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Sarbanes-Oxley's Officer Certification Requirements—Has Increased Accountability Equaled Increased Liability?

Erin MasseyEveritt*

I. INTRODUCTION

In the wake of countless corporate scandals, the demand for greater executive accountability was at a fever pitch by 2001. Congress responded by including Sections 302 and 906 in the Sarbanes-Oxley Act of 2002, which required more extensive certifications by corporate executives and heightened penalties for false certifications. Though directly responding to investor outcry, these provisions were met with as much skepticism as they were applause.

Some critics were concerned the provisions were too far-reaching and would essentially impose strict liability on officers—particularly for those running large, multi-national corporations—when it was entirely impractical to imagine an individual could verify the accuracy of every detail of the financial reports.1 Others argued the proposed provisions were largely a replica of rules already in place under the Exchange Act, which had already proven ineffective at preventing the earlier corporate debacles, and merely gave the appearance of reform without providing any real substantive change.2 Five years have now passed since Sections 302 and 906's enactment, and the case law, though limited, offers a telling glimpse of the true impact of these provisions.

This Article surveys the liability associated with officer certifications under Sections 302 and 906. Specifically, this Article examines whether the increased accountability demanded by Sections 302 and 906 has translated into increased liability for corporate executives. This Part provides a brief background on the Sarbanes-Oxley Act and,

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2. Id. at 4.
specifically, the impetus for Sections 302 and 906's officer certification requirements. Part II examines the actual substance of the provisions and guidance governing their immediate application. Part III surveys judicial interpretation and application of Sections 302 and 906 and identifies any significant trends or problems in uniformity. Part IV examines the role of these provisions in private litigation under the antifraud provisions of the securities laws. This Article ultimately concludes that, although the more extensive certification provisions have indisputably increased executives' potential liability to civil and criminal enforcement authorities, executives' liability in private actions has not proceeded in parallel fashion. This is a result of courts adhering strictly to the heightened pleading requirements under the Private Securities Litigation Reform Act ("PSLRA").

II. THE HISTORY BEHIND EXECUTIVE OFFICER CERTIFICATIONS

A. The Impetus for Increased Accountability of Corporate Officers

Much like the impetus for the securities regulation after the 1920s market collapse, the Sarbanes-Oxley Act was enacted after the overzealous and under-scrutinized market of the late-1990s imploded. Investors sustained billions in losses as scandals broke on some of the world's largest companies. As the details of the scandals came to light, it became increasingly implausible for legislators, regulators, and the public to imagine that the highest-ranking executives could have been in the dark as to the matters occurring right under their noses.

The first, and most publicized, case involved Enron Corporation ("Enron"), the world's seventh largest corporation at the time. From 1997 to 2001, Enron used illegal accounting methods to disguise and improperly record revenue "generated by phony, non-arm's-length transactions with Enron-controlled entities" to ensure steady earnings growth, "conceal its growing debt, [and] maintain its artificially high stock prices and investment grade credit rating." With the help of its auditor, Arthur Andersen, Enron executives illegally structured such deals to conceal Enron's true financial condition.

In late 2001, Enron announced a $544 million loss in the third quarter, an overstatement of earnings by $586 million, and that it would be

6. Id. at 613-14.
restating profits for the four previous years. After Enron revealed the massive accounting fraud, it immediately collapsed and was forced to declare bankruptcy. Remarkably, in the period leading up to the announcement and amidst market speculation, Enron’s chairman and CEO, Kenneth Lay, consistently claimed that the company had no accounting problems and that it was strong. Following Enron’s collapse, the United States Securities and Exchange Commission (“SEC”) brought charges against Lay. Lay sought to avoid all liability by claiming he was unaware of the accounting improprieties and relied on the counsel of others in the organization when he issued statements on behalf of the company.

On June 25, 2002, WorldCom admitted it had overstated its profits by a staggering $3.8 billion, wiping out all profits from 2001 and resulting in the arrests of several WorldCom executives. Like Ken Lay, WorldCom’s CEO, Bernie Ebbers, who had resigned just two months before the announcement, claimed he had no knowledge of the accounting fraud and that he left the daily details of running the company to subordinates.

Finally, in 2002, Tyco International, Ltd. was forced to make a $382.2 million pre-tax adjustment to its 2002 financial statements and another $1.1 billion in after-tax charges after “unearthing fresh accounting problems.” One aspect of the suspect accounting involved tens of millions of dollars in “loan forgiveness” to Tyco’s CEO Dennis Kozlowski. In response to the charges, Kozlowski claimed he had no knowledge of the accounting treatment given to the loans and

10. Id.
11. Id., supra note 4.
that he had merely instructed subordinates to address his outstanding loans at the end of each year.  

These events decimated investor faith in the "integrity of the world's capital markets." Much of the blame for "the roll call of corporate failures" fell to corporate executives who either directly engaged in the inappropriate activities or took a "head in the sand" approach with management by remaining willfully blind to the conduct of subordinates. As a result, investors and markets demanded accountability for the senior executives of publicly-traded companies. The Sarbanes-Oxley Act was intended to prevent such disasters in the future by increasing corporate transparency, auditor and executive accountability, and penalties for wrongdoing.

