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10 UNITED STATES DISTRICT COURT
11 DISTRICT OF ARIZONA

12 SECURITIES AND EXCHANGE
13 COMMISSION,

14 Plaintiff,

15 vs.

16 MAYNARD L. JENKINS,

17 Defendant.
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Case No. CV-09-01510-PHX-GMS

**MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
MOTION BY PLAINTIFF
SECURITIES AND EXCHANGE
COMMISSION FOR PARTIAL
SUMMARY JUDGMENT AGAINST
DEFENDANT MAYNARD L. JENKINS**

Date: October 29, 2010
Time: 9:00 a.m.
Place: Courtroom 602
(Hon. G. Murray Snow)

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1 **I. INTRODUCTION**

2 The Commission moves for partial summary judgment against Maynard Jenkins
3 on each of the three underlying elements of its claim for reimbursement under Section
4 304 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7243(a)). Those elements are: (1)
5 whether CSK was required to prepare an accounting restatement; (2) due to CSK's
6 material noncompliance with any financial reporting requirement under the securities
7 laws; and (3) that noncompliance was due to misconduct.

8 In its 2005 Form 10-K and related press releases, CSK stated that it was required
9 to restate its financial results as a result of "errors and irregularities." Under Generally
10 Accepted Auditing Standards ("GAAS"), the term "irregularities" means intentional
11 misstatements, *i.e., fraud*. AU § 316.03 (1997). In its 2005 Form 10-K CSK described,
12 with specificity, the nature of the "irregularities" that led to its restatement, which
13 included "improper journal entries," "inappropriate override of existing internal
14 controls," "withholding information from and providing improper explanations and
15 supporting documents to CSK's Audit Committee internal auditors and outside
16 accountants," and that CSK's improper accounting practices had been "directed" by
17 certain personnel. A clearer admission of employee misconduct is difficult to imagine.

18 By signing and certifying CSK's 2005 Form 10-K, Jenkins adopted CSK's
19 admissions. Moreover, Jenkins's testimony before the Commission during its
20 investigation, as well as CSK's Wells Submission to the Commission, in which the
21 company emphasized its employees' "misconduct" (using that very word), establish that
22 Jenkins clearly understood what he was signing, and that both he and the company had a
23 common understanding of the significance of the company's admission of "errors and
24 irregularities." Further admissible evidence of CSK's misconduct is presented by Don
25 Watson's (CSK's former CFO) repeated invocation of his Fifth Amendment privilege
26 against self-incrimination during his testimony before the Commission, and by Edward
27 O'Brien's (CSK's former controller) and Gary Opper's (CSK's former director of credits
28 and receivables) guilty pleas in the related criminal case, *United States v. Watson, et al.*

1 CR 09-373 PHX SRB LOA.

2 Lastly, there can be no legitimate factual dispute that CSK was required to prepare
3 an accounting restatement due to its material noncompliance with its financial reporting
4 requirement under the securities laws. Accordingly, the Commission's motion for partial
5 summary judgment must be granted.

6 **II. LEGAL STANDARDS**

7 **A. Summary Judgment**

8 A court must grant summary judgment if the pleadings and supporting documents,
9 viewed in the light most favorable to the non-moving party, "show that there is no
10 genuine issue as to any material fact and that the movant is entitled to judgment as a
11 matter of law." Fed. R. Civ. P. 56(c); *see also Celotex Corp. v Catrett*, 477 U.S. 317,
12 322-23 (1986). The moving party bears the initial responsibility of presenting the bases
13 for its motion and identifying those portions of the record which it believes demonstrate
14 the absence of a genuine issue of material fact. *Celotex*, 477 U.S. at 323; *Henderson v.*
15 *Arpaio*, 2010 U.S. Dist. LEXIS 65252, * 3 (D. Ariz. June 30, 2010). If the moving party
16 meets its initial responsibility, the burden then shifts to the opposing party who must
17 demonstrate the existence of a factual dispute and that the fact in contention is material,
18 *i.e.*, a fact that might affect the outcome of the suit under governing law, and that the
19 dispute is genuine, *i.e.*, the evidence is such that a reasonable jury could return a verdict
20 for the non-moving party. *Henderson*, 2010 U.S. Dist. LEXIS 65252, * 3 (*citing*
21 *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986)). Substantive law determines
22 which facts are material and "[o]nly disputes over the facts that might affect the outcome
23 of the suit under the governing law will properly preclude the entry of summary
24 judgment." *Campbell-Thompson v. Cox Communications*, 2010 U.S. Dist. LEXIS 43977,
25 * 10 (D. Ariz. May 5, 2010) (*quoting Anderson*, 477 U.S. at 248). *See also, Scott v.*
26 *Harris*, 550 U.S. 372, 380 (2007) ("Where the record taken as a whole could not lead a
27 rational trier of fact to find for the moving party, there is no 'genuine issue for trial'")
28 (*quoting Matsushita Elec. Indust. Co., Ltd v. Zenith Radio Corp.*, 475 U.S. 574, 586-87

(1986)).

B. Section 304 of the Sarbanes-Oxley Act

Section 304(a) of the Sarbanes-Oxley Act, 15 U.S.C. § 7243(a), provides:

(a) **Additional compensation prior to noncompliance with Commission financial reporting requirements**—If an issuer is required to prepare an accounting restatement due to the material non-compliance 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 of the issuer shall reimburse the issuer for—

(1) any bonus or other incentive-based or equity-based compensation received by that person 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 realized from the sale of securities of the issuer during that 12-month period.

(b) **Commission exemption authority**—The Commission may exempt any person from the application of subsection (a) of this section, as it deems necessary and appropriate.

1. “Misconduct” Defined

“Misconduct” is not a defined term under the statute. Accordingly, the term should be interpreted by its common meaning. *Perrin v. United States*, 444 U.S. 37, 42 (1979) (“A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning.”). *Accord, United States v. Maciel-Alcala*, 2010 U.S. App. LEXIS 15228, * 7 (9th Cir. July 21, 2010); *Greater Glendale Finance LLC v. Does 1-100*, 640 F. Supp. 2d 1124, 1139 (D. Ariz. 2009). *See also, McNary v. Haitian Refugee Ctr., Inc.*, 498 U.S. 479, 496 (1991) (Congress is presumed to legislate with knowledge of case law that sets forth principles of statutory construction).

