

**SEC SEEKS SARBANES-OXLEY CLAWBACK OF CEO COMPENSATION
DESPITE NO ALLEGATION OF FRAUDULENT MISCONDUCT**

July 28, 2009

Last week, the Securities and Exchange Commission filed suit against Maynard L. Jenkins, the former chief executive officer of CSK Auto Corporation, claiming that he should be forced to reimburse the company and its shareholders more than \$4 million that he received in bonuses and profits from the sale of stock while the company was committing accounting fraud.¹ The SEC alleges that Jenkins is required to reimburse the company under Section 304, the "clawback" provision, of the Sarbanes-Oxley Act of 2002 ("SOX"), but does not allege any other violation of the securities laws by Jenkins. The case represents the first time the SEC has taken action under Section 304 against an executive who is not otherwise accused of violating the securities laws and serves as further evidence of the intense scrutiny being placed today on executive compensation practices.

SOX's Section 304 Clawback Provision

SOX Section 304 generally requires the chief executive officer and chief financial officer of public companies to disgorge certain bonuses, other incentive- or equity-based compensation and profits on sales of company stock if the company has to issue a financial restatement because of material noncompliance, due to misconduct, with financial reporting requirements under the federal securities laws. Prior SEC action against an executive under Section 304 has alleged wrongdoing by the executive from whom reimbursement is sought. For instance, in a 2007 options backdating settlement against the former CEO and chairman of UnitedHealth Group Inc., the SEC announced recovery of approximately \$448 million under the Section 304 clawback provision.² Section 304 has been criticized on several grounds, including that it is unclear whether the executives subject to the statute must be accused of misconduct or whether there simply must have been misconduct by someone at the company in connection with the financial reports. Although the complaint is not entirely clear, the SEC's action suggests that the SEC believes that misconduct by *anyone* at the company is sufficient to pursue clawback from the CEO and CFO under Section 304. Courts have held that no private right of action exists under Section 304, so it is only enforceable by the SEC.

SEC Action Against Jenkins

The SEC's action against Jenkins is the third enforcement action in the SEC's investigation into CSK's alleged accounting misconduct that resulted in CSK twice restating its financial statements. In March 2009, the SEC charged four former CSK executives—but not Jenkins—with securities fraud, and in May 2009, the SEC

¹ The SEC complaint against Jenkins, filed in the U.S. District Court in the District of Arizona, is available at <http://www.sec.gov/litigation/complaints/2009/comp21149.pdf> (July 22, 2009), and a copy of the SEC press release describing the enforcement action is available at <http://www.sec.gov/litigation/litreleases/2009/lr21149.htm> (July 22, 2009).

² The SEC press release regarding the 2007 settlement with the former UnitedHealth Group CEO, William D. McGuire, is available at <http://www.sec.gov/news/press/2007/2007-255.htm> (Dec. 6, 2007).

and CSK settled without CSK having to make any payments.³ According to last week's SEC press release, Jenkins was "captain of the ship" and profited during a time that the company was misleading its investors regarding its financial health and, as a result, should be forced to return the compensation. Although Jenkins signed each of the annual reports on Form 10-K containing the fraudulent financial statements and the related SOX certifications, the SEC's complaint does not specifically allege that Jenkins was involved in any violation of the securities laws, other than failure to reimburse CSK under Section 304. The SEC seeks recovery from Jenkins of over \$2 million in bonuses and other incentive-based and equity-based compensation and an additional \$2 million from the sale of stock for the 12-month periods following the fraudulent financial statements.

Recommended Actions

The Jenkins action signals the SEC's willingness to proceed against CEOs and CFOs under Section 304 even in the absence of fraudulent wrongdoing by such executives and serves as further evidence of the SEC's renewed aggressiveness in the enforcement arena. While Jenkins may of course challenge the SEC's authority to proceed against him under Section 304 in the absence of personal wrongdoing, the SEC claim raises the question whether the SEC may routinely seek Section 304 recovery following accounting restatements due to misconduct. As a result, companies—and CEOs and CFOs in particular—should take even greater care to ensure that sufficient internal controls are in place to monitor conduct related to financial statement preparation and to minimize the likelihood of accounting restatements due to misconduct. In addition, companies that have not already done so should consider implementing clawback provisions, either as stand-alone policies or embedded in compensation plans and agreements. Clawback policies provide a means for a company to recoup compensation from its executives in the event of certain misconduct or other circumstances, including restatement of financial statements. A recent study indicates that almost two-thirds of the Fortune 100 companies have implemented clawback policies, and companies participating in the federal bailout program are required to implement clawback policies under certain circumstances.⁴ Such policies, if appropriately drafted and enforced, could allow companies and their CEOs and CFOs to avoid the time and expense of defending an SEC Section 304 claim.

If you have any questions regarding the SEC's action or your company's clawback policy, please contact Shandra N. Stout (<http://www.wcsr.com/ShandraStout>), the principal drafter of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link:

<http://www.wcsr.com/profSearch.php?fn=&ln=&office=0&PG=63&IT=0&school=0&txtKeywords=>

Womble Carlyle client alerts are intended to provide general information about significant legal developments and should not be construed as legal advice regarding any specific facts and circumstances, nor should they be construed as advertisements for legal services.

IRS CIRCULAR 230 NOTICE: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. tax advice contained in this communication (or in any attachment) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed in this communication (or in any attachment).

³ The SEC press release regarding the action against the other CSK executives is available at <http://www.sec.gov/litigation/litreleases/2009/lr20933.htm> (March 6, 2009). A copy of the settlement order is available at <http://www.sec.gov/litigation/admin/2009/33-9032.pdf> (May 26, 2009).

⁴ See Equilar study regarding clawbacks at http://www.equilar.com/press_20081030.php (October 30, 2008). See our client alert regarding the increasing use of clawback policies at <http://www.wcsr.com/resources/pdfs/cs012609.pdf> (January 26, 2009).