B. Perception of Officer Certification Provisions

Congress enacted Sections 302 and 906 of the Sarbanes-Oxley Act specifically to address the outraged demand for the increased accountability of corporate executives. Upon its enactment, President Bush noted that Sections 302 and 906 would usher in a new era of increased accountability:

My accountability plan . . . requires CEOs to personally vouch for their firm's annual financial statements. Currently, a CEO signs a nominal certificate and does so merely on behalf of the company. In the future, the signature of the CEO should also be his or her personal certification of the veracity and fairness of the financial disclosures.

President Bush further noted that the law ushered in a "new ethic of personal responsibility in the business community," where "[w]hen you sign a statement, you're pledging your word, and you should stand behind it."

The provisions were similarly lauded by other regulators and legislative officials. Then-Chairman of the SEC, Harvey L. Pitt, called cer-

18. Id.
25. Id.
tification "an unprecedented step" because it required CEOs and CFOs to "swear that the numbers they've reported in their financial reports are correct and that they've left nothing important out."26 Chairman of the House Judiciary Committee, Representative James Sensenbrenner, similarly supported officer certification because those provisions "w[ould] make CEOs directly responsible for the integrity of their company's financial statements . . . ."27

The business and academic communities' reactions to the new provisions were mixed.28 Many believed "CEO certification w[ould] underscore that CEOs are responsible for the management of the company and that they take responsibility for what happens in their company."29 Notwithstanding, others were skeptical of the decision to increase executive accountability because of costs associated with certifications. For example, one commentator noted:

The most significant cost of [Sarbanes-Oxley], one occasionally mentioned by others but not discussed in great detail, may be the opportunity costs associated with CEO and CFO review in connection with the certification process. To the extent officers decide to undertake substantial due diligence in connection with the process, this is time taken away from running the business. Of course, there may be business benefits that accompany a greater understanding of

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28. A law firm's commentary immediately following the Act stated:

Sentiments expressed about this legislation cover every color of the political spectrum. Some say that it is a prime example of Congressional overreaction to admittedly egregious corporate behavior, and that the wrongdoers (who could be dealt with under existing criminal statutes) are just a few "bad apples." Others say that Congress still has not gone far enough to address the root causes of the problem affecting corporate America. . . . [A] close reading of Sarbanes-Oxley reflects a Congressional desire to administer shock treatment to those with stewardship responsibility for America's publicly traded companies.


29. Anitha Reddy, Few Argue with Pitt's Proposal for CEO Accountability, WASH. POST., June 28, 2002; see also Howard v. Everex Sys., Inc., 228 F.3d 1057, 1061-63 (9th Cir. 2000) (finding that a corporate official who signs a financial report with scienter makes a statement within the meaning of § 10(b) and can be held liable for that statement); Sheehan v. Little Switzerland, Inc., 136 F. Supp. 2d 301, 312-14 (D. Del. 2001) (finding that CEO and CFO who signed 10-K with scienter could be held personally liable); SEC v. Enter. Solutions, Inc., 142 F. Supp. 2d 561, 575-76 (S.D.N.Y. 2001) (finding that a CEO could be personally liable for signing statement he knew was misleading); SEC v. Chester Holdings, Ltd., 41 F. Supp. 2d 505, 522-27 (D.N.J. 1999).
the financial statements. Either way, this is a cost that is difficult to assess with any accuracy, so it often gets ignored.30

Others pointed out that corporate officers already faced liability for signing company financial reports and the new provisions offered little in the way of true, substantive reform.31 As one newspaper article reported, some corporate officers referred to the enactment of the certification provisions as a "non-event," stating that "few executives feel they're anymore on the hook than they already were."32

III. Substance of Sections 302 and 906

A. Section 302

Section 302 directed the SEC to enact a new rule requiring officer certification, which the SEC did through Exchange Act Rule 15d-14.33 In substance, Section 302 requires certification addressing disclosure controls and procedures and internal controls and procedures. Regarding disclosure controls and procedures, the CEO and CFO must certify that they:

➢ are responsible for establishing and maintaining disclosure controls and procedures;

➢ have designed the company's disclosure controls and procedures, or caused the disclosure controls and procedures to be designed under their supervision, to ensure that material information about the company, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which the 10-Q or 10-K is being prepared; and

➢ have evaluated the effectiveness of the company's disclosure controls and presented in the 10-Q or 10-K their conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the 10-Q or 10-K, based on their evaluation.34


31. Fairfax, supra note 1, at 4; see also In re Enron Corp. Sec., Derivative & ERISA Litig., 235 F. Supp. 2d 549, 576 (S.D. Tex. 2002) (noting that the general signature requirement on a Form 10-K can give rise to § 10(b) liability). This case is important in that it notes the tone already in place for officers given the authority to attest to the accuracy and veracity of corporate filings filed with the SEC. There is a long history of case law noted establishing liability where the corporate officer signs the 10-K.