Misconduct is generally defined to mean improper or unacceptable behavior. *See, e.g., Webster’s II, New Riverside University Dictionary*, Riverside Publishing Company (1988) (defining “misconduct” to mean: “(1) behavior not in conformity with prevailing standards of law: impropriety. (2) dishonest or bad management, esp. by persons entrusted or engage to act on behalf of another”); *The Compact Edition of the Oxford*

1 *English Dictionary*, Oxford University Press (1971) (defining “misconduct” to mean:
 2 “(1) bad management; mismanagement; (2) improper conduct; wrong behavior).

3 A common-sense definition of “misconduct” is also appropriate in light of Section
 4 304(b), as well as other sections the Sarbanes-Oxley Act. Section 304(b) gives the
 5 Commission broad discretion to consider a variety of factors, such as the type of
 6 misconduct or the persons involved, when deciding whether it should exempt someone
 7 from a reimbursement action. The Commission’s discretion would be unduly restricted if
 8 the term “misconduct” were interpreted to require conduct akin to fraud or extreme
 9 recklessness. *See Neer v. Pelino*, 389 F. Supp. 2d 648, 654 (E.D.Pa. 2005).¹ In addition,
 10 in other sections of the Sarbanes-Oxley Act, Congress used qualifying words, such as
 11 “willful” or “knowing.” *See, e.g.*, Section 906 of the Sarbanes-Oxley Act, 18 U.S.C. §
 12 1350 (providing criminal penalties for “knowing” and “willful” false certifications of
 13 periodic financial reports). The absence of such qualifiers in Section 304(a) strongly
 14 indicates that the term “misconduct” should be given its ordinary meaning. *Egebjerg v.*
 15 *Anderson (In re Egebjerg)*, 574 F.3d 1045, 1050 (9th Cir. 2009) (“We ... presume that if
 16 Congress includes particular language in one section of a statute but omits it in another,
 17 Congress acted intentionally in that exclusion”).

18 Accordingly, the Commission respectfully submits that the term “misconduct,” as
 19 used in Section 304, simply means improper behavior.

20 **III. STATEMENT OF FACTS**

21 Beginning on March 27, 2006, CSK made a series of public announcements that it
 22 would be required to restate its prior years’ financial statements due to accounting “errors
 23 and irregularities” uncovered by its audit committee-led investigation, and that its interim
 24

25 ¹ The operative language when reported out of the Committee in the House of
 26 Representatives set the threshold at “extreme misconduct” but the “extreme” qualifier
 27 was rejected in the final draft of Section 304. *Neer v. Pelino*, 389 F. Supp. 2d 648, 656
 28 (E.D. Pa. 2005) (“‘extreme misconduct’ . . . [e]stablishing such a high standard will make
 it very difficult, if not impossible for the Commission to obtain disgorgement”) (*quoting*
 H.R. Rep. 107-414, at 50-51 (Minority Views) (2002)).

1 financial information for each of its quarters in fiscal 2003-2005 should no longer be
2 relied upon. PSSF ¶ 4; Declaration of Donald W. Searles ISO Plaintiff's Motion for
3 Partial Summary Judgment ("Searles Decl."), Ex. 3.² On September 28, 2006, CSK
4 announced that its investigation into various accounting practices was substantially
5 complete. PSSF ¶ 5; Searles Decl., Ex. 4. In that press release CSK announced that its
6 investigation had identified accounting errors and irregularities that materially and
7 improperly impacted various inventory accounts, vendor allowances, other accrual
8 accounts and related expense accounts. *Id.* The overstatements included \$70 million in
9 inventory, \$12 million in vendor allowances, and \$3-7 million in store surplus fixtures
10 and supplies. *Id.* At the same time, CSK announced that Martin Fraser (CSK's president
11 and chief operating officer), Don Watson (CSK's chief administrative officer and former
12 chief financial officer), as well as several other individuals in the company's finance
13 organization "are no longer employed by the Company." *Id.*³ In announcing those
14 departures and his own impending retirement, Jenkins stated, "Needless to say, I am
15 extremely disappointed by the results of the investigation, and I will work with the Board
16 to implement policies and procedures to assure that the issues identified by the
17 investigation do not recur." *Id.*

18 On May 5, 2007, CSK filed a second accounting restatement as part of its Form
19 10-K for fiscal year 2005 that included restated financial information ("the Second
20 Restatement"). PSSF ¶ 6; Searles Decl., Ex. 6.⁴ In discussing its investigation and the
21

22 ² "PSSF" refers to Plaintiff's Separate Statement of Facts filed in support in its motion for
23 partial summary judgment.

24 ³ In a subsequent press release issued on October 3, 2006, CSK clarified the
25 circumstances of Martin Fraser's departure from the company, stating that he had been
26 "terminated" effective September 27, 2006. PSSF ¶ 5, Searles Decl., Ex. 5.

