The Journal of Business, Entrepreneurship & the Law

Volume 8 | Issue 1 Article 5

4-15-2015

Deranged Disgorgement

James Tyler Kirk

DERANGED DISGORGEMENT

JAMES TYLER KIRK, ESQ., M.E.*

* Mr. Kirk is an attorney for the United States Securities and Exchange Commission. He works in the Chief Counsel's Office of the Division of Investment Management. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the Author and do not necessarily reflect the views of the Commission or of the author's colleagues upon the staff of the Commission.

ABSTRACT

Even before the promulgation of The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (SERPSRA), the United States Securities and Exchange Commission (SEC or Commission) was entitled to seek disgorgement. Since 1971, the courts have been explicating the remedy as applied in the SEC enforcement context, and much of the doctrinal development had taken place by the time SERPSRA was enacted. However, the doctrine of disgorgement as applied in the SEC enforcement context is not entirely settled. Increasingly, the defense bar is finding acquiescence by certain jurisdictions to offsetting disgorgement by a defendant's costs and expenses. Such costs have been deemed to fall within one of two categories: (1) direct or transactional costs and (2) general business expenses. Earlier in the same year SERPSRA was passed, a recondite case out of the Western District of New York held business expenses were legitimate offsets to disgorgement. This was when the doctrinal development became deranged.

This article seeks to explore the concept of equity embodied in the securities laws as intended by Congress. Accordingly, this article asks whether Congress intended to codify the traditional common law notions of equity in disgorgement, or is the SEC's disgorgement *sui generis*. To answer this question, the philosophy behind disgorgement is exhaustively fleshed out through a historical case analysis. Next, the article establishes what the author believes to be a new concept, the theory of regulatory equity. Following the establishment of this theory, the practice of offsetting disgorgement is analyzed to see whether it is faithful to this new concept of equity. The article then considers examples of offsetting which have enjoyed the imprimatur of the Supreme Court of the United States and explains why the practice is illegitimate. Finally, the article asks whether the grave need for meaningful and

effective fraud deterrence in the investment industry and the vast inconsistency in how disgorgement is applied in these contexts warrants certiorari by the Court.

I. INTRODUCTION

In the context of enforcement actions brought by the SEC, meaningful deterrence remains a desideratum.[1] There are several powerful remedies available to the SEC to assist it in its congressionally ordained crusade for this holy grail of law enforcement. Chiefly, the Commission almost entirely relies upon disgorgement. Disgorgement is the act of giving up something, such as profits illegally obtained, on demand or by legal compulsion.[2] "Disgorgement has become the routine remedy for a securities enforcement action. If a person is found in violation and has profited from the ensuing transaction, courts generally order the disgorgement of those profits."[3]

Yet, there is a dearth of scholarship on disgorgement as sought by the SEC in its enforcement actions. Notably, disgorgement was not expressly a part of the remedial scheme set forth by Congress until the last decade of the Twentieth Century.[4] This absence largely explains the scarcity of scholarship. But, beginning in 1971 with *Securities and Exchange Commission v. Texas Gulf Sulphur*,[5] the courts started the process of developing the doctrine of disgorgement in the SEC enforcement context. While the theories of equity and restitution were well known at common law, it was unclear how they would be applied to disgorgement in securities fraud cases given the absence of such a remedy in the legislative framework.[6] In fact, it was not even clear whether the law of restitution actually applied at all.[7] At the time of *Texas Gulf Sulphur*, the elaborate statutory scheme

---

[1] The Dodd-Frank financial reform bill, which was the result of high stakes securities practices, such as boundless leveraging and sophisticated derivatives investing, leading to the massive market downturns

[2] BLACK'S LAW DICTIONARY 214 (3d pocket ed. 2006).

[3] *See* Sec. and Exch. Comm'n v. Berlacher, 2010 WL 3566790 at 14 (E.D. Pa. Sept. 13, 2010); Sec. and Exch. Comm'n v. Pardue, 367 F. Supp. 2d 773, 778 (E.D. Pa. 2005); Sec. and Exch. Comm'n v. Yun, 148 F. Supp. 2d 1287, 1290 (M.D. Fla. 2001).

[4] *See* Securities Enforcement Remedies and Penny Stock Reform Act of 1990 [hereinafter SERPSRA], Pub. L. No. 101-429, 104 Stat. 931 (giving express authority for an accounting and disgorgement in the securities laws).

[5] Sec. and Exch. Comm'n v. Tex. Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1971) (first case granting disgorgement in an SEC enforcement action).

[6] It was not until October 15, 1990, that the term "disgorgement" appeared as remedial authority in the securities laws. *See* SERPSRA, *supra* note 5.

[7] Sec. and Exch. Comm'n v. Huffman, 996 F.2d 800, 802 (5th Cir. 1993). The court explicitly addressed the distinction between restitution and disgorgement in the SEC enforcement context:

Despite some casual references in our [case law] to the contrary, . . . disgorgement is not precisely restitution. Disgorgement wrests ill-gotten gains from the hands of a wrongdoer. . . . *It is an equitable remedy meant to prevent the wrongdoer from enriching himself by his wrongs. Disgorgement does not aim to compensate the victims of the wrongful acts, as restitution does*. . . . [Disgorgement] is not

Congress created for the regulation of securities did provide for an equitable remedy in the form of an injunction, and the court used this fact to conclude, where Congress granted one equitable remedy, it granted them all.[8]

Later in 1971, the same year the Second Circuit handed down its decision, the Supreme Court denied certiorari in *Texas Gulf Sulphur*.[9] As a consequence, the doctrine of disgorgement enjoyed the imprimatur of the Court from 1971 until 1990, when SERPSRA was passed.[10] Today, the legitimacy of disgorgement in SEC enforcement actions is unchallenged.

Ever since the Supreme Court denied review in *Texas Gulf Sulphur,* the lower courts have concentrated on two key doctrinal aspects of disgorgement: (1) developing the fundamental philosophy behind disgorgement and (2) determining how to calculate the amount to be disgorged. While at first blush the latter concept seems rather straightforward, it has proved to be vexing and is where the greatest amount of intellectual discourse is needed. Nevertheless, to understand how to calculate disgorgement in SEC enforcement actions, one must become intimately familiar with the purposes of, and the philosophy behind, disgorgement in the SEC enforcement context.[11]

The central philosophical frustration with disgorgement is the choice courts must make between using the profit or proceeds theory of unjust enrichment. Is the amount by which a wrongdoer was unjustly enriched limited to mere pecuniary accumulations? Or, does enrichment capture those non-monetary benefits conferred to the defendant, which are nonetheless valuable? In the former, a wrongdoer is allowed to perform a netting calculation—gross receipts less costs

---

restitution.

Id. at 802 (emphasis added) (citations omitted).

[8] "[I]n other contexts[,] the Supreme Court has upheld the power of the [g]overnment without specific statutory authority to seek restitution, and has upheld the lower courts in granting restitution, as an ancillary remedy in the exercise of the courts' general equity powers to afford complete relief." *Tex. Gulf Sulphur*, 446 F.2d at 1307. *See* Porter v. Warner Holding Co., 328 U.S. 395 (1946) (once a regulatory scheme set up by Congress invokes the equitable powers of the courts, it may bring to bear all such powers absent an express limitation); *see also*, L.A. Trust Deed Mortg. Exch. v. Sec. and Exch. Comm'n, 285 F.2d 162, 182 (9th Cir. 1960) [hereinafter *LATDME*] ("We conclude, therefore, as the Supreme Court has stated with respect to other regulatory statutes, that the Congress must be taken to have acted cognizant of the historic power of equity to provide complete relief in the light of statutory purposes. As the Supreme Court long ago recognized, there is inherent in the courts of equity a jurisdiction to give effect to the policy of the legislature.").

[9] *See Tex. Gulf Sulphur*, 446 F.2d at 1301.

[10] *See* SERPSRA, *supra* note 5.

[11] It is important for the reader to notice the phrase, "SEC enforcement context." This qualifying phrase is meant to emphasize, in every instance, this article is attempting to discuss disgorgement when the SEC is bringing suit as a consequence of its regulatory enforcement authority. Suits between private litigants arising out of a violation of the federal securities laws, and how disgorgement applies therein, is not being considered. As will be demonstrated, this distinction will be integral in understanding how the SEC may use disgorgement to give effect to Congress' intent when passing the securities laws. *See generally* Sec. and Exch. Comm'n v. Teo, 746 F.3d 90, 104–07 (3d Cir. 2014).

incurred—to come up with the amount to be disgorged.[12] In the latter, the same wrongdoer would not be afforded the benefit of his balance sheet and would be liable to disgorge the gross amount of funds flowing from the securities violation. It is at this nexus where the central thesis of this article lies. What, if any, offsets to gross proceeds are legitimate?

While the debate on what constitutes a legitimate offset spans as many topics as there are ways to violate the securities laws, the discussion can be reduced to offsets for costs or expenses incurred. Courts have then categorized costs and expenses as either "direct transactional costs" or "general business expenses." As will be made clear, to some jurisdictions, the category in which a defendant's request to offset falls is dispositive. To others, the ancient equitable mores of the courts sanction ad hoc remedial relief. And still, others, apoplectic over audacious securities violations, grant no offset for expenses and order gross funds received to be disgorged.[13] Nevertheless, each victory by the Commission where disgorgement is offset by direct or general expenses approaches the point of being a pyrrhic victory. Thus, the doctrine of disgorgement in the SEC enforcement context must be modified.

As with all great questions of law, there is great disquietude spanning across the jurisdictions of the country, in some instances leaving defendants wishing they were in the Second or the Eleventh Circuits, while in others finding the SEC longing for the Sixth or Ninth Circuits. The issue of "offsetting disgorgement" in the SEC enforcement context is especially frustrating because it calls upon the courts to employ their well understood ancient powers of equity, while not doing damage to the congressional intent underlying the securities laws. This in of itself is an equitable task. But, is there a new theory in equity which should be applied when the courts are adjudicating violations of elaborate federal regulatory schemes? When federal agencies bring suit in their law enforcement capacities, does the equitable relief they seek sound in this new theory of "regulatory equity?" In short, if offsetting is permitted in a case at common law between private litigants, is offsetting necessarily just and faithful to congressional intent in SEC enforcement actions? Finally, given the jurisdictional inconsistencies, should the SEC seek to use its resources to pursue cases on appeal, either to create conformity as a result or establish the circuit split which would capture the certification of the Supreme Court?

II. AN OVERVIEW OF OFFSETTING DISGORGEMENT

Having teed-up the issue of disgorgement in the securities fraud context, the

---

[12] HAL R. VARIAN, MICROECONOMIC ANALYSIS 23 (3d ed. 1992).

[13] It must be noted the lack of continuity could give rise to forum shopping concerns.

stage is set to discuss the offsetting issue. Depending on the context, the concept of an offset is also referred to as a "setoff," and more plainly as a mere reduction in some amount owed. In the SEC enforcement context, the term "offsetting" seems to be most frequently used. It describes the idea a defendant to an enforcement action may properly adduce evidence the Commission's calculation of disgorgement is over-inclusive, and, as such, the defendant is entitled to "offset" the disgorgement order by certain costs or expenses. Implicit in the practice of offsetting is the argument a defendant's unjust enrichment is reduced by certain netting arrangements—overhead costs or brokerage fees. This part of the article will address the current state of the law, while the remaining sections will reject offsetting through a new theory of regulatory equity and critique two cases which stand to threaten the deterrent framework intended by Congress.

A. The Offsetting Debate

Since 1971, essentially two lines of cases have emerged. Not surprisingly, there is a line of cases denying offsets[14] and another allowing them.[15] Despite the overwhelming authority supporting the proposition offsetting is illegitimate, the pro-offsetting line of cases remains an inimical precedent. In a case from the Sixth Circuit, a court recognized the bifurcation of the disgorgement doctrine, stating, "The [pro-offsetting] case law cited by the defendants is neither binding precedent, nor persuasive. First the defendants' cases are not precedent because none of them are from the Sixth Circuit or Supreme Court. Conversely, [the SEC] has cited two Sixth Circuit cases regarding disgorgement."[16] Siding with the anti-offsetting line of cases, the district court ardently opposed giving any precedential or persuasive

---

[14] *See* Sec. and Exch. Comm'n v. JT Wallenbrock & Assocs., 440 F.3d 1109 (9th Cir. 2006); Sec. and Exch. Comm'n v. United Energy Partners, Inc., 2004 WL 315185 at 2 (5th Cir. Feb. 18, 2004), *cert. denied sub nom*, 543 U.S. 1034 (2004); Sec. and Exch. Comm'n v. Calvo, 378 F.3d 1211 (11th Cir. 2004); Sec. and Exch. Comm'n v. TLC Invs. & Trade Co., 179 F. Supp. 2d 1149 (C.D. Cal. 2001); Sec. and Exch. Comm'n v. Kenton Capital, Ltd., 69 F. Supp. 2d 1 (D.D.C. 1998); Sec. and Exch. Comm'n v. Hughes Capital Corp., 917 F. Supp. 1080 (D.N.J. 1996); Sec. and Exch. Comm'n v. Great Lakes Equities, 775 F. Supp. 211 (E.D. Mich. 1991); Sec. and Exch. Comm'n v. United Monetary Servs., Inc., 1990 WL 91812 at 9 (S.D. Fla. May 18, 1990); Sec. and Exch. Comm'n v. Benson, 657 F. Supp. 1122 (S.D.N.Y. 1986); Sec. and Exch. Comm'n v. Blavin, 760 F.2d 706 (6th Cir. 1985); Sec. and Exch. Comm'n v. World Gambling Corp., 555 F. Supp. 930 (S.D.N.Y. 1983), *aff'd*, 742 F.2d 1440 (2d Cir. 1983), *cert. dismissed*, 465 U.S. 1112 (1984); Sec. and Exch. Comm'n v. Dimensional Entertainment Corp., 493 F. Supp. 1270 (S.D.N.Y.1980); Sec. and Exch. Comm'n v. R.J. Allen & Assocs., Inc., 386 F. Supp. 866 (S.D. Fla. 1974).

[15] *See* Sec. and Exch. Comm'n v. Video Without Boundaries, Inc., 2010 WL 5790684 (S.D. Fla. Dec. 8, 2010); Sec. and Exch. Comm'n v. Berlacher, 2010 WL 3566790 at 15 (E.D. Pa. Sept. 13, 2010); Sec. and Exch. Comm'n v. Shah, 1993 WL 288285 (S.D.N.Y. July 28, 1993); Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88 (W.D.N.Y. 1990).

[16] *Great Lakes Equity*, 775 F. Supp. at 215 n.22 (rejecting *Thomas James Assocs.*, 738 F. Supp. at 88).

value to pro-offsetting cases from other circuits.[17] The court further specified, absent a definitive ruling on the issue by the Supreme Court, it would continue to support the anti-offsetting line of cases.[18] Thus, case-by-case, the offsetting issue seems to be ripening, setting the stage for an inevitable circuit split warranting certiorari.

1. The Pro-Offsetting Line of Cases

Many courts have held direct transactional costs, such as brokerage fees, commissions, or price premiums, are valid offsets.[19] For example, courts in the Second Circuit have consistently held a court may, in its discretion, deduct from the disgorgement amount any direct transaction costs, such as brokerage commissions, which seem to reduce the wrongdoer's actual profit.[20] Still other jurisdictions have turned to the Second Circuit, presumptively expert in securities suits, to determine deductions for various transaction costs, including brokerage commissions paid to third party brokers as part of an agreement for services customarily rendered in connection with the transactions at issue, are proper offsets.[21]

Additionally, price premiums paid for securities acquired as part of a defendant's scheme to violate the securities laws have been accepted as proper offsets in the same way as brokerage fees.[22] The argument is as follows: given the measurable nature of the premiums paid by the defendant and the court's broad discretion in calculating disgorgement, the court will award disgorgement of net, not gross, profits, because they most accurately represent the amount by which the defendant was unjustly enriched.[23]

Finally, with the exception of a few,[24] the pro-offsetting line of cases have collectively compartmentalized disgorgement doctrine by erecting a partition,

---

[17] *Id.*

[18] *Id.*

[19] *See Berlacher*, 2010 WL 3566790 at 15; Sec. and Exch. Comm'n v. Universal Express, Inc., 646 F. Supp. 2d 552, 564 (S.D.N.Y. 2009); Sec. and Exch. Comm'n v. McCaskey, 2002 WL 850001 at 4 (S.D.N.Y. 2002); Sec. and Exch. Comm'n v. Rosenfeld, 2001 WL 118612 at 2 (S.D.N.Y. Jan. 9, 2001); Litton Indus., Inc. v. Lehman Bros., 734 F. Supp. 1071, 1077 (S.D.N.Y.1990).

[20] *See Universal Express*, 646 F. Supp. 2d at 564; *McCaskey*, 2002 WL 850001 at 4; *Rosenfeld*, 2001 WL 118612 at 2; Sec. and Exch. Comm'n v. Shah, 1993 WL 288285 (S.D.N.Y. 1993); *Litton Indus*., 734 F. Supp. at 1077.