34. § 240.13a-14(a); § 229.601(b)(31).
Regarding internal controls and procedures (amended in Section 302 upon publication of the final rules implementing Section 404), the CEO and CFO must certify that they:

- are responsible for establishing and maintaining internal control over financial reporting;
- have designed the company's internal control over financial reporting, or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP; and
- have indicated in the certified filing whether or not any changes in internal control over financial reporting occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the company's internal control over financial reporting.\(^{35}\)

The SEC defines "internal control over financial reporting" as a process designed by or under the supervision of the CEO and CFO and effectuated by the board of directors, management, and other personnel.\(^{36}\) The CEO and CFO must certify that the internal controls provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes was made in accordance with the Generally Accepted Accounting Principles ("GAAP").\(^{37}\) Internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of the company's management and directors;\(^{38}\) and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.\(^{39}\)

\(^{35}\) § 240.13a-15(a); § 240.13a-14(a); § 229.601(b)(31).
\(^{36}\) § 240.13a-15(f).
\(^{37}\) Id.
\(^{38}\) Id.
\(^{39}\) § 240.13a-14(a).
The SEC made clear that it intended Section 302 certifications to be taken seriously by stating: "Your Section 302 certification specifically speaks to your responsibility for disclosure controls and procedures and to you, as CFO and a certifying officer, having evaluated those and disclosed your conclusions about them in your company’s public filing — you cannot hide your head in the sand on this one." Through this statement, the SEC firmly established that certifying officers would be held to a higher standard than they previously had been and that, by certifying, the officers were expressly stating they had faithfully met that heightened standard.

B. Section 906

In substance, Section 906 amended the U.S. Criminal Code by enacting 18 U.S.C. § 1350, which requires officer certification. Under Section 906, a CEO and CFO must "certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or section 15(d) of the . . . Exchange Act" and based on his or her knowledge, the financial statements and other financial information included in the report "fairly presents, in all material respects, the financial condition[,] and results of operations," and cash flows of the registrant, as of, and for, the periods presented in the report.

The most attention-grabbing aspect of Section 906 was it explicitly provided for criminal liability for failing to make such certification or falsely certifying financial statements. Section 906 imposes two tiers of criminal liability, depending on the mental state associated with the violation. A person who knowingly violates the certification provision faces a maximum penalty of one million dollars, a maximum prison term of ten years, or both. In contrast, willful violations of the provision subject a person to a maximum five million dollar fine, a maximum prison term of twenty years, or both. The impact of the enhanced criminal punishment is beyond question—Sarbanes-Oxley’s new penalties doubled the previous penalties for signing false reports under the Exchange Act and is four times the maximum jail time for defendants under the mail and wire fraud statutes.

42. Id.
43. Id.
Notably, in the five years since Section 906's enactment, little guidance has emerged on the difference between "knowing" and "willful." In answering questions before Congress, Senator Joseph Biden attempted to explain the level of culpability required by the "knowing" standard by stating, while "those who act out of ignorance, mistake, accident or even sloppiness" would not be held criminally liable, the statute nevertheless was intended to send a clear message to executives "to watch your books and not bury your heads in the sand!"\textsuperscript{45}

The first person to be criminally charged pursuant to Section 906 was the former CEO of HealthSouth Corporation, Richard Scrushy, in October 2003. In seeking to dismiss the charges brought against him under Section 906, Scrushy challenged the constitutionality of Section 906 by arguing that its provisions were impermissibly vague.\textsuperscript{46} The court rejected this argument following careful consideration of the newly adopted language. In its closing, the court noted that determinations of:

[F]airness, materiality, and willfulness are fact intensive questions generally reserved for the jury. . . . If the jury finds that the reports did not fairly present, in all material respects, the financial condition and results of operations of HealthSouth, the jury must then determine whether Mr. Scrushy willfully certified these reports knowing that the reports did not comport with the statute's accuracy requirements.\textsuperscript{47}

Surprisingly, the Department of Justice ("DOJ") has not actively pursued charges under Section 906 since the Scrushy case. Even in the recent stock-options backdating scandals, where DOJ has targeted high-level corporate executives, not one individual has been indicted under this provision. Indeed, in the most recent, high-profile criminal trial of Brocade's CEO, Gregory Reyes, Reyes was indicted and convicted on a litany of charges, including allegations regarding false certifications, but none of the charges were brought under Section 906.\textsuperscript{48} Instead, the SEC brought a civil enforcement action against Reyes in which the SEC included a charge under Section 302.\textsuperscript{49} Whether this reflects a government reluctance to pursue criminal charges under Section 906 is unclear, and the DOJ has issued no commentary to ex-

\textsuperscript{47} Id. at *6 (emphasis in original).
plain thus far. Notwithstanding, the force of Section 906 is clear, and certifying officers must be mindful of the significant penalties imposed for the intentional violation of the certification provisions.