27 ⁴ On May 2, 2005, CSK filed its 2004 Form 10-K, which restated its financial statements
28 for prior periods (the "First Restatement"). In its First Restatement, which Jenkins
signed, CSK adjusted net income downward for the 2003, 2002, and 2001 fiscal years by
\$4.3 million, \$5.5 million, and \$0.3 million, respectively. CSK, however, falsely

1 restatement of its consolidated financial statements, CSK stated that its investigation
2 primarily focused on the company's accounting for inventory and vendor allowances and
3 other accounting errors and irregularities identified by the company in the course of the
4 restatement process. PSSF ¶ 10. CSK's audit committee concluded that "the errors and
5 irregularities were primarily the result of actions directed by certain personnel and an
6 ineffective control environment" which, among other things, permitted the following to
7 occur:

- 8 • *recording of improper accounting entries as directed by certain personnel;*
- 9 • *inappropriate override of, or interference with, existing policies,*
10 *procedures and internal controls;*
- 11 • *withholding information from, and providing of improper explanations and*
12 *supporting documentation to, the Company's Audit Committee and Board*
13 *of Directors, as well as its internal auditors and independent registered*
14 *public accountants; and*
- 15 • *discouraging employees from raising accounting related concerns and*
16 *suppressing accounting related inquiries that were made.*

17 PSSF ¶ 10; Searles Decl., Ex. 6, pp. 35, 114.

18 In discussing the errors and irregularities related to the accounting of its inventory,
19 CSK acknowledged that improper inventory balances accumulated over a number of
20 years in in-transit accounts (*i.e.*, store returns to the company's warehouses, distribution
21 centers and return centers; and to vendors), which required adjustment. PSSF ¶ 21. In
22 addition, certain inventory balances were recorded to certain inventory general ledger
23 accounts that were being systematically amortized to cost of sales in inappropriate
24 periods. *Id.* CSK also admitted that it did not properly oversee the processes for
25 accounting for inventory warranty obligations and did not establish adequate accruals for
26 warranty returns from customers. *Id.* CSK further reviewed its practice for capitalizing
27 inventory overheads (purchasing, warehousing and distribution costs) and identified

28 disclosed that its vendor allowance restatement and corresponding impact on its financial
statements were due to "errors in estimation" and "imprecise estimates, bookkeeping
errors" when, in fact, they were a result of fraud. PSSF ¶ 4; Searles Decl., Ex. 18.

1 errors in the costs included as well as errors in the inventory amounts used in the
2 calculations resulting from other errors and restatement adjustments. *Id.*

3 With respect to vendor allowances, CSK acknowledged that it had restated vendor
4 allowances in its 2004 Annual Report (the "First Restatement"); however, it subsequently
5 identified additional vendor allowances recorded in prior periods that had not been
6 collected as it appeared from its accounting records, determined that certain recorded
7 amounts were errors or irregularities in estimation that should not have been recognized
8 in earlier periods and identified additional instances in which vendor allowances that
9 were collected were recorded in the incorrect periods. PSSF ¶ 22. CSK further identified
10 improper vendor debits related to instances in which amounts not owed to the company
11 were deducted from vendor payments and, if not accepted by vendors, were subsequently
12 paid back to the vendors with the recognition and payback recorded in different
13 accounting periods. *Id.* CSK also identified errors in the application of GAAP to
14 provisions in certain of the vendor agreements. *Id.*

15 In its Second Restatement, CSK also acknowledged that had failed to design
16 controls to prevent or detect instances of inappropriate override of, or interference with,
17 existing policies, procedures and internal controls. PSSF ¶ 23. CSK also admitted that it
18 had not established and maintained a proper tone as to internal controls over financial
19 reporting. PSSF ¶ 25. As CSK explained, senior management failed to emphasize,
20 through consistent communication and behavior, the importance of internal control over
21 financial reporting and adherence to the Company's code of business conduct and ethics,
22 which, among other things, resulted in information being withheld from, and improper
23 explanations and inadequate supporting documentation being provided to, the company's
24 audit committee, its board of directors, its internal auditors and independent registered
25 public accountants. In addition, certain members of senior management created an
26 environment that discouraged employees from raising accounting related concerns and
27 suppressed accounting related inquiries that were made. *Id.*; Searles Decl., Ex. 6, p. 62.

28 Specifically, with respect to its accounting for inventory, CSK stated that its lack

1 of effective controls “did not prevent or detect the inappropriate override of established
2 procedures regarding the adjustment of inventories for the results of annual physical
3 inventory counts at each of the Company’s distribution centers, warehouses and stores.”
4 PSSF ¶ 26. In addition, CSK admitted that its lack of effective controls “did not prevent
5 or detect inappropriate and inaccurate accumulations of inventory balances in in-transit
6 accounts ... which was known or should have been known to several members of the
7 Finance organization.” *Id.* The lack of effective controls permitted “(i) errors in
8 inventory balances to be inappropriately systematically amortized to cost of sales in
9 improper periods; (ii) instances where improper adjustments were made to certain
10 product costs within the perpetual inventory system that, together with improper journal
11 entries to the general ledger, resulted in the overstatement of inventory and cost of sales
12 being recognized in incorrect periods; and (iii) the inappropriate capitalization of
13 inventory overheads (purchasing, warehousing and distribution costs) and vendor
14 allowance receivables.” *Id.* Additionally, company personnel did not properly oversee
15 the processes for accounting for inventory warranties and did not establish adequate
16 accrued liabilities for warranty returns from customers. *Id.*; Searles Decl., Ex. 6, pp. 62,
17 118.

18 With respect to its accounting for vendor allowances, CSK admitted that the
19 company’s lack of effective controls “did not detect or prevent the inappropriate override
20 of established procedures related to: (i) the review and approval process for initial vendor
21 allowance agreements; (ii) the monitoring of modifications to existing vendor allowance
22 agreements; and (iii) the accuracy of recording of various vendor allowance transactions,
23 including applicable cash collections and estimates.” PSSF ¶ 27. Furthermore, as a
24 result of the lack of a sufficient complement of personnel with the requisite level of
25 accounting knowledge, experience and training in GAAP, the company admitted that it
26 did not identify that provisions in certain agreements were required to be accounted for
27 differently. *Id.* The audit committee-led investigation also revealed that improper debits
28 were issued and applied to accounts payable for amounts the company was not entitled to

1 receive. *Id.* These amounts were subsequently repaid to those vendors through direct
 2 cash payments, the foregoing of future cash discounts, the acceptance of increased prices
 3 on future purchases and paybacks through the warranty account. *Id.* As CSK concluded,
 4 “this material weakness resulted in errors in vendor allowance receivables, inventory,
 5 accounts payable and costs of sales accounts.” *Id.* Ex. 6, pp. 63, 119.