[21] *See* Sec. and Exch. Comm'n v. JT Wallenbrock & Assocs., 440 F.3d 1109, 1114–15 (9th Cir. 2006); *Litton Indus*., 734 F. Supp. at 1077.

[22] *See Berlacher*, 2010 WL 3566790 at 15.

[23] *Id.*

[24] *See* Sec. and Exch. Comm'n v. Video Without Boundaries, Inc., 2010 WL 5790684 (S.D. Fla. Dec. 8, 2010); Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88, 94–95 (W.D.N.Y. 1990) (holding general business expenses as valid offsets to disgorgement).

which distinguishes direct transactional costs from general business expenses,[25] presumptively allowing offsets in the former and usually not in the latter. Nevertheless, *Thomas James Associates*, as well as *Video Without Boundaries*, loom large as paradigmatic precedents for offsetting disgorgement by general business expenses. "However, assuming this to be valid, it does not mean that a defendant can group his expenses under a broad category of business costs and accordingly expect deductions from the disgorgement amount without supporting evidence."[26] As a closing point, in the amount the Commission requests to be disgorged, the SEC can voluntarily deduct the cost of conducting the fraudulent scheme, but under the regulatory equity theory—explicated herein—this would not have to be done.[27]

2. The Anti-Offsetting Line of Cases

On the other hand, the overwhelming weight of authority holds securities law violators may not offset their disgorgement liability with business expenses.[28] Similarly, the SEC has tried the argument the overwhelming weight of authority supports no offsetting by direct transactional costs. But, there the court rejected the argument as applied to brokerage fees.[29] Nevertheless, the courts which have allowed an offset for direct transactional costs "have taken care to distinguish such costs from 'general business expenses, such as overhead expenses, which should not reduce the disgorgement amount.'"[30]

Initially, at the district court level, the D.C. Circuit passed on deciding whether general business expenses were valid offsets to a disgorgement order. In

---

[25] *See McCaskey*, 2002 WL 850001 at 4 n.6 (declaring brokerage fees should be distinguished from general business expenses, which should not offset disgorgement).

[26] *See* Sec. and Exch. Comm'n v. Rosenfeld, 2001 WL 118612 at 2 (S.D.N.Y. Jan. 9, 2001); Sec. and Exch. Comm'n v. Benson, 657 F. Supp. 1122, 1133–34 (S.D.N.Y. 1986); *Thomas James Assocs.*, 738 F. Supp. at 95. And, more importantly, we are not assuming this to be valid.

[27] *See* Sec. and Exch. Comm'n v. Hughes Capital Corp., 917 F. Supp. 1080, 1086–87 (D.N.J. 1996). Additionally, the SEC may, at its own discretion, decide the litigation risks associated with a particular suit warrant settling the case on disgorgement terms that take into consideration certain netting arrangements. Thus, the Commission may use any calculation of disgorgement it likes in light of its expertise and experience, subject to the reasonableness standard explicated later in this article.

[28] *See* Sec. and Exch. Comm'n v. JT Wallenbrock & Assocs., 440 F.3d 1109, 1115 (9th Cir. 2006); Sec. and Exch. Comm'n v. United Energy Partners, Inc., 2004 WL 315185 at 2 (5th Cir. Feb. 18), *cert. denied sub nom*, 543 U.S. 1034 (2004); Sec. and Exch. Comm'n v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 16 (D.D.C. 1998); *Hughes Capital*, 917 F. Supp. at 1087; Sec. and Exch. Comm'n v. Great Lakes Equity Co., 775 F. Supp. 211, 214–15 n. 22 (E.D. Mich. 1991); Sec. and Exch. Comm'n v. World Gambling Corp., 555 F. Supp. 930, 935 (S.D.N.Y. 1983), *aff'd*, 742 F.2d 1440 (2d Cir. 1983), *cert. dismissed*, 465 U.S. 1112 (1984).

[29] *See McCaskey*, 2002 WL 850001 at 4 n.5.

[30] *See* Sec. and Exch. Comm'n v. Universal Express, Inc., 646 F. Supp. 2d 552, 564 (S.D.N.Y. 2009); *McCaskey*, 2002 WL 850001 at 4 n.6; *Rosenfeld*, 2001 WL 118612 at 2 (S.D.N.Y Jan. 9, 2001).

Securities and Exchange Commission v. Bilzerian,[31] the court observed:

> [The defendant] alternatively argues that he incurred expenses of $6,000,000 in his attempt to purchase [the target company] and that these expenses should be offset against his $6,540,770 in profits. *Even assuming this to be proper*, defendant bears the burden of proving that these expenses were in fact incurred. [The defendant] has merely asserted a bald figure and has made no attempt to substantiate it.[32]

Note the court said, "Even assuming this to be proper," which indicated the D.C. district court was not going to decide the offsetting issue in this case because there was not enough evidence to properly present it. Importantly, the pronoun "this" in the block quote refers to offsetting. The phrase can be rewritten as, "Even assuming [offsetting] to be proper, defendant bears the burden of proving that these expenses were in fact incurred." Accordingly, the D.C. Circuit had the opportunity to say whether offsetting was proper and declined to do so on the facts.

In *Kenton Capital*, the D.C. district court finally had the opportunity to rule on the question it passed on five years earlier in *Bilzerian*. Rejecting *Thomas James Associates*, the court held the "[defendants] may not escape disgorgement by asserting that expenses associated with this fraud were legitimate."[33] Thus, *Kenton Capital* stands for the proposition whether the expenses incurred while violating the securities laws were legitimate or otherwise is irrelevant. A defendant is not allowed to offset disgorgement in the amount of general business expenses. Additionally, the Ninth Circuit adopted *Kenton Capital* in *Securities and Exchange Commission v. JT Wallenbrock & Associates*,[34] reasoning, "Neither the deterrent purpose of disgorgement nor the goal of depriving a wrongdoer of unjust enrichment would be served were we to allow these defendants—who defrauded investors of $253.2 million—to escape disgorgement by asserting that expenses associated with this fraud were legitimate."[35]

"When addressing the amount of money that a defendant must disgorge, the Sixth Circuit has held, by implication, that the entire amount .†.†. which was illicitly received must be disgorged."[36] The court in *Great Lakes Equity* dropped a footnote explaining this reasoning:

---

31 814 F. Supp. 116 (D.D.C. 1993).

32 *Id.* at 122 n.16 (emphasis added) (citations omitted).

33 69 F.Supp.2d 1, 15–17 (D.D.C. 1998).

34 440 F.3d 1109 (9th Cir. 2006).

35 *Id.* at 1115 (citing *Kenton Capital*, 69 F. Supp. 2d at 17) (internal quotation marks omitted).

36 *See* Sec. and Exch. Comm'n v. Great Lakes Equity Co., 775 F. Supp. 211, 214 (E.D. Mich. 1991); Sec. and Exch. Comm'n v. Blavin, 760 F.2d 706, 710 (6th Cir. 1985), *aff'g* 557 F. Supp. 1304 (E.D. Mich. 1983); *cf.* Sec. and Exch. Comm'n v. Wash. Cnty. Util. Dist., 676 F.2d 218, 227 (6th Cir.1982) (stating the SEC is entitled to total disgorgement).

> *Blavin* does not explicitly hold that no deductions may be taken for expenses; the issue of expenses is never directly addressed. In *Blavin*, however, there is no deduction taken for expenses. Moreover, it is clear that it is within the district courts' equitable discretion to disallow expenses incurred in perpetration of the fraud even if there were Sixth Circuit authority for the proposition that expenses may be deducted from disgorgement.[37]

Rounding off this line of cases, there is authority for denying offsets for overhead expenses and corporate income tax rates.[38] In sum, the anti-offsetting cases argue the SEC is entitled to total disgorgement,[39] and total disgorgement must mean a defendant is not entitled to offset the order by costs or expenses despite the category in which he or she falls.

B. Other Arguments Supporting Offsetting

While it is quite obvious by this point the central critique of the offsetting practice lies with certain costs and expenses incurred by the defendant, the defense bar has proffered several additional arguments which are worth settling before proceeding with the critique. First, there is the somewhat controversial issue of subsequent use. Then, there is the notion ability to pay and bankruptcy should mitigate against total disgorgement. We will consider each in turn.

1. Subsequent Use

"Subsequent use" is a broad phrase intended to describe all the ways in which a wrongdoer may use his or her ill-gotten gains—investments purchases or donations. The argument is the subsequent use of the defendants ill-gotten gain precludes him or her from satisfying the disgorgement order, and, thereby, the order works as a punishment. This argument has failed resoundingly. Several courts have previously noted "it is irrelevant for disgorgement purposes, how the defendant chose to dispose of [his or her] ill-gotten gains; subsequent investment of these funds, payments to charities, and/or payment to co-conspirators are not deductible from the gross profits subject to disgorgement."[40] "[A defendant's]

---

[37] *Great Lakes Equity*, 775 F. Supp. at 214 n.20; *see also Blavin*, 760 F.2d at 706.

[38] *See* Sec. and Exch. Comm'n v. World Gambling Corp., 555 F. Supp. 930, 935 (S.D.N.Y. 1983) ("[N]either do the circumstances warrant reducing this amount by [the defendant's] overhead costs or by a hypothetical corporate income tax rate.").

[39] *See Great Lakes Equity*, 775 F. Supp. at 214; *Blavin*, 760 F.2d at 706, *aff'g* 557 F. Supp. 1304; *Wash. Cnty. Util. Dist.*, 676 F.2d at 227.

[40] Sec. and Exch. Comm'n v. Universal Express, Inc., 646 F. Supp. 2d 552, 564 (S.D.N.Y. 2009) (citing Sec. and Exch. Comm'n v. Rosenfeld, 2001 WL 118612 at 2 (S.D.N.Y Jan. 9, 2001)).; *see also* Sec. and Exch. Comm'n v. JT Wallenbrock & Assocs., 440 F.3d 1109, 1115 (9th Cir. 2006); Sec. and Exch. Comm'n v. United Energy Partners, Inc., 2004 WL 315185 at 2 (5th Cir. Feb. 18, 2008), *cert.*

assertion that portions of the misappropriated money was used for [legitimate corporate purposes], even if true, serves only to strengthen [the Commission's] claim."[41] Thus, even capital investments in to legitimate business ventures are subject to disgorgement because they were the subsequent investment of the illegally obtained, or tainted, investor funds.

What is more, the fact a defendant's scheme ultimately fails and he or she loses a considerable amount of funds does not release him or her from disgorgement obligations.[42] And, in determining how much should be disgorged in a case in which a defendant has manipulated securities so as to mulct the public, there is no reason why the court must give him or her credit for the fact he or she had not succeeded in avoiding losses.[43] To waste or windfall, disgorgement deprives a wrongdoer of ill-gotten gains; and a person remains unjustly enriched by what was illegally received, whether or not he or she retains the proceeds of the wrongdoing.

2. Ability to Pay

The defense bar has also suggested the defendant's ability to pay ought to warrant an offset of disgorgement. The Second Circuit has said, "[T]o withhold the remedy of disgorgement or penalty simply because a swindler claims that he has already spent all the loot and cannot pay would not serve the purposes of the securities laws."[44] Consequently, the defendant's inability to pay seems to be clearly irrelevant.

However, not every court in the SEC enforcement context has dismissed ability to pay so readily. In one instance, the defendant's impecunious state caused by tax liabilities and the temporal decline in the stock market, in conjunction with having a mortgage and children ranging from nine to twenty-six, led the court to

denied sub nom, 543 U.S. 1034 (2004); Sec. and Exch. Comm'n v. McCaskey, 2002 WL 850001 at 5 (S.D.N.Y. Mar. 26, 2002); Sec. and Exch. Comm'n v. Hughes Capital Corp., 917 F. Supp. 1080, 1086 (D.N.J. 1996); *Great Lakes Equity*, 775 F. Supp. at 214; Sec. and Exch. Comm'n v. Benson, 657 F. Supp. 1122, 1134 (S.D.N.Y.1987) ("The manner in which [the defendant] chose to spend his misappropriations is irrelevant as to his objection to disgorge. Whether he chose to use this money to enhance his social standing through charitable contributions, to travel around the world, or to keep his co-conspirators happy is his own business.").

[41] *Benson*, 657 F. Supp. at 1134.

[42] *See JT Wallenbrock*, 440 F.3d at 1117; Sec. and Exch. Comm'n v. First Pac. Bancorp, 142. F.3d 1186, 1192 n.6 (9th Cir. 1998). Such factual scenarios are those in which the SEC may choose as a matter of litigation strategy to assert a modified disgorgement calculation, whether as a settlement offer or at trial. Nevertheless, the Commission is fully entitled to the gross pecuniary gain calculation if it chooses to pursue it.

[43] *See* Sec. and Exch. Comm'n v. Common Wealth Chem. Sec., Inc., 574 F.2d 90, 102 (2nd Cir. 1978). *But see* Sec. and Exch. Comm'n v. Video Without Boundaries, Inc., 2010 WL 5790684 (S.D. Fla. Dec. 8, 2010).

[44] *See Universal Express*, 646 F. Supp.2d at 565; *see also United Energy Partners*, 2004 WL 315185 at 2, *cert. denied sub nom*, 543 U.S. 1034; *McCaskey*, 2002 WL 850001 at 5.

determine a disgorgement amount equal to a little more than a sixth of the defendant's unjust enrichment would ensure the defendant did not gain from the violation.[45] Correspondingly, *Securities and Exchange Commission v. Huffman*[46] has indirectly accepted ability to pay as a valid offset to disgorgement.[47] There, the court said the evidentiary standard to be applied to a defendant's ability to pay disgorgement was the usual civil preponderance of the evidence standard.[48] By so holding, the court adopted the premise a defendant's ability to pay should be considered when calculating disgorgement. Especially illuminating was footnote four, in which the court more explicitly accepted ability to pay as an offset to disgorgement.[49]

Nevertheless, the balance of authority weighs in favor of dismissing a defendant's ability to pay as a valid offset.[50] Furthermore, when given the opportunity to review a case on point, which supported the anti-offsetting line of cases, the Supreme Court denied certiorari.[51] Hence, inability to pay is irrelevant.[52] Disgorgement deprives a wrongdoer of ill-gotten gains; and a person remains unjustly enriched by what was illegally received, whether he or she retains the proceeds of the wrongdoing.[53] Therefore, ability to pay is not a valid offset to a disgorgement order.

---

[45] *See* Sec. and Exch. Comm'n v. Pardue, 367 F. Supp. 2d 773, 778 (E.D. Pa. 2005).

[46] 996 F.2d 800 (5th Cir. 1993).

[47] *Id.* at 803 n.4.

[48] *Id.*

[49] Footnote 4 reads:

> It does not disserve the SEC or other federal agencies to hold that a party bound by a consent order implicating public rights must satisfy the court of his inability to pay by a preponderance of the evidence. There is no statutory mandate for a higher burden of proof, and implying one from the language in [the cited case] verges on semantic gamesmanship. [That case's] careful description of the types of evidence [the defendant] should adduce to prove inability to pay is far more useful to the public than the vague, unusual call for plain and unmistakable proof.

Id.

[50] *See Universal Express*, 646 F. Supp. 2d at 565; *United Energy Partners*, 2004 WL 315185 at 2, *cert. denied sub nom*, 543 U.S. 1034; *McCaskey*, 2002 WL 850001 at 5.

[51] *See United Energy Partners*, 2004 WL 315185 at 2, *cert. denied sub nom*, 543 U.S. 1034.

[52] To the extent a defendant's ability to pay is considered, the Commission should evaluate whether in such instances, disgorgement should be sought as relief, and if lesser relief would serve as an adequate proxy for deterrence. In these scenarios, the SEC, as a matter of public relations, may feel ordering disgorgement of ill-gotten gains, which has no hope of being complied with, looks like a waste of resources. But, the validity of this strategy is not the object of this article. Accordingly, this article reserves passing judgment on such strategies.

[53] *Id.*

3. Bankruptcy

Bankruptcy follows ability to pay in this section because of how one may inferentially imply the other. Additionally, the case law on bankruptcy has helped to conclusively solidify the proposition disgorgement is not restitution. In so doing, the penultimate chess move has been made, setting the pieces in place for checkmating the practice of offsetting disgorgement in an SEC enforcement action by any category of business expense.

Consider the following passage:

> We first address whether the Debt Act applies to disgorgement orders in the context of a securities violation. The Debt Act is the exclusive means for the United States and its agencies to collect "debts." It permits an individual debtor to exempt from collection under the Act any property [which] is exempt from debt collection under the state law of the debtor's domicile. 28 U.S.C. § 3014(a)(2)(A). The Act expressly does not apply to collection of any monies owed which are not debts. 28 U.S.C. § 3001(c). The critical question is what the Act means by "debt."