C. Construing the "Fairly Present" Language in Sections 302 and 906

Both Section 302 and 906 contain language wherein the officer must certify that the financial statements filed with the SEC "fairly present" the issuer's true financial condition, results of operations, and cash flows. Given its inherently subjective nature, counsel and executives of publicly traded companies immediately sought to clarify what "fairly presents" meant in the certifications. Almost immediately, the SEC specifically rejected suggestions that "fairly present" should mean that the financial statements were GAAP compliant. Thus, even where financial information is presented in conformity with generally accepted accounting principles, it may not necessarily satisfy obligations under the antifraud provisions of the federal securities laws.

Instead, the SEC adopted a broader standard for satisfying the "fairly presents" certification:

In our view, a 'fair presentation' of an issuer's financial condition, results of operations and cash flows encompasses the selection of appropriate accounting policies, proper application of appropriate accounting policies, disclosure of financial information that is informative and reasonably reflects the underlying transactions and events and the inclusion of any additional disclosure necessary to provide investors with a materially accurate and complete picture of an issuer's financial condition, results of operations and cash flows.

Thus, an officer may certify that financial statements "fairly present" the company's true financial condition and cash flows when the officer has weighed the appropriateness of utilized accounting policies and whether the corporation properly applied those accounting policies. Additionally, an officer must consider whether the disclosure of finan-


53. See id.
cial information is informative, whether it reasonably reflects the underlying transactions and events, and whether any additional disclosures are necessary to provide investors with a materially accurate assessment of an issuer's financial picture.\footnote{See id.}

D. Which Filings Have Certification Requirements?

Only "periodic reports" must be certified pursuant to Sections 302 and 906.\footnote{See id. at 57,278.} Because there are no timing requirements on when a Form 6-K or Form 8-K must be filed, thereby making them "current reports" instead of "periodic reports," the SEC's certification requirements do not require CEOs and CFOs to certify either Forms 6-K or 8-K.\footnote{See id.} In contrast, annual and quarterly reports filed or submitted under either § 13(a) or 15(d) of the Exchange Act must be certified. This includes annual reports on Form 10-K, 10-KSB, 20-F and 40-F, quarterly reports on Form 10-Q and 10-QSB, as well as any amendments to these filings. Sections 302 and 906 were significant in that those provisions extended officer certification to quarterly filings (10-Q, 10-QSB), which were not previously required.

IV. Liability Under Sections 302 & 906: How the Case Law Has Developed

Since their enactment, judicial interpretation and application of Sections 302 and 906 has been largely reasoned and, fortunately, with little inconsistency emerging within and among the circuits on important issues.

A. No Private Right of Action for Sections 302 & 906

Most fundamentally, in 2006, two courts found Sections 302 and 906 do not create a private right of action for individuals. In \textit{Srebnik v. Dean}, plaintiffs argued that a private right of action should exist because Congress did not specifically prohibit private rights of action under Sections 302 and 906.\footnote{Srebnik v. Dean, No. 05-cv-01086, 2006 WL 2790408, at *5 (D. Colo. Sept. 26, 2006).} Plaintiffs also argued that allowing a private right of action was consistent with precedent cases that found private rights of action under other sections of the Exchange Act.\footnote{Id. (noting that the plaintiffs did not cite to any court recognizing a private right of action and stating that it was not aware of any).} The court rejected plaintiffs' argument, finding there was no "rights creating" language, such as that employed by Congress in Section 306,
to support the argument that Congress intended to omit a right of action. The District Court of New Jersey arrived at the same holding in In re Intelligroup Securities Litigation and likewise cited to the language of Section 306 as the basis of its reading. These rulings appear to be settled law, as subsequent private plaintiffs have not attempted to bring direct claims under Sections 302 and 906.

B. Qualified Certifications Will Not Evade Liability

The only court to address certifications where the officer qualifies his certification upon some other event or condition found such qualification could not be used to evade liability. The court noted "[d]oubletalk stating that controls were 'effective' subject to a discussion of internal weaknesses that was itself knowingly or recklessly false or misleading bespeaks more of conscious evasion of the truth rather than candor." Significantly, the court found the use of qualifying language to be an indication of culpability, rather than a protection against it.

Without further adjudication of this issue, it is too early to determine whether other courts will agree that qualified certifications cannot be used to evade liability. Nevertheless, any argument that a qualified certification offers protection from the penalties or responsibilities of Sections 302 or 906 should fail. To hold otherwise would allow publicly traded companies to issue their quarterly or annual reports without necessarily accurate financial statements so long as the certifying officer selected the correct qualification. Qualified certifications would thereby undermine the legislature's intent in passing Sections 302 and 906 and diminish regulators' ability to hold officers to a higher degree of accountability for their certifications.

