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SARBANES-OXLEY AND CEO ACCOUNTABILITY: LOOKING FOR A  
CORPORATE SCAPEGOAT IN *S.E.C. V. JENSEN*

JACQUELINE DAKIN\*

“If there were a bullseye painted in black on the back of the CFO, now it would be painted in red.”<sup>1</sup>

I. INTRODUCTION

If asked for the common characteristics of chief executive officers (CEOs) and chief financial officers (CFOs), several things might come to mind: creative, extroverted, risk-taking, or innovative.<sup>2</sup> Maybe even crazy.<sup>3</sup> But what about dishonest?<sup>4</sup> In 2002, just prior to the enactment of the Sarbanes-Oxley Act of

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\* J.D. Candidate, 2019, Villanova University Charles Widger School of Law; B.A., 2016, University of Connecticut. This Note is dedicated to my parents, Robert and Michelle Dakin, and sisters, Jennifer and Kristen Dakin, for their unwavering love and support. I would also like to thank everyone on the *Villanova Law Review* for making the publication of this Note possible.

1. Randy Myers, *The Rising Risk of Being CFO*, CFO MAGAZINE (Dec. 19, 2016), <http://ww2.cfo.com/risk-management/2016/12/rising-risk-cfo/> [<https://perma.cc/AZV6-QUJJ>] (internal quotation marks omitted) (quoting John J. Carney). Carney opined that “[t]here’s not a public company in America that could withstand a full, substantive audit and not have errors and mistakes found . . . .” *Id.* He emphasized the fear that potential individual liability will ignite in CEOs and CFOs—even those who act honestly and are diligent in their certifications. *See id.* (internal quotation marks).

2. *See* Stephanie Chung, *10 Personality Traits Successful CEOs Share*, INC. (Apr. 10, 2017), <https://www.inc.com/stephanie-chung/10-personality-traits-every-ceo-should-have.html> [<https://perma.cc/RH7B-EAA6>] (writing that successful CEOs have “[s]trong communication skills,” are “[w]illing[] to take calculated risks,” and “[t]hink[] outside the box”).

3. *See* Jeff Bercovici, *Why (Some) Psychopaths Make Great CEOs*, FORBES (June 14, 2011, 08:46 AM), <https://www.forbes.com/sites/jeffbervovici/2011/06/14/why-some-psychopaths-make-great-ceos/#2bec30dc261a> [<https://perma.cc/5GAM-GLZV>] (“[T]he incidence of psychopathy among CEOs is about 4 percent, four times what it is in the population at large.” (citing Jon Ronson, *THE PSYCHOPATH TEST: A JOURNEY THROUGH THE MADNESS INDUSTRY* (2011))); *see also* Lindsay Dodgson, *Here’s Why CEOs Often Have the Traits of a Psychopath*, BUS. INSIDER (July 7, 2017, 05:42 AM), <http://www.businessinsider.com/ceos-often-have-psychopathic-traits-2017-7> [<https://perma.cc/6Y3W-FHA3>] (writing that “CEOs are more likely to be psychopaths”); Gene Marks, *21 Percent of CEOs Are Psychopaths. Only 21 Percent?*, WASH. POST (Sept. 16, 2016), [https://www.washingtonpost.com/news/on-small-business/wp/2016/09/16/gene-marks-21-percent-of-ceos-are-psychopaths-only-21-percent/?utm\\_term=.9a6f22621391](https://www.washingtonpost.com/news/on-small-business/wp/2016/09/16/gene-marks-21-percent-of-ceos-are-psychopaths-only-21-percent/?utm_term=.9a6f22621391) [<https://perma.cc/Y62D-DYSC>] (providing results of study of 261 United States senior corporate professionals). According to the cited study, one in five CEOs are psychopaths, in contrast to about one in 100 among the general population. *See id.*

4. *See* Matti Rantanen, *Reasons of Systemic Collapse in Enron*, in *SYSTEMS INTELLIGENCE IN LEADERSHIP AND EVERYDAY LIFE* 171, 171 (Raimo P. Hamalainen and Esa Saarinen eds., 2007) <http://sal.aalto.fi/publications/pdf-files/rran07.pdf> (studying how long-term CEO’s leadership led to immoral behavior at Enron); *see also* *Lessons from the Enron Scandal*, MARKKULA CENTER FOR APPLIED ETHICS (Mar. 5, 2002), <https://www.scu.edu/ethics/focus-areas/business-ethics/resources/lessons-from-the-enron-scandal/> [<https://perma.cc/2ZYC-UB63>] (interviewing Kirk Hanson, executive director of the Markkula Center for Applied Ethics). When asked why the collapse of Enron happened, Hanson cited senior executives trying to “cover up their own failures” and a “lack of truthfulness

2002 (Sarbanes-Oxley or SOX), widespread dishonesty and misconduct by corporate officers resulted in many highly-publicized scandals, leading to public outrage.<sup>5</sup> Sarbanes-Oxley was the hastily drafted response to that outrage.<sup>6</sup> Section 304 of Sarbanes-Oxley (“section 304” or “SOX 304”) created penalties for CEOs and CFOs when misconduct caused noncompliance with reporting requirements.<sup>7</sup> Section 304 provides that, when an issuer’s misconduct requires the company to prepare an accounting restatement, the CEOs and CFOs must reimburse the issuer incentive-based compensation, as well as any profits from the sale of securities earned during the twelve-month period following the first issuance of the erroneous financial statement.<sup>8</sup>

Because of its quick drafting, the statute’s language is ambiguous in several respects, including whether the U.S. Securities and Exchange Commission (SEC) can seek disgorgement of compensation from an issuer’s CEO or CFO.<sup>9</sup> Disgorgement is the act of giving back illegally obtained profits.<sup>10</sup> The ambiguity occurs because it is not the CEO’s or CFO’s personal misconduct, but rather the misconduct of a lower-level employee that results in the issuing of an accounting

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by management.” *See id.*

5. *See* Isaac U. Kimes, Note, *Unfettered Clawbacks—Why Section 304 of the Sarbanes-Oxley Act Requires a Personal Misconduct Standard*, 42 U. MEM. L. REV. 797, 798 (2012) (suggesting that the corporate scandals which prompted the enactment of the statute “rocked” the country and the resulted in “increase in public anger towards big business created a policy window that facilitated the passage of SOX”).

6. *See* Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And it Just Might Work)*, 35 CONN. L. REV. 915, 927–28 (2003) (writing that Sarbanes-Oxley was political response to pressure caused by successive corporate scandals); *see also* Kimes, *supra* note 5, at 798–99 (noting increase in public anger from scandals and criticism that Sarbanes-Oxley was hastily constructed and heavily politicized); Gregory C. Leon, *Stigmata: The Stain of Sarbanes-Oxley on U.S. Capital Markets*, 9 DUQ. BUS. L.J. 125, 127 (2007) (calling Sarbanes-Oxley Act response to scandals surrounding corporate icons and “Congress’s answer to the corporate wrong doing of the 1990s”).

7. *See* Cunningham, *supra* note 6, at 956 (noting penalties for CEOs and CFOs were intended to de-incentivize financial manipulation); *see also* Kimes, *supra* note 5, at 800 (explaining how section 304 functions).

8. 15 U.S.C. § 7243(a) (2012). Section 2(4) of the Securities Act of 1933, an “issuer” is “every person who issues or proposes to issue any security.” 15 U.S.C. § 77B(a)(4); *see also* 15 U.S.C. § 78(c)(8) (defining “issuer” as “any person who issues or proposes to issue any security”).

9. *See* Matthew J. O’Hara, *Financial Fraud: New Ninth Circuit Case on SOX Clawback Leaves Unresolved Issues*, 2 CORP GOVERNANCE REP. (BNA) No. 12, Dec. 5, 2016, (highlighting that statute has been criticized for its ambiguities, such as: (1) it fails to define misconduct, and more specifically, it fails to state whether the misconduct of the issuer needs to be intentional in order to trigger disgorgement under section 304; and (2) it fails to state whether there needs to be a causal connection between the amount of money that the SEC seeks to “claw back” and the increase in compensation resulting from the misconduct).

10. *See* *Disgorgement*, BLACK’S LAW DICTIONARY (10th ed. 2014) (defining disgorgement as “[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion”). It has generally been considered a restitution remedy that is designed to prevent a conscious wrongdoer from profiting from their wrongdoing. *See* RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 51 cmt. e (AM. LAW. INST. 2011) (noting object of disgorgement); *see also id.* at cmt. a (“Restitution measured by the defendant’s wrongful gain is frequently called ‘disgorgement.’”); *cf. id.* at § 51(5)(d) (stating “[a] claimant who seeks disgorgement of profit has the burden of producing evidence permitting at least a reasonable approximation of the amount of the wrongful gain”).

restatement.<sup>11</sup> In this context, section 304 would allow the SEC to “recapture,” from senior officers, any incentive-based compensation they received during the years in which the corporate issuer failed to comply with reporting requirements.<sup>12</sup>

Until recent years, SEC enforcement of section 304 was virtually non-existent.<sup>13</sup> The statute’s ambiguities are likely to blame for why the SEC has so scarcely enforced it since its enactment in 2002.<sup>14</sup> It was not until 2007, five years after the enactment of the statute, that the SEC even attempted to enforce section 304.<sup>15</sup> Further, the SEC did not seek disgorgement of compensation under section 304 from an individual who did not personally engage in misconduct until as late as 2009.<sup>16</sup>

11. See O’Hara, *supra* note 9 (discussing scope of misconduct under section 304 with cases showing that there are many ambiguities).

12. See *S.E.C. v. Baker*, No. A-12-CA-285-SS, 2012 WL 5499497, at \*5 (W.D. Tex. Nov. 13, 2012) (“[I]t was Congress’s purpose to recapture the additional compensation paid to a CEO during any period in which the corporate issuer was not in compliance with financial reporting requirements.” (quoting *S.E.C. v. Jenkins*, 718 F. Supp. 2d 1070, 1075 (D. Ariz. 2010))).

13. See *id.* at \*3 (“For reasons best known to the SEC, the Commission has been historically reluctant to utilize § 304 in the ten years since Sarbanes-Oxley was enacted.”).

14. See Kimes, *supra* note 5, at 822 (“The reason why the SEC has not actively pursued section 304 claims against CEOs regardless of their misconduct may be the ambiguity of the statute.”); Allison List, Note, *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, 222 (2009) (suggesting that section 304’s ambiguity may be one reason why SEC has failed to enforce it more vigorously). It has even been reported that members of the Commission were (and perhaps still are) divided on their support of the provision. See William McLucas et al., *SOX 304 “Clawback” as an Enforcement Tool*, WILMERHALE, [http://news.acc.com/accwm/downloads/WilmerHale\\_123110.pdf](http://news.acc.com/accwm/downloads/WilmerHale_123110.pdf) [<https://perma.cc/Q5JV-XUSV>] (noting, in 2010, Bloomberg reported that “SEC’s five commissioners have been arguing on how to use the clawback authority since July 2009” (quoting *SEC Rift on When to Claw Back Bonus May Leave Policy in Limbo*, BLOOMBERG (BNA) (Aug. 6, 2010))).

15. See List, *supra* note 14, at 217 (noting that SEC admitted its first time using section 304 was in 2007). In a press release dated May 31, 2007, the SEC announced that it would be using section 304 of the Sarbanes-Oxley Act for the first time in pursuing charges against four senior officers of Mercury Interactive, LLC. See 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> [<https://perma.cc/997Y-FKJP>] (“The Commission’s first ever use of Section 304 of Sarbanes-Oxley . . . reflects the Commission’s willingness to use all available remedies to deprive such senior officers of illicit gains.”). In *S.E.C. v. Mercury Interactive, LLC.*, four senior officers personally participated in an “array of fraudulent conduct,” including, but not limited to, backdating stock options. See *id.* (quoting Linda Chatman Thomsen, Director of Commission’s Division of Enforcement). In order to conceal their fraudulent activity, they falsified a number of documents over a five-year period. See *id.* Their behavior was purposefully designed so that they could award themselves and other employees “secret compensation,” all the while deceiving shareholders. See *id.* The numbers were shocking: over the five-year period, Mercury had backdated forty-five stock option grants to executives and employees and failed to record over \$258 million in compensation expenses. See *id.* It was clear that the fraudulent activity was not the result of an innocent mistake or just lazy accounting: two of the charged officers even created a PowerPoint presentation titled “Our Hidden Backlog . . . What Any Analyst Would Love to Get Their Hands On!” See *id.*

16. See *Feds Defend First Use of Sarbanes-Oxley’s ‘Clawback’*, 25 ANDREWS CORP. OFF. & DIR. LIAB. LITIG. REP. (WESTLAW) 3 (2009) (noting that this was first time that SEC

Instead of section 304's implementation resulting in a decrease in the issuance of accounting restatements, there was actually a significant increase in the issuance of restatements in the decade following section 304's enactment.<sup>17</sup> In 2001, the year before Sarbanes-Oxley was enacted, only about 2% of exchange-listed firms issued accounting restatements while in 2011, roughly 9% of exchange-listed firms issued such restatements.<sup>18</sup> Despite the vast number of restatements, the SEC only pursued a handful of claims, many of which were attached to other more serious charges and were ultimately dropped or ended in settlement.<sup>19</sup>