6 **IV. ARGUMENT**

7 **A. The Meaning of the Phrase “Errors and Irregularities”**

8 CSK’s use of the phrase “errors and irregularities” in its 2005 Form 10-K is
 9 significant. As defined in the AICPA Professional Standards, AU Section § 316.02, the
 10 term “errors” refers to unintentional misstatement and omissions of amounts or
 11 disclosures in financial statements. Searles Decl., Ex. 17. In contrast, the term
 12 “irregularities” refers to *intentional* misstatements or omissions of amounts or disclosures
 13 in financial statements. AU § 316.03 (emphasis in original). “Irregularities include
 14 fraudulent financial reporting undertaken to render financial statements misleading,
 15 sometimes called management fraud, and misappropriation of assets, sometimes called
 16 defalcations. AU § 316.03. “The primary factor that distinguishes errors from
 17 irregularities is whether the underlying cause of a misstatement in financial statements is
 18 intentional or unintentional.” AU § 316.04.

19 As Judge Campbell found, in refusing to dismiss the private plaintiffs’ second
 20 amended consolidated complaint against Maynard Jenkins and Don Watson, CSK’s “use
 21 of the term ‘irregularities’ is significant, because it ‘refers to intentional misstatements or
 22 omissions of amounts in disclosure statements.’” *Communications Workers of America*
 23 *v. CSK Auto Corp.*, 525 F. Supp. 2d 1116, 1122 (D. Ariz. 2007). *Accord, In Re:*
 24 *International Rectifier Corp. Sec. Lit.*, 2008 U.S. Dist. LEXIS 106929, * 8 n. 2 (C.D. Cal.
 25 Dec. 31, 2008); *In Re: Goodyear Tire & Rubber Co. Sec. Lit.*, 436 F. Supp. 2d 873, 893
 26 (N.D. Ohio 2006); *In Re Paracelsus Corp. Sec. Lit.*, 61 F. Supp. 2d 591, 599 (S.D.N.Y.
 27 1998); *In re CBI Holding Co., Inc. v. Ernst & Young, LLP*, 247 B.R. 341, ** 28-29
 28 (S.D.N.Y. Apr. 5, 2000).

1 Nor was CSK reticent in describing the nature of the “accounting irregularities” its
 2 audit committee-led investigation had uncovered. As set forth above, CSK admitted that:
 3 the irregularities were directed by certain personnel; information had been withheld from,
 4 and improper explanations had been made to CSK’s audit committee, internal auditors
 5 and in outside independent auditors; there had been an inappropriate override of
 6 established procedures; and improper debits had been issued and applied to accounts
 7 payable for amounts the Company was not entitled to receive and subsequently had to be
 8 repaid.

9 In short, CSK in its 2005 Form 10-K admitted not only to misconduct (*i.e.*,
 10 improper behavior), but to intentional management fraud. *Communications Workers of*
 11 *America v. CSK Auto Corp.*, 525 F. Supp. 2d at 1123 (“more than financial bungling
 12 occurred at CSK. The 10-K and presses releases make clear that “irregularities” –
 13 intentional misstatements – occurred.”).

14 **B. By Signing and Certifying CSK’s 2005 Form 10-K, Jenkins Admitted**
 15 **That CSK’s Second Restatement Was A Result of Misconduct.**

16 Jenkins signed CSK’s 2005 Form 10-K on April 30, 2007, as CSK’s chairman and
 17 chief executive officer. PSSF ¶¶ 6-8. Pursuant to Sections 302 and 906 of the Sarbanes-
 18 Oxley Act, and Exchange Act Rules 13a-14 and 15d-14 (17 C.F.R. § 240.13a-14, 17
 19 C.F.R. § 240.15d-14) Jenkins also signed a certification, as CSK’s chief executive
 20 officer, certifying, among other things, that he had reviewed CSK’s 2005 annual report
 21 on Form 10-K, and that based on his knowledge, that report did not contain any untrue
 22 statement of material fact or omit to state a material fact necessary to make the statements
 23 made, in light of the circumstances under which such statements were made, not
 24 misleading with respect to the period covered by the report. *Id.*

25 By signing and certifying CSK’s 2005 Form 10-K, Jenkins adopted the
 26 Company’s admission of misconduct. *United States v. Orellana-Blanco*, 294 F.3d 1143,
 27 1148 (9th Cir. 2002) (“Ordinarily a signed statement, even if written by another in
 28 another’s words, would be adopted as the party’s own if he signed it, because signing is a

1 manifestation of adopting the statement.’). *Accord, McQueeney v. Wilmington Trust Co.*,
 2 779 F.2d 916, 930 (3rd Cir. 1985); *Pillsbury Co. v. Cleaver Brooks Div. of Aqua-Chem*,
 3 *Inc.*, 646 F.2d 1216, 1218 (8th Cir. 1981); *United States v. Smith*, 609 F.2d 1294, 1301 n.
 4 7 (9th Cir. 1979); *United States v. Biaggi*, 705 F. Supp. 830, 846 (S.D.N.Y. 1988). *Cf.*,
 5 *United States v. Moran*, 759 F.2d 777, 786 (9th Cir. 1985) (letter and deposit slips signed
 6 by defendant are admissible as admissions of a party opponent under Fed. R. Evid.
 7 801(d)(2)(A)).

8 Furthermore, personal knowledge is not a prerequisite for the adoption of
 9 another’s statement pursuant to Rule 801(d)(2) of the Federal Rules of Evidence. *United*
 10 *States v. Orellana-Blanco*, 294 F.3d at 1148. *Accord, Pillsbury Co. v. Cleaver Brooks*
 11 *Div. of Aqua-Chem, Inc.*, 646 F.2d at 1218; *Ross v. Salminen*, 191 F. 504, 505 (1st Cir.
 12 1911).