V. LIABILITY UNDER THE ANTIFRAUD PROVISIONS FOR SECTION 302 & 906 VIOLATIONS

Perhaps the most interesting development stemming from the implementation of officer certification requirements is the more significant role the Sarbanes-Oxley certifications are playing in allegations

59. Id.
61. In re OCA, Inc. Sec. & Derivative Litig., No. 05-2165, 2006 WL 3747560, at *22 (E.D. La. Dec. 14, 2006) (rejecting defendants' argument that their certifications were qualified, in that their certifications were subject to OCA's internal controls weaknesses, as exceptions to liability).
62. Id.
involving other provisions of the securities laws. Most notably, Section 302 and 906 certifications are frequently mentioned in cases brought by private plaintiffs under the antifraud provisions of the Exchange Act (e.g., Section 10(b), Rule 10b-5, and Rule 20(a)). Although officer certifications were often cited in cases prior to the enactment of Sarbanes-Oxley, the public policy statements and the heightened responsibilities and expectations associated with the new provisions have given plaintiffs enhanced ammunition with which to attack certifying officers.

As a public policy matter, the judiciary and enforcement authorities approve of such overlap in liability. As Justice Ginsberg noted in a recent opinion: "This Court has long recognized that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the Securities and Exchange Commission." Consequently, executives must be mindful that liability from Section 302 and 906 certifications can always extend beyond the actual provisions.

A. The Role of Section 302 & 906 Certifications Section 10(b)/Rule 10b-5 Claims

Officer certifications have long played a role in claims alleging fraud under Section 10(b) and Rule 10b-5. As a result of the more extensive certification provisions implemented through Sections 302 and 906, however, the question arises whether the increased accountability imposed by these provisions exposes corporate executives to greater liability under the antifraud provisions. Arguably, corporate executives’ exposure has increased on two grounds: 1) some courts allow the officer certifications filed with SEC filings to constitute a “false or misleading statement” for purposes of establishing liability under Section 10(b) and Rule 10b-5 and 2) plaintiffs argue that the enhanced accountability imposed by the provisions weighs more heavily in the scienter assessment than previous officer certifications.

1. Certifications as “False or Misleading Statements”

Numerous courts have been asked to decide whether an officer’s certification can serve as a “false or misleading statement” for purposes of asserting a claim under Section 10(b) of the Exchange Act. While some courts recognize signed certifications as “statements” 64. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2504 (2007).
under Section 10(b), others reject the idea that Sarbanes-Oxley certifications standing alone may provide a basis for liability. Given these disparate conclusions, it will be necessary going forward for courts to uniformly decide whether officer certification statements may constitute "false and misleading statements" to avoid plaintiff forum-shopping.

The latter approach, however, may be the most appropriate for several reasons. First and foremost, legislative history and statutory language do not authorize plaintiffs to base fraud claims on the Sarbanes-Oxley officer certifications. As the district court for the Northern District of California noted in In re Silicone Technologies, Inc.: Moreover, with regard to both the statement regarding inventory valuations and the statement regarding compliance with GAAP, the court notes that there is nothing in either the 1934 Securities Exchange Act or the Sarbanes-Oxley Act and implementing regulations that authorizes plaintiffs to base a claim for securities fraud on an alleged misstatement in a Sarbanes-Oxley certification.

Moreover, there is a logical gap in allowing stand-alone liability for Sarbanes-Oxley certifications under Section 10(b) or Rule 10b-5 when Congress did not create a private right of action under Sections 302 and 906. Congress's explicit decision to exclude rights creating language in 302 and 906 for private plaintiffs is therefore evidence that Sarbanes-Oxley certifications were not meant to provide a basis for liability to private plaintiffs.

Finally, as explained below, courts are able to balance this more restricted approach by allowing the officer certifications to be considered for the far more difficult and critical component that plaintiffs sufficiently allege cogent, plausible facts that give rise to a strong in-


ference of scienter. In short, by restricting certifications from constituting "false and misleading statements" under the antifraud provisions, courts recognize congressional intent and history without depriving plaintiffs entirely of utilizing the certification statements in their pleadings. This is a balanced and appropriate approach under the Exchange Act and Sarbanes-Oxley.

2. Certifications Supporting an Inference of Scienter

Since Sarbanes-Oxley's enactment, a clear majority of the courts allow Sections 302 and 906 certifications to be considered as evidence that a defendant acted with the requisite "scienter" under the antifraud provisions. As one district court noted:

[C]ommentators argue that when a corporate officer certifies a company's financial reports, the company’s later revelation that the reports contained material false statements can support an inference that the officer either knew or was reckless about the false statements, by virtue of the company’s disclosure controls, or that he knew or was reckless in not knowing that the company’s disclosure controls were inadequate. Either of these inferences can help a plaintiff establish scienter.