*S.E.C. v. Jensen*<sup>20</sup> was the first time a court of appeals addressed the question of whether personal misconduct on the part of the CEO or CFO is required for the SEC to seek enforcement of section 304.<sup>21</sup> The United States Court of

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had relied solely on section 304 to "claw back" compensation awarded to senior officers who were not themselves guilty of accounting fraud); *see also* Press Release, SEC, SEC Seeks Return of \$4 Million in Bonuses and Stock Sale Profits from Former CEO of CSK Auto Corp., Enforcement Action Is First Solely Under "Clawback" Provision of Sarbanes-Oxley Act (July 22, 2009), <https://www.sec.gov/news/press/2009/2009-167.htm> [<https://perma.cc/2DEX-FE95>] (announcing that "Jenkins [CEO] was captain of the ship and profited during the time that CSK was misleading investors about the company's financial health"). In *S.E.C. v. Jenkins*, the court faced an issue of first impression: "whether Section 304 requires a CEO to reimburse an issuer even where the CEO committed no personal wrongdoing." 718 F. Supp. 2d 1070, 1073 (D. Ariz. 2010). Defendant Jenkins was the CEO of CSK Auto Corporation from 1997 to 2007. *See id.* at 1072. In 2002, 2003, and 2004, CSK filed inaccurate financial statements that overstated the amount of gross income the company generated in those years. *See id.* (noting that "CSK reported greater pretax income than the company actually earned"). Jenkins personally certified each of these inaccurate financial statements. *See id.* Then, in 2004, CSK filed a restatement, again certified by Jenkins, in an apparent attempt to correct those inaccuracies; however, the restatement was also materially inaccurate. *See id.* at 1072-73. Finally, in 2007, CSK filed a second restatement, which restated the financial statements for 2002-2004. *See id.* at 1073. The SEC, although it did not file any civil complaints or criminal indictments against Jenkins, sought enforcement of section 304 to require Jenkins to disgorge some two million dollars in incentive-based compensation he received in the years 2003-2005. *See id.*

17. *See* J. Royce Fichtner et al., *The Unfulfilled Promise of Sarbanes-Oxley Section 304: A Call for Pervasive Enforcement*, 14 DEPAUL BUS. & COM. L.J. 49, 75-76 (2015) (noting that even though section 304 seemingly creates incentive for companies to limit restatements, total number of restatements exceeds number before SOX).

18. *See id.* (stating that, in 2001, there were 7,921 exchange-listed firms and 163 of them issued restatements while, in 2011, there were 5,552 exchange-listed firms and 499 of them issue restatements).

19. *See id.* at 76 (acknowledging that SEC did not use section 304 in way that it was intended). Fichtner gives several examples of high-profile cases that involved corporation's restating financial statements as a result of "clear misconduct" where "the SEC inexplicably chose to use its prosecutorial discretion to exempt large portions of collectible monies." *See id.* at 77 (citing to cases where disgorgement seemed clear but SEC decided to exempt portions of monies); *see also* Gretchen Morgenson, *Clawbacks Without Claws*, N.Y. TIMES, (Sept. 10, 2011), <http://www.nytimes.com/2011/09/11/business/clawbacks-without-claws-in-a-sarbanes-oxley-tool.html> [<https://perma.cc/54Q8-G38M>] (condemning the SEC for its failure to utilize section 304 and seek its enforcement against officers). Morgenson called the statute a "clawback[] without claws" and Sarbanes-Oxley "a bark decidedly worse than its bite." *See id.*

20. 835 F.3d 1100 (9th Cir. 2016).

21. *See id.* at 1115 (stating that they are unaware of any circuit court that has addressed this issue); *see also* O'Hara, *supra* note 9 (stating that Ninth Circuit became first appeals court to address whether clawback provision in section 304 required personal misconduct).

Appeals for the Ninth Circuit, looking to the text and legislative history of the statute, reached the conclusion that the SEC could seek disgorgement of compensation from CEOs and CFOs absent personal misconduct.<sup>22</sup> Nevertheless, the court did not consider the extent to which such an interpretation conflicts with Sarbanes-Oxley's statutory scheme, as well as other securities laws and common law principles.<sup>23</sup>

This Note argues that the *Jensen* court should have considered in its analysis (1) Sarbanes-Oxley's statutory scheme; (2) other federal securities laws; and (3) whether disgorgement is an appropriate remedy for individuals who have not committed wrongdoing.<sup>24</sup> Moreover, the court missed an important opportunity to bring some clarity to the ambiguous statute by failing to define what type of "misconduct" is required to trigger section 304, while the concurrence's proposed definition not only conflicts with previous interpretations of misconduct, but would make CEOs and CFOs strictly liable for the intentional acts of their employees.<sup>25</sup> Part II of this Note provides background, including the legislative

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22. See *Jensen*, 835 F.3d at 1116 ("Here, disgorgement is merited to prevent corporate officers from profiting from the proceeds of misconduct, whether it is their own misconduct or the misconduct of the companies they are paid to run."). The court's analysis has been met with dissatisfaction and criticized as "draconian" for its failure to clarify unclear provisions of the statute that have plagued the courts below them. See *id.* at 1123 (Bea, J., concurring) (criticizing majority opinion as "announc[ing] broad, but unclear rules" and "leav[ing] for another day important questions . . . about the precise scope of the rules"); see also O'Hara, *supra* note 9 ("The Ninth Circuit thus placed its approval on a draconian reading of the reach of the statute by holding that it may be employed to claw back large amounts paid to top executives who engaged in no wrongdoing."). It seems that, despite the fact that a court of appeals finally addressed this issue, the area of the law remains fairly unsettled and it is unclear how it will develop in the future and what impact, if any, the court's holding in *Jensen* will have moving forward. See O'Hara, *supra* note 9.

23. For a discussion of the manner in which the *Jensen* court's interpretation of section 304 conflicts with Sarbanes-Oxley's statutory scheme, other federal securities laws, and common law equity principles, see *infra* notes 114–42 and accompanying text.

24. See *Kimes*, *supra* note 5, at 824 (writing that section 304 should be considered in light of the rest of the Act and that "[t]he relationship between sections 302 and 304 mandates that section 304 have a scienter requirement"); see also Notice of Motion and Motion by Defendant Maynard L. Jenkins to Dismiss the Complaint; Memorandum of Points and Authorities in Support Thereof at 12, *S.E.C. v. Jenkins*, 718 F. Supp. 2d 1070 (D. Ariz. 2010) (No. CV-09-01510-PHX-GMS) (writing that "construing section 304 as establishing a new substantive offense, untethered to any wrongdoing by the CEO or CFO, would be inconsistent with" rules of statutory construction and common law principles); Memorandum of Points and Authorities in Support of Defendant Peter L. Jensen's Motion for Partial Summary Judgment at 18–19, *S.E.C. v. Jensen*, 2012 WL 4339871 (C.D. Cal. Aug. 20, 2012) (No. CV11-05316R (AGRx)) (arguing that SEC cannot seek disgorgement of gains from defendant that were not result of fraudulent behavior).

25. See O'Hara, *supra* note 9 (noting that "the question of what is 'misconduct' under SOX 304 remains a question on which reviewing courts have yet to speak"). O'Hara noted that requiring intentional misconduct on the part of the issuer would "raise[] the thorny question of when an agent's conduct can be imputed to the corporation." See *id.* O'Hara also emphasized that the concurrence's interpretation of "misconduct" differs substantially from how other courts have interpreted the term. See *id.* (concluding that concurrence is not consistent with other courts and SEC); cf. *Sabella v. Scantek Med, Inc.*, No. 08 Civ. 453(CM)(HBP), 2009 WL 3233703, at \*31 (S.D.N.Y. Sept. 25, 2009) (giving "willful misconduct" its "ordinary meaning," which court took to be "[m]isconduct committed voluntarily and intentionally" (quoting *Misconduct*, BLACK'S LAW DICTIONARY (8th ed. 2004))). The court noted that "misconduct,"

history of Sarbanes-Oxley and relevant case law.<sup>26</sup> Part III discusses the facts of *Jensen*.<sup>27</sup> Part IV provides a narrative analysis of the court's reasoning in *Jensen*.<sup>28</sup> Part V of this Note analyzes the court's reasoning in *Jensen* and argues for an alternative analysis of the statute.<sup>29</sup> Part VI concludes by discussing the potential impact of the Ninth Circuit's holding.<sup>30</sup>

## II. BACKGROUND: "NO MORE EASY MONEY FOR CORPORATE CRIMINALS, JUST HARD TIME"<sup>31</sup>

Sarbanes-Oxley, specifically section 304, is notoriously ambiguous.<sup>32</sup> Years after its enactment, courts, legal commentators, and senior officers are grappling with how to interpret it.<sup>33</sup> In order to understand why there is so much confusion surrounding Sarbanes-Oxley, this section will first examine the circumstances under which it was enacted and the Act's legislative history.<sup>34</sup> Then, it will discuss how the SEC initially applied section 304 narrowly by only seeking its enforcement against corporate officers who had personally participated in the fraudulent activity or misconduct.<sup>35</sup> Next, this section will analyze cases which

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as opposed to "willful misconduct," is "[a] dereliction of duty; unlawful or improper behavior." *Id.* (internal quotation marks omitted) (quoting *Misconduct*, BLACK'S LAW DICTIONARY (8th ed. 2004)).

26. For a discussion of the legislative history of Sarbanes-Oxley and accompanying case law, see *infra* notes 38–54 and accompanying text.

27. For a further discussion of the facts in *Jensen*, see *infra* notes 89–102 and accompanying text.

28. For a discussion of the court's analysis in *Jensen*, see *infra* notes 103–13 and accompanying text.

29. For a critical analysis of the court's reasoning in *Jensen*, see *infra* notes 114–55 and accompanying text.

30. For a discussion of the impact of *Jensen*, see *infra* notes 156–80 and accompanying text.

31. Elisabeth Bumiller, *Corporate Conduct: The President; Bush Signs Bill Aimed at Fraud in Corporations*, N.Y. TIMES (July 31, 2002), <http://www.nytimes.com/2002/07/31/business/corporate-conduct-the-president-bush-signs-bill-aimed-at-fraud-in-corporations.html?mcubz=1> [<https://perma.cc/NU39-AYDZ>] (internal quotation marks omitted) (quoting former U.S. President George W. Bush).

32. See J. Royce Fichtner et al., *Clarifying the Original Clawback: Interpreting Sarbanes-Oxley Section 304 Through the Lens of Dodd-Frank Section 954*, 10 J. BUS. ENTREPRENEURSHIP & L. 1, 2 (2016) (noting reluctance of SEC to enforce Section 304 has been attributed to "ambiguous language, undefined terms, and open questions surrounding how to apply the clawback to certain types of incentive-based compensation"); see also Kimes, *supra* note 5, at 821–22 (calling section 304 ambiguous); O'Hara, *supra* note 9 (writing that "ambiguities continue to lurk in nearly every phrase in this statute").

33. See Kimes, *supra* note 5, at 822 (calling section 304 "empty instruction manual" and noting "CEOs are not provided any instructions to avoid violating section 304"); see also John F. Savarese & Wayne M. Carlin, *SEC Clawbacks of CEO and CFO Compensation*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 15, 2016) <https://corpgov.law.harvard.edu/2016/09/15/sec-clawbacks-of-ceo-and-cfo-compensation/> [<https://perma.cc/LF45-H8NY>] (noting "key issue" courts have faced in interpreting section 304).

