Sarbanes-Oxley, which seeks to impose greater responsibilities upon corporate officers for their companies' financial practices and disclosures in order to protect investors.[99] Thus, while the constitutionality of Section 304 and the *Jenkins* decision is ultimately a matter for the appellate courts to resolve, it seems likely, based on the foregoing discussion, that the imposition of clawback liability will be upheld even in situations where the defendant does not engage in misconduct or have knowledge of it.

B. The Definition of "Misconduct" as an Interpretive Issue Moving Forward

During the eight-year period between the enactment of Sarbanes-Oxley and the decision in *Jenkins*, there have been more than 6,000 accounting restatements,[100] many of which were due to "errors" or other

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95. Kelsh, *supra* note 2, at 1033-34 (asserting that the holding in *Park* and other similar cases is not analogous to the standard imposed under Section 304 because those decisions provided that a "defendant could avoid liability by showing that he or she was 'powerless' to prevent or correct the violation at issue").

96. Schwartz, *supra* note 7, at 26-27.

97. Schwartz, *supra* note 7, at 26.

98. *See supra* notes 84-90 and accompanying text.

99. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, 745 (2002).

100. *See, e.g.*, Kevin LaCroix, *Restatements Decline – Again*, THE D&O DIARY (Mar. 10, 2010), http://www.dandodiary.com/2010/03/articles/corporate-governance/restatements-decline-again (discussing recent statistical trends for accounting restatements); *see also*

irregularities involving an issuer's accounting practices.[101] Yet, during that same time period, there were only a handful of Section 304 actions brought against the CEOs and CFOs of offending issuers.[102] While scholars have commented on the reasons behind the SEC's hesitancy to invoke Section 304,[103] there can be no doubt that such actions will be on the rise in the coming years due to the liberal standard established by *Jenkins*. A key issue which arose in *Jenkins*,[104] and is certain to be contested in future Section 304 actions, relates to the prerequisite that clawback liability be predicated upon the issuance of an accounting restatement resulting from "misconduct" of the issuer. Such a requirement inherently gives rise to interpretive questions regarding the level of "misconduct" necessary to invoke the reimbursement obligation and is pivotal in assessing the extent to which Section 304 may be utilized by the SEC.

"Misconduct" has been described as an "abstract term,"[105] the definition and interpretation of which varies widely by jurisdiction.

Huron Consulting Group, *2003 Interim Restatement Study* (July 29, 2003), http://www.huronconsultinggroup.com/library/InterimRestatementStudy2003.pdf (identifying restatement trends between 1999 and 2003).

101. Kelsh, *supra* note 2, at 1011 (citing Huron Consulting Group, *An Analysis of Restatement Matters: Rules, Errors, Ethics, for the Five Years Ended December 31, 2002* (Jan. 2003), www.huronconsultinggroup.com/uploadedFiles/Huron_RestatementStudy 2002.pdf) (identifying the number of accounting restatements that were issued due to an "error" as defined in Accounting Principles Board Opinion 20).

102. List, *supra* note 25, at 217 (stating that as of December 2007 the SEC had filed only five actions under Section 304). The SEC filed an additional eleven Section 304 actions between January 2008 and March 2011. *See* SEC v. Geswein, No. 5:10-cv-01235 (N.D. Ohio 2010); SEC v. Spongetech Delivery Systems, Inc., No. CV10-2031 (E.D.N.Y. 2010); SEC v. Morrice, No. SACV09-01426 (C.D. Cal. 2009); SEC v. Home Solutions of Am., Inc., No. 3:09-CV-02269 (N.D. Tex. 2009); SEC v. Fuhlendorf, No. C09-1292 (W.D. Wash. 2009); SEC v. Jenkins, No. CV-09-01510 (D. Ariz 2009); SEC v. Fraser, 209-CV-00443 (D. Ariz. 2009); SEC v. Microtune, Inc., No. 3-08-CV-1105 (N.D. Tex. 2008); SEC v. Sabhlok, No. 08-CV-04238 (N.D. Cal. 2008); SEC v. Sycamore Networks, Inc., No. 08-CA-11166 (D. Mass. 2008); SEC v. Nicholas, No. SACV08-539 (C.D. Cal. 2008).