The Act defines a "debt" as:

> (A) an amount that is owing to the United States on account of a direct loan, or loan insured or guaranteed by the United States; or
>
> (B) an amount that is owing to the United States on account of a fee, duty, lease, rent, service, sale of real or personal property, overpayment, fine, assessment, penalty, restitution, damages, interest, tax, bail bond forfeiture, reimbursement, recovery of a cost incurred by the United States, or other source of indebtedness to the United States[] but that is not owing under the terms of a contract originally entered into by only persons other than the United States.[54]

"Although 'disgorgement' nowhere appears on this list, the defendants argue that disgorgement should be considered a form of 'restitution' or an 'other source of indebtedness to the United States.' .†.†. It is not restitution."[55]

Furthermore, "the statutory definition of 'prejudgment remedy' does not include disgorgement."[56] Lastly, consider *Bilzerian*:

---

[54] 28 U.S.C. § 3002(3)(A)–(B) (2012).

[55] Sec. and Exch. Comm'n v. Huffman, 996 F.2d 800, 802 (5th Cir. 1993). However, there is this curious quote, the implications of which the article punts, to be addressed on a future date: "The district court has broad discretion in fashioning the equitable remedy of a disgorgement order. It may decide that some property should be exempt from such an order and may take state law as its guide." *Id.*

[56] Sec. and Exch. Comm'n v. ETS Payphones, Inc., 408 F.3d 727, 735 (11th Cir. 2005) (citations omitted).

> [The] defendant sought to enjoin the SEC from pursuing this disgorgement action on the grounds of the automatic stay provision of 11 U.S.C. § 362(a). The bankruptcy court rejected defendant's argument, finding that *the disgorgement action was excepted from the automatic stay as an exercise of the government's police or regulatory powers*.[57]

In light of the implications regarding bankruptcy and indebtedness law, the courts have had to unequivocally state disgorgement is not restitution, and, by rejecting the invocation of *ejusdem generis*, so held disgorgement in the SEC enforcement context is *sui generis*.[58] Consequently, ability to pay, bankruptcy, or indebtedness will not stand in the way of a disgorgement order in an SEC enforcement action.

C. Legitimate Offsets

Before going too far and denouncing offsetting wholesale, it is worth pausing to address the instances in which the disgorgement order may properly be reduced. Where remittances arise out of the same colorable transaction or occurrence, several jurisdictions have held settlement payments, restitution to private parties, payments in a previous criminal case, and deposits already in the registry of the court to be valid offsets to disgorgement.[59]

Notably, *Penn Central* in 1976 adopted offsetting for disgorgement paid in a private litigation action but in the specific circumstance where the SEC enforcement action arose under the same colorable claim or securities law violation.[60] By contrast, in *Shah*, the monies paid as a result of the private litigation action were pursuant to a different violation of the securities laws than those alleged in the Commission's complaint, although arguably arising out of the same transaction or occurrence.[61] Taken together, *Penn Central* and *Shah* tell us offsetting disgorgement in an SEC enforcement action by amounts paid in a private securities litigation action is only proper where the same colorable claim or securities law

---

[57] Bilzerian v. Sec. and Exch. Comm'n, 146 B.R. 871, 873 (Bankr. M.D. Fla. 1992).

[58] *See Huffman*, 996 F.2d at 803 n.3.

[59] *See* Sec. and Exch. Comm'n v. United Energy Partners, Inc., 2004 WL 315185 at 2 (5th Cir. Feb. 18, 2008), *cert. denied sub nom*, 543 U.S. 1034; Sec. and Exch. Comm'n v. Palmisano, 135 F.3d 860, 863–64 (2nd Cir. 1998); Sec. and Exch. Comm'n v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 15 (D.D.C. 1998); Sec. and Exch. Comm'n v. First Jersey Sec., Inc., 101 F.3d 1450, 1475 (2nd Cir. 1996); Sec. and Exch. Comm'n v. Shah, 1993 WL 288285 (S.D.N.Y. 1993); Sec. and Exch. Comm'n v. Penn Cent. Co., 425 F. Supp. 593 (E.D. Pa. 1976).

[60] *See Penn Cent.*, 425 F. Supp. 593 (E.D. Pa. 1976) (offsetting disgorgement paid in the SEC enforcement action by an amount disgorged for the same complaint alleged in the private action).

[61] *See Shah*, 1993 WL 288285 at 4–5. It follows, therefore, one defendant can create one scheme comprised of multiple securities violations and be liable for disgorgement in every suit brought pursuant thereto, as long as no part of the complaints overlap.

violation has been alleged. Consequently, if a private securities litigation action stems from a material misrepresentation to investors but the Commission's complaint alleges insider trading, then offsetting disgorgement in the Agency's litigation by amounts given up in the private action seems to be beyond the discretion of the court.

However, offsets in the amount of a defendant's previous distributions related to the same violative transaction or occurrence do not extend to fines paid as a result of the associated criminal case.[62] Furthermore, the balance of *Penn Central* and *Shah* notwithstanding, the gravity of the SEC's objective of deterrence has been held so flattening previous payments of restitution as dramatic as one hundred forty-five million dollars can be denied as an offset to disgorgement in the commission's civil action.[63] Even when a defendant has already provided restitution to some defrauded investors pursuant to the settlement agreement with the Department of Justice, *the district court can still require the defendant to disgorge all of his or her ill-gotten gains*.[64]

III. REGULATORY EQUITY AND ITS APPLICATION

A. Introduction

Before a detailed analysis of the calculation of disgorgement and the subsequent critique of offsetting can be performed, a distinction between "regulatory equity" and traditional common law equity and restitution must be made. In this article, regulatory equity refers to the type of equity deemed by the Supreme Court to have been intended by Congress when passing the securities laws. As the bifurcated line of disgorgement cases evinces, regulatory equity has been, and continues to be, an unrecognized area of the law. This article seeks to contribute to its establishment and promotion.

While, in many ways regulatory equity is similar to traditional common law equity, it allows for fashioning remedies, which do not match one-for-one the elements necessary in the common law between private litigants. Consequently, disgorgement in the context of an SEC enforcement action has become a remedy which is *sui generis*. The fundamental difference between common law equity and regulatory equity is in the composition of the parties involved. Common law cases in equity are typically between an alleged wrongdoer and a complaining party who seeks the restoration of money or property after having a legally protected right

---

[62] *See Shah*, 1993 WL 288285 at 4.

[63] *See* Sec. and Exch. Comm'n v. JT Wallenbrock & Assocs., 440 F.3d 1109, 1113 at n.10 (9th Cir. 2006).

[64] *See* Sec. and Exch. Comm'n v. Currency Trading Int'l, Inc., 2006 WL 988104 (9th Cir. Apr. 14, 2006) (emphasis added).

impinged. In the context of an SEC enforcement action, the agency as the complaining party has no legally protected interests. Rather, the agency acts not as a result of restorative impulses but as a necessary consequence of its law enforcement mandate.

To darn together, for the first time, this tapestry I have chosen to call "regulatory equity," we must first journey through swaths of cases which do not address disgorgement by the SEC directly. These cases are the equitable antecedents to *Texas Gulf Sulphur*. They are crucial to the development of regulatory equity because there the court was explicating the unique remedial scheme Congress intended the securities laws to embody, as well as the unique role the SEC has in enforcing them. While later cases will weave the doctrine of disgorgement centrally into this theory, the initial cases represent the structural loom built by the federal courts prior to 1971.

B. The Foundational Cases

Regulatory equity broadly refers to the form Congress intended equity to take in the context of federal administrative enforcement. Absent a mandate to codify the common law, the pursuit of regulating industries through regulatory regimes—most replete with industry specific provisions and remedial frameworks—can be informed by the common law but should never be assumed equivalent. Accordingly, where Congress has incorporated a remedial framework into its regulatory regime, courts are compelled to give effect to that framework, common law principles notwithstanding. Thus, the efficacy of the broad remedial scheme embodied in the securities laws depends upon the federal courts identifying the remedial intentions of Congress when it incorporated equitable relief into those statutes—whether Congress intended silence to be tacit acquiescence to the common law.

The early cases in the regulatory equity line dealt with interpreting the scope of equitable relief absent express restrictions by Congress. Before *Texas Gulf Sulphur*, the Supreme Court found it to be within the equitable jurisdiction of the Court to order disgorgement, pursuant to the law of restitution, where the federal statute in question was silent on such authority.[65] There, the Court relied upon one of its earlier cases explicating a similar regulatory framework:

> [C]ourts must act primarily to effectuate the policy of the [Act] and to protect the public interest while giving necessary respect to the private interests involved. The inherent equitable jurisdiction which is thus called into play clearly authorizes a court, in its discretion, to decree restitution of excessive charges that to give effect to the policy of

---

[65] *See* Porter v. Warner Holding Co., 328 U.S. 395 (1946).

Congress.[66]

Going further, the Supreme Court explained, "it is not unreasonable for a court to conclude that such a restitution order is appropriate and necessary to enforce compliance with the Act and to give effect to its purposes. Future compliance may be more definitely assured if one is compelled to restore one's illegal gains.†.†. ."[67] Accordingly, where a federal regulatory regime created by Congress invokes the equitable jurisdiction of the Court—"calls it into play"—the Court may fashion an equitable remedy to give effect to such regime, as long as the remedy itself is not expressly barred.[68]

A few years later, the federal courts seized the opportunity to begin explicating the intended remedial scheme of the securities laws in *LATDME*:

> We conclude, therefore, as the Supreme Court has stated with respect to other regulatory statutes, that the Congress must be taken to have acted cognizant of the historic power of equity to provide complete relief in the light of statutory purposes. As the Supreme Court long ago recognized, there is inherent in the courts of equity a jurisdiction to give effect to the policy of the legislature.[69]

Taken together, these precedents framed the issue of equity's scope in the SEC enforcement context, and it would not be long before the highest court of the land got its chance to address the question, Is equity's scope in a regulatory enforcement action the same as in a private right of action?

Accordingly, in the 1963 case, *Securities and Exchange Commission v. Capital Gains Research Bureau*,[70] the Supreme Court took to answering this question. "We granted certiorari to consider the question of statutory construction because of its importance to the investing public and the financial community."[71] The Court held the securities laws were, "designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930s."[72] "A fundamental purpose, common to [the securities laws], was to substitute a philosophy of full disclosure

---

[66] *Id.* at 400 (citations omitted).

[67] *Id.*

[68] Furthermore, when the United States brings suit in its sovereign capacity, a statute of limitations does not ordinarily apply unless Congress has expressly provided otherwise. Sec. and Exch. Comm'n v. Calvo, 378 F.3d 1211, 1218 (11th Cir. 2004); *see also* United States v. Banks, 115 F.3d 916, 919 (11th Cir. 1997), *cert. denied*, 522 U.S. 1075 (1998) (bringing to the fore an interesting aspect of federal enforcement and how it differs from private rights of action).

[69] L.A. Trust Deed Mortg. Exch. v. Sec. and Exch. Comm'n, 285 F.2d 162, 182 (9th Cir. 1960).

[70] 375 U.S. 180 (1963).

[71] *Id.* at 184 (overturning the lower courts' reading of the securities laws and finding the securities laws are not confined by traditional common-law concepts of fraud and deceit).

[72] *Id.* at 186–87.

for the philosophy of caveat emptor and[,] thus[,] to achieve a high standard of business ethics in the securities industry."[73] In this way, Congress intended the remedial scheme of the securities regulations to detract from unethical behavior, relying upon the courts to give effect to the deterrent purposes of the regime.

Subsequently, the Supreme Court chose to characterize the new theory of regulatory equity as a species of common law equity, one newly adopted to the new ecosystem of the regulatory environment:

> It would defeat the manifest purpose of the [securities laws] for us to hold, therefore, that Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit,' intended to require proof of intent to injure and actual injury to clients.†.†. . This conclusion moreover, is not in derogation of the common law of fraud, as the [d]istrict [c]ourt and the majority of the [c]ourt of [a]ppeals suggested. To the contrary, it finds support in the process by which the courts have adapted the common law of fraud to the commercial transactions of our society. It is true that at common law intent and injury have been deemed essential elements in a damage suit between parties to an arm's-length transaction.[74]
>
> [But, t]he content of common-law fraud has not remained static as the courts below seem to have assumed. It has varied, for example, with the nature of the relief sought, the relationship between the parties, and the merchandise in issue. It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages.[75]

Thus, equity in SEC enforcement actions was never meant to reflect, point-for-point, the common law of equity as it existed prior to the 1933 and 1934 Acts.[76]

Furthermore, subsequent amendments to the original securities enactments do not necessarily substitute a narrower interpretation for the original, broader one. There is no indication in the 1990 Act Congress desired to supplant the doctrine of disgorgement as it had been developing since 1971. "Moreover, the intent of Congress must be culled from the events surrounding the passage of the [original] legislation. '[O]pinions attributed to a Congress [fifty-six] years after the event cannot be considered evidence of the intent of the Congress'" at the time of enacting the securities laws for the first time.[77]

Since the largest body of securities violations is arguably based on fraud or

---

[73] *Id.*

[74] *Capital Gains*, 375 U.S. at 192–93.

[75] *Id.* at 193.

[76] *See generally* Securities Act of 1933, 15 U.S.C. § 77(a) (1933); Securities and Exchange Act of 1934 15 U.S.C. § 78(a) (1934).

[77] *Capital Gains*, 375 U.S. at 199–200.

material misrepresentations, the Supreme Court went on to further distinguish equity in the SEC enforcement context from traditional common law equity. "Fraud has a broader meaning in equity (than at law) and intention to defraud or to misrepresent is not a necessary element."[78] "Fraud, indeed, in the sense of a court of equity properly includes all acts, omissions[,] and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed, and are injurious to another, or by which an undue and unconscientious advantage is taken of another."[79]

There is even further evidence the Supreme Court was tailoring a new flavor of equity:

> There has also been a growing recognition by common-law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities, and that, accordingly, *the doctrines must be adapted to the merchandise in issue*.[80]

The Supreme Court then presented the smoking gun:

> We cannot assume that Congress, in enacting legislation to prevent fraudulent practices by [members of the investment industry], was unaware of these developments in the common law of fraud. Thus, even if we were to agree with the courts below that Congress had intended, in effect, to codify the common law of fraud in the [securities laws], it would be logical to conclude that Congress codified the common law "remedially" as the courts had adapted it to the prevention of fraudulent securities transactions by [participants in the securities markets], not "technically" as it has traditionally been applied in damage suits between parties to arm's-length transactions involving land and ordinary chattels.[81]

In sum, Congress intended all securities legislation "'enacted for the purpose of avoiding frauds' [to be construed], not technically and restrictively, but flexibly to effectuate its remedial purposes."[82]

Following *Capital Gains Research Bureau*, the strongest single case supporting the regulatory equity theory is *Securities and Exchange Commission v.*

---

[78] *Id.* at 193.

[79] *Id.* at 194.

[80] *Id.* at 194 (emphasis added) (citing Ridgely v. Keene, 119 N.Y.S. 451 (N.Y. App. Div. 1909) (illustrating the continuing doctrinal development of fraud in the context of equity)).

[81] *Id.* at 195 (stating Congress did not codify the common law of fraud and equity in the securities laws).

[82] *Id.*

Management Dynamics, Inc.[83] The following excerpt from the appellate court's decision is not only illuminating but absolute in its implication:

> The appellants' crucial error on this score is their assumption that SEC enforcement actions seeking injunctions are governed by criteria identical to those which apply in private injunction suits. Unlike private actions, which are rooted wholly in the equity jurisdiction of the federal court, SEC suits for injunctions are creatures of statute. Proof of irreparable injury or the inadequacy of other remedies as in the usual suit for injunction is not required.[84]

The Court went on to distinguish the traditional principles of equity when ordering an injunction at common law from ordering the same in an SEC enforcement action.

> [When] deciding whether to grant injunctive relief, a district court is called upon to assess all those considerations of fairness that have been the traditional concern of equity courts. But[,] the statutory imprimatur given SEC enforcement proceedings is sufficient to obviate the need for a finding of irreparable injury at least where the statutory prerequisite the likelihood of future violation of the securities laws has been clearly demonstrated.[85]

Therefore, in the same way an injunction in the SEC enforcement context can be doctrinally distinguished from a traditional order between private parties, disgorgement in the SEC enforcement context is distinguishable. The court reasoned:

> The rationale for this rule is readily apparent. It requires little elaboration to make the point that the SEC appears in these proceedings not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws. Hence, by making the showing required by statute that the defendant is engaged or about to engage in illegal acts, *the Commission is seeking to protect the public interest, and the standards of the public interest not the requirements of private litigation measure the propriety and need for [equitable] relief.*[86]

Therefore, in the face of this supreme precedence, any dispositive reliance upon the common law of private litigation—when fashioning the disgorgement

[83] Sec. and Exch. Comm'n v. Mgmt. Dynamics, Inc. 515 F.2d 801 (2d Cir. 1975).

[84] *Mgmt. Dynamics*, 515 F.2d at 808 (internal quotation marks omitted) (citations omitted). Today, following the promulgation of the SERPSRA, disgorgement orders too are creatures of statute, and the same analysis applies.