34. For a discussion of the SOX's legislative history, see *infra* notes 38–49 and accompanying text.

35. For a discussion of early enforcement of section 304, see *infra* notes 55–62 and accompanying text.

represent the sudden shift to enforcing section 304 against otherwise innocent corporate officers.<sup>36</sup> Finally, this section will examine the history of the disgorgement remedy, which allows for a comparison of how it has operated in the securities laws context in the past, and how it operates as part of section 304.<sup>37</sup>

A. *Haste Makes Waste: A Legislative Response in the Wake of Corporate Scandal*

Sarbanes-Oxley was a response to numerous highly-publicized scandals, including the infamous collapse of Enron.<sup>38</sup> These events caused investors to question the “integrity of our capital markets” and the soundness of their investments.<sup>39</sup> The legislature had to respond quickly and in April of 2002, the House of Representatives asked the SEC to determine whether, and if so, under what conditions, an officer should be required to disgorge profits gained in the six-month period prior to filing a financial restatement.<sup>40</sup> The House of Representatives stated that if the SEC found that requiring officers or directors to disgorge their profits was appropriate, they should also identify the requisite scienter element, suggesting that they contemplated scienter as a prerequisite to imposing the disgorgement penalty.<sup>41</sup> Importantly, the House Committee stated

36. For a discussion of more recent instances of section 304 enforcement, see *infra* notes 63–73 and accompanying text.

37. For a discussion of the history of the disgorgement remedy, see *infra* notes 74–88 and accompanying text.

38. See Scott Barancik, *Outback’s Chief Financial Officer Quits*, TAMPA BAY TIMES (Apr. 22, 2005), [http://www.sptimes.com/2005/04/22/Business/Outback\\_s\\_chief\\_finan.shtml](http://www.sptimes.com/2005/04/22/Business/Outback_s_chief_finan.shtml) [<https://perma.cc/CYT3-AU5D>] (stating that Sarbanes-Oxley was “created to prevent a repeat of Enron Corp.-type ethical and financial meltdowns”); see, e.g., 3 HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SEC. & FED. CORP. L. § 1.1 (2d ed. 2017) (noting Enron demise created responses from President, Congressional investigations, bills, and regulatory responses); Joseph M. McLaughlin & Yafit Cohn, *Corporate Litigation: SOX Certification Requirement and Clawback Provision*, SIMPSON THACHER & BARTLETT 1 (Oct. 14, 2016), [http://www.stblaw.com/docs/default-source/Publications/nylj\\_joe-mclaughlin\\_corporate-litigation\\_10\\_14\\_16.pdf?sfvrsn=2](http://www.stblaw.com/docs/default-source/Publications/nylj_joe-mclaughlin_corporate-litigation_10_14_16.pdf?sfvrsn=2) [<https://perma.cc/WNJ8-HXRR>] (stating that Sarbanes-Oxley was “enacted in the wake of several high-profile accounting frauds at public companies”); Ramachandran Natarajan & Kenneth Zheng, *Clawback Provision of SOX, Financial Misstatements, and CEO Compensation Contracts*, J. OF ACCT., AUDITING, & FIN., Jan. 23, 2017, at 1 (writing that Congress enacted Sarbanes-Oxley in response to cases like Enron and WorldCom).

39. See BLOOMENTHAL & WOLFF, *supra* note 38 (stating that investors began to question markets).

40. See H.R. REP. NO. 107-414, at 12 (2002) (the House of Representatives asked 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 . . . 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”).

41. See *id.* (asking SEC to “identify the scienter requirement that should be used in order to determine to impose the requirement to disgorge”). Importantly, the Committee did not qualify its command to “identify the scienter requirement” with words like “whether” or “if any.” See *id.* The fact that the Committee qualified its instruction to the SEC in section 12(a) shows that they know how to do so when they desire. See *id.* (instructing the Commission to conduct analysis of *whether* disgorgement should be required). In the securities laws context, scienter has been defined as “the intent to deceive, manipulate, or defraud.” See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976); cf. Clegg v. Conk, 507 F.2d 1351, 1362 (10th



that, if the Commission chose to issue rules pursuant to section 12, it should also provide adequate safeguards that would ensure officers and directors would only be subject to the disgorgement penalty for “extreme misconduct.”<sup>42</sup>

In the months following, and before the Senate passed its own bill, several other corporate scandals made headlines.<sup>43</sup> This is likely what led the Senate to pass a much harsher bill, which, unlike the House of Representatives’ bill, failed to direct the SEC to identify a scienter requirement and extended the Houses’ six-month time period to twelve months.<sup>44</sup> Thereafter, and upon completion of the Senate bill, both versions of the bill went to a Conference Committee formed by the House and Senate.<sup>45</sup> The Conference Committee ultimately approved a bill that was, in all material respects, identical to the Senate’s bill.<sup>46</sup> The bill went into effect on July 30, 2002, and stated that if an issuer’s misconduct results in the issuance of a restatement, the CEO and CFO may be required to repay incentive-based compensation and profits received from the sale of securities

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Cir. 1974) (associating “scienter” with “conscious fault”). See also Racheal E. Schwartz, *The Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive to Keep the Corporate House Clean*, 64 BUS. LAW. 1, 6 (2008) (noting that House Committee “contemplated that some level of scienter be proven before disgorgement could be imposed”).

42. See H.R. REP. NO. 107-414, at 44 (2002) (“The Committee intends that, if the Commission chooses to issue rules pursuant to this section, 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.”); see also Schwartz, *supra* note 41, at 6-7 (quoting House Committee’s explanation of section 12 in support of statement that the Committee “contemplated [] some level of scienter be proven before disgorgement could be imposed”).

43. See Jordan Eth & Brian L. Levine, *The Jenkins Case: SEC Raises Stakes on Restatements*, 6 No. 8 SEC. LITIG. REP. 1 (2009) (noting “lynch-mob mentality” on the Hill from additional corporate scandals such as Adelphia, WorldCom, ImClone, and Tyco). See David Hancock, *World-Class Scandal at WorldCom*, CBS, (June 26, 2002), <https://www.cbsnews.com/news/world-class-scandal-at-worldcom/> (writing that the market got a “king-sized jolt” when WorldCom revealed accounting scandal on June 25, 2006); Penelope Patsuris, *The Corporate Scandal Sheet*, FORBES, (Aug. 26, 2002), <https://www.forbes.com/2002/07/25/accountingtracker.html#2c349b0a57e8> (compiling a list of major corporate accounting scandals that included 19 scandals occurring between January and July of 2002); Andrew Ross Sorkin, *2 Top Tyco Executives Charged With \$600 Million Fraud Scheme*, N.Y. TIMES, (Sept. 13, 2002), <https://www.nytimes.com/2002/09/13/business/2-top-tyco-executives-charged-with-600-million-fraud-scheme.html> (reporting on the Sept. 12, 2002, indictment of Tyco’s CEO, CFO and former general counsel); Joseph B. Treaster, *Adelphia Files for Bankruptcy*, N.Y. TIMES, (June 26, 2002), <https://www.nytimes.com/2002/06/26/business/adelphia-files-for-bankruptcy.html> (writing that Adelphia filed for bankruptcy on June 25, 2002, after investigations by the S.E.C. and two federal grand juries).

44. See S. REP. NO. 107-205, at 26 (2002) (stating that disgorgement applies to 12-month period prior to restatement). See also Eth & Levine, *supra* note 43 (recounting Senate’s choice to not discuss scienter and required disgorgement); cf. Kimes, *supra* note 5, at 801 (suggesting that “the Senate’s decision was hastened by the spate of sensational corporate lawbreaking just prior to its vote”).

45. See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1567 (2005) (describing unravelling of conference committee’s compromise strategy because of additional scandals).

46. See *id.* (noting that bill was “virtually identical to the Senate bill” as the result of “a media frenzy and the precipitous drop in the stock market, in conjunction with reelection concerns”).

during the twelve-month period following the filing of the non-compliant statement.<sup>47</sup> Initial impressions of the bill varied: some viewed it as necessary given the recent spate of corporate scandals, while others considered it to be unduly harsh and intrusive.<sup>48</sup> Regardless, it was clear that it would dramatically change the corporate landscape.<sup>49</sup>

Before *Jensen*, only a handful of district courts had occasion to interpret section 304.<sup>50</sup> Most of these courts have interpreted the statute broadly and

47. 15 U.S.C. § 7243(a) (2012). The statute provides the following:

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—

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

*Id.*

48. See *Darned SOX*, THE ECONOMIST (Sept. 14, 2006), <http://www.economist.com/node/7914930> [<https://perma.cc/3GXQ-78PL>] (writing that both American and foreign firms view Sarbanes-Oxley as “intrusive, expensive and heavy-handed”); see also John Montana, *The Sarbanes-Oxley Act: Five Years Later: Corporate America Still Finds SOX Compliance Requirements to be Burdensome, Vague, and Frustrating*, 41 INFO. MGMT. J., no. 6, Nov. 1, 2007 (“The Act, which sets only the highest level and most general of requirements but imposes the possibility of substantial penalties for not complying with them, was immediately criticized by corporate America as being overbroad and vague.”). A survey found that the [auditing] profession was deeply divided on the benefits of Sarbanes-Oxley, and these differences in opinion existed across rank: from partners, to directors, to managers. See Nancy T. Hill et al., *Auditors’ Reactions to Sarbanes-Oxley*, CPA J. (July 2007), <http://archives.cpajournal.com/printversions/cpaj/2007/707/p6.htm> [<https://perma.cc/HUY4-PV9U>] (surveying professionals affected by Sarbanes-Oxley and providing both negative and positive reactions). For example, one partner of a Big Four firm stated that complaints about the cost of complying with Sarbanes-Oxley were unwarranted: these internal controls are “the cost of doing business responsibly” and management will ultimately reap the benefits of such a system. See *id.* In contrast, a manager of a Big Four firm stated that Sarbanes-Oxley merely resulted in “a lot of meaningless flowcharts, checklists, procedures, etc.” See *id.* The authors noted that it is “rare” for a profession to be as divided as it is on the value of Sarbanes-Oxley, and this divide might “indicate just how complex and far-reaching the implementation of SOX is.” See *id.*

49. See Leon, *supra* note 6, at 128 (writing that “SOX altered the face of federal securities regulation”); see also Craig S. Lerner & Moin A. Yahya, “Left Behind” After Sarbanes-Oxley, 44 AM. CRIM. L. REV. 1383, 1383 (2007) (noting that Sarbanes-Oxley “dramatically escalated penalties for white-collar crimes,” and “diluted the mens rea . . . requirement for criminal regulatory offenses”); cf. Bumiller, *supra* note 31 (writing that President Bush referred to legislation as “the most far-reaching reforms of American business practices since the time of the Franklin Delano Roosevelt”).

50. See *Ninth Circuit Supports Expansive Interpretation of SOX 304*, SHEARMAN & STERLING LLP (Sept. 12, 2016), <http://www.lit-wc.shearman.com/ninth-circuit-supports-expansive-interpretation-of-sox-304> [<https://perma.cc/3KQU-PRVW>] (recognizing that pre-*Jensen*, no circuit court had addressed whether section 304 requires personal misconduct); see also, e.g., S.E.C. v. Jenkins, 718 F. Supp. 2d 1070 (D. Ariz. 2010); S.E.C. v. Life Partners Holdings, Inc., 71 F. Supp. 3d 615 (W.D. Tex. 2014); S.E.C. v. Baker, No. A-12-CA-285-SS, 2012 WL 5499497 (W.D. Tex. Nov. 13, 2012), *aff’d in part, vacated in part, rev’d in part*, 854

reached the conclusion that personal misconduct on the part of the officer is not a prerequisite for section 304 enforcement.<sup>51</sup> In doing so, the courts have typically confined their analysis to the text and legislative history of section 304, and have declined to explore other canons of interpretation available to them despite the ambiguities that have surrounded the statute since its enactment in 2002.<sup>52</sup> Moreover, most of these courts have spent little time addressing whether the remedy of disgorgement is merited in the absence of any personal wrongdoing, and of those that have, the results are contradictory.<sup>53</sup> This mirrors the widespread confusion regarding the application of disgorgement in the securities law context.<sup>54</sup>

### B. *The Early Cases*

Until recently, the only instances in which the SEC sought enforcement of section 304 were in cases against senior officers who had also violated other securities laws.<sup>55</sup> These individuals had personally participated in misconduct, and thus, the section 304 claim was just one of many claims for relief by the

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F.3d 765 (5th Cir. 2017); *S.E.C. v. Geswein*, No. 5:10CV1235, 2011 WL 4541303, at \*3 (N.D. Ohio Sept. 29, 2011).

51. See *Jenkins*, 718 F. Supp. 2d at 1074 (holding that “specific misconduct of the issuer’s CEO or CFO” is not required for enforcement of clawback provision); see also *S.E.C. v. Life Partners Holdings*, No. 1-12-CV-00033, 2013 WL 12076555, at \*3 (W.D. Tex. Nov. 19, 2013) (refusing to read personal misconduct element into section 304 and claiming to do so would be “tantamount to re-writing the statute”); *Baker*, 2012 WL 5499497, at \*5 (holding that enforcement of section 304 does not require scienter or personal misconduct); *Jenkins*, 718 F. Supp. 2d at 1074 (holding that “specific misconduct of the issuer’s CEO or CFO” is not required for enforcement of clawback provision); cf. Jonathan E. Richman, *Ninth Circuit Holds That SOX Disgorgement of Incentive Compensation Does Not Depend on Executives’ Own Misconduct*, NAT’L L. REV. (Aug. 31, 2016), <https://www.natlawreview.com/article/ninth-circuit-holds-sox-disgorgement-incentive-compensation-does-not-depend> (noting that while no appellate court had addressed the issue, several district courts have concluded no personal misconduct is required).

52. See *Jenkins*, 718 F. Supp. 2d at 1074 (writing that the court does not need to “resort to additional canons [of interpretation]” because text of statute clearly reveals Congress’s intent); see also *Baker*, 2012 WL 5499497, at \*5 (writing that because text of statute is clear, it is dispositive); *supra* note 32 for commentators explaining that section 304 is ambiguous.

53. See *S.E.C. v. Jensen*, 835 F.3d 1100, 1116 (9th Cir. 2016) (holding that “the reimbursement provision is an equitable and not a legal remedy”); see also *S.E.C. v. Jasper*, 678 F.3d 1116, 1130 (9th Cir. 2012) (holding that reimbursement provision in section 304 is equitable remedy); *In re Digimarc Corp. Derivative Litig.*, 549 F.3d 1223, 1233 (9th Cir. 2008) (holding that section 304’s disgorgement remedy is equitable). *Contra Baker*, 2012 WL 5499497, at \*7 (agreeing with SEC that reimbursement has different meaning than disgorgement); *Jenkins*, 718 F. Supp. 2d at 1078 (writing that section 304 uses term “reimburse” so “disgorge” has no application to text of statute).

