On February 10, 2015, the SEC announced settlements with two former chief financial officers of Saba Software, a Silicon Valley software company, that require the CFOs to repay Saba more than $500,000 in bonuses and profits from stock sales earned subsequent to Saba’s false filings. Notably, the SEC did not allege that either former officer violated the federal securities laws in any fashion, nor was there evidence of either officer’s knowledge of, or complicity in, the underlying conduct that prompted the company to settle accounting fraud charges lodged against it by the SEC in September 2014.

The first CFO, William Slater, a former accountant who served as CFO from November 2011 through February 2013, and the second, Peter E. Williams III, a California attorney who served as CFO from March 2004 through July 2007 and again on an interim basis from October 2011 through January 2012, agreed to reimburse the company approximately $337,000 and $142,000, respectively, pursuant to Sarbanes-Oxley Section 304(a).

Section 304(a) provides that in the event an “issuer,” as defined under the Securities and Exchange Act of 1934, is required to issue a restatement of its accounting records as a result of misconduct under the securities laws, the issuer’s CEO and CFO “shall reimburse the issuer” for any bonus, “incentive-based,” or “equity-based” compensation, or for the profits from the officers’ personal sale of any of the issuer’s securities during the 12-month period following the first issuance of each allegedly violative financial statement. See 15 U.S.C. § 7243(a).

In September 2014, the SEC charged Saba with accounting fraud, and the company agreed to a settlement. The company was required to restate its financial records for the years 2008–2011 and for parts of 2012. In connection with the settlement with Saba, the SEC alleged that two Saba vice presidents had overseen a practice of misstating the hourly work of international consultants, both pre-booking and underbooking time statements, in order to adhere to prearranged time estimates. The practice violated GAAP and allegedly led to an overstatement of Saba’s revenues by approximately $70 million. The vice presidents responsible for the misconduct agreed to a collective disgorgement of approximately $55,000 and a collective penalty of $100,000, while the company agreed to pay a $1.75 million fine. At the time of the settlement, Saba’s CEO agreed to reimburse the company for more than $2.5 million in bonus, incentive, and equity-based pay that he received during the 12-month periods following the original issuance of the financial statements containing the alleged fraud.

The SEC claims that “Section 304 does not require that a chief financial officer [or chief executive officer] engage in misconduct to trigger the reimbursement requirements.” William Slater, CPA and Peter E. Williams, III, Securities & Exchange Act of 1934 Release No. 74240, File No. 3-16381 (Feb. 10, 2015) at 5. Indeed, despite no evidence of fault or liability, Mr. Williams, who served as interim CFO for only four months between 2011 and 2012, was forced to reimburse the company for more than $140,000 in compensation he had received as a result of the allegedly violative financial statements.

This draconian clawback provision went into effect in 2002, although the SEC declined to actively enforce it until 2009. That year, the enforcement division settled accounting fraud charges with CSK Auto and four of its former executives, but in that case, it did not stop there. As former SEC Director of Enforcement Robert Khuzami...
announced in a December 8, 2009 speech, the SEC sought “to clawback more than $4 million in bonuses and stock sale profits from the former CEO, despite the fact that he was not alleged to have personally participated in the underlying financial wrongdoing.” Khuzami noted that, going forward, the SEC would use this “powerful enforcement tool” in “appropriate circumstances” in order to prevent CEOs and CFOs from “personally prof[iting] from misstated financial filings” and to incentivize these officers “to ensure the accuracy of [their] compan[ies’] financials.” Robert Khuzami, Remarks at AICPA National Conference on Current SEC and PCAOB Developments (Dec. 8, 2009).

Though Khuzami touted the new priority of the enforcement of this provision in another speech, see Robert Khuzami, Remarks at AICPA National Conference on Current SEC and PCAOB Developments (Aug. 5, 2009) (“This is the first Section 304 action seeking to clawback compensation from an officer that was not alleged to have personally participated in the underlying financial wrongdoing.”), it is unclear when and why the staff will deem officers “appropriate” targets for clawbacks. In fact, because the provision requires no proof of culpability on the part of the corporate officers, the employment of this enforcement tool is particularly difficult to forecast.

Looking ahead, because Section 304(a) does not provide for a private right of action that would allow shareholders to seek reimbursement from CEOs and CFOs, see Cohen v. Viray, 622 F.3d 188, 193-194 (2d Cir. 2010), the SEC remains the exclusive enforcement entity of this powerful provision. There is some indication that we may see an expansion of requirements related to companies’ internal clawback policies through the implementation of Dodd-Frank, see Kara M. Stein, Remarks at the “SEC Speaks” Conference (Feb. 21, 2014) (“We also need to finalize rules about executive compensation, including provisions requiring issuers to have policies in place to claw back compensation.”), but in the meantime, enforcement will remain at the SEC’s whim.

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