13 Nor can there be any question that Jenkins understood what he was signing. *See*
 14 *United States v. Monks*, 774 F.2d 945, 950 (9th Cir. 1985) (before letting in evidence as
 15 an adoptive admission, “the district court must find that sufficient foundational facts
 16 have been introduced for the jury reasonably to conclude that the defendant did actually
 17 hear, understand and accede to the statement.”). Ordinarily, a signature makes adoption
 18 plain. *United States v. Orellana-Blanco*, 294 F.3d at 1148. Here, however, Jenkins, not
 19 only signed CSK’s 2005 Form 10-K, but certified it pursuant to Sections 302 and 906 of
 20 the Sarbanes-Oxley Act, in which he affirmatively stated that he had reviewed CSK’s
 21 2005 annual report and that, based on his knowledge, that report did not contain any
 22 material misstatements or omissions. *See, In re Lattice Semiconductor Corp. Sec. Litig.*,
 23 2006 U.S. Dist. LEXIS 262, at * 49 (D. Or. Jan. 3, 2006) (SOX certifications are
 24 designed to thwart a “head in the sand” defense); *Middesex Retirement System v. Quest*
 25 *Software, Inc.*, 527 F. Supp. 2d 1164, 1190 (C.D. Cal. 2007) (“SOX certifications are
 26 clearly ‘statements’ for the purpose of establishing contemporaneous knowledge.”); John
 27 T. Bostelman, Practising Law Institute, *The Sarbanes-Oxley Deskbook* § 4:2:1 (2004)
 28 (one of the purposes of the SOX certification requirement is to force CEOs and CFOs to

1 become sufficiently personally involved in the preparation of SEC annual and quarterly
2 reports so that their personal liability for misstatements contained therein may be readily
3 established). Accordingly, by signing and certifying CSK's 2005 Form 10-K, Jenkins
4 admitted that CSK's Second Restatement was a result of misconduct.

5 **C. Jenkins Admitted In His Testimony Before the Commission That**
6 **CSK's Second Restatement Was the Result of Employee Misconduct**

7 Should there remain any question as to Jenkins's understanding of what he
8 acknowledging in signing and certifying CSK's 2005 Form 10-K, any such doubt is
9 dispelled by Jenkins's testimony before the Commission. Among other things, Jenkins
10 admitted that he had been fully briefed on the results of the Audit Committee-led
11 investigation and, as a result of that investigation, he understood that LWT vendor
12 allowance funds had been moved to earlier years to make up for shortfalls in collections,
13 which "should not have been done;" that erroneous debits had been made to vendors
14 which had to be paid back; and that Don Watson had lied to him, as well as the Audit
15 Committee, in connection with CSK's First Restatement, which was ostensibly the result
16 of mere errors in estimates, as opposed to intentional fraud. PSSF ¶¶ 28-46. As Jenkins
17 testified, "things were done on purpose." PSSF ¶ 40.

18 In short, Jenkins clearly understood, when he signed and certified CSK's 2005
19 Form 10-K, that both he and the company were acknowledging not only "misconduct"
20 *i.e.*, improper behavior by certain employees in its Finance Department, but *management*
21 *fraud*. Thus, CSK's 2005 Form 10-K, standing alone, is sufficient to establish the
22 element of misconduct.

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1 D. CSK's Wells Submission Candidly Admitted That Its Second
2 Restatement Was the Result of Employee "Misconduct"

3 On June 6, 2008, CSK made a Wells Submission⁵ to the Commission, in which it
4 emphasized that in many of its public filings which described the findings of its audit
5 committee-led investigation, "that irregularities, not merely errors, were identified in its
6 historical financial statements that preceded its Audit Committee-led investigation."
7 PSSF ¶¶ 47-48; Searles Decl., Ex 11. CSK stated that the "errors and irregularities" were
8 found in primarily two areas: inventory and vendor allowances. CSK further
9 acknowledged that the \$17 million cumulative negative impact of CSK's May 1, 2007,
10 restatement on net income for fiscal years 2001 through 2004 and the first three quarters
11 of 2005 was material. *Id.*

12 CSK also candidly acknowledged the "misconduct" of its employees. Indeed, the
13 Company's Wells Submission had a discrete section entitled "**Misconduct Was**
14 **Concentrated in the Finance Department.**" *Id.*, Searles Decl., Ex. 11, p. 7. Among
15 other things, CSK admitted that, "the misconduct was concentrated in the Finance
16 Department and that the Finance Department had been dominated by a CFO, Don
17 Watson, who fostered an environment that stifled the raising of questions and concerns.
18 *Id.* CSK further acknowledged that "[t]he officers and employees identified by the Audit
19 Committee-led investigation as key participants in the Finance Department's misconduct
20 were required to leave the Company, as was the Company's President and Chief
21 Operating Officer [Martin Fraser]."

22 CSK's Wells Submission is admissible against Jenkins as it is being offered as
23 corroborative evidence of what the company and Jenkins understood regarding the
24 meaning of CSK's 2005 Form 10-K, and specifically, that the company admitted
25 employee misconduct. *See In re: Initial Public Offering Sec. Lit.*, 2003 U.S. Dist. LEXIS

26
27 ⁵ A Wells Submission is a written statement to the Commission by an individual or party
28 whose conduct is within the scope of the Commission's investigation, and is usually
made in an effort to persuade the Commission that either no violation has occurred or that
any violation that has occurred is not as serious as the Commission may believe.

23102, * 22 (S.D.N.Y. Dec. 24, 2003) (Wells Submissions do not constitute settlement materials protected by Fed.R.Evid. 408, and they are both discoverable and may be used for impeachment, or corroborative purposes or as admissions by a party opponent).⁶

E. An Inference of Company Misconduct May Be Drawn from Watson's Assertion of His Fifth Amendment Privilege.

On November 13-14, 2007, Watson was called to testify before the Commission in connection with the Commission's investigation of CSK's accounting practices. Over the course of two days of testimony, Watson repeatedly invoked his Fifth Amendment right against self-incrimination in response to virtually every substantive question. PSSF ¶¶ 53; Searles Decl., Exs. 15-16. As the Ninth Circuit has noted, "[p]arties are free to invoke the Fifth Amendment in civil cases, but the court is equally free to draw adverse inferences from their failure of proof." *SEC v. Collelo*, 139 F.3d 674, 678 (9th Cir. 1998). It is equally settled, depending on the circumstances of the case, that an adverse inference may be drawn against a party by a non-party's invocation of the privilege. When deciding whether such an inference is warranted, the Court should consider a variety of