54. See James Tyler Kirk, *Deranged Disgorgement*, 8 J. BUS. ENTREPRENEURSHIP & L. 131, 187 (2014) (stating “the chaotic application of disgorgement in SEC enforcement actions across the circuits is pernicious”).

55. See SEC Seeks Return of \$4 Million in Bonuses and Stock Sale Profits from Former CEO of CSK Auto Corp., *supra* note 16 (acknowledging Commission had only sought enforcement of section 304 against wrongdoers in past).

SEC.<sup>56</sup> For example, in *S.E.C. v. Mercury Interactive, LLC*,<sup>57</sup> the SEC filed suit against the CEO and CFOs of Mercury Interactive, LLC.<sup>58</sup> The SEC asserted in its complaint that the individual defendants had participated in a years-long stock option backdating scheme, and in the process, violated ten different securities laws.<sup>59</sup> It further sought relief in the form of disgorgement of incentive-based compensation pursuant to section 304 of the Sarbanes-Oxley Act.<sup>60</sup> The district court noted that the section 304 “claim” for relief amounted to a single sentence in the prayer for relief of the SEC’s complaint and called the basis for the section 304 claim entirely unclear.<sup>61</sup> This acknowledgement evidences, and is exemplary of, the subsidiary role that section 304 played in the earlier cases, as well as the courts’ lack of familiarity with the provision.<sup>62</sup>

C. *The Claws Come Out: A New Trend in SEC Enforcement of Section 304*

The SEC made a shocking departure from the aforementioned cases in *S.E.C. v. Jenkins*.<sup>63</sup> Unlike *Mercury* and the similar cases that followed, the SEC’s complaint against Jenkins, the CEO of CSK Auto Corporation, did not allege that Jenkins had violated a single securities law, or that he had knowledge

56. See, e.g., *S.E.C. v. Shanahan*, 646 F.3d 536, 541 (8th Cir. 2011) (listing numerous alleged violations of securities laws in addition to Section 304 claim); *S.E.C. v. Mercury Interactive, LLC*, No. 5:07-cv-02822-JF/PVT, 2010 WL 3790811, at \*1 (N.D. Cal. Sept. 27, 2010) (listing numerous alleged violations of securities laws). In *Shanahan*, the SEC filed a complaint against the CEO of a corporation for, over a period of five years, participating in the backdating of stock options. See *S.E.C. v. Shanahan*, 624 F. Supp. 2d 1072, 1074–75 (E.D. Mo. 2008), *aff’d*, 646 F.3d 536 (8th Cir. 2011) (describing basis for SEC’s complaint). The SEC further contended that the defendant had actively participated in concealing the backdating of the options and approved official documents that he knew contained materially false information. See *id.* (describing basis for SEC’s complaint). In total, the SEC charged the defendant with violating seven different securities laws, and, in addition to the order, they sought to require Shanahan to repay incentive-based compensation under section 304. See *id.* at 1076 (listing allegations against defendant and prayer for relief in SEC’s complaint). In its opinion, the court acknowledged that the Eighth Circuit had never addressed whether section 304 required the actual filing of restatements. See *id.* at 1078 (“The Eighth Circuit has never ruled on whether Section 304 requires the actual filing of restated accounting reports.”).

57. No. 5:07-cv-02822-JF/PVT, 2010 WL 3790811 (N.D. Cal. Sept. 27, 2010).

58. See *id.* at \*1 (stating that SEC had filed suit against four of Mercury Interactive, LLC’s senior executives).

59. See *id.* at \*1–2 (listing the alleged violations).

60. See *id.* at \*2 (listing prayer for relief as seeking “permanent injunctive relief, disgorgement of wrongfully obtained benefits plus prejudgment interest, civil monetary penalties, an order precluding the individual defendants from serving as officers or directors of any public company, and repayment of bonuses and stock profits”).

61. See *S.E.C. v. Mercury Interactive, LLC*, No. C 077-2822 JF (RS), 2008 WL 4544443, at \*9 (N.D. Cal. Sept. 30, 2008) (“The entirety of the SEC’s ‘claim’ under Section 304 is a single sentence in the prayer . . . . The bases for this claim are entirely unclear.”).

62. See *id.* (dismissing 304 claim because filing financial statements that need to be restated did not trigger section 304). In the 2010 order, the court also addressed an issue of first impression regarding what documents can be considered a “first public issuance or filing” within the meaning of the statute. See *Mercury Interactive*, 2010 WL 3790811, at \*5 (“There do not appear to be any cases directly on point.”).

63. 718 F. Supp. 2d 1070 (D. Ariz. 2010); see Kimes, *supra* note 5, at 801 (writing that suit against Jenkins “sent a tidal wave through the corporate law community”).

of or consented to the misconduct of others.<sup>64</sup> Rather, the SEC filed separate civil and criminal charges against two CSK vice presidents, alleging that they had intentionally concealed their fraudulent activity from Jenkins.<sup>65</sup> Jenkins was ultimately required to disgorge four million dollars of incentive-based compensation pursuant to section 304, as the district court held that enforcement of the provision did not require personal misconduct on part of the senior officer.<sup>66</sup> Because the court was addressing an issue of first impression, the court did not rely on any precedential case law in reaching their conclusion, but instead relied almost solely on the text and legislative history of the statute.<sup>67</sup> The *Jenkins* case was not an isolated instance; rather, it started a new trend in SEC enforcement of section 304.<sup>68</sup> After *Jenkins*, the SEC continued to seek enforcement of the provision against CEOs and CFOs who had not committed any wrongdoing.<sup>69</sup>

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64. *See Jenkins*, 718 F. Supp. 2d at 1073 (acknowledging that SEC did not allege Jenkins participated in misconduct).

65. *See id.* (noting that SEC filed civil and criminal complaints against other officers alleging they had perpetuated fraudulent scheme and hid it from Jenkins).

66. *See id.* (identifying incentive-based compensation Jenkins received during relevant periods and ruling for SEC on section 304 claim).

67. *See id.* at 1074 (noting that text and structure of section 304 led to the conclusion that no personal misconduct is required).

68. *See, e.g., S.E.C. v. Baker*, No. A-12-CA-285-SS, 2012 WL 5499497, at \*1 (W.D. Tex. Nov. 13, 2012); Slater, Exchange Act Release No. 34-74240, at 5 (Feb. 10, 2015); Diebold, Inc., Accounting and Auditing Enforcement Act Release No. AE-3137, 2010 WL 2199552, at \*1 (June 2, 2010). In 2010, the SEC brought suit against Diebold, Inc. and three of the company's financial officers, alleging they had engaged in fraudulent accounting practices and charging them with violations of several securities laws. *See Diebold, Inc.*, 2010 WL 2199552, at \*1 (providing factual background for complaint). The SEC filed a separate enforcement action against O'Dell, Diebold's former CEO, seeking repayment of certain bonuses and incentive-based compensation under section 304. *See id.* at \*2 (stating action against O'Dell). The Commission acknowledged in a press release that they were not alleging any wrongdoing on part of O'Dell; regardless, O'Dell consented to repaying cash bonuses, shares of Diebold stock, and stock options. *See Press Release, SEC, SEC Charges Diebold and Former Executives with Accounting Fraud (June 2, 2010)*, <https://www.sec.gov/news/press/2010/2010-93.htm> [<https://perma.cc/SN69-LSGF>] ("The SEC has not alleged that O'Dell engaged in the fraud.").

69. *See Baker*, 2012 WL 5499497, at \*1. In *Baker*, the SEC sought enforcement of section 304 against the CEO and CFO of a company that was required to restate quarterly and annual financial statements due to the alleged fraudulent activities of the company's senior vice presidents. *See id.* at \*1. The SEC brought a separate civil action against these individuals, charging them with various violations of securities laws. *See id.* at \*12 n.1 (writing that SEC brought separate civil proceeding against vice presidents). They did not allege that the defendants partook in this fraudulent activity or had committed any conscious wrongdoing, but rather, argued they were responsible for repayment pursuant to section 304 simply because of the positions they held at the time of the restatements. *See id.* at \*1 ("Baker and Gluk are not alleged in the Complaint to have committed any conscious wrongdoing; rather, the SEC argues they are required to reimburse Arthrocare simply because they were the CEO and CFO at the time . . ."). The U.S. District Court for the Western District of Texas agreed. *See id.* at \*5 (rejecting defendant's claims); *see also Slater*, Release No. 34-74240, at 1. In 2015, the SEC reached another settlement in *Slater*, where the respondents were required to repay several hundred thousand dollars to Saba Software, Inc., a Silicon Valley-based company where the respondents had each served as CFO. *See id.* at 6 (ordering defendants to reimburse Saba). Saba had to issue restatements for several fiscal years and two fiscal quarters, as a result of fraudulent activity that took place in the company's subsidiary located in India. *See id.* at 1–2. The SEC conceded that the respondents, both residents of California, did not participate in the

Courts interpreting section 304 have no precedential opinions to rely upon, and they have each focused their analysis around principles of statutory interpretation.<sup>70</sup> Most district courts that have concluded section 304 does not have a personal misconduct requirement, began their analysis by looking at the “plain language” of the statute, and concluded that because it was unambiguous, they did not need to look to other canons of statutory interpretation.<sup>71</sup> In addition,

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activity, nor did they have knowledge of it. *See id.* at 1 (noting that Commission is not alleging defendants committed any wrongdoing). Regardless, because the respondents received bonuses and benefited financially from the sale of Saba stock during the twelve-month time periods preceding the issuance of the restatements, it was determined that they had violated section 304 and must repay those profits. *See id.* at 5–6 (providing holding on Section 304 claim).

70. *See, e.g., Baker*, 2012 WL 5499497, at \*5 (relying primarily on text of statute in reaching conclusion); *Jenkins*, 718 F. Supp. 2d at 1074 (placing premium on text of statute).

71. *See Baker*, 2012 WL 5499497, at \*5 (“The text of the statute plainly contains no such additional requirements, and absent any ambiguity, the words of the statute itself are dispositive.” (citations omitted)). This approach is not the only or best way to uncover legislative intent. *See, e.g., United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988) (advocating for most holistic approach to statutory interpretation). It is a well-established principle of statutory interpretation that the courts will *start* by looking at the statutory text. *See, e.g., BP Am. Prod. Co. v. Burton*, 549 U.S. 84, 91 (2006) (“We start, of course, with the statutory text.” (citations omitted)); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring) (“The starting point in every case involving construction of a statute is the language itself.”). Under the “plain meaning rule,” these words should be interpreted using their ordinary meaning. *See, e.g., Caminetti v. United States*, 242 U.S. 470, 485 (1917) (“It is elementary that the meaning of a statute must, in the first instance, be sought in the language in which the act is framed . . .”); *Rosenberg v. XM Ventures*, 274 F.3d 137, 141 (3rd Cir. 2001) (“Because it is presumed that Congress expresses its intent through the ordinary meaning of its language, every exercise of statutory interpretation begins with an examination of the plain language of the statute.” (citations omitted)). Federal courts still frequently employ the historic rule that, when the language of the text is unambiguous, the analysis ends there—no other mode of interpretation is necessary. *See, e.g., Caminetti*, 242 U.S. at 242 (holding that “[w]here the language is plain and admits of no more than one meaning, the duty of interpretation does not arise, and the rules which are to aid doubtful meanings need no discussion.” (citations omitted)). However, the Supreme Court has, on numerous occasions, advocated for a more holistic approach to statutory interpretation. *See, e.g., FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000) (“In determining whether Congress has specifically addressed the question at issue, a reviewing court should not confine itself to examining a particular statutory provision in isolation.”); *Timbers of Inwood Forest Assocs.*, 484 U.S. at 371. The Court has argued that the inquiry should not end at the statutory text because of the potential for error. *See Train v. Colorado Interest Research Grp., Inc.*, 426 U.S. 1, 10 (1976). A “superficial examination” of a statute might lead a court to incorrectly believe the text of a statute is unambiguous, and looking beyond the text can correct those assumptions and enable the court to more accurately ascertain legislative intent. *See id.* (“When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no ‘rule of law’ which forbids its use, however clear the words may appear on ‘superficial examination.’” (internal quotation marks omitted) (quoting *United States v. Am. Trucking Ass’n*, 310 U.S. 534, 543–44 (1940))). While the court has not necessarily been consistent in its approach, specifically with respect to when the plain meaning rule should end the inquiry versus when a more holistic approach should be taken, the goal has remained consistent—to uncover legislative intent. *See, e.g., Nat’l R. R. Passenger Corp. v. Nat’l Ass’n of R. R. Passengers*, 414 U.S. 453, 458 (1974) (holding that “even the most basic general principles of statutory construction must yield to clear contrary evidence of legislative intent” (citation omitted)); *Am. Trucking Ass’n*, 310 U.S. at 544 (“This duty requires one body of public servants, the judges, to construe the meaning of what another body, the legislators, has said.”). Regardless of whether they strictly adhere to the plain meaning rule or advocate for a more holistic approach, all agree that when the language of the text is ambiguous, the court must

the courts have given short shrift to the appropriateness of the disgorgement remedy in this context even though it is an argument consistently raised by defendants.<sup>72</sup> Thus, in order to analyze the appropriateness of disgorgement as a remedy under section 304, it is relevant to consider the history of the disgorgement remedy and how it has been used in the securities laws context.<sup>73</sup>