[85] *Id.*

[86] *Id.* (emphasis added) (internal quotation marks omitted).

remedy—is an abuse of the Court's discretion[87] and erodes the deterrent mandate of the SEC.

C. The Disgorgement Cases[88]

After *Capital Gains Research Bureau*, the basic concept underlying regulatory equity is clear. "In an SEC enforcement action, the remedial purpose of the statute takes on special importance."[89] As long as it is reasonable, "substantial deference is due the construction of a statute made by those charged with its execution."[90] When describing the anti-fraud provisions of the securities laws, the *Steadman* court stated: "[T]he offenses they define are fraud in the broadest 'remedial' sense of that term and require no showing of intent to injure or injury."[91] Significantly, when ordering disgorgement, "[t]he Supreme Court has consistently stated that the federal securities laws, enacted for the purpose of avoiding frauds must be construed not technically and restrictively[] but flexibly to effectuate their remedial purposes."[92] Accordingly, by applying the equitable doctrine of restitution with technical exactitude, a court would be ignoring the resolute distinction between the common law doctrine of restitution and the doctrine of disgorgement in the SEC enforcement context.[93] Yet, within this understanding, "once the equity jurisdiction of the district court properly has been invoked, the court has power to order all equitable relief necessary under the circumstances. Such discretion in fashioning appropriate remedies is a necessary (if unspoken) concomitant of the legislative grant of power to enforce the laws."[94] "Unless otherwise provided by statute, all the inherent equitable powers of the [d]istrict [c]ourt are available for the proper and complete exercise of that jurisdiction."[95] And, where the inherent

---

[87] *See* Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2303 n.8 (2011) ("We note, however, that we have previously expressed skepticism over the degree to which the SEC should receive deference regarding the private right of action."). If the Supreme Court is skeptical deferring to the SEC in a private right of action, then, as the article asserts, the converse ought to be true.

[88] With the exception of *Steadman v. Securities and Exchange Commission*, 603 F.2d 1126 (5th Cir. 1979), these cases all dealt with a disgorgement request by the SEC. *Steadman* is cited for the purpose of additional doctrinal support during the post *Texas Gulf Sulphur* disgorgement era.

[89] Sec. and Exch. Comm'n v. Burger, 244 F. Supp. 2d 180, 193 (S.D.N.Y. 2001) (internal quotation marks omitted).

[90] *Steadman*, 603 F.2d at 1135.

[91] *See id.* at 1138; *see also* Sec. and Exch. Comm'n v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963).

[92] Sec. and Exch. Comm'n v. R.J. Allen & Assocs., Inc., 386 F. Supp. 866, 875 (S.D. Fla. 1974) (quoting *Capital Gains*, 375 U.S. at 195 (1963)) (internal quotation marks omitted)).

[93] *See supra* Part II.B.3.

[94] Sec. and Exch. Comm'n v. Materia, 745 F.2d 197, 200 (2d Cir. 1984).

[95] Sec. and Exch. Comm'n v. First City Fin. Corp., Ltd., 890 F.2d 1215, 1230 (D.C. Cir. 1989). (citing Porter v. Warner Holding Co., 328 U.S. 395, 398 (1946)); *cf.* 15 U.S.C. § 1117(a) (codifying the ability to set off unjust enrichment explicitly in the text of the trademark laws). *Compare* Part IV.C.2

equitable powers of the district courts have given gloss to the securities laws, a departure from the case law ought to be questioned.[96] At bottom, a disgorgement order in the SEC enforcement context not only deprives the wrongdoer of benefits derived from unlawful conduct, but it also effectuates the purposes underlying the securities laws, the protection of the investing public, and the deterrence of future violations.[97]

D. The Unique Position of the SEC as Party

The foundational and disgorgement cases in the regulatory equity line are powerful evidence of this new theory of equity. Considerable effort was made in the previous sections to touch on the salient cases supporting the distinction between common law equity and the kind intended to be applied in SEC enforcement actions. Notably, an additional plinth is found in the fundamental difference between a private litigant bringing suit and the SEC bringing suit pursuant to its law enforcement authority. But, what is this fundamental difference, and how can it be described?

To begin, in an SEC enforcement action the judiciary's jurisprudence does in fact change because it is the SEC who is the plaintiff. However, consider the Court's response in *Securities and Exchange Commission v. Management Dynamics, Inc.*:[98] "We scarcely mean to imply that judges are free to set to one side all notions of fairness because it is the SEC, rather than a private litigant, which has stepped into court."[99] But, "[i]t requires little elaboration to make the point that the SEC appears in these proceedings not as an ordinary litigant[] but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws."[100] These passages support the conclusion equity takes on a different gloss when the Commission is before the court, but the conclusion is counterbalanced by the fungible principle of fairness rooted in all forms of equity. Our highest Court has agreed with this point. Bolstering the latter quote even further, the Supreme Court has said, "[Where] the public interest is involved in a proceeding of this nature, .†.†. [a Court's] equitable powers assume an even broader and more flexible

(limiting the use of the word "all" in this quotation since the legislative history indicates Congress desired to define unjust enrichment as the wrongdoer's "gross pecuniary gain.").

96 *But see* Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88 (W.D.N.Y. 1990); Sec. and Exch. Comm'n v. Video Without Boundaries, Inc., 2010 WL 5790684 (S.D. Fla. Dec. 8, 2010).

97 *See generally* Commodity Futures Trading Comm'n v. British Am. Commodity Options Corp., 788 F.2d 92, 94 (2nd Cir. 1986) (giving purposeful effect to the remedial scheme intended by Congress).

98 515 F.2d 801 (2d Cir. 1975).

99 *Id.* at 808.

100 *Mgmt. Dynamics*, 515 F.2d at 808.

character than when only a private controversy is at stake."[101] In short, public policy demands a different equitable standard.

Moreover, we know all uncertainties in the Commission's disgorgement calculation are resolved against the defendant.[102] Simply put, the SEC is given the benefit of the doubt. Accordingly, there is a principle of viewing all uncertainties surrounding disgorgement in a light most favorable to the Commission. However, this principle applies only in the context of an SEC enforcement suit, where deterrence is the key objective, and the SEC has met its burden to show the amount to be disgorged is reasonable.[103] Endorsing the unique position of the SEC as a party, the D.C. district court explained:

> This test applies only in the context of an SEC enforcement suit, where deterrence is the key objective. Where two private parties seek monetary remedies, compensation for wrongdoing becomes a more important, perhaps the dominant, rationale. Thus, in a private action, the party seeking monetary compensation may have a greater burden to prove its claim to the amount requested.[104]

Thus, the unique status of the SEC as complaining party is significant because it enjoins a new set of legal standards than at common law.

Management Dynamics' progeny has continued the development of the Commission's unique litigant status, affirming the "SEC does not stand in the shoes of the purchasers and sellers who it asserts were defrauded"[105]:

> At bottom, the defendants' arguments rest on the proposition that the SEC stands in the shoes of private litigants in bringing this injunctive proceeding. Such an assertion, however, was affirmatively rejected in [*Securities and Exchange Commission*] *v. Petrofunds, Inc.*
>
> *There is a critical distinction between actions brought by the SEC and actions brought by private litigants. Regardless of the fact that defendants may be required to disgorge profits, the SEC in no way stands in the shoes of a private litigant with respect to its claims for*

---

[101] *Porter* 328 U.S. 395, 398 (1946) (citations omitted).

[102] Sec. and Exch. Comm'n v. Universal Express, Inc., 646 F. Supp. 2d 552, 564 (S.D.N.Y. 2009); Sec. and Exch. Comm'n v. Miller, 2006 WL 2189697 at 12 (N.D. Ga. July 31, 2006); Sec. and Exch. Comm'n v. Calvo, 378 F.3d 1211, 1217 (11th Cir. 2004); Sec. and Exch. Comm'n v. Rosenfeld, 2001 WL 118612 at 2 (S.D.N.Y. Jan. 9, 2001); Sec. and Exch. Comm'n v. First Jersey Sec., Inc., 101 F.3d 1450, 1475 (2nd Cir. 1996); Sec. and Exch. Comm'n v. Hughes Capital Corp., 917 F. Supp. 1080, 1085 (D.N.J. 1996); Sec. and Exch. Comm'n v. Bilzerian, 814 F. Supp. 116, 121–22 (D.C. 1993) (lending credence to the assumption all profits gained while defendants were in violation of the law constituted ill-gotten gains); Sec. and Exch. Comm'n v. Great Lakes Equity Co., 775 F. Supp. 211, 214 (E.D. Mich. 1991); Sec. and Exch. Comm'n v. First City Fin. Corp., 890 F.2d 1215, 1232 n.24 (D.C. Cir. 1989).

[103] Sec. and Exch. Comm'n v. First City Fin. Corp., 890 F.2d 1215, 1232–33 n.24 (D.C. Cir. 1989).

[104] *Id. at* 1232 n.24 (citations omitted).

[105] Sec. and Exch. Comm'n v. Penn Cent. Co., 450 F. Supp. 908 (E.D. Pa. 1978).

ancillary relief.[106]

Therefore, "[o]nce the Commission has established a defendant has violated the securities laws, the district court possesses the equitable power to grant disgorgement without inquiring whether, or to what extent, identifiable private parties have been damaged by the fraud."[107]

From the foregoing, we can conclusively state the equitable standards applied in common law suits between competing private interests are not the same standards whenever the SEC appears as the plaintiff. But, what is this "critical distinction" between SEC enforcement actions and private suits? First, as plaintiff, the SEC is bringing suit pursuant to its law enforcement mandate. This distinction was noted in *Securities and Exchange Commission v. Dimensional Entertainment Corp.*,[108] "[The defendant] contends that disgorgement is appropriate only to reimburse those victimized by a defendant's criminal conduct, not to promote law enforcement.†.†. . [The defendant's] assertion does not persuade the Court that such an order is not proper here."[109] Courts in several jurisdictions thus agree "the equitable standard to be applied changes when the Commission appears before [the Court] as the statutory guardian charged with safeguarding the public interest in enforcing the securities laws."[110]

Secondly, through the Commission, the United States is acting in its sovereign capacity. "In suing to enforce the securities laws, the SEC is vindicating public rights and furthering public interests."[111] The fact the regulatory agency is seeking a traditional common law remedy in no way alters this sovereign position.[112] "Although the Commission may use the disgorged proceeds to compensate injured victims, this does not detract from the public nature of Commission enforcement actions: the touchstone remains the fact that public

---

[106] Sec. and Exch. Comm'n v. Tome, 638 F. Supp. 596, 627 (S.D.N.Y. 1986) (emphasis added) (internal quotation marks omitted), *aff'd*, 833 F.2d 1086 (2d Cir. 1987), *cert. denied sub nom*, Lombardfin S.p.A v. Sec. and Exch. Comm'n, 486 U.S. 1014 (1988), *cert. denied sub nom*, Sec. and Exch. Comm'n v. Tome, 833 F.2d 1086 (2d Cir. 1987); Transatlantic Fin. Co., S.A. v. Sec. and Exch. Comm'n, 486 U.S. 1015 (1988); *see also Mgmt. Dynamics*, 515 F.2d at 808 ("[T]he SEC appears in these proceedings not as an ordinary litigant but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws.").

[107] *Tome*, 833 F.2d at 1096 (citing Sec. and Exch. Comm'n v. Blavin, 760 F.2d 706 (6th Cir. 1985)).

[108] 493 F. Supp. 1270 (S.D.N.Y. 1980).

[109] *Id.* at 1283.

[110] Litton Industries, Inc. v. Lehman Brothers Kuhn Loeb, Inc., 734 F. Supp. 1071, 1076 n.3 (S.D.N.Y.1990) (citing *Mgmt. Dynamics*, 515 F.2d at 808); *see also* Sec. and Exch. Comm'n v. Great Lakes Equity Co., 775 F. Supp. 211 (E.D. Mich. 1991); *see generally First City Financial*, 890 F.2d at 1232–33 n.24.

[111] Sec. and Exch. Comm'n v. Calvo, 378 F.3d 1211, 1218 (11th Cir. 2004) (citing Sec. and Exch. Comm'n v. Rind, 991 F.2d 1486, 1491 (9th Cir.), *cert. denied*, 510 U.S. 963 (1993)).

[112] *Calvo*, 378 F.3d at 1218.

policies are served and the public interest is advanced by the litigation."[113] Therefore, the critical distinction that sets SEC enforcement actions apart from private litigation is the immovable public policy the securities laws be enforced by the United States acting in its sovereign capacity.

Thus, if we juxtapose the traditional equitable principles behind adjudicating disputes between private litigants with the public policy and congressional purpose behind regulating the financial industry, equitable remedies in pursuit of the latter are justified in being more of a bright line. Accordingly, courts must not so ardently eschew from such bright line notions of equity in the regulatory enforcement context.[114] The doctrinal approach is therefore to apply the securities laws in a non-technical and unrestrictive manner. And, if such an approach allows the court to reach the conclusion of liability, flexibility is then exchanged for rigidity; for the Court is bound to give effect to the remedial purposes Congress intended the securities laws to serve. Consequently, the malleable common law principles used to adjudicate disputes as between private litigants are forged into a less forgiving equitable tool.[115]

IV. SCOPE OF UNJUST ENRICHMENT

A. Almost Any Benefit Unjustly Enriches

It does not make sense to discuss disgorgement and the associated offsetting jurisprudence without exploring the scope of what unjustly enriches perpetrators of securities fraud. One of the principle purposes of disgorgement in the SEC enforcement context is to prevent the defendant from *benefiting* from his or her fraudulent activities.[116] While seemingly innocuous, this opening salvo is actually a

---

[113] *Id.* (citing *Rind*, 991 F.2d at 1491–92, *cert. denied*, 510 U.S. 963 (1993)).

[114] *Cf.* Lemon v. Kurtzman, 411 U.S. 192, 201 (1973).

[115] In an administrative proceeding, the "fashioning of an appropriate and reasonable remedy is for the Commission, not this court, and the Commission's choice of sanction may be overturned only if it is found unwarranted in law or without justification in fact." Steadman v. Sec. and Exch. Comm'n, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd*, 450 U.S. 91, 101 (1981) (internal quotation marks omitted) (citing Am. Power & Light Co. v. Sec. and Exch. Comm'n, 329 U.S. 90, 112–13 (1946) (internal quotation marks omitted)). *See* Chevron, U.S.A., Inc. v. Nat'l Res. Def. Council, Inc., 467 U.S. 837 (1984). Combining this rule of law with the doctrine of Chevron Deference, the author reserves passing on the hypothesis whether within the context of administrative rule making, the SEC is able to interpret the disgorgement provisions of the securities laws as having the meaning expressed herein. *See also* Monetta Fin. Servs., Inc. v. Sec. and Exch. Comm'n, 390 F.3d 952, 957 (7th Cir. 2004).

[116] The purpose of disgorgement is to deprive the wrongdoer of his ill-gotten gain and to prevent unjust enrichment. *See* Sec. and Exch. Comm'n v. ETS Payphones, Inc., 408 F.3d 727, 735 (11th Cir. 2005); Sec. and Exch. Comm'n v. Burger, 244 F. Supp. 2d 180, 193 (S.D.N.Y. 2001); *aff'd*, 322 F.3d 187 (2d Cir. 1993); Sec. and Exch. Comm'n v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 15 (D.D.C. 1998); Hateley v. Sec. and Exch. Comm'n, 8 F.3d 653, 655 (9th Cir. 1993); Sec. and Exch. Comm'n v. First City Fin. Corp., Ltd., 890 F.2d 1215, 1230 (D.C. Cir. 1989); Sec. and Exch. Comm'n v. Blatt, 583

philosophical gambit. For regulatory equity to mean anything, and for this article's subsequent denouncement of offsetting disgorgement by direct and general business expenses to be feasible, we must infer unjust enrichment as including the broader concept of "benefits to the wrongdoer," rather than simply saying the wrongdoer should not profit from his or her wrongdoing. This notion is not completely without support in the case law. Most notably, we see this with insider trading cases where the tipper's only violation is being the conduit for material, non-public information.[117] In these instances, despite receiving no money, the courts have determined tippers "benefit" from their position as the tipper, as they become coveted by those future tippees who demand the material, non-public information they are so willing to supply.[118] Thus, from the very first successful disgorgement case, there has been an acceptance: liable defendants can be unjustly enriched even where they receive no monetary enrichment.[119]

Insider trading, however, is not the only scenario where this broad notion of benefit avoidance can be found. Most frequently, the maxim wrongdoers should not benefit from their wrongdoing is cited to support the imposition of prejudgement interest. Where a defendant has mulcted the public through a scheme designed to evade the securities laws, he or she should not get the benefit of an interest free loan.[120] In one case from the D.C. Circuit, the Court reasoned:

> While it is true that the [d]efendants did not retain possession of the funds they collected, having returned most to investors and having used the remainder to pay finder's fees, [another defendant's] expense, and other [firm] expenses, this does not mean that they did not benefit from those funds. The funds were paid out to various [agents of the defendant] for the purpose of furthering [the defendant's] fraudulent scheme. Viewed in light of the totality of the circumstances, including the statute's remedial purposes and the need to fully compensate investors who have been deprived of the use of these funds for a considerable period of time, the [c]ourt finds that an award of prejudgment interest on the disgorgement amount is proper.[121]

F.2d 1325, 1335 (5th Cir. 1978).