103. List, *supra* note 25, at 217 (describing "lazy enforcement" as the main reason behind the SEC's failure to more readily utilize Section 304); *see also* Schwartz, *supra* note 7, at 2 (discussing generally the lack of reimbursement actions under Section 304).

104. *See generally* Memorandum of Points and Authorities in Support of Motion by Plaintiff Securities and Exchange Commission for Partial Summary Judgment Against Defendant Maynard L. Jenkins, *supra* note 49; *see also* Memorandum of Points and Authorities of Defendant Maynard L. Jenkins in Opposition to Motion of Securities and Exchange Commission for Partial Summary Judgment, SEC v. Jenkins, 718 F. Supp. 2d 1070 (D. Ariz. Oct. 29, 2010) (No. CV-09-01510-PHX-GMS), 2010 WL 4340003. On summary judgment, the parties debated extensively as to whether the "misconduct" occurring at CSK could be considered actionable under Section 304. *Id.* However, this issue was never ruled upon by the court because the matter settled.

105. Smith v. Bd. of Review, 658 A.2d 310, 313 (N.J. Super Ct. App. Div. 1995) (citing Beaunit Mills v. Div. of Emp't Sec., 128 A.2d 20, 26 (N.J. Super Ct. App. Div. 1956)).

Sarbanes-Oxley does not expressly define this term, and courts have yet to specify a uniform standard for the nature and degree of misconduct needed to maintain an action under Section 304. The legislative history of Sarbanes-Oxley provides some guidance as to the upper range of misconduct that Congress considered actionable. As discussed, *supra*, the House version of Section 304 contemplated "extreme misconduct" in order for the SEC to seek disgorgement of an officer's compensation.[106] This "extreme" qualifier, however, was ultimately left on the cutting room floor, and the statute enacted without any express indication as to what conduct is actionable.[107] Thus, while Sarbanes-Oxley itself does not solidify an interpretive standard, the legislative history implies that Congress sought to hold CEOs and CFOs accountable for something less than "extreme" misconduct.

The few judicial decisions that have assessed "misconduct" within the context of Section 304 also provide some indication as to the current interpretation of the term and the minimum level necessary to maintain an action for reimbursement. The court in *In re AFC Enterprises, Inc. Derivative Litigation* made clear that "the purpose of the Act is to punish 'misconduct,' not the mere decision to restate financial reports."[108] Thus, a restatement itself cannot be seen as implying misconduct sufficient to maintain an action under Section 304. In *SEC v. Mercury Interactive, LLC*, the court allowed a Section 304 action to be maintained based upon the alleged concealment of compensation expenses resulting from a stock options backdating scheme.[109] The "wrongful conduct," therefore, rose above the level of mere negligence or mistake to an active and fraudulent scheme by employees of the issuer.[110] Similarly, in *Jenkins*, the alleged misconduct involved pervasive accounting fraud, which resulted in criminal indictments and multiple financial restatements.[111]

While these decisions and the legislative history of Sarbanes-Oxley allow for certain inferences regarding an actionable level of "misconduct" under Section 304, the best interpretive source for this term may be found in the labor codes of various jurisdictions. Many of these statutory provisions provide express and judicially scrutinized definitions for misconduct and impose obligations on employees which can be equated to those set forth in Sarbanes-Oxley. The range of behavior articulated in these statutes and

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106. H.R. REP. NO. 107-414, s*upra* note 34.

107. *Supra* notes 37-38 and accompanying text.

108. *In re* AFC Enter., Inc. Derivative Litig., 224 F.R.D. 515, 521 (N.D. Ga. 2004).

109. Order Granting in Part and Denying in Part Motions to Dismiss, Without Leave to Amend, SEC v. Mercury Interactive, LLC, (No. 5:07-cv-02822), 2010 WL 3790811, at *4 (N.D. Cal. Sept. 27, 2010).