#### D. *A History of the Disgorgement Remedy*

Disgorgement is an “ancient remedy” that has been used across many areas of the law.<sup>74</sup> In recent years, disgorgement has become increasingly popular in the securities law context.<sup>75</sup> Despite its popularity, its application has been inconsistent across the circuits.<sup>76</sup>

It is unclear whether disgorgement is an appropriate remedy under section

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consider other rules of statutory interpretation. *See, e.g.,* *Sebelius v. Cloer*, 569 U.S. 369, 381 (2013) (noting that canons of construction and policy considerations come into play if statutory text is ambiguous). This includes, but is not limited to, looking to the statutory scheme and common law principles. *See* John Patrick Kelsh, *Section 304 of the Sarbanes-Oxley Act of 2002: The Case for a Personal Culpability Requirements*, 59 BUS. L. 1005, 1036–37, 1040 (2004) (suggesting that courts should consider liability provisions in existing securities laws when interpreting section 304); *see also* Notice of Motion and Motion by Defendant Maynard L. Jenkins to Dismiss the Complaint, *supra* note 24 (“When Congress legislates, it is presumed to do so against a background of established common law principles . . . .” (citing *Timbers of Inwood Forest Assocs.*, 484 U.S. at 371)); Defendant Michael a. Baker’s Motion to Dismiss at \*6, *S.E.C. v. Baker*, No. A-12-CA-285-SS, 2012 WL 5499497 (W.D. Tex. Nov. 13, 2012) (No. 1:12-CV-00285) (“Statutes must be read holistically with an eye toward the overall statutory scheme.” (citations omitted)); Kimes, *supra* note 5, at 823 (“If a provision of a statute is ambiguous, it should be read together with the entire statute.”). Kimes argued that courts, when interpreting section 304, must consider the statutory scheme of the Sarbanes-Oxley Act, as well as other securities laws. *See id.* The Supreme Court will decline to adopt a specific interpretation when it would contradict common law principles, unless Congress has clearly specified the intent to do so. *See Meyer v. Holley*, 537 U.S. 280, 281 (2003) (standing for proposition that “unusually strict rules” should only be applied in situations where Congress has clearly “specified that such was its intent”). In *Meyer*, the Court rejected the Ninth Circuit’s interpretation of the statute, which made officers liable for employees’ actions, for its application of “nontraditional vicarious liability principles.” *See id.* at 280–81. The Court held that “[a]bsent special circumstances, it is the corporation, not its owner or officer, who is the principal or employer . . . subject to vicarious liability for the torts committed by its employees or agents.” *See id.* at 286. They refused to, in the absence of an express provision evidencing Congress’s intent, “impose[] this special duty of protection upon individual officers or owners of corporations . . . in respect to the corporation’s unlawfully acting employee.” *See id.*

72. *See* Memorandum of Points and Authorities in Support of Defendant Peter L. Jensen’s Motion for Partial Summary Judgment, *supra* note 24, at 18; *see also* Notice of Motion and Motion by Defendant Maynard L. Jenkins to Dismiss the Complaint, *supra* note 24, at 12.

73. For a discussion of the history of the disgorgement remedy in the securities laws context, *see infra* notes 74–88 and accompanying text.

74. *See, e.g.,* Caprice L. Roberts, *Supreme Disgorgement*, 68 FLA. L. REV. 1413, 1416 (2016) (writing that disgorgement is “ancient remedy” that “applies across a spectrum of contexts”).

75. *See* Kirk, *supra* note 54, at 133 (“Disgorgement has become the routine remedy for a securities enforcement action.” (internal quotation marks omitted) (quoting *S.E.C. v. Berlacher*, No. 07-3800, 2010 WL 3566790, at \*14 (E.D. Pa. Sept. 13, 2010))).

76. *See id.* at 187 (writing that “the courts have struggled with applying the remedial intentions of Congress”).

304 if the statute is read without a personal misconduct requirement.<sup>77</sup> Few courts interpreting this statute have squarely addressed the question.<sup>78</sup> Nevertheless, it is clear that in the securities law context, disgorgement has historically and consistently been considered a remedy to be applied against a wrongdoer.<sup>79</sup> A recent Supreme Court decision reinforces this notion.<sup>80</sup> In *Kokesh v. S.E.C.*,<sup>81</sup> the Court ruled that SEC disgorgement is a penalty under section 2462 of the Securities Exchange Act of 1934.<sup>82</sup> The Court gave three reasons for this ruling.<sup>83</sup> First, disgorgement is imposed upon individuals who violated public laws, meaning that the violation is committed against the United States, not any particular individual.<sup>84</sup> Second, SEC disgorgement is a punitive measure, meaning it is meant to serve as a deterrent.<sup>85</sup> Lastly, SEC disgorgement is not always compensatory, meaning the disgorged compensation is paid to the courts, who are responsible for determining how the funds are dispersed.<sup>86</sup> The Court may have limited its holding in a footnote by stating that the opinion should not be interpreted as calling to question “whether courts have properly applied disgorgement principles” in SEC enforcement proceedings in the past.<sup>87</sup> Nevertheless, it seems likely that the holding will seriously limit the SEC’s ability to seek disgorgement as a remedy moving forward, especially in a section 304 enforcement proceeding, which is a “penalty” or “punitive measure” that is meant to deter.<sup>88</sup>

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77. See Notice of Motion and Motion by Defendant Maynard L. Jenkins to Dismiss the Complaint, *supra* note 24 (arguing that disgorgement is remedy used to punish wrongdoers).

78. See *S.E.C. v. Jensen*, 835 F.3d 1100, 1115 (9th Cir. 2016); see also *S.E.C. v. Jenkins*, 718 F. Supp. 2d 1070, 1073 (D. Ariz. 2010).

79. See *S.E.C. v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997) (discussing that courts have consistently held that “[t]he primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains” (citations omitted)); see also *S.E.C. v. Baker*, No. A-12-CA-285-SS, 2012 WL 5499497, at \*7 (W.D. Tex. Nov. 13, 2012) (“[D]isgorgement on equitable grounds is generally limited to cases in which the officers themselves have engaged in wrongdoing.” (citations omitted)); *Neer v. Pelino*, 389 F. Supp. 2d 648, 654–55 (E.D. Pa. 2005) (holding that sections 304 and 306 are similar in that both provide for reimbursement of wrongdoing officer’s compensation).

80. See *Kokesh v. S.E.C.*, 137 S. Ct. 1635, 1643–44 (2017). Although *Kokesh* was decided after *Jensen*, its holding is relevant to the discussion of disgorgement in the federal securities laws context.

81. 137 S. Ct. 1635, 1643–44 (2017).

82. See *id.* at 1643 (“SEC disgorgement constitutes a penalty within the meaning of § 2462”).

83. See *id.*

84. See *id.* (describing first principle that shows SEC disgorgement is penalty).

85. See *id.* (stating that primary purpose of disgorgement is deterrence).

86. See *id.* at 1644 (describing different functions and uses of disgorged funds).

87. See *id.* at 1645 n.3 (“Nothing in this opinion should be interpreted as an opinion on . . . whether courts have properly applied disgorgement principles in this context.”).

88. See *Wrongdoing*, BLACK’S LAW DICTIONARY (10th ed. 2014) (defining wrongdoing as “an instance of bad or immoral behavior”); see also *Wrongdoer*, COLLINS ENGLISH DICTIONARY, <https://www.collinsdictionary.com/us/dictionary/english/wrongdoer> [<https://perma.cc/YBM8-6Q6E>] (last visited Sept. 15, 2017) (defining “wrongdoer” as “a person who acts immorally or illegally”); *Wrongdoer*, OXFORD DICTIONARIES, <https://en.oxforddictionaries.com/definition/wrongdoer> [<https://perma.cc/3BBF-JNV8>] (last visited Sept. 15, 2017) (defining wrongdoer as “[a] person who behaves illegally or dishonestly; an offender”); Brad S. Karp et al., *Five Year Statute of Limitations Applies to Claims for*



III. THE FACTS OF *S.E.C. v. JENSEN*

In 1999, Defendant Peter Jensen started what would become an incredibly successful business venture when he founded Basin Water, Inc. (Basin), a corporation which designed and manufactured water treatment units.<sup>89</sup> He would thereafter serve as CEO of Basin for several years.<sup>90</sup> During his time as CEO, Jensen hired the co-defendant, Thomas Tekulve, who was then responsible for the company's financial structure.<sup>91</sup> This included putting the appropriate controls into place before taking the company public in 2006.<sup>92</sup> During their time as CEO and CFO of Basin, Jensen and Tekulve, respectively, certified quarterly and annual reports on behalf of the company.<sup>93</sup> In 2008, both defendants resigned from their positions.<sup>94</sup> Thereafter, the company filed a restatement with the SEC, amending and restating financial reports that were filed with the SEC in 2006 and 2007, at which time Jensen and Tekulve still held their positions as CEO and CFO of Basin.<sup>95</sup>

After reviewing these restatements, the SEC alleged that Basin had failed to comply with generally accepted accounting principles (GAAP) in its preparation of financial reports and that, as a result, Jensen and Tekulve had received hundreds of thousands of dollars in compensation through salary, bonuses, and shares of Basin stock.<sup>96</sup> In 2011, the SEC brought this action against the defendants, alleging the defendants were required to repay incentive-based compensation they made during the years in question pursuant to section 304 of Sarbanes-Oxley.<sup>97</sup> Following a bench trial, the trial court ruled for the defendants

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*Disgorgement Brought by the SEC*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (June 12, 2017) <https://corpgov.law.harvard.edu/2017/06/12/five-year-statute-of-limitations-applies-to-claims-for-disgorgement-brought-by-the-sec/> [<https://perma.cc/QZW5-K7V9>] (noting that concerns over scope and availability of disgorgement remedy may “re-emerge in litigation” moving forward).

89. *See S.E.C. v. Jensen*, No. CV 11-5316-R, 2013 WL 6499699, at \*1, \*4 (C.D. Cal. Dec. 10, 2013) (providing factual background for claim), *vacated*, 835 F.3d 1100, 1116 (9th Cir. 2016).

90. *See id.* at \*1 (describing defendant Jensen's role at Basin).

91. *See S.E.C. v. Jensen*, 835 F.3d 1100, 1105 (9th Cir. 2016) (describing defendant Tekulve's role at Basin).

92. *See id.* at 1104–05.

93. *See Jensen*, 2013 WL 6499699, at \*1 (providing facts of case).

94. *See id.* (providing factual background for claim).

95. *See id.* at \*2, \*31 (describing issuing of restatements which triggers section 304).

96. *See Jensen*, 835 F.3d at 1106 (providing SEC's allegations against defendants). However, it was established at trial that Jensen did not receive any incentive-based compensation during 2006 and 2007, and any stock off which he profited during those years was stock he received when he founded the company in 1999. *See Jensen*, 2013 WL 6499699, at \*25 (providing district court's factual findings). It was also established at trial that “Tekulve did not profit from Basin's decision to recognize revenue on any of the disputed transactions” because “his salary nor his bonuses were linked to Basin's revenue or stock price.” *See id.* (providing factual findings which partly refute SEC's claim regarding incentive-based compensation).

97. *See id.* at \*27–30 (listing allegations that are basis for SEC's claim against defendants). The SEC also alleged violations of 17(a), (b), and (c) of the Securities Act, issuer reporting violations under Section 13(a) of the Exchange Act, and record-keeping violations and misrepresentation to accountants under Section 13(b)(5) of the Exchange Act. *See id.*

on all counts.<sup>98</sup> The SEC appealed, challenging several factual and legal conclusions reached at trial.<sup>99</sup> One of the legal conclusions challenged on appeal was the district court's interpretation of section 304 as requiring personal misconduct on part of the officer.<sup>100</sup> The Ninth Circuit reversed the aforementioned legal conclusions on appeal.<sup>101</sup> Specifically, the Ninth Circuit held that personal misconduct of an issuer's CEO or CFO is not necessary to trigger the disgorgement remedy.<sup>102</sup>

#### IV. NARRATIVE ANALYSIS: THE NINTH CIRCUIT TAKES A DRACONIAN APPROACH TO SECTION 304 IN *S.E.C. V. JENSEN*

The *Jensen* court held that the SEC's interpretation of Section 304 was correct because it (1) tracked the plain language of the statute; (2) was supported by the legislative history and purpose of the statute; (3) was consistent with the holdings of the district courts that have addressed the issue; and (4) was consistent with the court's previous conclusions that "the reimbursement provision is an equitable and not a legal remedy."<sup>103</sup> First, the court looked to the plain language of the statute and found that "[t]he clause 'as a result of misconduct' modifies the phrase 'the material noncompliance of the issuer,'" which suggests that it is the issuer's misconduct, not that of the CEO or CFO, that is relevant.<sup>104</sup> The court suggested that the history of the statute supported such an interpretation, noting that the report from the Senate Committee on Banking, Housing, and Urban Affairs emphasized an intention to expand the SEC's enforcement powers.<sup>105</sup>

The *Jensen* court went on to compare the Senate bill with the House bill.<sup>106</sup> It noted that the House bill provided for disgorgement of compensation from an officer only "if such officer or director engaged in misconduct resulting or, or made or caused to be made in, the filing of a financial statement."<sup>107</sup> In contrast, the Senate bill, which was ultimately signed in, tweaked the language to simply state "as a result of misconduct" generally.<sup>108</sup> According to the court, this showed

98. *See Jensen*, 835 F.3d at 1104 (providing trial court's holding).