[117] *See* Sec. and Exch. Comm'n v. Yun, 148 F. Supp. 2d 1287 (M.D. Fla. 2001); Sec. and Exch. Comm'n v. Tex. Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1971). The tippers did not receive any pecuniary benefit but were still ordered to disgorge ill-gotten gains.

[118] *Yun*, 148 F. Supp. 2d 1287 (M.D. Fla. 2001).

[119] *See id.* ("As an initial matter, this [c]ourt recognizes [the tipper] received no tangible, monetary benefit from the insider trading scheme. However, in a previous order, this [c]ourt also recognized that there is some evidence of an intangible benefit for [the tipper's] tip to [the tippee], in the form of a gift, or improved networking contacts.").

[120] Sec. and Exch. Comm'n v. Universal Express, Inc., 646 F. Supp. 2d 552, 566 (S.D.N.Y. 2009) *aff'd*, 438 F. App'x 23 (2d Cir. 2011).

[121] Sec. and Exch. Comm'n v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 17 (D.D.C. 1998) (emphasis added) (citations omitted).

Incredibly, the courts have begun to establish factors to take into consideration when determining the amount of prejudgement interest, and whether to impose such accumulations at all.[122] While this article does not attempt to address this issue, it is worth passing perfunctorily upon the legitimacy of such analysis. Especially in light of the thesis painstakingly explicated in this article, what should have always been clear ought to now be in sharp relief, "unjust enrichment" and "benefit" have broad meaning in the SEC enforcement context. Again, fraud is fraud, whether genteel or egregious. Equity is demeanor agnostic, even though civil penalty analysis may take such factors into consideration. Accordingly, receipt of ill-gotten gains must always be subject to prejudgement interest because the potential for the defendant to earn interest on his or her bounty is always available, regardless of whether he or she seeks such accumulations.

B. Defrayments and Deferrals

As we have seen in the imposition of prejudgement interest and in the insider trading scenario, "[t]he benefit or unjust enrichment of a defendant includes not only what it gets to keep in its pocket after the fraud[] but also the value of the other benefits the wrongdoer receives through the scheme."[123] But, the scope of benefit is not limited to merely these two contexts. Consider the expenses incurred by a nonprofit when it hosts a silent auction. The proceeds serve two primary purposes. Ultimately, the proceeds will fill the nonprofit's philanthropic coffers but, and most importantly for the thesis of this article, only after defraying the costs and expenses of the event itself. Thus, given the purposes of disgorgement as outlined in this article, ignoring the benefit of cost defrayment and expense deferrals would be an abstruse analytical approach.

Correctly, the Sixth Circuit has rejected such an approach[124] and broadened the concept of unjust enrichment to encompass all three categories of the benefit principle herein defined[125]:

> For example, *where the expenditures are to defray obligations of the wrongdoer, the wrongdoer is benefited by those expenditures*. Thus,

[122] There are four factors a court should consider when deciding whether to order prejudgment interest: "(1) the need to fully compensate the wronged party for actual damages suffered, (2) considerations of fairness and the relative equities of the award, (3) the remedial purpose of the statute involved, and/or (4) such other general principles as are deemed relevant by the court . . . . " Sec. and Exch. Comm'n v. Rosenfeld, 2001 WL 118612 at 3 (S.D.N.Y. Jan. 9, 2001) (citing Sec. and Exch. Comm'n v. First Jersey Sec., Inc., 101 F.3d 1450, 1477 (2nd Cir. 1996)).

[123] Sec. and Exch. Comm'n v. Great Lakes Equity Co., 775 F. Supp. 211, 214 (E.D. Mich. 1991) ("The defendants in this case misinterpret the terms 'profit or benefit' as they are used in cases ordering disgorgement . . . .").

[124] *Id.* at 215 n.22.

[125] *See Great Lakes Equity*, 775 F. Supp. at 211.

> .†.†. even under defendants' theory, there is no basis for deducting the costs of fixed expenses [because] those expenses would be incurred whether or not the fraud took place. *By allowing a deduction for fixed expenses, part of the proceeds of the fraud is being used to defer costs [the defendants] had to pay in any event, and they would be unjustly enriched by those payments*. Clearly, [the defendants] should not be allowed to profit by their fraud.[126]

"[And], where the expenditures are made to maintain a valuable asset of [the defendants], they have benefitted from those expenditures, and the amount of those expenditures is not a proper deduction from the amount of unjust enrichment."[127]

As the foregoing sections have made clear, a wrongdoer is unjustly enriched by more than mere monetary receipts.[128] Unjust enrichment of the defendant can constitute benefits in the form of improved reputation, interest free loans, and cost defrayments.[129]

V. CALCULATING DISGORGEMENT

In the following sections, the entrenched definition of unjust enrichment as net profit will be met head on. Having laid the foundations of the equitable framework in the SEC enforcement context and the broader definition of unjust enrichment that it endorses, it becomes quite simple to reject the profit calculation of ill-gotten gain in favor of the gross proceeds theory; and, in so doing, firmly proving offsetting disgorgment by direct or general business expenses to be illegitimate.

A. Net Profits vs. Gross Proceeds

The fundamental problem that underlies the "offsetting" debate is, and must be, how the courts choose to define ill-gotten gain or unjust enrichment. This article takes the position the proceeds theory of ill-gotten gain, or unjust enrichment,[130] only applies where the courts are interpreting the remedial purposes of the securities laws the agencies are charged with enforcing, rejecting the appropriateness of applying the common law principles of equity flowing from

---

126 *Id.* at 215 (emphasis added).

127 *Id.*

128 *Id.*

129 *Id.*

130 *See* Sec. and Exch. Comm'n v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2nd Cir. 1972) ("Clearly the provision requiring the disgorging of proceeds received in connection with the Manor offering was a proper exercise of the district court's equity powers. The effective enforcement of the federal securities laws requires that the SEC be able to make violations unprofitable." The Court went on to hold "it was appropriate for the district court to order appellants to disgorge the proceeds received in connection with the Manor offering.").

private securities actions.[131]

Specifically, the central difficulty with the case law involving the SEC's request of disgorgement is the way in which the courts, the Commission, Congress, and commentators have all lacked precision when speaking about the purpose of disgorgement. The analysis has been so frustrated due to the use of three phrases: profit, ill-gotten gain, and unjust enrichment. Profit is not the same as ill-gotten gain and unjust enrichment. The latter two are legal terms of art, fashioned to characterize the change of wealth realized through illegitimate means. Therefore, it must be more than a curiosity why the common law chose the phrase "ill-gotten gain" over "ill-gotten profit." Accordingly, the use of the economic term—profit—is misplaced as a matter of legal significance. Understandably, the use of the term is helpful in an exposition articulating disgorgement. But, just because the term profit aids the courts, the Commission, Congress, and commentators in explaining how disgorgement seeks to remove the incentive behind violating the securities laws, it does not mean it is proper to employ the economist's tool of profit to calculate the jurist's remedy of disgorgement.

The struggle between profits and proceeds, and the resulting confusion, was evident early in the development of the disgorgement doctrine. The court in *Blatt* stated, "In [*Securities and Exchange Commission*] *v. Manor Nursing Centers, Inc.*, that the court held that the trial court erred in ordering restitution of income earned on ill-gotten profits. The court held that the defendant could be compelled only to disgorge profits and interest wrongfully obtained."[132]

Manor Nursing Centers, however, dealt with an order to disgorge any proceeds, profits, and income received in connection with the sale of the common stock, which is a more inclusive characterization of ill-gotten gain.[133] Still, *Blatt* chose to interpret *Manor Nursing Centers* as using a profit calculation where the court explicitly stated "proceeds."[134] "We hold that it was appropriate for the district court to order appellants to disgorge the proceeds received in connection with the *Manor* [*Nursing Centers*] offering."[135] At bottom, the confusion stems from the simple fact profits, proceeds, gains, and benefit are not all the same calculation, but all have been used to describe the same thing, ill-gotten gain or

[131] *See* Sec. and Exch. Comm'n v. R.J. Allen & Assocs., Inc., 386 F. Supp. 866 (S.D. Fla. 1974) (common law equitable principles are not used to give effect to the remedial purposes of the securities laws); *see also* RESTATEMENT (THIRD) OF RESTITUTION § 51(4)(c) (Tentative Draft No. 5, 2007) (a wrongdoer may be given a credit for expenses). *But see* Litton Indus., Inc. v. Lehman Bros. Kuhn Loeb Inc., 734 F. Supp. 1071, 1077 (S.D.N.Y. 1990) (when disgorging fees and commissions earned, the defendant can deduct transaction costs such as brokerage commissions incurred).

[132] Sec. and Exch. Comm'n v. Blatt, 583 F.2d 1325, 1325 (5th Cir. 1978) (emphasis added).

[133] *Manor Nursing*, 458 F.2d at 1104.

[134] Notably, *Manor Nursing* did speak of "proceeds" and "illicit profit" in the same respect. While the ambiguous treatment did not change the result, it did add to lexicographic confusion.

[135] *Id.* at 1104 (emphasis added).

unjust enrichment. Courts have even used both "profits" and "proceeds" to describe unjust enrichment in the same breath.[136]

Thus far, we have seen how the courts have used a profit theory and a proceeds theory to calculate the defendant's unjust enrichment. However, neither calculation has elicited resounding support in lieu of the other. The profit theory of ill-gotten gain is arguably too under-inclusive, and, on the other hand, the gross proceeds theory is arguably over-inclusive.[137] It has also been suggested the facts and circumstances of the case can dictate the choice.[138] "The Court may order disgorgement in the amount of the wrongdoer's total gross profits, without giving consideration to whether or not the defendant may have squandered and/or hidden the ill-gotten profits."[139] So, is the profit theory really under-inclusive? Or, does the non-punitive standard require the gross proceeds calculation to be considered over-inclusive?[140] As we proceed, keep in mind the holding from *Texas Gulf Sulphur*. Specifically, if *Texas Gulf Sulphur* allows for a tipper to be responsible for disgorging a tippee's ill-gotten gains, then the concept of non-punitive disgorgement in an SEC enforcement action is broad.

To reconcile the choice between the two theories, we must return to the philosophy underlying disgorgement—the giving up of an ill-received benefit. Accordingly, we know the disgorgement doctrine in the SEC enforcement context will not give the wrongdoer the benefit of the doubt.[141] Still, where a defendant had diligently kept records allowing an exact calculation of net illicit profits, thus

---

[136] *See, e.g.*, Sec. and Exch. Comm'n v. Materia, 745 F.2d 197, 201 (2nd Cir. 1984) (recognizing both profits and proceeds characterization (citing Sec. and Exch. Comm'n v. Tex. Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971); *Manor Nursing*, 458 F.2d at 1082); *Manor Nursing*, 458 F.2d at 1104; *see also* Sec. and Exch. Comm'n v. Hughes Capital Corp., 917 F. Supp. 1080 (D.N.J. 1996) (demonstrating the characterization confusion in a case adjudicated after the promulgation of the SERPSRA).

[137] See *Securities and Exchange Commission v. McCaskey*, 2002 WL 850001 (S.D.N.Y. March 26, 2002), where the proceeds or gain theory of unjust enrichment would capture the receipts from wash trades during a sixteen day window while ignoring losses incurred on wash trades realized outside that window. *Id.* Because the negative wash trades were part and parcel of the fraudulent artifice, at least as much as the positive wash trades were, the defendant was not enriched by its scheme. *Id.* Thus, in this instance, the court held the gross receipts theory was over-inclusive. *Id.* Where a defendant's losses are part and parcel of its fraudulent scheme, such losses are distinguishable from those losses incurred after a law enforcement agency intervenes and may therefore be properly considered. Contrastingly, the profit theory, as this article seeks to explain, is almost always under-inclusive. *Cf.* Sec. and Exch. Comm'n v. Mayhew, 916 F. Supp. 123, 132 (D. Conn. 1995), *aff'd on other grounds*, 121 F.3d 44 (2nd Cir. 1997) (holding losses during same trading period not considered).

[138] *See* Sec. and Exch. Comm'n v. Rosenfeld, 2001 WL 118612 at 2 (S.D.N.Y. Jan. 9, 2001); Sec. and Exch. Comm'n v. Benson, 657 F. Supp. 1122, 1133–34 (S.D.N.Y. 1986); Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88, 95 (W.D.N.Y. 1990).

[139] *See Rosenfeld*, 2001 WL 118612 at 2.

[140] *Id.; see also Thomas James Assocs.*, 738 F. Supp. at 95.

[141] Any uncertainty in the amount to be disgorged should rest on the wrongdoer whose fraudulent activity created such uncertainty. *See supra* Part II.

creating no uncertainty, courts are more inclined to adopt the profit theory.[142] When, in the first instance, the meticulous fraudster is only liable to disgorge net profits, and, in the same breath, the unorganized wrongdoer feels the burden of uncertainty by disgorging gross proceeds, the courts unnecessarily force the distillatory mission of the SEC into brackish waters.[143] Is not the broad remedial scheme embodied in the securities laws betrayed by allowing differing results based upon the sophistication of the defendant? The answer to the question must be yes. Consider the following two case studies.

In *Securities and Exchange Commission v. Berlacher*,[144] the defendant performed insider trading temporally with a Private Investment in Public Equity (PIPE) transaction.[145] There, the court recognized the two lines of cases that have formed around using business expenses as offsets to disgorgement.[146] The court held it was within its broad equitable powers to choose the net profit calculation

---

[142] "Economic profit is defined to be the difference between the revenue a firm receives and the costs that it incurs." HAL R. VARIAN, MICROECONOMIC ANALYSIS 23 (3rd ed. 1992). While that definition carries water in the boardroom, it must drown in the courtroom. This would be tantamount to allowing Bonnie and Clyde to reduce the amount of money they stole by the cost of bullets, guns, and gas. While it is well settled law the amount the SEC seeks in disgorgement does not have to be refined with technical precision, a mere reasonable approximation is sufficient. However, it is not the intent of this article to assert the definition of economic profit fails in the courtroom in all contexts. Rather, this author seeks to contribute a thoughtful critique of the economic term as applied to capturing unjust enrichment solely within the context of SEC enforcement actions.

[143] To ensure disgorgement does not work a punishment, the Commission:

> generally must distinguish between legally and illegally obtained profits. . . . If exact information were obtainable at negligible cost, we would not hesitate to impose upon the government a strict burden to produce that data to measure the precise amount of the ill-gotten gains. Unfortunately, we encounter imprecision and imperfect information. Despite sophisticated econometric modeling, predicting stock market responses to alternative variables is, as the district court found, at best speculative. Rules for calculating disgorgement must recognize that separating legal from illegal profits exactly may at times be a near-impossible task.

Sec. and Exch. Comm'n v. First City Fin. Corp., Ltd., 890 F.2d 1215, 1231 (D.C. Cir. 1989).

[144] 2010 WL 3566790 (E.D. Pa. Sept. 13, 2010).

[145] *Berlacher* dealt with a PIPE transaction. It is done when a publicly traded company needs an immediate infusion of cash. *Id.* at *1. The company gets the cash from private investors in exchange for an allotment of shares that are restricted and typically discounted from market value. *Id.* After a prescribed period of time—usually three to four months—the SEC allows the registration statements for the shares to become active, thereby permitting those shares to be traded publicly. *Id.* The details of the transaction are kept confidential until negotiations are complete and the transactions take place. *Id.* PIPEs tend to depress the stock's price due to dilution effects. *Id.* However, if existing shares from a large share holder are privately sold, then the share price is not at risk to price depression due to market dilution. *Id.* Nevertheless, the price may still be impacted by the PIPE announcement due to inferences the market may draw as a result of the PIPE itself. *Id.*

[146] 2010 WL 3566790 (E.D. Pa. Sept. 13, 2010).

over the gross profit calculation because adequate evidence was available to perform a reasonably accurate net profit calculation.[147] Unjust enrichment was therefore equal to net profits. But, does this send the signal as long as a wrongdoer keeps detailed records he or she will benefit from her balance sheet and only be forced to disgorge less than the unorganized fraudster? Is this equity? Is this deterrence? Not only should the risk of uncertainty in the calculation fall upon the shoulders of the defendant, but should not the gross profits—total proceeds—as well? Compare *Berlacher* with *Securities and Exchange Commission v. Calvo*:

> Where a defendant's record-keeping or lack thereof has so obscured matters that calculating the exact amount of illicit gains cannot be accomplished without incurring inordinate expense, it is well within the district court's discretion to rule that the amount of disgorgement will be the more readily measurable proceeds received from the unlawful transactions.[148]

Accordingly, there is a pervasive and deleterious fallacy in disgorgement doctrine when two fraudsters mulct a million dollars each, but the one with the best bookkeeper gets to disgorge less.

