

Ninth Circuit Holds SOX 304 Clawback Applies to Executives Not at Fault



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The *Ninth Circuit* recently held that **Section 304** of the **Sarbanes-Oxley Act (SOX 304)** allows for a *clawback* of certain CEO and CFO compensation regardless of whether the clawback was triggered by the personal misconduct of such officers. District courts have reached this conclusion before, but the Ninth Circuit appears to be the first circuit to adopt such a view. The Ninth Circuit also held that Rule 13a-14 of the Securities Exchange Act (Rule 13a-14) provides the SEC with a cause of action against a CEO and CFO who certify false or misleading statements.

In [SEC v. Jensen, No. 14-55221](#) (9th Cir. Aug. 31, 2016), the **SEC** filed suit against a former CEO and CFO alleging that they engaged in a scheme to defraud their former employer's investors by fraudulently overstating financial results. The SEC brought the action after the company had restated its financial statements.

SOX 304 Clawback

The SEC sought to clawback compensation of the CEO and CFO under SOX 304, which

provides that if an issuer is required to prepare an accounting restatement “as a result of misconduct,” the CEO and CFO of the issuer shall reimburse the issuer for certain incentive and equity-based compensation received and certain profits realized from sale of securities of the issuer. The CEO and CFO argued that there was no personal misconduct and thus they should not be subject to the clawback under SOX 304. The Ninth Circuit disagreed. The court focused on the statute’s plain meaning and legislative history and held that SOX 304 allows a clawback from the CEO and CFO “even if the triggering restatement did not result from misconduct on the part of those officers.” The court noted that clawbacks are warranted in such situations 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 majority opinion did not address the meaning of “misconduct”, but a concurring judge would have adopted a meaning requiring an intentional violation of law or standard on the part of the issuer.

Rule 13a-14 Certifications

Rule 13a-14 provides that the CEO and CFO of an issuer are required to submit certifications as to the accuracy of certain reports (including Form 10-Qs and 10-Ks), and the SEC said they violated this rule. The CEO and CFO argued that Rule 13a-14 only creates a cause of action for failures to certify, not for false certifications. The Ninth Circuit, once again, disagreed. The court held that Rule 13a-14 includes an implicit truthfulness requirement and, as a result, the CEO and CFO are not only responsible for submitting certifications, but for the accuracy of the reports they certify. The concurring judge would provide that “liability for false certification under Rule 13a-14 [] lie[s] only where a CEO or CFO acts with knowledge or at least recklessness as to the falsity of a certification.”

Takeaway

Jensen is a warning to CEOs and CFOs that their compensation is subject to clawback regardless of fault and that such officers should be diligent in their duties, including certifications and insuring proper internal controls.

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