99. *See id.* (detailing procedural posture of case).

100. *See id.* (detailing legal conclusions that are challenged on appeal). The other legal conclusion challenged on appeal was the district court's interpretation of Rule 13a-14 as only providing a cause of action against CEOs and CFOs who completely fail to file required certifications, but not for officers who unknowingly certify false or misleading statements. *See id.*

101. *See id.* (reversing district court's decision).

102. *See id.* (ruling on section 304 scienter requirement). The court held that "[t]he disgorgement remedy authorized under SOX 304 applies regardless of whether a restatement was caused by the personal misconduct of an issuer's CEO and CFO or by other issuer misconduct." *See id.*

103. *See id.* at 1114-16 (describing holding of court).

104. *See id.* at 1114.

105. *See id.* at 1115.

106. *See id.*

107. *See id.* (internal quotation marks omitted) (quoting H.R. REP. NO. 107-418, at 31 (2002)).

108. *See id.* (comparing language of Senate Bill against language of House Bill). Specifically, the Senate Bill required CEOs and CFOs to personally certify financial statements, while the House Bill did not. Mark Jickling, *The Sarbanes-Oxley Act 2002: A Side-by-Side*

that Congress had consciously chosen not to include a personal misconduct element.<sup>109</sup> In other words, the court opined that the differences between the language of the House bill and the “as a result language” of the Senate bill “suggests that Congress knew how to draft a statute that would limit the disgorgement remedy to cases of officer or director misconduct, and chose not to do so.”<sup>110</sup>

The Ninth Circuit acknowledged that while no other circuit court had addressed the issue, most district courts that have done so have reached the same conclusion—no personal misconduct element is required.<sup>111</sup> Like most district courts that have addressed section 304, the Ninth Circuit only briefly mentioned the question of whether disgorgement is an appropriate remedy in this context.<sup>112</sup> The court called the reimbursement provision an equitable remedy, not a legal one, and noted that precedent allows federal courts to recover ill-gotten gains “for the benefit of the victims of wrongdoing” whether or not those “gains” are in the hands of the original wrongdoer or some third party who profited off that wrongdoing.<sup>113</sup>

#### V. CRITICAL ANALYSIS: AN ARGUMENT FOR RETRACTING THE CLAWS AND REQUIRING PERSONAL MISCONDUCT

In its analysis, the *Jensen* court purported to follow the plain language of the statute and the district courts below it in interpreting section 304.<sup>114</sup> While such methods are not invalid, the court regrettably turned a blind eye to other modes of interpretation and information that would have required a different conclusion.<sup>115</sup> First, other sections of Sarbanes-Oxley should have been considered in order to maintain a coherent and cohesive statutory scheme.<sup>116</sup> In

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*Comparison of House, Senate, and Conference Versions, U.S. Congressional Research Service, Order Code RL31483, 9-10 (July 26, 2002), [https://www.everycrsreport.com/files/20020726\\_RL31483\\_4643ff95130f94c80da9f0451e9acc782fd8d1d9.pdf](https://www.everycrsreport.com/files/20020726_RL31483_4643ff95130f94c80da9f0451e9acc782fd8d1d9.pdf). The Senate Bill provided for forfeiture of trading profits and bonuses received in the 12-month period before a restatement was made as a result of misconduct; the House Bill, by contrast, simply asked the SEC to consider whether disgorgement of insider trading profits was appropriate, and if so, to adopt such rule. See *id.**

109. *See id.*

110. *See id.*

111. *See id.* (citing *S.E.C. v. Jenkins*, 718 F. Supp. 2d 1070, 1075 (D. Ariz. 2010)); *see also S.E.C. v. Life Partners Holdings, Inc.*, 71 F. Supp. 3d 615, 625 (W.D. Tex. 2014); *S.E.C. v. Baker*, No. A-12-CA-285-SS, 2012 WL 5499497, at \*4 (W.D. Tex. Nov. 13, 2012); *S.E.C. v. Geswein*, No. 5:10CV1235, 2011 WL 4541303, at \*3 (N.D. Ohio Sept. 29, 2011).

112. *See Jensen*, 835 F.3d at 1116.

113. *See id.* (“[A]mple authority supports the proposition that the broad equitable powers of the federal courts can be employed to recover ill-gotten gains for the benefit of the victims of wrongdoing, whether held by the original wrongdoer or by one who has received the proceeds after the wrong.” (alteration in original) (internal quotation marks omitted) (quoting *S.E.C. v. Colello*, 139 F.3d 674, 676 (9th Cir. 1998))).

114. *See id.* at 1114.

115. For a further discussion of other modes of interpretation and information the court failed to consider, see *infra* notes 116-118 and accompanying text.

116. For a further discussion of SOX’s statutory scheme and how it might have commanded a different conclusion, see *infra* notes 129-127 and accompanying text.

the same vein, a different conclusion is necessary to prevent tension between Sarbanes-Oxley, a relatively recent enactment, and other securities laws that have formed the basis of this body of law for nearly a century.<sup>117</sup> Third, the purpose of the disgorgement remedy has been understood in all areas of the law as a way to punish wrongdoers; the court's interpretation of section 304 turns this long-standing presumption on its head.<sup>118</sup> These reasons warrant rethinking the Ninth Circuit's interpretation in favor of an interpretation requiring more consistent with Sarbanes-Oxley itself, other federal securities laws, and the common law understanding of disgorgement.<sup>119</sup>

A. *One of These Things Is Not Like the Others: Sarbanes-Oxley's  
Statutory Scheme*

First, the court's interpretation of section 304 is inconsistent with other sections of the Act, particularly section 302.<sup>120</sup> Section 302 requires that CEOs and CFOs review annual and quarterly reports.<sup>121</sup> In doing so, they must certify that, *to their knowledge*, the report does not contain any false or misleading material facts or omit any material facts and that, *based on their knowledge*, any financial statement included in the report is accurate "in all material respects."<sup>122</sup> As a general matter, section 302 does not hold officers strictly liable for inaccurate financial statements.<sup>123</sup> Rather, section 302 merely requires that the officers certify the accuracy of the financial statements to the best of their knowledge and implement internal controls designed to prevent the filing of false or misleading statements.<sup>124</sup> Thus, so long as an officer does not (a) knowingly or recklessly certify a misleading financial statement, or (b) fail to implement internal controls designed to prevent this from happening, then an officer can escape liability for the actions of others.<sup>125</sup> Section 304 is a dramatic departure from section 302 in that section 304 imposes absolute liability and does not consider the officer's knowledge, or lack thereof, nor does it require the officer to do anything (i.e., implement internal controls) or punish them for failing to do

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117. For further discussion of how SOX 304 fits into the broader securities laws context, see *infra* notes 128-132 and accompanying text.

118. For a further discussion of the history and purpose of the disgorgement remedy, and how it should have influenced the court's decision, see *infra* notes 133-142 and accompanying text.

119. For a discussion of an alternative interpretation that would avoid such inconsistencies, see *infra* notes 143-155 and accompanying text.

120. See Kelsh, *supra* note 71, at 1028; see also Kimes, *supra* note 5, at 824; Defendant Michael a. Baker's Motion to Dismiss, *supra* note 71, at 6; Notice of Motion and Motion by Defendant Maynard L. Jenkins to Dismiss the Complaint, *supra* note 24, at 18; Memorandum of Points and Authorities in Support Thereof, *supra* note 24, at 18-19.

121. 15 U.S.C. § 7241 (a) (2012).

122. See *id.* § 7241 (a)(3). Section 302 also requires that these individuals certify that they have "establish[ed] and maintain[ed] internal controls" designed to ensure the accuracy of such reports, and that they have disclosed to the issuer's auditors any fraud or "significant deficiencies" that are detected. See *id.* § 7241 (a)(4)-(5).

123. See Kelsh, *supra* note 71, at 1028; see also Kimes, *supra* note 5, at 824 (stating that "section 302 does not require a CEO to take total responsibility for the content of reports").

124. See 15 U.S.C. § 7241(a)(2).

125. See Kelsh, *supra* note 71, at 1028.

so.<sup>126</sup> If Congress had intended to craft section 304 in such a way that significantly departs from other provisions within its statutory scheme, it would have done so clearly and explicitly.<sup>127</sup>

B. *If it Ain't Broke, Don't Fix It: Looking to Decades-Old Securities Laws for Guidance*

The way the *Jensen* court interpreted section 304 is not only inconsistent with other provisions of the Sarbanes-Oxley Act, it is also at odds with securities law generally.<sup>128</sup> While there are other securities laws that impose strict liability, all of these laws allow the officer to disclaim liability by a showing of good faith or due diligence.<sup>129</sup> Securities laws, with the exception of section 304, can be

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126. *See id.* at 1029. Kelsh poses the following thought-provoking question in his analysis of section 304:

If Congress had in fact intended to impose a form of absolute liability that is inconsistent not only with the existing structure of the federal securities laws, but also inconsistent with other provisions of the very Act in which it was passed, would it not have been rational to explain itself more clearly?

*See id.*

127. *See id.* (arguing that if Congress had intended section 304 to be a departure from other provisions of securities laws, then it necessarily would have had to explain itself). Kelsh suggested that, given the “careful limitations on officer liability in section[] 302,” had Congress intended to make such an extreme departure in section 304, it is likely they would have done so clearly and explicitly. *See id.* The Ninth Circuit should have followed the Supreme Court’s holding in *Meyer* and recognized that, in the absence of clear congressional intent, the courts should not interpret a statute in such a way that clearly departs from common law principles. *See Meyer v. Holley*, 537 U.S. 280, 281 (2003) (declining to interpret statute in way that would represent marked departure from common law principals in absence of clear and explicit congressional intent); *see also FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (writing that “we must be guided to a degree by common sense as to the manner in which Congress is likely to delegate a policy decision of such economic and political magnitude”); *cf. Morton v. Mancari*, 417 U.S. 535, 551 (1974) (declining to find that Congress would have “consciously abandoned its policy of furthering Indian self-government” with subsequent enactment in absence of clear expression). The courts can reasonably expect that Congress, should they desire to create law that significantly departs from common law principles, will do so explicitly. *See id.* Of course, the converse argument has been made: courts have argued that if Congress wanted section 304 to have a personal misconduct element, it could have easily drafted it to include one. *See S.E.C. v. Jensen*, 835 F.3d 1100, 1115 (9th Cir. 2016) (“Congress knew how to draft a statute that would limit the disgorgement remedy to cases of officer or director misconduct, and chose not to do so.”); *see also Kelsh, supra* note 71, at 1023 (“If Congress had intended for the remedy to apply only in those instances in which the misconduct was on the part of the Covered Officer, the argument goes, it easily could have drafted the statute to make this clear.”).

128. *See* Def. Michael a. Baker’s Mot. to Dismiss, *supra* note 71, at 8 (stating that statute holding officers strictly liable for other’s misconduct is a “weapon unknown to eighty years of federal securities regulation”); *see also Kelsh, supra* note 71, at 1024. Kelsh notes that “the courts have long looked to the overall context of the securities laws in interpreting ambiguous provisions therein.” *See id.* at 1024 n.113 (citations omitted). For example, in *S.E.C. v. National Securities, Inc.*, the court stated that “the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen.” 393 U.S. 453, 466 (1969).

129. *See* Defendant Michael a. Baker’s Motion to Dismiss, *supra* note 71, at 8; *see also Kelsh, supra* note 71, at 1026. For example, section 20 of the Securities Exchange Act of 1934

broken up into three general categories: (1) laws that hold individuals liable for their own conduct, and provide a defense based on the individual's state of mind; (2) laws that make individuals liable for their own actions but do not provide a defense based on state of mind; and (3) laws that impose liability on individuals for the actions of others, but provide a defense, or allow the individual to disclaim liability based on their state of mind with respect to that action.<sup>130</sup> The third category holds individuals vicariously liable for the actions of others but provides certain "good faith" defenses.<sup>131</sup> Reading section 304 to impose strict vicarious liability on officers for the misconduct of other employees would create a fourth category of securities law: one that imposes liability on officers for the actions of others, but fails to provide a defense based on the officer's mental state.<sup>132</sup>

C. *Punishment Without Crime? The Ninth Circuit Fails to Consider the Purpose of Disgorgement*

Finally, by finding that the SEC could seek the remedy of disgorgement absent personal misconduct, the court failed to apply accepted principles of common law equity.<sup>133</sup> It is well established that disgorgement is designed to prevent conscious wrongdoers from profiting off of their wrongdoing.<sup>134</sup> SEC disgorgement has long been understood as a penalty designed to target wrongdoers.<sup>135</sup> While the text of section 304 uses the word "reimburse" rather

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provides that an individual will be held liable for the actions of any person under their control, but it provides a complete defense for a control person who acted in good faith and did not "induce the act or acts constituting the violation." 15 U.S.C. § 78t(a) (2012).