110. *Id.*

111. *Supra* note 54 and accompanying text; *see also* SEC v. Jenkins, 718 F. Supp. 2d at 1072 (D. Ariz. 2010).

opinions is consistent and generally gives rise to actionable misconduct in the case of an employee's willful and wanton disregard of an employer's interests as found in the deliberate violation or disregard of standards of behavior, which the employer has the right to expect of his employee.[112] Misconduct will also arise where there is evidence of carelessness or negligence of such degree or recurrence as to manifest equal culpability, wrongful intent or evil design or an intentional and substantial disregard of the employer's interests or employee's duties and obligations.[113] Mere inefficiency, unsatisfactory conduct, ordinary negligence in isolated instances or good faith errors in judgment are not considered to be misconduct under these provisions.[114]

The standards expressed in these statutes and decisions could provide a consistent interpretive framework for assessing misconduct in a manner that conforms to the purpose and enforcement scheme of Sarbanes-Oxley. Through the enactment of Section 304, Congress sought to hold corporate officers personally accountable for the quality of their company's internal controls and financial disclosures.[115] Defining misconduct as a willful and wanton disregard for an issuer's interests, or negligence sufficient to evidence wrongful intent or substantial disregard, imposes realistic obligations on CEOs and CFOs to identify intentional or pervasively negligent conduct in order to prevent financial fraud and the need for accounting restatements. Additionally, such a standard promotes judicial efficiency by allowing reimbursement actions only in those cases in which conduct rises above the level of simple negligence. Accordingly, while courts have yet to squarely address the precise level of "misconduct" necessary to maintain an action under Section 304, limiting liability under the clawback provision to cases involving intentional or pervasively negligent conduct seems to be a logical and efficient standard through which to ensure compliance with Sarbanes-Oxley.

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112. TENN. CODE ANN. § 50–7–303(a)(2) (West 2011); HAW. ADMIN. R. § 12-5-51(c) (West 2011); MO. REV. STAT. § 288.030(23) (West 2011); Chapman v. NYK Line N.A., Inc., 207 P.3d 154, 158 (Idaho 2009); Meyers v. Nebraska State Penitentiary of the Nebraska Dep't of Corr. Servs., 791 N.W.2d 607, 611 (Neb. 2010); Boynton Cab Co. v. Neubeck, 296 N.W. 636, 639 (Wis. 1941).

113. TENN. CODE ANN.§ 50–7–303(a)(2) (West 2011); HAW. ADMIN. R. § 12-5-51(c) (West 2011); MO. REV. STAT. § 288.030(23) (West 2011); *Chapman*, 207 P.3d at 158 (Idaho 2009); *Meyers*, 791 N.W.2d at 611 (Neb. 2010); *Boynton Cab Co*., 296 N.W. at 639 (Wis. 1941).

114. *See* TENN. CODE ANN. § 50–7–303(a)(2) (West 2011); HAW. ADMIN. R. § 12-5-51(c) (West 1981); Duncan v. Accent Mktg., LLC, 328 S.W.3d 488, 491 (Mo. Ct. App. 2010); Turner v. Brown, 134 So.2d 384, 387 (La. Ct. App. 1961); *Boynton Cab Co.*, 296 N.W.2d at 639 (Wis. 1941).

115. *See supra* notes 21-22.

CONCLUSION

Sarbanes-Oxley was a necessary legislative response to the spectacular financial scandals of the early 2000s and has been credited with establishing a consistent, formalized structure for corporate governance and disclosures.[116] Section 304 is a key component of that regulatory package, providing a powerful incentive for corporate officers to be rigorous in their creation and certification of internal controls.[117] *Jenkins* further emphasized the need to effectively maintain these controls by allowing compensation and stock profits to be clawed back from a CEO despite the absence of any allegations of personal misconduct. While this decision raises certain constitutional concerns and leaves open the question of what misconduct will be considered actionable, CEOs and CFOs have been put on notice that they must be vigilant in guarding against financial fraud in order to avoid liability under Section 304. In that sense, *Jenkins* furthers the original goals of Sarbanes-Oxley by imposing greater responsibilities upon corporate executives in order to ensure compliance with the securities laws. Moving forward, however, courts must be mindful to apply the newly refined standards of Section 304 in a manner that places realistic obligations upon corporate officers such that reimbursement may be sought only for failures to identify sufficiently pervasive misconduct. Success in this regard will allow courts to impose clawback liability upon CEOs and CFOs in a manner that comports with due process and ensures that the requirements of Sarbanes-Oxley are satisfied.

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116. Janet Whitman, *Sarbanes-Oxley Act Begins to Take Hold*, Wall St. J., Mar. 25, 2003, at C9.

117. *Supra* text accompanying note 27; *Jenkins*, 718 F. Supp. 2d at 1077.