⁶ In any event, CSK's Wells Submission is admissible against Jenkins, as evidence of the company's misconduct, under the residual hearsay exception, Fed.R.Evid. 807. Under Rule 807, a statement not specifically covered by Rule 803 or 804 but having equivalent circumstantial guarantees of trustworthiness, is not excluded by the hearsay rule, if the court determines that (A) the statement is offered as evidence of a material fact; (B) the statement is more probative on the point for which it is offered than any other evidence which the proponent can procure through reasonable efforts; and (C) the general purposes of the rules of evidence will best be served by admission of the statement into evidence. *United States v. Sanchez-Lima*, 161 F.3d 545, 547 (9th Cir. 1998). Here, CSK's Wells Submission is inherently trustworthy, as it summarizes the company's exhaustive internal investigation, and is clearly probative on the essential issue of CSK's (admitted) misconduct. In addition, it is more probative on the point for which it is offered than any other evidence that the Commission can reasonably procure (other than CSK's 2005 Form 10-K), given Watson's, Oppen's and O'Brien's invocation of their Fifth Amendment privilege against self incrimination and the recent death of Martin Fraser. See, e.g., *United States v. Dumeisi*, 424 F.3d 566, 577 (7th Cir. 2005) (admitting collection of documents from the Iraqi Intelligence Service, known as "the Baghdad File," under Rule 807); *United States v. Thunder Horse*, 370 F.3d 745, 748 (8th Cir. 2004) (admitting testimony of investigator who interviewed child abuse victim under residual hearsay exception); *United States v. George*, 960 F.2d 97, 100 (9th Cir. 1992) (same).

1 non-exclusive factors, including: (1) the nature of the relationship between the party and
2 the non-party; (2) the degree to which the party controls the non-party; (3) the
3 compatibility of the interests of the party and non-party in the outcome of the litigation:
4 and (4) the role of the non-party in the litigation. *LiButti v. United States*, 107 F.3d 110,
5 123-124 (2nd Cir. 1997). “The overarching concern is fundamentally whether the adverse
6 inference is trustworthy under all the circumstances and will advance the search for the
7 truth.” *Id.* at 124.

8 Analyzing the *LiButti* factors, it is clear that an adverse inference against CSK on
9 the issue of misconduct is warranted by Watson’s invocation of his Fifth Amendment
10 privilege. *LiButti*’s first factor, “loyalty,” tests how likely the non-party witness would
11 be to render testimony in order to damage the relationship. *LiButti*, 107 F.3d at 123. In
12 other words, does the non-party witness have an incentive to falsely claim the Fifth
13 Amendment in order to “torpedo” the party’s case. *N.H. Ins. Co. v. Blue Water Off*
14 *Shore, LLC*, 2009 U.S. Dist. LEXIS 24223, * 43 (D. Ala. Mar. 23, 2009). Here, it is
15 inconceivable that Watson falsely invoked his right to remain silent out of a desire to
16 damage CSK; rather, he did so to protect his own interests. As to the second factor, the
17 degree of control, this factor “addresses the degree of control the party ‘has vested in the
18 non-party witness in regard to the key facts and general subject matter of the litigation’
19 and approximates the analysis for admissions of a party opponent under Federal Rule of
20 Evidence 801(d)(2).” *N.H. Ins. Co. v. Blue Water Off Shore, LLC*, 2009 U.S. Dist.
21 LEXIS 24223, * 43 (*quoting LiButti*, 107 F.3d at 123). Here, CSK vested Watson, who,
22 at the time of the conduct at issue was the company’s chief financial officer, with primary
23 responsibility over the company’s accounting practices; hence, *LiButti*’s second factor is
24 satisfied. Lastly, *LiButti*’s third and fourth factors are also satisfied: Watson’s assertion
25 of the privilege clearly advanced his own interests, as well as that of CSK, in avoiding
26 civil or criminal charges, and he was a key figure in the underlying misconduct. *See*
27 *Garrish v. UAW*, 284 F. Supp. 2d 782, 797 (E.D. Mich. 2003). Accordingly, it is entirely
28 appropriate for the Court to draw an inference of company misconduct based on

Watson's invocation of his Fifth Amendment rights. *See, e.g., F.D.I.C. v. Fidelity & Deposit Co. of Maryland*, 45 F.3d 969, 977-79 (5th Cir. 1995) (imputing silence of an employee to his employer under Rule 801(d)(2)(D)); *Rad Services, Inc. v. Aetna Casualty & Surety Co.*, 808 F.2d 271, 275 (3d Cir. 1986) (former employee); *Rosebud Sioux Tribe v. A&P Steel, Inc.*, 733 F.2d 509, 521-22 (8th Cir. 1984); *Brink's Inc. v. City of New York*, 717 F.2d 700, 710 (2d Cir. 1983) (ex-employee). *Cf., Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1576-77 & n. 27 (9th Cir. 1990) (*en banc*), *amended, reh'g denied*, 1990 U.S. App LEXIS 19892 (9th Cir. Nov. 13, 1990) (recognizing doctrine of respondeat superior as a basis for an entity's vicarious liability under the securities laws for the acts of its employees, where such employees are acting within the scope of their employment).

F. In Pleading Guilty to Obstruction of Justice, O'Brien and Oppen Admitted That They Had Engaged Not Only In Misconduct, But Fraud.

In addition to the inference of CSK's misconduct that may be drawn from Watson's invocation of his Fifth Amendment privilege, compelling direct evidence of that misconduct is provided by his co-conspirators' guilty pleas. In April 2009, both Edward O'Brien and Gary Oppen pled guilty to a one-count felony information, charging each of them with obstruction of justice for misleading CSK's outside law firm that had been hired to conduct an independent investigation into the company's accounting practices, knowing that the results of that investigation would be shared with the Commission. PSSF ¶¶ 49-52; Searles Decl., Exs. 12-15.