The conclusion of impropriety rests upon settled notions of legitimacy. Bona fide business ventures that operate within their respective regulatory environments rightfully identify their gain, reduced by expenses, as profit. Allowing illegitimate businesses, or other fraudulent schemes, to enjoy the connotations of economic profit when calculating ill-gotten gain, perverts the notion itself. Even more fundamentally, profit is a two step analysis, whereas ill-gotten gain is but one. Profit asks: What did you receive, and what did you spend?; whereas, ill-gotten gain simply asks: What did you receive? To this end, disgorgement commands the defendant to give back what was received. The pro-offsetting line of cases insists on forcing an illegitimate square peg in a legitimate round hole. Because fraudulent schemes lack the legitimacy of bona fide business ventures, the reliance upon the legitimate measure of profit is misplaced.

Lastly, it is important to note the current treatment in the pro-offsetting opinions lends itself to gamesmanship. That is, if one was going to pursue a fraudulent scheme in the securities market, they should at least do it expensively. Which raises an additional consideration, What if the liable defendant used the proceeds from an unlawful distribution of securities, or from a pump and dump scheme to pay for business expenses? The precedent set by the pro-offsetting courts leads us to the unsettling conclusion: deterrence is indeed a chimera. In this scenario the unscrupulous would have no skin in the game, merely the hides of innocent investors, and it is they who will bear the expenses of the fraud.

---

[147] *Id.*

[148] *Calvo*, 378 F.3d 1211, 1217–18 (11th Cir. 2004).

B. Technical Transgressions and Judicial Discretion

Although the rejection of the profit theory pervades this article, readers should not conclude the "gross proceeds" or "gross pecuniary benefit" calculations replace the profit calculation in all instances. Where a mere technical transgression of the securities laws has occurred, such as an elapsed filing deadline, the courts would be justified in ordering the disgorgement of net profits, choosing the imposition of a statutorily mandated fine, or imposing both.[149] Such a decision would be within the discretionary authority of the judiciary. Yet, where the violation is not a mere technical transgression, the egregiousness or degree of scienter is inapposite when determining the amount of disgorgement.

With respect to this point, it is important to note a court's tradition of discretion by way of this article has not been completely abrogated. As indicated, the equitable powers of the court may be used to decide which calculation of ill-gotten gains to employ based upon the following analysis. Mere technical violations of the securities laws, devoid of scienter, do not require gross gain calculation of disgorgement to achieve deterrence.[150] However, a finding of scienter indicates a willingness to rebuff the securities laws in no uncertain terms. Therefore, the gross gain calculation of ill-gotten gains must be used.

Finally, the courts have been incorrect when using egregiousness as a prophylactic measure, insulating funds from disgorgement.[151] Defrauding sophisticated investment bankers out of one million dollars, through an equally sophisticated scheme, procures no less when perpetrated against pensioners. From the soccer mom tippee trading between errands to the egregiously faithless fiduciary, total disgorgement of illicitly procured benefits is to be made. Fraud is fraud, and speaking the Queen's English while excising your pound of flesh does not make what you took less than a pound. Thus, egregiousness does not thumb the scale in regulatory equity analysis and should be reserved for the determination of civil penalties.[152]

---

[149] *See* Hateley v. Sec. and Exch. Comm'n, 8 F.3d 653 (9th Cir. 1993); Sec. and Exch. Comm'n v. World-Wide Coin Invs., Ltd., 567 F. Supp. 724 (N.D. Ga. 1983).

[150] Sec. and Exch. Comm'n v. Classic Min. Corp., 1986 WL 10898 (M.D. Tenn. July 31, 1986) (holding, even where a preliminary or permanent injunction has been imposed, the court may not order disgorgement pending a conclusive finding of securities violations and findings on the degree of scienter).

[151] *See* Sec. and Exch. Comm'n v. JT Wallenbrock & Assocs., 440 F.3d 1109, 1115 n.12 (9th Cir. 2006); Sec. and Exch. Comm'n v. R.J. Allen & Assocs., Inc., 386 F. Supp. 866 (S.D. Fla. 1974).

[152] However, egregiousness and scienter do play an integral role when determining civil penalties under the securities laws. In the insider trading context, see Sec. and Exch. Comm'n v. Chapnick, 1994 WL 113040 at 4 (S.D. Fla. Feb. 11, 1994) and Sec. and Exch. Comm'n v. Brethan, 1992 WL 420867 at 25 (S.D. Ohio 1992).

VI. REGULATORY EQUITY APPLIED

A. Direct and Transactional Costs

It is important to note the nature of the defendant's fraudulent scheme has undoubtedly influenced many judges' equitable reasoning. Consider the following two hypotheticals. First, Johnny promises to pay you one dollar tomorrow if you lend him one dollar today. Tomorrow comes, goes, and Johnny does not pay you back. We can call this a "naked fraudulent scheme." Second, Jane sells you a one-dollar cup of lemonade and promises you the drink is made from fresh squeezed lemon juice. Later, you see Jane making the lemonade from a powder mix and hear her tell her mother she needs more lemonade powder. We can call this a "disguised fraudulent scheme."

The first scenario contains little to no expense associated with execution. By contrast, the second scenario requires start-up costs to make the first cup of lemonade—water, lemonade mix, and building the lemonade stand. Should it matter the funds used to purchase these instrumentalities of Jane's fraud were as of then untainted? What if Jane put the illicitly obtained, and therefore tainted, proceeds towards buying fresh lemons to squeeze—towards legitimate purposes?

Although common law equity may require us to take these expenses into consideration when fashioning our remedy,[153] the argument herein is such considerations are not in line with the remedial regulatory regime controlling the United States securities industry. Analyzing the first scenario, the federal courts would define unjust enrichment as total payments received or one dollar. In the second, they seem to be inclined to apply a profit theory to unjust enrichment, which is more akin to the common law principles of equity and restitution. Accordingly, Jane would be permitted to adduce detailed expense reports and accountings of her lemonade business to arrive at the conclusion the profit she made on the cup sold to you was fifty cents. Therefore unjust enrichment was not one dollar, but rather half that amount.

Perhaps under common law equitable principles these two approaches would be consistent when adjudicating disputes as they arise between private litigants. But, as this article has routinely noted by citing to the Supreme Court and other SEC enforcement actions,[154] equitable principles applied within a regulatory framework take on a broader focus and are not required to be as technically applied as in a dispute between private litigants. Accordingly, the equitable remedy of disgorgement in SEC enforcement actions is *sui generis*.

The increasing willingness of the judiciary to recognize offsetting cuts against

---

[153] RESTATEMENT (THIRD) OF RESTITUTION § 51(4)(c) (Tentative Draft No. 5, 2007) (a wrongdoer may be given a credit for expenses).

[154] *See supra* Part III.D

the enforcement efforts by the investment industry's regulators, whether a naked fraud or one disguised as a business. The analysis begs the question whether there is a compelling fundamental difference between the above fraudulent schemes within the context of SEC enforcement actions, and whether such a difference justifies using different characterizations of unjust enrichment. Admittedly, the second scheme cost money to perpetrate. Nevertheless, just because a defendant chooses a more expensive, and potentially lucrative, way to mulct the public, it does not mean he or she gets to make above-the-line and below-the-line deductions to his or her illicit proceeds. Even when a defendant has put his or her unjust enrichment to bona fide purposes, the SEC and the Court cannot turn a blind eye. Once defined as unjust enrichment, supported by evidence, such funds are forever tainted.[155]

For the statutory purpose of deterrence to be meaningful, fraudulent contrivances cannot be given the benefit of their balance sheet. As it has been repeatedly argued, whether this is consistent with common law principles of equity as they relate to private litigants is irrelevant. Within an SEC enforcement context, there are no fundamental differences between the schemes, and disgorgement of the gross pecuniary gain is justified. The general business expenses incurred by the defendant, affording him or her the opportunity to violate the securities laws and erode the integrity of the capital markets, are therefore nugatory.[156]

Curiously, the cases do not show a strong resistance by the Commission or the judiciary to the netting out of brokerage fees, despite the fairly consistent argument business costs incurred by defendants should not be used to offset disgorgement. We are then compelled to ask whether there is a fundamental difference between fraudulent schemes centered on the purchase and sale of securities, from unregistered offerings and Ponzi schemes, high risk startups, etc., all of which involve costs analogous to operational or business expenses. If so, we are then drawn to know whether such a fundamental difference warrants the broad acceptance of offsetting ill-gotten gains by the brokerage fees incurred.[157] Ultimately, does distinguishing between direct transactional costs and general business expenses make sense in light of the unique law enforcement role of the

[155] *See supra* Part II.B.1.

[156] The overwhelming weight of authority holds securities law violators may not offset their disgorgement liability with business expenses. *See* Sec. and Exch. Comm'n v. JT Wallenbrock & Assocs., 440 F.3d 1109, 1115 (9th Cir. 2006); Sec. and Exch. Comm'n v. United Energy Partners, Inc., 2004 WL 315185 at 2 (5th Cir. Feb. 18), *cert. denied sub nom*, 543 U.S. 1034 (2004); Sec. and Exch. Comm'n v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 16 (D.D.C. 1998); Sec. and Exch. Comm'n v. Hughes Capital Corp., 917 F. Supp. 1080, 1087 (D.N.J. 1996); Sec. and Exch. Comm'n v. Great Lakes Equity Co., 775 F. Supp. 211, 214–15, n. 22 (E.D. Mich. 1991); Sec. and Exch. Comm'n v. World Gambling Corp., 555 F. Supp. 930, 935 (S.D.N.Y. 1983), *aff'd*, 742 F.2d 1440 (2d Cir. 1983), *cert. dismissed*, 465 U.S. 1112 (1984).

[157] *See* Sec. and Exch. Comm'n v. Yun, 148 F. Supp. 2d 1287, 1291 (M.D. Fla. 2001) ("At least one court has reduced the disgorgement remedy by the amount a defendant paid to his broker, in recognition of the fact that money paid for broker fees cannot be unjust enrichment or an ill-gotten gain.").

SEC?

In the latter scenarios, the key doctrinal concept is all costs become ex post facto tainted. Such costs can be those associated with the defendant's fraud or those proximate expenses affording the defendant his or her ability to violate the securities laws. This concept derives legitimacy from significant case law supporting the proposition the equitable standards to be applied in SEC enforcement actions are fundamentally different from traditional common law principles of equity and restitution. Thus, disgorgement in an SEC enforcement action casts a broader net than at common law.[158]

Furthermore, applying the gross proceeds theory to frauds centered around the purchase and sale of a security deserves separate treatment because doing so would be a sweeping shift in the current state of the law. As previously mentioned, in many cases the SEC, the courts, and the defense bar all agree broker fees associated with the trades by an insider are legitimate offsets to disgorgement.[159] Supporting this conclusion, some courts have erected a hermetic distinction between direct transactional costs and general business expenses.[160] And, as the adroit D.C. Circuit so presciently averred, "Placing the burden on the defendants of rebutting the SEC's showing of actual profits, we recognize, may result, as it has in the insider trader context, in actual profits becoming the typical disgorgement measure."[161] But, is this result correct? Should the investment industry, the public, or Congress simply yield to fallacious inertia? The remainder of this section explains why the answer to these questions is no.

A broker fee is a type of transaction cost. Taking into account these costs entirely when calculating ill-gotten gain bases unjust enrichment on the profit theory. This is an incorrect result. The central principle that courses through the lines of this article is the defendant who has been found liable for violating the

---

[158] In *Capital Gains Research Bureau*, and *First City Financial*, the courts held the standard to be applied differs from the common law when the SEC appears as the "statutory guardian" charged with safeguarding the public interest in enforcing the securities laws. Additionally, in *Penn Central*, the court held the SEC does not stand in the shoes of individual investors who it asserts were harmed. Moreover, the intent of Congress was to establish a broad remedial scheme in the regulation of the investment industry, reflecting the need to promote the highest standards of ethics and professionalism in the management of, and transactions in, securities. Thus, the technical application of common law restitution was never intended to apply in SEC enforcement actions seeking disgorgement.

[159] *See* Sec. and Exch. Comm'n v. Universal Express, Inc., 646 F. Supp. 2d 552, 564 (S.D.N.Y. 2009); Sec. and Exch. Comm'n v. McCaskey, 2002 WL 850001 at 4 (S.D.N.Y. Mar. 26, 2002); Sec. and Exch. Comm'n v. Rosenfeld, 2001 WL 118612 at 2 (S.D.N.Y. Jan. 9, 2001); Sec. and Exch. Comm'n v. Shah, 1993 WL 288285 (S.D.N.Y. July 28, 1993); Litton Indus., Inc. v. Lehman Bros., 734 F. Supp. 1071, 1077 (S.D.N.Y.1990).

[160] *McCaskey*, 2002 WL 850001 at 4 n.6 (declaring brokerage fees should be distinguished from general business expenses and should not offset disgorgement).

[161] Sec. and Exch. Comm'n v. First City Financial Corp., Ltd., 890 F.2d 1215, 1232 (D.C. Cir. 1989)*; cf. Universal Express*, 646 F. Supp. 2d at 564; *McCaskey*, 2002 WL 850001 at 4; *Rosenfeld*, 2001 WL 118612 at 2; *Shah*, 1993 WL 288285; *Litton Indus*., 734 F. Supp. at 1077.

securities laws benefits by his or her illicit gains in an amount greater than mere net profits. The broad remedial scheme originally intended by Congress and accepted by the Supreme Court cannot tolerate discretionary decisions by the lower courts endorsing a defendant's defrayment of outlays and deferral of costs. Whether the outlays or costs were associated with their fraud or just afforded them the opportunity to perpetrate the fraud, the conclusion is the same. When a defendant enters and exits an unlawful trade and incurs a cost to do so—a broker's commission—his or her profits are what is left after the broker takes his or her cut. These broker fees associated with the defendant's navigation into and out of his or her unlawful trade were simply the costs of committing fraud and should not be used to offset disgorgement.[162]

Admittedly, when the average investor evaluates the result of a stock trade, he or she must look at all he or she has received, less any costs associated with the trade. This method shows the investor his or her profit. But, equating the profits of a bona fide investor with the ill-gotten gain of a liable defendant betrays the remedial purpose behind the securities laws. Thus, in the insider trading context, the calculation of ill-gotten gain need not take into consideration the cost of entering and exiting the trade.

Consider the insider trading context. It seems quite simple to accept the reasoning behind denying an offset for the costs associated with exiting a position on the basis of material, non-public information.[163] When a defendant exits a position he or she so entered, or is selling because of the same, he or she embraces a mental state to deceive the SEC and the investing public.[164] Thus, these brokerage costs are direct costs of perpetrating a fraud. The direct costs or transactional costs associated with securities fraud should not insulate disgorgement.[165] When a court is faced with deciding on whom to place the market's loss, the entire weight must rest squarely on the shoulders of the liable defendant. To the extent the defense bar would argue disgorgement of gross proceeds without netting out brokerage fees constitutes a penalty by forcing a defendant to give up more than he or she received, the argument ignores reality. Whether a defendant pays all fees up front and out of pocket, or uses illicitly procured funds to satisfy the broker, the defendant has

---

[162] The ability to recoup the costs associated with a defendant's securities violation, whether the costs were at the time incurred in anticipation of fraud or in the pursuit of bona fide trade or business, is a benefit unlawfully conferred. Keep in mind this reasoning flows from the broader remedial purposes of securities regulation, which is not a codification of the common law philosophies of equity and restitution.

[163] Sec. and Exch. Comm'n v. Ginsburg, 362 F.3d 1292, 1297–98 (11th Cir. 2004) (setting out the case against an insider).

[164] *Id.*

[165] *Cf.* Sec. and Exch. Comm'n v. Berlacher, 2010 WL 3566790 at 15 (E.D. Pa. Sept. 13, 2010); *Universal Express*, 646 F. Supp. 2d at 564; *McCaskey*, 2002 WL 850001 at 4; *Rosenfeld*, 2001 WL 118612 at 2; *Shah*, 1993 WL 288285; *Litton Indus*., 734 F. Supp. at 1077.

chosen to squander his or her enrichment and impose the pangs of punishment upon him- or herself. Brokerage fee defrayment is therefore illegitimate and inconsistent with the remedial scheme of the securities laws, which have adopted the gross pecuniary gain definition of unjust enrichment.[166]

Additionally, and somewhat less intuitively, we must consider the scenario in which the defendant has lawfully, and without premeditation, entered into a trade that he or she subsequently exited illicitly. In such an instance, the cost of entering into the insider's position was not initially shrouded in a patina of deceit. However, once the transaction has been proven to have been based on material, non-public information, the entry fee associated with taking the position becomes tainted ex post facto. This brings the doctrine of disgorgment in insider trading cases brought by the SEC in line with the proceeds theory proffered in this article. Thus, because the profit theory of ill-gotten gain would further reduce disgorgement by the cost of entering the trade—thereby conferring a benefit to the defendant in the form of an unlawful defrayment—staying the course in these cases would be incompatible with the broad remedial scheme intended by Congress. Thus, offsetting disgorgement in the insider trading context by the brokerage fees associated with entry and exit are no more appropriate than offsetting disgorgement by general business outlays incurred during the pursuit of any other fraudulent scheme.