130. See Kelsh, *supra* note 71, at 1024–25 (providing three general categories of securities laws).

131. See Defendant Michael a. Baker's Motion to Dismiss, *supra* note 71. One such good faith defense can be found in 15 U.S.C. § 78t(a) of the United States Code, which provides:

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable (including to the Commission in any action brought under paragraph (1) or (3) of section 78u(d) of this title), *unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.*

15 U.S.C. § 78t(a) (emphasis added).

132. See Kelsh, *supra* note 71, at 1026 ("A court that interpreted section 304 broadly would have to ascribe to Congress intent to create a fourth category of liability: i.e., a liability that is (i) vicarious and (ii) not subject to any defense.").

133. For a discussion of the common law history of disgorgement, see *supra* notes 74–88 and accompanying text.

134. See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 51 cmt. a (AM. LAW INST. 2011); see also *id.* at cmt e.

135. See *S.E.C. v. Fischbach Corp.*, 133 F. 3d 170, 175 (2d Cir. 1997) ("The primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains." (citations omitted)); see also *S.E.C. v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996) ("The primary purpose of disgorgement as a remedy for violation of the securities laws is to deprive violators of their ill-gotten gains, thereby effectuating the deterrence objectives of those laws." (citations omitted)); *S.E.C. v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) ("The court's power to order disgorgement extends only to the amount with interest by which the defendant profited from *his* wrongdoing." (emphasis added)).

than “disgorge,” the legislature intended, at least initially, to make disgorgement the remedy available for a violation of the statute.<sup>136</sup> The courts that have interpreted the statute have consistently understood the word “reimburse” to mean “disgorge.”<sup>137</sup> Many of these courts also recognize that disgorgement is a remedy designed to deprive wrongdoers of ill-gotten gains.<sup>138</sup> This understanding is inconsistent with the *Jensen* court allowing the SEC to seek disgorgement from CEOs and CFOs who have not themselves committed any wrongdoing.<sup>139</sup>

This departure from common law principles of equity is especially problematic in the absence of any argument that disgorgement in the SEC enforcement context is *sui generis*: a remedy unique to the securities laws enforcement context, materially different from the common law remedy.<sup>140</sup> If the

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136. See H.R. REP. NO. 107-414, at 12 (2002) (asking the Commission to determine when an officer or director should be required to “disgorge” profits gained, and if necessary, promulgate a rule requiring the “disgorgement” of ill-gotten gains). For a discussion of the legislative history of the Sarbanes-Oxley Act, see *supra* notes 38–48 and accompanying text. The *Jenkins* court attempted to argue that, because the text of the statute utilizes the term “reimburse” rather than “disgorge,” the preexisting common law theory of disgorgement is irrelevant in this context. See *S.E.C. v. Jenkins*, 718 F. Supp. 2d 1070, 1078 (D. Ariz. 2010). In doing so, the court failed to apply the rules of statutory interpretation it recognized earlier in its opinion, which was that the court’s ultimate goal is to uncover Congress’s intent, and when such intent is unclear using certain methods of statutory interpretation, the court should look to additional canons. See *id.* at 1074.

137. See *In re Digimarc Corp. Derivative Litig.*, 549 F.3d 1223, 1232 (9th Cir. 2008) (recognizing that section 304 requires “non-compliant directors and officers to reimburse the issuer by disgorging the profits of their noncompliance”); *Mehlenbacher ex rel. Asconi Corp. v. Jitaru*, No. 6:04CV1118ORL-22KRS, 2005 WL 4585859, at \*9 (M.D. Fla. June 6, 2005) (writing that violation of section 304 allows the SEC to recover “via the remedy of disgorgement”).

138. See *Neer v. Pelino*, 389 F. Supp. 2d 648, 655 (E.D. Pa. 2005) (stating that section 304 “address[es] wrongdoing of officers”). More recently, the Supreme Court has recognized disgorgement in the securities laws context as a punitive remedy. See *Kokesh v. S.E.C.*, 137 S. Ct. 1635, 1643–44 (2017). For a discussion of the holding in *Kokesh*, see *supra* notes 80–88 and accompanying text.

139. See *S.E.C. v. Jensen*, 835 F.3d 1100, 1116 (9th Cir. 2016) (holding that disgorgement is appropriate under section 304 even when there is no wrongdoing on the part of the CEO or CFO). For a discussion of the court’s analysis in *Jensen*, see *supra* notes 103–13 and accompanying text.

140. See *Kirk*, *supra* note 54, at 145–46. Some have argued that disgorgement in the SEC enforcement context is *sui generis*, meaning that common law principles of equity are inapplicable. See *id.* *Kirk* established the theory of “regulatory equity,” which he refers to as “the type of equity deemed by the Supreme Court to have been intended by Congress when passing the securities laws.” See *id.* at 135, 145. He notes that this theory of equity is similar in many respects to traditional common law equity; the fundamental difference between them is the composition of the parties. See *id.* at 145. Unlike at common law, in the SEC enforcement context, the complaining party, the SEC, has no legally protected interest. See *id.* at 145–46. Importantly, the author does not argue that regulatory equity allows for the application of the disgorgement remedy against a blameless individual. See *id.* at 142. In contrast, the author appears to clearly support the notion that disgorgement, under both common law and regulatory equity, targets wrongdoers, or people who have personally acted in some unlawful manner. See *id.* at 141–42 (“Disgorgement deprives a wrongdoer of ill-gotten gains . . .”). In his article, *Kirk* consistently refers to defendants in these SEC enforcement actions as “wrongdoers” and supports the application of this principle of common law equity as consistent with the purpose of securities laws. See *id.* at 151–52 (“[A] disgorgement order in the SEC enforcement context

Ninth Circuit felt that SEC disgorgement in the enforcement context warranted an alternative application of the remedy, they did not state so in their opinion.<sup>141</sup> Thus, the court failed to provide adequate reasoning for diverging from common law principles and in doing so, contributed to a chaotic body of law plagued by inconsistent application of the disgorgement remedy in the SEC enforcement context.<sup>142</sup>

D. *Maintaining Harmony: An Alternative Interpretation Avoids Inconsistencies*

In order to avoid such an erroneous result, the Ninth Circuit should have interpreted section 304 to be read with the same scienter requirement as section 302: “based on an officer’s knowledge.”<sup>143</sup> Requiring that an officer at least have knowledge of the misconduct that triggers a restatement would be consistent with Sarbanes-Oxley’s statutory scheme, which purports to hold officers liable “based on what they knew rather than the title they held.”<sup>144</sup> A knowledge requirement would resolve inconsistencies between sections 302 and 304.<sup>145</sup> Under the *Jensen* court’s holding, sections 302 and 304 read together produce the following problematic result: when senior officers certify the accuracy of financial statements, they must only do so to the best of their knowledge, but should one of these statements contain an error that requires it to be restated, the officer will be held strictly liable, regardless of whether they were aware of such error or inaccuracy.<sup>146</sup> This could not be what Congress intended.<sup>147</sup> Reading section 304 without a knowledge requirement would, as one legal commentator noted, render section 302 meaningless.<sup>148</sup> If section 304 will hold an officer vicariously strictly liable regardless of their knowledge, or lack thereof, then the provisions of section 302 that require certification of financial statements “based on an officer’s

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not only deprives the wrongdoer of benefits derived from unlawful conduct, but it also effectuates the purposes underlying the securities laws, the protection of the investing public, and the deterrence of future violations.”)

141. *See Jensen*, 835 F.3d at 1116 (stating that disgorgement is merited but failing to note justifications for diverging from common law equity principles).

142. *See Kirk*, *supra* note 54, at 159. Kirk cites the fact that the courts, the SEC, Congress, and legal commentators have “lacked precision” when speaking about the purpose of disgorgement in the SEC enforcement context as the primary reason for its chaotic application. *See id.* He notes that there is a lot of uncertainty in the application of disgorgement and inconsistency across the circuits, “in some instances leaving defendants wishing they were in the Second or the Eleventh Circuits, while in others finding the SEC longing for the Sixth or Ninth Circuits.” *See id.* at 135.

143. *See Kimes*, *supra* note 5, at 826 (internal quotation marks omitted) (quoting 15 U.S.C. § 7241(a) (2012)). This would make CEOs and CFOs liable for negligent or reckless behavior, and thus “avoid[] unlimited liability” while still “maintain[ing] the unique purpose of section 304—to incentivize CEOs to rigorously root out misconduct and sign off on certifications that are true.” *See id.* at 827.

144. *See id.* at 829 (writing that consideration of SOX’s statutory scheme, particularly section 302, would require finding that officer had knowledge of wrongdoing before imposition of liability); Defendant Michael a. Baker’s Motion to Dismiss, *supra* note 71, at 6.

145. *See id.*

146. *See id.*

147. *See id.*

148. *See Kimes*, *supra* note 5, at 826.



knowledge” are useless and clearly contradictory.<sup>149</sup> Requiring that an officer at least have knowledge of misconduct to enforce section 304 would also be consistent with securities laws generally.<sup>150</sup> Such a provision would fit squarely into the previously defined third category of securities laws that includes those that hold individuals liable for the actions of others but enable them to disclaim liability based on a lack of knowledge of those actions.<sup>151</sup>

Finally, requiring a CEO or CFO to at least have knowledge of misconduct that results in the issuance of a restatement in order to enforce section 304 against them is consistent with common law principles of equity and the historical application of the disgorgement remedy.<sup>152</sup> Disgorgement has been consistently and historically applied against wrongdoers.<sup>153</sup> A senior officer who does not even have knowledge of a lower-level employee’s misconduct cannot be labeled a “wrongdoer.”<sup>154</sup> Therefore, reading section 304 to require, at the very least, “knowledge” of misconduct on part of the officer would resolve the inconsistencies created by the *Jensen* court’s holding while still effectuating Congress’s goal of rooting out corporate misconduct.<sup>155</sup>

#### VI. THE CORPORATE LANDSCAPE IN THE WAKE OF *JENSEN*: CEO OMNIPOTENCE REQUIRED

The Ninth Circuit’s holding might be the reinforcement the SEC needed to start seeking disgorgement from innocent officers under section 304 with greater frequency.<sup>156</sup> Regardless, it remains unclear whether other courts will follow the Ninth Circuit’s lead and reach the same conclusions.<sup>157</sup> The court’s holding puts

149. *See id.* (internal quotation marks omitted) (quoting § 7241(a)).

150. For a discussion of three main “types” of securities laws, see *supra* notes 116–18 and accompanying text.

151. *See* Kelsh, *supra* note 71, at 1024–25 (describing three categories that securities laws generally fall into).

152. For a discussion of the history of the disgorgement remedy, see *supra* notes 74–88 and accompanying text.

153. For a discussion of the history of disgorgement, see *supra* notes 74–88 and accompanying text.

154. *See* BLACK’S LAW DICTIONARY, *supra* note 88 (defining wrongdoing); *see also* COLLINS ENGLISH DICTIONARY, *supra* note 88 (defining wrongdoer); OXFORD DICTIONARIES, *supra* note 88 (defining wrongdoer).

155. *See* Defendant Michael a. Baker’s Motion to Dismiss, *supra* note 71, at 7 (writing that interpreting section 304 to require that CEOs or CFOs be aware of misconduct “would implement Congress’s goal of improving financial reporting and disclosure without creating an inconsistent standard for liability”).

156. *See, e.g.,* O’Hara, *supra* note 9; *see also* Savarese & Carlin, *supra* note 33 (stating that “this victory at the appellate level may lead the Commission to seek this relief with greater frequency”); Richman, *supra* note 51 (stating that Ninth Circuit’s decision might increase risk of SEC seeking disgorgement from innocent CEOs and CFOs).

157. *See, e.g.,* Myers, *supra* note 1 (stating that *Jensen*’s “ultimate influence” is to be determined); O’Hara, *supra* note 9 (“Whether other courts of appeal will agree with [the Ninth Circuit’s] conclusion . . . remains to be seen.”); Richman, *supra* note 51 (stating that court’s decision might influence courts in future cases). It is also unclear what effect, if any, the *Jensen* concurrence will have on the Ninth Circuit’s holding, as it seemingly tempers an otherwise pro-SEC holding. *See* O’Hara, *supra* note 9 (noting that, by stating that the misconduct required to trigger disgorgement under section 304 must be intentional, “what the Ninth Circuit gave with

CEOs and CFOs at great risk by requiring them to have complete and perfect knowledge regarding the conduct of their lower-level employees—even when those employees go to great lengths to conceal information from them.<sup>158</sup> Given the complex internal structure of corporations, such precise monitoring may not be feasible, yet senior officers are forced to roll the dice and hope that those employees in charge of filing statements are both honest and diligent.<sup>159</sup> This risk may deter some qualified individuals from taking on the role of CFO or CEO or lead highly-qualified and experienced executives to leave public companies in favor of private equity, where they will not face the increased potential for criminal liability brought on by Sarbanes-Oxley.<sup>160</sup> Those that choose to take the risks associated with these positions may waste valuable time on over-monitoring when their talents could be put to better use.<sup>161</sup>

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one hand, the concurrence might partly take back.”)