As expected, plaintiffs immediately jumped on the enhanced accountability aspects of the Sarbanes-Oxley officer certification provisions to satisfy the heightened pleading requirements of the antifraud provisions under the PSLRA. For instance, in In re OCA, Inc. Securities and Derivative Litigation, the plaintiffs argued:

The Sarbanes-Oxley certification requirements were expressly intended to prevent top executives from using a "head in the sand" defense to actions for securities fraud committed on their watch. Indeed, the SEC has warned that corporate officers that provided a "false certification potentially could be subject to . . . both Conmis-

69. See Tellabs, 127 S. Ct. at 2509.
72. See, e.g., Tellabs, 127 S. Ct. at 2509 (articulating the standard for pleading a "strong inference" under section 10(b)).
sion and private actions for violation of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5.”

Similarly, in In re Watchguard Securities Litigation, plaintiffs directly attacked individual certifying officers for allegedly failing to meet Sarbanes-Oxley’s heightened obligations:

Section 302’s certification requirements were expressly designed to counter arguments that Sarbanes-Oxley certifications do not support an inference of scienter by preventing top executives from adopting a “head in the sand” defense to actions for securities fraud committed on their watch. The SEC recognized as much in implementing § 302, by expressly warning corporate officers that “a false certification potentially could be subject to . . . both Commission and private actions for violations of Section 10(b) and of the Exchange Act and Exchange Act Rule 10b-5.”

The same arguments were seen in In re Intelligroup, Inc. Securities Litigation, where plaintiffs referred the court to the legislative commentary highlighting the enhanced accountability associated with the new certification provisions:

[Section 302] simply seeks to facilitate full disclosure and ensure the accuracy of financial reports by requiring corporate executives’ personal stamp of approval. As Secretary Miller stated plainly but poignantly, “if the CEO is required to certify the reports he will be hard pressed later to say he thought that the CFO had everything in apple pie shape. So the certificate becomes the hook that establishes accountability.”

In seeking to use Section 302 certifications to demonstrate the requisite culpable state of mind, the plaintiffs in Intelligroup went further by distinguishing Section 302 certifications from the pre-Sarbanes-Oxley boilerplate language often unsuccessfully cited by earlier plaintiffs as proof of scienter. In Intelligroup, the plaintiffs argued:

Defendants did not merely sign SEC filings containing “boilerplate” - they certified the Company’s financials with personal endorsements of the design and evaluation of Intelligroup’s internal controls, the material weakness or non-existence of which directly caused material misstatements and ultimately necessitated the Company’s restatement. . . . [F]or the foregoing reasons, the Sarbanes-

73. Lead Plaintiff’s Consolidated Opposition to the Motion to Dismiss the Consolidated Class Action Complaint, In re OCA, Inc. Sec. & Derivative Litig., No. 05-2165 (E.D. La. Apr. 3, 2006).


Oxley certifications in this case strongly suggest the Individual Defendants' scienter.\footnote{76}{Id.}

One of the first court decisions to consider the interplay of Sarbanes-Oxley certifications and alleging scienter, In re Lattice Semiconductor, indicated that plaintiffs' arguments were well-received. In that case, the district court found:

Sarbanes-Oxley certifications give rise to an inference of scienter because they provide evidence either that defendants knew about the improper [accounting] that led to the over-reporting of revenues (because of the internal controls they said existed) or, alternatively, knew that the controls they attested to were inadequate.\footnote{77}{In re Lattice Semiconductor Corp. Sec. Litig., No. CV04-1255-AA, 2006 WL 538756, at *18 (D. Or. Jan. 3, 2006).}

Subsequently, in SEC v. Penthouse International, Inc., the district court also found that Sarbanes-Oxley certifications were materially misleading in their own right and contributed to a strong inference of scienter.\footnote{78}{SEC v. Penthouse Int'l, Inc., 390 F. Supp. 2d 344, 354-55 (S.D.N.Y. 2005).}

Notwithstanding these initial rulings, Sarbanes-Oxley officer certifications do not provide plaintiffs with a "home-run" allegation of scienter. Courts have been absolutely rigid in holding that "an incorrect Sarbanes-Oxley certification does not, by itself, create a strong inference of scienter."\footnote{79}{See In re Hypercom Corp. Sec. Litig., No. CV-05-0455, 2006 WL 1836181, at *11 (D. Ariz. July 5, 2006) (citing In re Invision Techs., Inc. Sec. Litig., No. 04-03181, 2006 WL 538752, at *21 (N.D. Cal. 2006)).}

Since Lattice Semiconductors, most courts have analyzed the certification obligations under a more critical approach, requiring plaintiffs to show a connection between the wrongdoing and the certifying officers before holding those officers accountable. Thus, in WatchGuard, the court distinguished Lattice Semiconductors, noting:

In a case like this one, however, where the court finds no strong inference that any Defendant was at least deliberately reckless in issuing corporate earnings statements, the court has no basis for a strong inference that the Sarbanes-Oxley certifications are culpably false. . . . Plaintiffs in this matter have not pleaded any connection between WatchGuard's accounting inadequacies and the Defendants. These Plaintiffs have alleged merely that because WatchGuard was a small company, the Defendants must have known about the improprieties. The court has already found this allegation insufficient to support a strong inference of scienter.\footnote{80}{In re Watchguard Sec. Litig., No. C05-678J, 2006 WL 2038656, at *10 (W.D. Wash. Apr. 21, 2006) (distinguishing Lattice Semiconductors) (citations omitted).}
Where the plaintiff can plead other facts in addition to the officer certifications, however, courts have given weight to the obligations inherent in the certification statements:

The Court does not hold that a Sarbanes-Oxley certification, without more, would support a strong inference of scienter under the PSLRA. However, under the particular facts of this case, the Court does find that the Sarbanes-Oxley certifications executed by [the defendants], when combined with the allegations of scienter contained in the previous sections, support an inference of scienter as to the defendants’ statements about OCA’s disclosure controls because the certifications show that both defendants stated that they designed and evaluated OCA’s control procedures to ensure that they worked to provide them with material information about the company and then certified that the controls were effective, while at the same time failing to disclose serious, unremedied internal control problems. 81

Likewise, in Watchguard, the district court noted:

The court finds that, in this case, Defendants’ Sarbanes-Oxley certifications are inadequate to support a strong inference of scienter. Plaintiffs contend that Congress passed the Sarbanes-Oxley Act to prevent certifying corporate officers from invoking a “head-in-the-sand” defense to 10b-5 allegations. Accepting Plaintiffs’ view of congressional intent for the present, the court nonetheless finds that the Sarbanes-Oxley Act does not doom these Defendants. Although the passage of Sarbanes-Oxley may make it somewhat more reasonable to infer that a certifying Defendant whose head is in the sand is being deliberately reckless, it does not transform the PSLRA’s requirement of falsity-plus-scienter into a requirement of falsity-plus-a-Sarbanes-Oxley-certification. 82

Similarly, in In re Invision Technologies, Inc. Securities Litigation, the court held that despite plaintiffs’ claims “alleging the falsity of Defendants’ Certification statement, . . . [t]here [we]re insufficient facts alleged to infer that [Defendants] had any knowledge of the alleged FCPA violations in light of the PSLRA’s heightened scienter requirements.” 83 The Eleventh Circuit specifically affirmed this approach in Garfield v. NDC Health Corp. 84 In Garfield, the Eleventh Circuit held that the plain meaning of the language contained in the Sarbanes-Oxley Act did not indicate any intention to change the requirements for pleading scienter set forth in the PSLRA. 85

82. Watchguard, 2006 WL 2038656, at *11.
84. Garfield v. NDC Health Corp., 466 F.3d 1255, 1266 (11th Cir. 2006).
85. Id.
Such flexibility in deciding whether plaintiffs have satisfied their scienter requirements via false certification allegations is critical to allowing courts the means to properly apply the antifraud provisions against defendants. Further, the majority approach is consistent with the Supreme Court’s recent ruling in *Tellabs Inc. v. Makor Issues & Rights*, in which the Court held scienter analysis should not turn on a single factor, but should require “a comparative evaluation” of the facts. Thus, the fact that an officer certified a company’s SEC filing will qualify as a “strong” inference of scienter “only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.”

Thus, despite Congress’s intention to enhance CEO and CFO accountability with Sections 302 and 906, it is abundantly clear that plaintiffs must have more in their pleading arsenal than simply Sarbanes-Oxley certifications by corporate executives. Plaintiffs must still be able to plead facts sufficient to raise a strong inference of scienter for each individual defendant with respect to the wrongdoing accused. Imposing the burden on plaintiffs is not only preferred, but necessary to avoid having officer certification create strict liability. Moreover, to limit allegations of false certifications as circumstantial, rather than dispositive, evidence to establish scienter is consistent with the congressional intent behind the heightened pleading requirements imposed by the PSLRA and the Supreme Court’s ruling in *Tellabs*.

**B. The Role of Sections 302 & 906 Certification in Section 20(a) Claims**

False officer certifications are also frequently alleged in control-person liability claims under Section 20(a) of the Exchange Act of 1934. In pertinent part, Section 20(a) states:

88. *Id.* at 2510; see also *In re ProQuest Sec. Litig.*, No. 06-10619, 2007 WL 3275109, at *15 (E.D. Mich. Nov. 6, 2007) (order on Defendant’s Motion to Dismiss). In *ProQuest*, the court found that plaintiffs had sufficiently alleged scienter, even in light of *Tellabs*, by alleging other evidence of scienter, such as the size of the restatement, the timing of share sales by the certifying executive, and statements by confidential informants. *Id.* However, the court specifically noted that “the most significant evidence of scienter” was from the “SOX certifications.” *Id.* The court noted that the executives “cannot say that the SOX certifications concerning knowledge of and adequacy of internal controls were truthful, yet, at the same time claim that the controls were so deficient that one ‘rogue’ employee could single-handedly be the cause of all the company’s accounting problems.” *Id.* at *27.
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, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation of cause of action.\(^9\)

The debate over this provision revolves around the meaning of "control."\(^9\) The SEC defined "control" as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise,"\(^9\) although not all courts have adopted this definition.