Next, consider a fraudulent scheme in which a defendant has made material misrepresentations causing the price of a security to rise. The defendant purchased the security at five dollars and subsequently sold it for ten dollars. The benefit to the defendant causally connected to the unlawful activity was the five-dollar increase in the price of the security. Assuming a ten percent brokerage commission, the transactional costs associated with the trade are fifty cents entering the position and one dollar exiting. To the lawful investor, the profit from this transaction would be three dollars and fifty cents. But, for the defendant found liable for pumping the stock, would the net profit calculation truly capture the defendant's benefit? What if the defendant hired an innocent assistant to answer the phone and make photocopies of false reports? Would the net profit be further reduced by those overhead expenses? Plainly not. The philosophical purposes of disgorgement in SEC enforcement actions are clear.[167] To deprive the wrongdoer of his or her ill-gotten gains, all five dollars of proceeds must be disgorged, otherwise the defendant unjustly receives a benefit in the form of cost defrayments and deferrals.

Finally, there is the matter of wash trades. A wash trade scheme gives the illusion of volume or trading activity in the targeted security. In certain instances, the scheme has the effect of stabilizing the price of a security, which can be

---

[166] S. REP. No. 101-337, at 11 (1990) (defining unjust enrichment as gross pecuniary gain); *see also*, Sec. and Exch. Comm'n v. Tex. Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971), *cert. denied*, 404 U.S. 1005 (1971) (establishing a broad definition of "punitive" in the SEC enforcement context).

[167] *See supra* Part II.

extremely beneficial to one who wants the security's price to stay aloft. Typically, the conductor of the wash trade scheme accounts for a non-trivial percentage of the security's trading volume.[168]

A wash trade scheme is usually executed by two types of transactions: wash sales and matched orders. Wash sales are transactions having no change in beneficial ownership, and matched orders are defined as orders for the purchase or sale of a security that are entered with the knowledge orders of substantially the same size, at substantially the same time and price, have been or will be entered by the same or different persons for the sale or purchase of such security.[169] The question remains whether a defendant who realizes losses in the pursuit of illicit proceeds should be given credit for those losses. When the losses are less than proceeds, the foregoing sections argue such losses are not valid offsets to disgorgement. Yet, in the instance where the defendants' losses were greater than or equal to the proceeds from the wash trades, courts have argued there is no unjust enrichment.[170]

However, this is an incorrect result under the regulatory equity thesis and should not be the case henceforth. If a defendant put untainted proceeds, or those tainted funds from positive wash trades, to use in trades resulting in a loss, the overwhelming weight of authority, in addition to the thesis of this article, supports not giving the defendant credit for those losses in the form of an offset to disgorgement in which the trading activity was part and parcel of the securities violation.[171] The broad remedial scheme intended by Congress calls upon the defining of unjust enrichment to include those benefits, not just those pure profits or proceeds, garnered by the wrongdoer. Loss defrayment is quite clearly a benefit conferred by the proceeds of a wash trade, in addition to the stabilizing, or other desired market effects of the scheme.[172] Moreover, "in determining how much should be disgorged in a case in which defendants have manipulated securities so as to mulct the public," there is no reason why "the court must give them credit for the

---

[168] *See* Sec. and Exch. Comm'n v. McCaskey, 2002 WL 850001 at 1 (S.D.N.Y. Mar. 26, 2002). Defendant accounted for ninety-nine percent of the trading volume in the targeted security. *Id.*

[169] *Id.* at 1 n.1.

[170] *See McCaskey*, 2002 WL 850001 at 1 (using the net profit theory).

[171] The overwhelming weight of authority holds securities law violators may not offset their disgorgement liability with business expenses. *See* Sec. and Exch. Comm'n v. JT Wallenbrock & Assocs., 440 F.3d 1109, 1115 (9th Cir. 2006); Sec. and Exch. Comm'n v. United Energy Partners, Inc., 2004 WL 315185 at 2 (5th Cir. Feb. 18, 2004), *cert. denied sub nom*, 543 U.S. 1034 (2004); Sec. and Exch. Comm'n v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 16 (D.D.C. 1998); Sec. and Exch. Comm'n v. Hughes Capital Corp., 917 F. Supp. 1080, 1087 (D.N.J. 1996); Sec. and Exch. Comm'n v. Great Lakes Equity Co., 775 F. Supp. 211, 214-15, n. 22 (E.D. Mich. 1991); Sec. and Exch. Comm'n v. World Gambling Corp., 555 F. Supp. 930, 935 (S.D.N.Y. 1983), *aff'd*, 742 F.2d 1440 (2d Cir. 1983), *cert. dismissed*, 465 U.S. 1112 (1984). Of course when faced with this or a similar set of facts, the SEC would likely reflect upon the propriety of pursuing full disgorgement despite being entitled to do so.

[172] *JT Wallenbrock*, 440 F.3d 1109 (asserting investment losses are not offsets).

fact that they had not succeeded in" avoiding losses.[173] Even where the value of illicit benefits is not readily available, as in the value of illicitly stabilizing a stock price, courts have still been willing to order disgorgement.[174] Just as the tipper, whose only violative act is to misappropriate material, non-public information, is liable to disgorge the gains of his or her tippee,[175] courts may use the more easily quantifiable monetary benefits flowing from the securities laws violation as a proxy for those benefits not so trivially appraised.

At bottom, using illicitly obtained funds to defray the impact of associated losses is unconscionable in light of the law enforcement role of the SEC, the broad remedial scheme intended, the object of deterrence, the promotion of ethics, and the knife to the throat of the economy that members of the investment industry can so easily draw. While the offsetting of disgorgement by amounts incurred in brokerage fees originated as an equitable bromide, it has since frustrated the deterrent purposes of the securities laws' remedial scheme. Nevertheless, such wholesale allowances are both unfaithful to the remedial purpose of the investment industry's regulatory framework and the proceeds theory of unjust enrichment, which it arguably endorses. Because the costs incurred while performing insider trading and other fraudulent security transactions are not fundamentally different from those general business expenses incurred in other fraudulent securities schemes, a setoff in the amount of brokerage fees is likewise not appropriate. Consistency is the hallmark of effective deterrence, and deterrence is the great object of enforcement. Therefore, the Supreme Court's broad remedial interpretation of the securities laws demands nothing less than the disgorgement of gross proceeds in every non-technical violation of the securities regulations.

B. Windfall Accumulations on Ill-gotten Gains

Where the disgorgement calculation is over-encompassing by including profits and income earned on the proceeds of a defendant's securities violation, some courts have found it proper to reduce disgorgement by the amount of those profits and income. On appellate review, the court in *Manor Nursing Centers* said:

> Having held that ordering the refunding of the proceeds was a proper exercise of the district court's equity powers, we hold that the court erred in ordering appellants to transfer to the trustee all the profits and income earned on such proceeds.†.†. .We believe that ordering the disgorging of profits and income earned on the proceeds is in fact a penalty assessment.†.†. .The only plausible justification for this part of

---

[173] Sec. and Exch. Comm'n v. Common Wealth Chem. Sec., Inc., 574 F.2d 90, 102 (2nd Cir. 1978).

[174] *See generally McCaskey*, 2002 WL 850001 (S.D.N.Y. Mar. 26, 2002).

[175] *See* Sec. and Exch. Comm'n v. Yun, 148 F. Supp. 2d 1287 (M.D. Fla. 2001); Sec. and Exch. Comm'n v. Tex. Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971).

> the court's order is that the deterrent force of requiring the disgorging of the profits on the proceeds is essential to effective enforcement of the federal securities laws. In balance, however, we believe that the injunctive relief and the requirement that the proceeds be returned are sufficient deterrence to further violations.[176]

Supporting this finding of error, the court said, "This provision of the order cannot be justified as remedial relief to purchasers of [the company's] shares. As defrauded purchasers in a private enforcement action, public investors would be entitled to recover only the excess of what they paid over the value of what they got."[177]

However, this rationale is misplaced because courts are not limited by amounts private litigants could receive as damages. "Unlike damages, disgorgement is a method of forcing a defendant to give up the amount by which he was unjustly enriched."[178] Moreover, *Manor Nursing Center's* reasoning is fatally flawed because a court is not restricted in an SEC enforcement action by the equitable principles applied in cases between competing private interests.[179] "The amount to be disgorged is not limited as a matter of law to the damages inflicted upon purchasers and sellers. The SEC does not stand in the shoes of the purchasers and sellers who it asserts were defrauded."[180]

The broad remedial scheme intended by Congress accepts no benefit conferred upon the wrongdoer, even by his or her own toil, if his or her violative acts afforded him or her the opportunity to reap the blossoms he or she had sewn. At common law, however, this principle is limited. "If an artist acquired paints by fraud and used them in producing a valuable portrait we would not suggest that the defrauded party would be entitled to the portrait[] or to the proceeds of its sale."[181] But, the gravity of the deterrent purposes behind disgorgement in the SEC enforcement context and the fact the SEC does not stand in the shoes of private litigants seeking to be made whole,[182] must deprive a wrongdoer of all benefits flowing from his or her violation.[183]

---

[176] Sec. and Exch. Comm'n v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2nd Cir. 1972).

[177] *Id.* (internal quotation marks omitted).

[178] Sec. and Exch. Comm'n v. Berlacher, 2010 WL 3566790 at 14 (E.D. Pa. Sept. 13, 2010).

[179] *See supra* Part III.D.

[180] Sec. and Exch. Comm'n v. Penn Cent. Co., 450 F. Supp. 908, 916 (D.C. Pa.1978).

[181] Janigan v. Taylor, 344 F.2d 781, 787 (1st Cir. 1965).

[182] *Penn Cent*., 450 F. Supp. at 916.

[183] The court has the discretion to fashion whatever equitable relief it deems necessary to deprive defendants of all gains flowing from the wrong. *See* Sec. and Exch. Comm'n v. JT Wallenbrock & Assocs., 440 F.3d 1109, 1114 (9th Cir. 2006); Sec. and Exch. Comm'n v. Pardue, 367 F. Supp. 2d 773 (E.D. Pa. 2005); Sec. and Exch. Comm'n v. Rogers, 2000 WL 642467 at 1 (9th Cir. May 18, 2000); Sec. and Exch. Comm'n v. Cross Fin. Servs., 908 F. Supp. 718, 734 (C.D. Cal. 1995); Sec. and Exch. Comm'n v. Benson, 657 F. Supp. 1122, 1133 (S.D.N.Y. 1986); *Penn Cent*., 450 F. Supp. at 916–17.

Consider the rationale behind ordering prejudgement interest on a wrongdoer's ill-gotten gain. It has been characterized as denying the defendant the "benefit" of an interest free loan.[184] Here, the terms "benefit" and "windfall" can be used interchangeably. Interest is windfall based on the idea that otherwise the defendant gets the benefit of an interest free loan. But, what if the illicit proceeds are creatively invested as a result of the skill and talents of the wrongdoer? At common law, this would be analogous to the artist using stolen paints to complete his or her masterpiece. There, disgorgement would be limited to the value of the stolen paint. However, is the SEC enforcement context the same thing? If you have made it this far in the article, then you already know the answer. Of course it is not. The SEC does not regulate mere arms length transactions of chattels, nor does it stand in the shoes of private litigants.[185] Unlike damages, disgorgement is a method of forcing a defendant to give up the amount by which he or she was unjustly enriched.[186] Thus, in light of the subsequent doctrinal development, the court in *Manor Nursing Centers* got this wrong. Those windfall accumulations proximately traced to the defendant's illicitly garnered proceeds are as tainted in the eyes of an SEC enforcement context as the illicit proceeds themselves.

Plainly, a wrongdoer is not to reap benefits that flow from violating the law. But, if one violates the securities laws, receives illicit gains from the violation, and, through his or her own efforts, devises a way to earn money from those illicit proceeds, he or she has benefited. To give effect to the deterrent purposes of disgorgement, the remedial scheme must have a way to neutralize secondary and tertiary benefits flowing from the securities violation. Including those subsequent gains a defendant earns through his or her own creative efforts is the only way to ensure a defendant does not benefit from his or her violation.[187]

Disgorgement, constrained by gross pecuniary gain, can never be a penalty. But, for the defendant's conscious and deliberate efforts, no gain at all would have been mulcted. The defendant's costs were conceived, calculated, anticipated, and, in all other respects, voluntarily self-imposed. The allocation of ill-gotten gains, to waste, windfall, or work of financial art, is of no moment. Courts will find support for this conclusion in the regulatory equity line of cases. Therefore, the gross gain

---

[184] *See supra* Part II.

[185] *See supra* Part III.D.

[186] *See supra* Part II.

[187] While it is already clear disgorgement in the SEC enforcement context is not restitution, this body of law can continue to inform the doctrine as it continues to solidify. Regarding the subsequent use of ill-gotten gains, RESTATEMENT (THIRD) OF RESTITUTION § 51(4) (Tentative Draft No. 5, 2007) instructs, (a) Profit includes any form of secondary enrichment that is identifiable and measurable on the facts of the case and not unduly remote; and (b) A wrongdoer who makes unauthorized investments of the claimant's assets is accountable for profits and liable for losses. These two rules are used when the profit theory would provide a greater amount to be disgorged than the market value of the benefit wrongfully obtained. *See* RESTATEMENT (THIRD) OF RESTITUTION § 51(2)–(3) (Tentative Draft No. 5, 2007).

calculation is the ballast to right the ship.

VII. CRITIQUE OF OFFSETTING CASES

A. Introduction

A thorough critique of *Thomas James Associates* will demonstrate how the Court ignored over a half a century of doctrinal development, willfully altering the landscape of equity in SEC enforcement actions. To begin, let us recall *LATDME* set out the earliest criteria by which the courts must adhere when fashioning equitable remedies under the securities laws: "[T]he statutory policy in the mind of the Congress in passing SEC regulations to afford 'broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae.'"[188] While in the first instance, the amount to be disgorged must be realistic and relevant to the securities violation for which liability has been found, it likewise follows an offset in the latter instance must be realistic and relevant. For deterrence to mean anything, it must not be starved by unrealistic and irrelevant reductions in disgorgement.

Since *Texas Gulf Sulphur* in 1971, the courts have been explicating a doctrine of disgorgement in the context of SEC enforcement actions, a doctrine that has emerged *sui generis*. Thus, by the time Congress codified the remedy of disgorgement in the securities laws,[189] it could only have intended to adopt that unique equitable remedy that had been developed and relied upon for the preceding nineteen years.[190]

Nothing in the legislative history suggests Congress intended to appropriate the common law doctrine of disgorgement as applied in cases between two private litigants.[191] Significantly, in other fields of regulation where Congress has chosen to act, it has made clear the damages contemplated by the provisions passed were in fact a codification of those remedies and principles that have guided courts at common law. On this issue, we are once more confronted with the erroneous rationale of the court in *Thomas James Associates*.[192]

Thomas James Associates looms as the paradigmatic example of a court abusing its discretionary power in the face of substantial and significant countervailing precedent. Because the case itself has become authority upon which

---

[188] L.A. Trust Deed Mortg. Exch. v. Sec. and Exch. Comm'n, 285 F.2d 162, 168 (9th Cir. 1960) (citations omitted) (This quote was directly aimed at defining what constitutes a security but was indirectly aimed at keeping equitable enforcement of the securities laws in line with congressional intent).

[189] SERPSRA, *supra* note 5.

[190] Sec. and Exch. Comm'n v. Tex. Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971).

[191] *See supra* Part III.B.

[192] Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88 (W.D.N.Y. 1990).

defendants have been able to dodge disgorging millions of dollars, each fracture in the court's philosophical facade must be revealed.

B. Critique of Securities and Exchange Commission v. Thomas James Associates, Inc.

As the foregoing sections have definitively demonstrated, the philosophy of common law equity under the securities laws has been legislatively altered. Consequently, all those ancient notions of fairness and equitable relief, justly relied upon by our federal trial courts and their magistrates, have been replaced—or ought to be replaced—with the doctrine of regulatory equity. Understandably, the inertia of common law equity is great, providing a defense, however weak, to judges presiding over cases brought by the SEC. Nevertheless, giving in to such inertia is an abdication of those duties pressed upon Article III courts to apply the laws as our legislature has constitutionally promulgated.

In no other case is this abdication so apparent as in *Thomas James Associates*.[193] There, by enumerating nine reasons to offset the SEC's reasonable estimation of disgorgement, the Commission's most powerful deterrence mechanism received death by a thousand cuts.[194] Admittedly, the enumeration would likely be a fair and just quantification under our most ancient and common standards of equity. However, under Congress's regulatory equity regime, traditional cardinal considerations become subordinate to the weighty public policy of eradicating fraud in the securities industry. The nine offsetting factors were: (1) commissions; (2) telephone charges; (3) underwriting expenses; (4) a proportionate share of overhead; (5) injunctions connected with the suit; (6) resulting harm to defendant's reputation; (7) whether the defendant provides employment for a large number of individuals in a number of states; (8) prior to the litigation at bar, whether the defendant had enjoyed a relatively clean record with both the SEC and the industry's self-regulating bodies; and (9) whether defendants fill a niche in the capital markets as an entity willing to underwrite highly speculative, but credible, companies.[195] The following sections will address each of the rationales that the court asserted supported these factors and explain why the court's reasoning was nothing other than erroneous.

