Cooley

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On November 15, 2011, the Securities and Exchange Commission ("SEC") announced that the former CEO of CSK Auto Corporation ("CSK") agreed to return $2.8 million in compensation to the company, pursuant to a settlement with the SEC. The SEC sued the former CEO in 2009 seeking an order compelling him to reimburse the company for his bonuses, incentive-based compensation and stock sale profits pursuant to Section 304 of the Sarbanes-Oxley Act of 2002 ("SOX"). Section 304 of SOX requires a CEO or CFO of an issuer to pay back certain types of bonus, incentive and equity-based compensation if the issuer materially restates its financial statements as a result of misconduct.

This was the first suit the SEC brought pursuant to Section 304 of SOX in which the executive was not also charged with misconduct related to the restatement. As part of the settlement, the former CEO acknowledged the SEC's position that a public company's agreement to indemnify an officer for violations of SOX Section 304 violates public policy and agreed not to seek indemnification from the company.

Section 304 of SOX

Section 304 of SOX provides:

If any issuer is required to prepare an accounting restatement due to 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 shall reimburse the issuer for:

1. any bonus or other incentive-based or equity-based compensation received by that officer 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
2. any profits from the sale of the issuer's securities by that officer during this 12-month period.

15 U.S.C. § 7243(a).

CSK's restatements

CSK filed two restatements related to its accounts receivables for fiscal years 2002 through 2004. Following the restatements, the SEC charged four former executives of CSK with accounting fraud and separately charged the company for filing false financial statements. The company settled the charges with the SEC. The lawsuit against the three surviving former executives is continuing.

In July 2009, the SEC also filed suit pursuant to Section 304 of SOX against the former CEO, who had not been previously sued by the SEC for accounting fraud, because he failed to repay to the company bonuses and profits from stock sales during the relevant period. The SEC's complaint against the former CEO did not contain any allegations that he participated in any of the misconduct or was even aware of the misconduct.

Observations

CEOs and CFOs should be aware that if an accounting restatement occurs on their watch as a result of misconduct, the SEC may seek to force them to return bonuses, profits from stock sales and various other types of incentive compensation, whether or not they were involved in the misconduct.

Further, the SEC's position is that a public company cannot indemnify an officer for payments made pursuant to Section 304 of SOX, even though under Delaware law an officer is allowed to be indemnified if he or she acted in "good faith" and in a manner "reasonably believed to be in or not opposed to the best interests of the corporation." 8 Del. C. § 145(a).

The SEC settlement does not address whether the CEO can seek income tax, wage tax or other tax refund or gross-ups for the repayment.

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