As part of the factual basis for his guilty plea, O'Brien admitted, under oath, both orally and in writing, that: he knew that a sizeable portion of CSK's earnings recognized from 2001 to 2003 for vendor allowances had, in fact, not been earned and were uncollectible; he and other high level executives at the company intentionally failed to write off and took steps to hide those uncollectible amounts; he and others instructed employees to apply current year collections to previous years receivables in order to make it appear that the earnings recognized in those prior years were legitimate; he and

1 others had intentionally misled the company's outside auditors; that he and others had
2 caused CSK to file its First Restatement, in which the company had failed to write off
3 approximately \$15 million in uncollectible vendor allowance receivables; and that he and
4 others had caused the company in mid-2005 to issue "debit memos" to make up that \$15
5 million, knowing that those sums had already been collected from vendors and applied to
6 prior year account receivable balances. PSSF ¶¶ 49-50; Searles Decl., Exs. 12-13.
7 Similarly, as part of the factual basis of his guilty plea, Opper admitted under oath, both
8 orally and in writing, that he had misled CSK's outside law firm about his knowledge that
9 he had deceived CSK's outside auditors from at least 2003 through 2005, by, among
10 other things, intentionally concealing the fact that CSK had a large, uncollectible vendor
11 allowance account receivable. PSSF ¶¶ 51-52; Searles Decl., Exs. 14-15.

12 O'Brien's and Opper's guilty pleas and their sworn factual bases in support
13 thereof are admissible to prove that CSK, through its employees, engaged in
14 "misconduct." Indeed, O'Brien and Opper flatly admit to as much. Nor is there any
15 reason why this Court should not consider their guilty pleas, both as corroborative
16 evidence of CSK's and Jenkins's admissions in the company's 2005 Form 10-K, as well
17 as direct evidence of that misconduct under Fed.R.Evid. 804(b)(3) (statement against
18 interest) and 803(22) (judgment of previous conviction).

19 In the present case, counsel for O'Brien and Opper stated, at the joint case
20 management report in *SEC v. Watson, et al*, CV 09-443-PHX-GMS, that their respective
21 clients would assert their Fifth Amendment right to remain silent in the event they were
22 deposed prior to the conclusion of the criminal case in *United States v. Watson*, CR 09-
23 372-2-PHX-SRB.⁷ See *SEC v. Watson, et al*, CV 09-443-PHX-GMS (Docket Entry No.
24 91, p. 8). As such, they are "unavailable" within the meaning for Fed.R.Evid. 804(a).
25 *California v. Green*, 399 U.S. 149, 168 n. 17 (1970). Once the witness is shown to be
26

27 ⁷ O'Brien and Opper also repeatedly asserted their Fifth Amendment privilege in their
28 respective answers to the Commission's complaint in *SEC v. Watson, et al.*, Case No. CV
09-443-PHX-GMS (Docket Entry Nos. 86, 87).

1 unavailable, his statement is admissible provided it bears adequate “indicia of reliability.”
 2 *Idaho v. Wright*, 497 U.S. 805, 814-15 (1990). Here, Oppen and O’Brien’s guilty pleas
 3 derive considerable reliability as statements against penal interest, they are self-
 4 incriminating, they carry the risk of substantial imprisonment, and they were under oath.
 5 As such, they are admissible as proof of CSK’s misconduct under Rule 804(b)(3).

6 Furthermore, regardless of Oppen’s and O’Brien’s unavailability, their guilty pleas
 7 remain admissible, in this civil case, under Rule 803(22), to establish the “essential fact”
 8 of CSK’s misconduct. *See, e.g., RSBI Aerospace, Inc. v. Affiliated FM Ins. Co.*, 49 F.3d
 9 399, 401, 403 (8th Cir. 1995) (non-party former employee’s guilty plea and
 10 accompanying sworn statement were admissible against defendant employer in
 11 subsequent civil case); *Miller v. Holzman*, 563 F. Supp. 2d 54, 85 (D.D.C. 2008); *N.H.*
 12 *Ins. Co. v. Blue Water Off Shore, LLC*, 2009 U.S. Dist. LEXIS 24223, *20; *BCCI*
 13 *Holdings v. Kahlil*, 184 F.R.D. 3, 9 (D.D.C. 1999); *American International Specialty*
 14 *Lines, Ins. Co. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 1997 U.S. Dist. LEXIS
 15 22610, * 14 (S.D.N.Y. Sept. 12, 1997) (collecting cases). *See also, United States v.*
 16 *Seventy Thousand One Hundred Fifty Dollars in United States Currency (\$70,150.00)*,
 17 2009 U.S. Dist. LEXIS 100572 (S.D. Ohio Oct. 28, 2009) (admitting non-party’s guilty
 18 plea under both Fed. R. Evid. 803(8) (public records exception) and 803(22)).
 19 Furthermore, it does not matter that judgment has not yet been imposed. *See Boykin v.*
 20 *Alabama*, 395 U.S. 238, 242 (1969) (“A plea of guilty ... is itself a conviction; nothing
 21 remains but to give judgment and determine punishment.”); *N.H. Ins. Co. v. Blue Water*
 22 *Off Shore, LLC*, 2009 U.S. Dist. LEXIS 24223, *18 (“An adjudication of guilt is not only
 23 consistent with a plea of guilty but follows inexorably from such a plea.”).

24 In summary, the underlying element of “misconduct” is satisfied in myriad ways,
 25 namely: CSK’s and Jenkins’s admissions in CSK’s 2005 10-K; Jenkins’s testimony
 26 before the Commission; CSK’s admission of “misconduct” in its Wells Submission;
 27 Watson’s assertion of his Fifth Amendment rights; and O’Brien’s and Oppen’s guilty
 28 pleas. Accordingly, the Commission is entitled to summary judgment on this element.

1 **G. Section 304's Remaining Elements Are Also Satisfied.**

2 The two remaining elements under Section 304(a) are: (1) whether CSK was
3 required to prepare an accounting restatement; (2) due to CSK's material noncompliance
4 with any financial reporting requirement under the securities laws. A fact is material if
5 there is a substantial likelihood that a reasonable investor would consider the information
6 important in making an investment decision. *Basic v. Levinson*, 485 U.S. 224, 231-32
7 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Information
8 concerning a company's financial condition and profitability is material information.
9 *See, e.g., SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980).