Plaintiffs argue it is axiomatic that where an officer may face criminal liability for certifying financial statements, the officer is in a position to exert "control" over the alleged primary violator because that officer may otherwise refuse to certify.\(^9\) Notably, courts seem willing to allow plaintiffs to enjoy an inference of control against officers who signed the SEC filings, at least at the initial pleading stage:

"[A]n allegation that a board member signed an SEC filing that contains a misleading or fraudulent statement can raise a sufficient inference of control because it comports 'with common sense to presume that a person who signs his name to a report has some measure of control over those who write the report.'"\(^9\)

Pre-Sarbanes-Oxley plaintiffs were able to cite to officer certifications of a company's financial statements as evidence of an individual's "control" over a primary violator.\(^9\) The rhetoric behind Sections 302 and 906's enactment, however, lends greater weight to such allegations because of the enhanced responsibilities imposed on officers and

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93. Id. at 1144.
94. See Howard v. Everex Sys., Inc., 228 F.3d 1057, 1066 (9th Cir. 2000); In re Indep. Energy Holdings PLC, 154 F. Supp. 2d 741, 772 (S.D.N.Y. 2001); In re Philip Servs. Corp. Sec. Litig., No. 98 Civ. 0835 (MBM), 2004 U.S. Dist. LEXIS 9261, at *62 (S.D.N.Y. May 24, 2004) ("While there is case law suggesting that a defendant's execution of a fraudulent SEC filing is insufficient by itself to establish control, [the court] share[s] the view that it 'comports with common sense to presume that a person who signs his name to a report has some measure of control over those who write the report.'") (internal citations omitted); Jacobs v. Coopers & Lybrand, L.L.P., No. 97 CIV. 3374, 1999 WL 101772, at *18 (S.D.N.Y. Mar. 1, 1999) (alleging outside directors signed fraudulent report sufficient to meet pleading standard for § 20(a)).
their exposure to criminal liability for willfully or knowingly certifying false statements.\textsuperscript{95}

Beyond acknowledging that Sections 302 and 906 certifications may provide a basis for alleging "control person" status, one cannot generalize the true impact of officer certifications under Sections 302 and 906 because different jurisdictions apply different tests in determining "control." Stated another way, the likely success or failure of a plaintiff's claim is entirely dependent upon the test of control that a jurisdiction applies. For instance, where the plaintiff need only show potential or actual control to establish liability under Section 20(a), it will be harder for a certifying officer to argue lack of knowledge or control given the enhanced expectations associated with the certification provisions.\textsuperscript{96} In contrast, where the court requires the culpable participation of the control person in the fraudulent transaction, the officer's culpability will be dispositive of liability, and officer certifications will play little to no role in the "control" assessment. Consequently, a uniform control-person test under Section 20(a) is necessary to avoid having certifying defendants subject to different outcomes as a result of the jurisdiction in which the plaintiff brings suit.

VI. CONCLUSION

The officer certification requirements of the Sarbanes-Oxley Act have proven quite effective at prompting executives of publicly traded companies to become more engaged in the financial reporting process.\textsuperscript{97} Two aspects of the officer certification provisions have been critical to the enhancement of executive accountability. First, certifying officers are now answerable to criminal authorities with the addition of criminal penalties pursuant to Section 906, which provides a substantial deterrent effect. Second, officer certifications under Sec-

\textsuperscript{95} See \textit{In re OCA, Inc. Sec. & Derivative Litig.}, 2006 WL 3747560, at *23 (E.D. La. Dec. 14, 2006) (allowing plaintiff to proceed on certain Section 20(a) claims where control was established, in part, because of the defendants' certification of company's SEC filings).


\textsuperscript{97} U.S. Gov. Accountability Office, No. GAO-06-678, \textit{Update of Public Company Trends, Market Impacts, and Regulatory Enforcement Activities} (2006) ("Some industry observers noted that several factors may have prompted more U.S. publicly traded companies to restate previously reported financial results, including (1) the financial reporting requirements of the Sarbanes-Oxley Act, especially the certification of financial reports required by Section 302 . . . .")
tions 302 and 906 are playing an increasingly visible role in private securities litigation brought under the Exchange Act’s antifraud provisions.

Notably, however, increased executive accountability for SEC filings has not equally translated into increased liability to private plaintiffs. By consistently employing critical, fact-specific analyses to plaintiffs’ pleading allegations involving officer certifications, the courts uphold and reinforce the heightened pleading requirements of the PSLRA\(^98\) without allowing the certifications to impose strict liability. It is therefore clear that both the doomsdayers and the naysayers were wrong about Sections 302 and 906. Plaintiffs are better equipped to plead officer accountability under the new Sarbanes-Oxley provisions, but Sections 302 and 906 are by no means a free ticket to the imposition of liability. As a result, the law has developed in a manner consistent with Congress’s ambition to increase officer accountability without running afoul of other congressional mandates to limit frivolous private litigation, thereby striking an impressive balance of substantive reform without undue burden on corporate officers.

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