158. See *S.E.C. v. Jenkins*, 718 F. Supp. 2d 1070, 1072–73 (D. Ariz. 2010) (describing situation that happened in *Jenkins*). This is what happened to the CEOs and CFOs in *Jenkins*. See *id.* at 1073. There, the SEC filed civil and criminal complaints against two other officers of the company, alleging that they had intentionally concealed the fraudulent scheme from *Jenkins*. See *id.*

159. See Myers, *supra* note 1. John J. Carney, former securities fraud chief for the Department of Justice, expressed similar concern over the holding, stating:

[I]t’s very scary for a certifier of financial statements. Assuming you are an honest, diligent officer of the company, how do you get comfortable in an environment where the authorities are targeting individual liability, and the courts are saying that even an innocent mistake might form a basis for liability?

*Id.* (quoting John J. Carney).

160. See Lerner & Yahya, *supra* note 49, at 1383 (noting that many managers are fleeing public companies because of Sarbanes-Oxley). Outback Steakhouse’s long-time CEO, Bob Merritt, cited the increased time spent on regulatory matters during the two years following the enactment of Sarbanes-Oxley as his reason for resigning. See *id.* (citing omitted). According to him, he is not the only one frustrated by the increased regulatory burdens associated with Sarbanes-Oxley; in an interview, he stated, “I don’t know of a single CFO of a publicly traded company who hasn’t thought about quitting in the last six months.” See Barancik, *supra* note 38 (quoting Bob Merritt). Ron Paul, a CEO of a restaurant research company, reinforced this notion, stating that “Sarbanes-Oxley has just raised the whole fear level in the public arena.” See *id.* (quoting Ron Paul).

161. See Barancik, *supra* note 38 (writing about interview with former Outback Steakhouse CEO Bob Merritt). According to Barancik, Merritt lamented the expansive regulations implemented by the Sarbanes-Oxley Act, which left “executives like himself with little time for strategic planning or profit building.” See *id.*; see also Lerner & Yahya, *supra* note 49, at 1385 (answering “[w]ho . . . will be ‘left behind’ as CEOs and CFOs” after Sarbanes-Oxley?). The authors suggest that increased criminal penalties brought on by Sarbanes-Oxley will result in the “model” CEO “flee[ing] for other environments.” See *id.* at 1385. The “ideal” CEO will be replaced by two types of individuals: “bean counters” and “swashbucklers.” See *id.* “Bean counters” are entrepreneurs “who delight in the minutia of regulatory compliance” and will fail to take the necessary business risks and waste valuable time by “spending eighty hours per week crossing every t, and dotting every i.” See *id.* at 1383, 1386. Even more alarming are the “swashbucklers.” See *id.* at 1386. These individuals cannot be deterred by increased criminal penalties; they are the “truly the ‘unrighteous.’” See *id.*; see also The Good, The Bad, and Their Corporate Codes of Ethics: Enron, Sarbanes-Oxley, and the Problems with Legislating Good Behavior, 116 HARV. L. REV. 2123, 2125 (2003) (writing that SOX and other recent legislative efforts “may do little to constrain dishonest executives and may instead hamstring honest executives in their efforts to use codes effectively”).

Given the increased risk brought on by Sarbanes-Oxley, it appears that CEOs have begun demanding higher fixed salaries because that money is not subject to disgorgement.<sup>162</sup> In 2016, a study on the effects of section 304 on CEO compensation showed that, when compared to “control” firms, firms that frequently issue restatements and whose CEO is the chairman of the board showed a notable increase in CEO salaries after Sarbanes-Oxley’s enactment.<sup>163</sup> From the results of their study, the authors concluded that “CEOs are concerned about potential clawbacks, and powerful CEOs are able to receive higher salaries . . . which are not subject to the [Sarbanes-Oxley] clawback provision.”<sup>164</sup> This represents a move away from the “pay-for-performance” trend, which has been praised as one solution to the agency problem because officers compensated based on how well the company performs have efficient incentives to not appropriate and to work hard.<sup>165</sup> Conversely, if their total pay is largely made up of a “base salary,” and the portion of their pay that is based on performance is marginal, officers have less incentive to perform well.<sup>166</sup>

Proponents of a broad interpretation of section 304 claim that such an interpretation will encourage CEOs and CFOs to exercise particular care and vigilance in implementing and maintaining a financial structure that ensures agents act honestly when preparing financial statements, or at least guarantees that any misconduct is detected before the statements are filed with the SEC.<sup>167</sup> These individuals further suggest that a broad interpretation will give investors, shareholders, and the general public a sense of security that officers of corporations will not profit off of wrongdoing.<sup>168</sup> However, such a broad

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162. See Kelsh, *supra* note 71, at 1036–37 (suggesting CEOs and CFOs may begin to demand higher fixed salaries); see also Natarajan & Zheng, *supra* note 38, at 20–21 (suggesting that CEOs and CFOs have already begun to demand higher fixed salaries).

163. See Natarajan & Zheng, *supra* note 38, at 20–21.

164. See *id.*

165. See Kelsh, *supra* note 71, at 1035–36; see also Margaret M. Blair, *Rationalizing Compensation Systems for the Twenty-First Century*, BROOKINGS, (Dec. 1, 1996), <https://www.brookings.edu/opinions/rationalizing-compensation-systems-for-the-twenty-first-century/> (noting that “[a]dvocates of equity-based compensation systems for directors and executives usually argue that tying compensation to stock performance aligns the incentives of directors and executives with those of shareholders”); Michael C. Jensen and Kevin J. Murphy, *CEO Incentives—It’s Not how Much You Pay, But How*, HARVARD BUSINESS REVIEW, (May–June 1990), <https://hbr.org/1990/05/ceo-incentives-its-not-how-much-you-pay-but-how> (writing that one way that is thought to align the incentives of CEOs and shareholders is to structure salaries and bonuses in a way that provides “big rewards for superior performance”).

166. See Blair, *supra* note 165. Blair presents a hypothetical scenario whereby a manager is compensated \$80,000 in fixed compensation, versus \$60,000 in fixed compensation with an additional \$20,000 in stock grants based on “firm-specific contributions.” See *id.* Blair suggests that in the latter scenario, the manager would have greater incentive to confront productivity issues earlier on – implying that officers receiving greater fixed compensation with lower variable compensation have less incentive to perform optimally. See *id.*

167. See, e.g., Kelsh, *supra* note 71, at 1034 (“A broad form of liability is, therefore, justifiable on the ground that it will maximize the incentive for Covered Officers to root out misconduct and thereby avoid the need for restatements.”); see also List, *supra* note 14, at 249 (arguing that section 304, if properly clarified, “will target those inattentive officers who have failed to find the corporate misconduct being perpetrated right under their noses”).

168. See Fichtner, *supra* note 17, at 77 (arguing that SEC’s failure to enforce section 304 more vigorously “has betrayed the sense of security it was supposed to have created for

interpretation is not necessary and does not take into account the corporate landscape at the time of Sarbanes-Oxley's enactment.<sup>169</sup> Sarbanes-Oxley was a response to the growing public concern after scandals like Enron.<sup>170</sup> What made these scandals particularly shocking, however, was the CEO or CFO involvement that permeated them.<sup>171</sup> This was the type of behavior Sarbanes-Oxley was meant to target.<sup>172</sup> Instead, the SEC has insisted in recent years on a broad interpretation of section 304 that unnecessarily targets innocent officers instead of deterring intentional misconduct by officers.<sup>173</sup>

The original goal of Sarbanes-Oxley could be accomplished through a much narrower interpretation of section 304—one requiring personal misconduct.<sup>174</sup> The personal misconduct element would not render section 304 moot.<sup>175</sup> In fact, had it been in place at the time of the Enron or WorldCom scandals, the SEC could have enforced section 304, which would have required both CFOs to disgorge their compensation because both individuals participated in personal misconduct as the creators of the fraudulent reports.<sup>176</sup>

investors”).

169. See Kelsh, *supra* note 71, at 1007–08 (calling legislative response to corporate scandals “dramatic” and Sarbanes-Oxley Act “a bombshell”). A broad interpretation would have a negative effect “on (i) compensation practices, (ii) insurance, and (iii) the perceived fairness of the federal securities laws.” See *id.* at 1035 (advocating for narrow interpretation of section 304). Kelsh further noted that a narrow interpretation of Section 304 would still accomplish a “meaningful purpose” without subjecting CEOs and CFOs to significant personal liability. See *id.* at 1042. See also Kalani A. Morse, *Much Ado About Nothing: Looking Past the Drama of the Sarbanes-Oxley Act and Reevaluating the U.S. Delisting Trend Among Non-U.S. Firms*, 2 BYU INT’L L. & MGMT. R. 87, 88 (2005) (explaining that SOX was enacted in response to financial scandals and bankruptcies that caused investor panic and subsequent “mass exodus of investors from U.S. securities markets”).

170. See Tosha Huffman, Note, *Section 404 of the Sarbanes-Oxley Act: Where the Knee Jerk Bruises Shareholders and Lifts the External Auditor*, 43 BRANDEIS L.J. 239 (calling Enron scandal “the first wave of a tsunami of many corporate and auditor corruptions”); see also Kelsh, *supra* note 71, at 1007–08; Morse, *supra* note 169, at 88.

171. See *id.* at 1005–06. For example, in the collapse of Enron, it was discovered the corporation’s CFO, Andrew Fastow, was the “financial architect of, and key investor in, several of the off-balance sheet entities,” which allowed him to profit both directly in his investments, by taking on very little risk, and indirectly, by making the corporation’s performance appear better. See *id.* This then allowed him to obtain substantial bonus compensation. See *id.* Fastow’s deceptive behavior earned him millions, while investors lost billions. See *id.*

172. See *id.* at 1006–07 (calling political and legislative action in 2002 “responses” to these highly-publicized corporate scandals).

173. See, e.g., S.E.C. v. Jensen, 835 F.3d 1100, 1105 (9th Cir. 2016); S.E.C. v. Jenkins, 718 F. Supp. 2d 1070, 1072–73 (D. Ariz. 2010); S.E.C. v. Baker, No. A-12-CA-285-SS, 2012 WL 5499497, at \*1 (W.D. Tex. Nov. 13, 2012); Slater, Exchange Act Release No. 34-74240, at 2 (Feb. 10, 2015); S.E.C. v. Diebold, Inc., Accounting and Auditing Enforcement Act Release No. AE-3137, 2010 WL 2199552, at \*1 (June 2, 2010).

174. See Kimes, *supra* note 5, at 820 (arguing that personal misconduct should be a prerequisite for section 304 liability). Specifically, Kimes suggests that “[c]onstruing section 304 with a scienter requirement reinforces the purpose of section 302 and creates a statutory scheme that avoids contradiction.” See *id.* at 826. See also Kelsh, *supra* note 71, at 1041–42 (arguing that narrow interpretation of section 304 would still accomplish purpose of Sarbanes-Oxley).

175. See *id.* at 1005–06 (providing factual details regarding Enron and WorldCom scandals and executive officer’s personal misconduct in bringing about scandals).

176. Cf. *id.*

It is unclear precisely what impact *Jensen* will have moving forward and whether other circuits will take the same approach.<sup>177</sup> Because the case is only binding upon lower courts in the Ninth Circuit, the district courts of other circuits will have the freedom to interpret the statute as they see fit.<sup>178</sup> Even if other courts take the Ninth Circuit's approach, the court's failure to address other major ambiguities in the statute will leave defendant CEOs and CFOs with other avenues by which to push back against enforcement.<sup>179</sup> Thus, over fifteen years after its enactment, it is unclear exactly what section 304 mandates, and until the Supreme Court reviews such a case, CEOs and CFOs will continue to walk around with a bullseye on their backs.<sup>180</sup>

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177. See O'Hara, *supra* note 9 (writing that it is not yet clear whether other courts of appeals will agree with *Jensen* court's conclusion); see also McLaughlin & Cohn, *supra* note 38, at 3 (stating it is unclear whether other circuits would take same approach as Ninth Circuit in *Jensen*).

178. Cf. Barbara Bintliff, *Mandatory v. Persuasive Cases*, PERSPECTIVES: TEACHING LEGAL RES. & WRITING 83, 83–85 (2001), (stating that decisions of U.S. courts of appeals are mandatory on district courts in that circuit).

179. See *Ninth Circuit Supports Expansive Interpretation of SOX 304*, *supra* note 50 (writing that because Ninth Circuit did not define misconduct defendants will still be able to argue that section 304 does not require disgorgement); see also *S.E.C. v. Jensen*, 835 F.3d 1100, 1123 (9th Cir. 2016) (Bea, J., concurring) (addressing majority opinion's failure to interpret pertinent parts of statute).

180. See Myers, *supra* note 1 (making bullseye reference).