10 Based on CSK's Second Restatement alone, CSK improperly overstated its net
11 income for fiscal year 2001, 2002 and 2003 by at \$25 million, \$16 million and \$12
12 million, respectively, thereby reporting net income instead of a loss in 2002, and
13 understating net losses in 2001 by 60% and in 2003 by 130%. PSSF ¶¶ 14; Searles
14 Decl., Ex. 6. These reported results become even more distorted when compared against
15 CSK's reported financial results before its First Restatement, showing that the combined
16 effect of CSK's two restatements result in net losses instead of reported net income in
17 both 2002 and 2003, and more than a tripling of CSK's reported losses in 2001. Searles
18 Decl., Ex. 19. The financial statements in those annual reports failed to comply with
19 GAAP, namely, EITF No. 02-16 and FAS No. 5. Regulation S-X states that that
20 financial statements filed with the Commission that are not prepared in accordance with
21 GAAP are presumed to be inaccurate and misleading. 17 C.F.R. § 210.4-01(a)(1).

22 As a result of filing annual reports that materially failed to comply with GAAP,
23 CSK was required to issue a restatement. Paragraph 13 of Accounting Principles Board
24 ("APB") Opinion No. 20, *Accounting Changes*, states that errors in financial statements
25 result from mathematical mistakes, mistakes in the application of accounting principles,
26 or oversight or misuse of facts that existed at the time the financial statements were
27 prepared. Paragraph 20 of APB Opinion No. 20 states that the correction of such errors
28 should be reported as prior period adjustments. Paragraph 18 of APB Opinion No. 9,

1 *Reporting the Results of Operations*, states that “[w]hen comparative statements are
2 presented, prior period adjustments should be made of the amounts of net income (and
3 the components thereof) and retained earnings balances (as well as of other affected
4 balances) for all of the periods reported therein, to reflect the retroactive application of
5 these prior period adjustments.” In addition, Paragraph 25 of Statement of Financial
6 Accounting Standards 154, *Accounting Changes and Error Corrections*, a replacement of
7 *APB Opinion 20 and FASB Statement 3*, states that “[a]ny error in the financial
8 statements of a prior period discovered subsequent to their issuance should be reported as
9 a prior period adjustment by restating the prior period financial statements.”

10 Here, CSK was required to issue a restatement because it had overstated its
11 income (or understated its losses) for fiscal years 2001, 2002, and 2003. CSK issued two
12 restatements during Jenkins’ tenure. The First Restatement, however, falsely disclosed
13 that CSK’s vendor allowance misstatements and corresponding impact on its financial
14 statements were due to “imprecise estimates and bookkeeping errors” when they were
15 actually due to CSK’s fraudulent conduct. *See* Searles Decl., Ex. 18, p. 19. It also failed
16 to write off all known, uncollectible vendor allowance receivables. CSK was thus
17 required to issue its Second Restatement, in which it restated for, among other things,
18 additional vendor allowances that it had improperly recognized. Accordingly, the
19 remaining elements of Section 304(a) are clearly satisfied.

20 **V. CONCLUSION**

21 For all of the foregoing reasons, the Commission’s motion for partial summary
22 judgment should be granted.

23
24 DATED: September 17, 2010

Respectfully submitted,

25 /s/ Donald W. Searles
26 DONALD W. SEARLES
27 Attorneys for Plaintiff
28 Securities and Exchange Commission

PROOF OF SERVICE

I am over the age of 18 years and not a party to this action. My business address is:

[X] U.S. SECURITIES AND EXCHANGE COMMISSION, 5670 Wilshire
Boulevard, 11th Floor, Los Angeles, California 90036-3648

Telephone No. (323) 965-3998; Facsimile No. (323) 965-3908.

On September 17, 2010, I caused to be served the document entitled **MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION BY PLAINTIFF SECURITIES AND EXCHANGE COMMISSION FOR PARTIAL SUMMARY JUDGMENT AGAINST DEFENDANT MAYNARD L. JENKINS** on all the parties to this action addressed as stated on the attached service list:

[] **OFFICE MAIL:** By placing in sealed envelope(s), which I placed for collection and mailing today following ordinary business practices. I am readily familiar with this agency's practice for collection and processing of correspondence for mailing; such correspondence would be deposited with the U.S. Postal Service on the same day in the ordinary course of business.

[] **PERSONAL DEPOSIT IN MAIL:** By placing in sealed envelope(s), which I personally deposited with the U.S. Postal Service. Each such envelope was deposited with the U.S. Postal Service at Los Angeles, California, with first class postage thereon fully prepaid.

[] **EXPRESS U.S. MAIL:** Each such envelope was deposited in a facility regularly maintained at the U.S. Postal Service for receipt of Express Mail at Los Angeles, California, with Express Mail postage paid.

[] **HAND DELIVERY:** I caused to be hand delivered each such envelope to the office of the addressee as stated on the attached service list.

[] **UNITED PARCEL SERVICE:** By placing in sealed envelope(s) designated by United Parcel Service ("UPS") with delivery fees paid or provided for, which I deposited in a facility regularly maintained by UPS or delivered to a UPS courier, at Los Angeles, California.

[] **ELECTRONIC MAIL:** By transmitting the document by electronic mail to the electronic mail address as stated on the attached service list.

[X] **E-FILING:** By causing the document to be electronically filed via the Court's CM/ECF system, which effects electronic service on counsel who are registered with the CM/ECF system.

[] **FAX:** By transmitting the document by facsimile transmission. The transmission was reported as complete and without error.

I declare under penalty of perjury that the foregoing is true and correct.

Date: September 17, 2010

/s/ Donald W. Searles
Donald W. Searles

SEC v. Maynard L. Jenkins
United States District Court - District of Arizona
Case No. 2:09-cv-01510-JWS
(LA-3305)

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