1. Background

Thomas James Associates arose out of alleged securities law violations perpetrated in connection with four initial public offerings (IPOs) conducted by the

[193] *Id.*
[194] *Id.*
[195] *Id.* at 92–93.

defendants during 1989.[196] The defendants operated as the underwriter for the offering.[197] For purposes of the disgorgement hearing, the defendants accepted as true all allegations in the Commission's complaint.[198] Accordingly, the SEC brought suit because the defendants had:

> [P]articipated in a scheme to manipulate the market for [the four IPOs] .†.†. . [T]he scheme was effectuated by means of dominating and controlling the supply, the demand, and the price of [the offerings (known as market making)] to permit [the defendants] to charge excessive markups in the initial aftermarket and thereby [mulct] an illegal profit.[199]

What is more, the purchasers of securities sold by the defendants were in reality not receiving the total number of shares they were paying for.[200] Because the defendants had acceded to the allegations in the complaint, the court was only left with making findings and resolving those issues associated with the Commission's request for disgorgement.[201] In the end, the court granted a fifty percent offset to the SEC's disgorgement calculation, taking in to consideration all those business costs associated with effecting the market manipulation of the IPOs in question.[202] The court explained, "markups are a function of the way a securities firm does business, and[,] thus[,] have corresponding costs and expenses related to them."[203]

2. Critique of Rationales

a. Reliance on the Trademark Regime

In *Thomas James Associates*, the court decided to rest its flawed reasoning on a 1941 case explicating the 1905 Trademark Act.[204] The case was *Aladdin Manufacturing Co. v. Mantle Lamp Co. of America*.[205] Without plunging into the substance of *Aladdin* and the Trademark Act of 1905, significant and sufficiently distinctive characteristics of the case already cast into doubt any reliance upon its

---

196 *Id.* at 89.
197 *Id.*
198 *Id.* at 89 n.1.
199 *Id.* at 89–90.
200 *Id.* at 90–91.
201 *Id.* at 91.
202 *Id.* at 92.
203 *Id.* at 95.
204 *Id.* at 94.
205 116 F.2d 708 (7th Cir. 1941).

holdings in an SEC enforcement action. First, the litigation was between two private litigants.[206] This is important because "the [equitable] standard to be applied [changes] when the [C]ommission appears [before the court] as the statutory guardian charged with safeguarding the public interest in enforcing the securities laws."[207] Second, the case obviously has nothing to do with regulating the securities industry, an industry whose complexity and inherent opacity are irresistible sirens to the unscrupulous. Finally, there is no comparable sovereign extension of the federal government charged with protecting the general public from the inimical act of trademark infringement. The Supreme Court has been clear, the remedial scheme of the securities laws was intended to be broader and less technical than at common law, and to account for those public policy concerns of promoting the highest degree of ethics and professionalism in the investment industry.[208] Therefore, it does not follow our trademark jurisprudence bears any relevance to an SEC enforcement action.

Clearly, the Trademark Act codified the common law understanding of damages and equitable relief. According to *Aladdin Manufacturing*, the damages contemplated by the Trademark Act, authorizing the mark's rightful owner to recover damages in addition to profits to be accounted for by the infringer, are the same as might be recovered in an action at law from any tortfeasor.[209] Yet, as we have already seen, the remedy of disgorgement contemplated by the securities laws, unlike the equitable relief contemplated by the trademark provisions, is not the common law notion of disgorgement.[210]

Despite this plainly erroneous reliance on the jurisprudence of the trademark bar, the court averred offsetting to be entirely appropriate because it was permissible under the regulatory regime Congress had established for trademark protection.[211]

"Even where Congress has expressly provided a disgorgement remedy in a statutory context, as in the area of trademark infringement, it has provided that a violator is entitled to set off all proven costs or deductions against the profits accruing from his violation."[212]

---

206 *Id.*

207 Sec. and Exch. Comm'n v. Great Lakes Equities Co., 775 F. Supp. 211, 215 n.23 (E.D. Mich. 1991) (internal quotation marks omitted) (citing Sec. and Exch. Comm'n v. First City Financial Corp., 890 F.2d 1215 (D.C. Cir. 1989), and Litton Industries, Inc. v. Lehman Brothers Kuhn Loeb, Inc., 734 F. Supp. 1071 (S.D.N.Y. 1990)).

208 Sec. and Exch. Comm'n v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186–87 n.13 (1963).

209 116 F.2d 708, 716 (7th Cir. 1941).

210 *See supra* Part II.

211 *See generally Aladdin Mfg. Co.*, 116 F.2d 708 (7th Cir. 1941).

212 Sec. and Exch. Comm'n v. Thomas James Assocs., Inc. 738 F. Supp. 88, 94–95 (W.D.N.Y. 1990).

However, just because Congress saw fit to expressly provide for offsetting under one regime, it does not necessarily follow it intended to under an entirely separate and distinct regulatory framework.

Although at the time this case was decided Congress had not provided comparable guidance on disgorgement,[213] there seemed to be no precedent for offsetting anything more than brokerage fees.[214] Additionally, there was a clear expression by the courts adopting a broader, less technical principle of regulatory equity, thereby completely rejecting the argument Congress sought to codify the common law principles of equity in the securities laws.[215]

Moreover, Congress is said to act fully aware of the antecedent legal frameworks when passing new legislation.[216] Consequently, if Congress wanted the securities laws to be applied in the same manner, it could have put the offsetting language from the Trademark statute in the securities laws. Consider the following section from the trademark statutes:

> (a) Profits; damages and costs; attorney fees that:
>
> When a violation of any right of the registrant of a mark registered in the Patent and Trademark Office, a violation under section .†.†. 1125(a) or (d) [of this title], or a willful violation under section .†.†. 1125(c) [of this title], shall have been established in any civil action arising under this [chapter], the plaintiff shall be entitled, subject to the provisions of sections .†.†. 1111 and 1114 [of this title], and subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action. The court shall assess such profits and damages or cause the same to be assessed under its direction. In assessing profits[,] the plaintiff shall be required to prove defendant's sales only; *defendant must prove all elements of cost or deduction claimed*. In assessing damages[,] the court may enter judgment, according to the circumstances of the case, for any sum above the amount found as actual damages, not exceeding three times such amount. If the court shall find that the amount of the recovery based on profits is either inadequate or excessive[,] the court may in its

---

213 *See* SERPSRA, *supra* note 5.

214 *But see supra* Part II.A.1.

215 *See supra* Part III.B.

216 As the Ninth Circuit has said:

> We conclude, therefore, as the Supreme Court has stated with respect to other regulatory statutes, that the Congress must be taken to have acted cognizant of the historic power of equity to provide complete relief in the light of statutory purposes. As the Supreme Court long ago recognized, there is inherent in the courts of equity a jurisdiction to give effect to the policy of the legislature.

L.A. Trust Deed Mortg. Exch. v. Sec. and Exch. Comm'n, 285 F.2d 162, 182 (9th Cir. 1960).

> discretion enter judgment for such sum as the court shall find to be just, according to the circumstances of the case. Such sum in either of the above circumstances shall constitute compensation and not a penalty. The court in exceptional cases may award reasonable attorney fees to the prevailing party.[217]

Nevertheless, the fully cognizant Congress chose not to provide a liable defendant with the ability to reduce a disgorgement order in an SEC enforcement action as it did in the Trademark Act.[218]

Now that disgorgement has been codified, and not in a way as 15 U.S.C. § 1117—which takes into consideration deductions from gross proceeds—the SEC is due deference to the regulatory form of disgorgement always intended by Congress. Absent an express desire not to codify the understanding of regulatory equity as laid out by this article, the intent of Congress in 1990 was the same intent of Congress when originally passing the securities laws.[219] Thus, the line of cases that form the doctrine of regulatory equity was not unchanged, and the unique form of disgorgement available to the SEC remains valid. In this way, relying upon a 1941 case interpreting a statute passed almost two decades before the first securities act was anachronistic and misguided at best.

b. Reliance on the Doctrine of Restitution

i. Equitable Posture

The court in *Thomas James Associates* clearly saw itself as the preeminent arbiter of equity. Consider the following quote:

> I find that it is appropriate to offset these gross profits from the four IPOs with certain business expenses attributable thereto by [the defendant]. These expenses include, for example, commissions, telephone charges, underwriting expenses[,] and a proportionate share of overhead.†.†. . I reduce [the defendant's] gross revenues from the four IPOs by 50%, [] to reflect a fair setoff for necessary business

---

[217] 15 U.S.C. § 1117(a) (LexisNexis 2014) (emphasis added).

[218] *See* Securities Act §§ 8A(e) & 20(f), 15 U.S.C. §§ 77h-1(e), 77t(f) (LexisNexis 2014); Exchange Act §§ 20A(b)(2), 21(d)(4)–(5), B(e), C(e), F(a)(4), 15 U.S.C. §§ 78t-1(b)(2), 78u(d)(4)–(5), 78u-2(e), 78u-3(e), 78u-6(a)(4) (2014); Investment Company Act §§ 9(e) & (f)(5), 15 U.S.C. §§ 80a-9(e), (f)(5) (2014); Advisors Act §§ 203(j), (k)(5), 15 U.S.C. §§ 80b-3(j), (k)(5).

[219] The author believes Congress' intent in 1990 when it codified disgorgement into the federal securities laws must have been the same when the federal securities laws were originally passed because the codification did not limit the doctrine of disgorgement as it had developed through case law prior to 1990.

expenses.[220]

Further exemplifying its presumed equitable discretion, the court considered factors such as: (a) "the firm provide[d] employment for [three hundred] individuals in a number of states;" and (b) the firm's "relatively clean record with both the SEC and the industry's self-regulating bodies."[221]

Nevertheless, the court's holding in *Thomas James Associates* was proven to be a doctrinal anomaly just eight years later in *Kenton Capital*. There, the district court in the D.C. Circuit finally got to answer the offsetting question it reserved in footnote 16 in its *Bilzerian* opinion.[222] Addressing the objection to the Commission's reasonable estimation of unjust enrichment to be disgorged, the D.C. district court said, "In response, [d]efendants argue that disgorgement is improper because these funds are no longer in Kenton's possession, having been paid to third parties for 'legitimate business expenses.'"[223] Supporting their objection, the defendants relied "primarily on [*Thomas James Associates*] in which the court held that a court ordering disgorgement 'may consider as an offset the expenses incurred by defendant in garnering such unjust enrichment.'"[224] Significantly, the court agreed with the Commission *Thomas James Associates* does not reflect the overwhelming weight of authority holding securities law violators may not offset their disgorgement liability with business expenses.[225] The defendants in *Kenton Capital* attempted unsuccessfully to distinguish such cases. The SEC had provided ample evidence all the funds collected by the defendants were obtained fraudulently, "and [d]efendants may not escape disgorgement by asserting that expenses associated with this fraud were legitimate."[226]

In sum, there could not have been a clearer rejection of the erroneous rationale employed by the court in *Thomas James Associates*. Taken together, *Bilzerian* and *Kenton Capital* stand for the proposition allowing offsets for business expenses associated with a securities law violator's fraud is illegitimate. Therefore, reliance upon *Thomas James Associates* to support reducing a reasonably calculated disgorgement order is beyond the pale of equitable discretion.

---

[220] Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88, 92 (W.D.N.Y. 1990).

[221] *Id.* at 93.

[222] Sec. and Exch. Comm'n v. Bilzerian, 814 F. Supp. 116, 122 n.16 (D.D.C. 1993).

[223] Sec. and Exch. Comm'n v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 15 (D.D.C. 1998).

[224] *Id.* at 16.

[225] *Id.*; *see also* Sec. and Exch. Comm'n v. Hughes Capital Corp., 917 F. Supp. 1080, 1086 (D.N.J. 1996) (distinguishing *Thomas James Associates* as limited to disgorgement of "excessive profits"); Sec. and Exch. Comm'n v. Great Lakes Equities Co., 775 F. Supp. 211, 214–15 (E.D. Mich. 1991) (rejecting deductions from the disgorgement amount for overhead, commissions, and other expenses and criticizing *Thomas James Associates* for equating disgorgement with restitution); Sec. and Exch. Comm'n v. Benson, 657 F. Supp. 1122, 1134 (S.D.N.Y. 1987) (stating the "manner in which [defendant] chose to spend his misappropriations is irrelevant as to his objection to disgorge.").

[226] *Kenton Capital*, 69 F. Supp. 2d at 16.

ii. Rebutting the Application of Restitution

The rationale in *Thomas James* fails primarily because the court attempted to equate disgorgement in the SEC enforcement context with the common law doctrine of restitution.

In determining the proper amount of restitution, a court may consider as an offset the sums that a defendant paid to effect a fraudulent transaction.[227]

However, this grossly ignores the settled notion disgorgement is not restitution[228] and common law principles of equity, as applied to disputes arising between two private litigants, are not appropriate in federal regulatory enforcement.[229]

Furthermore, Ellsworth's article even points out by implication disgorgement is not restitution,[230] which we have already seen stems from the fundamental difference between private securities litigation and SEC actions.[231] There are reasons why the philosophy behind disgorgement in private securities litigations differs from that of SEC actions. Significantly for this critique, Ellsworth acknowledged as much without demur.[232] At common law, disgorgement in a private securities litigation action requires all elements of restitution to be pled.[233] Therefore, private parties must show they were injured.[234] However, the Commission's congressional mandate is both specific and general deterrence. As an enforcer of the securities laws, the SEC is authorized to seek disgorgement, even when no identifiable injured party exists.[235] Therefore, the common law elements of restitution need not be pled in the SEC enforcement context.[236]

In no other case brought by the Commission prior to *Thomas James Associates* had a court recognized the above nine identified considerations when ordering disgorgement. While such factors would plainly be relevant in a case between private litigants, they are inapposite because disgorgement in the SEC enforcement context is not restitution. To this point, the overwhelming weight of binding and persuasive primary authority has consistently held the purpose of

---

[227] Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88, 94 (W.D.N.Y. 1990); *see* RESTATEMENT OF RESTITUTION ch. 7 (1937); *see also* John D. Ellsworth, *Disgorgement in Securities Fraud Actions Brought by the SEC*, DUKE L.J. 641, 651 (1977).

[228] Sec. and Exch. Comm'n v. Teo, 746 F.3d 90, 104–07 (3d Cir. 2014).

[229] *See supra* Part III.D.

[230] Ellsworth, *supra* note 228, at 650–52

[231] *See supra* Part III.D.

[232] Ellsworth, *supra* note 228, at 650–52.

[233] *Id.*

[234] *Id.*

[235] *Id.*

[236] *Id.*

disgorgement is not restitution but simply to deprive the defendant of his or her ill-gotten gain.[237]

The following year in *Securities and Exchange Commission v. Great Lakes Equity*,[238] the court took notice of the philosophical split between the Second and Sixth Circuits by recognizing *Thomas James Associates* as a relevant, though not binding, choice of authority by the defendant.[239] In footnote 22, the court subtly rejected the offsetting of business expenses granted in *Thomas James Associates* and went on in its opinion to explain the equitable standards to be applied in SEC enforcement actions are fundamentally different from traditional common law principles of equity and restitution.[240] More specifically, the district court in *Great Lakes Equity* stated:

> Finally, with regard to *Securities and Exchange Commission v. Thomas James*, the district court clearly equated disgorgement with restitution, 738 F. Supp. 88, 94 (W.D.N.Y.1990). The Sixth Circuit in *Blavin* rejected the defendant's argument that disgorgement was a type of restitution that should be based on investor losses. Instead, the Sixth Circuit stated that once the Commission has established that a defendant has violated the securities laws, the Court possesses the equitable power to grant disgorgement of a sum of money equal to all other "illegal payments received." 760 F.2d at 713.[241]

At bottom, the court in *Thomas James Associates* clearly abused its discretion by ignoring over a half a century of doctrinal development. The notion disgorgement in the SEC enforcement context is not restitution is well settled and beyond reproach. The abusively broad holding of *Thomas James Associates* continues to plague the SEC and confound the judges who decide its cases.[242]

iii. "Real Dollar Restitution"

"Real dollar" restitution may be the common law remedy available to private

---

[237] *See* Sec. and Exch. Comm'n v. Hughes Capital Corp., 917 F. Supp. 1080, 1084–85 (D.N.J. 1996) (citing Sec. and Exch. Comm'n v. Huffman, 996 F.2d 800, 802 (5th Cir. 1993) (stating disgorgement is not restitution)) *aff'd* 124 F.3d 449 (3d Cir. 1997); Sec. and Exch. Comm'n v. Blavin, 760 F.2d 706, 713 (6th Cir. 1985).

[238] 775 F. Supp. 211 (E.D. Mich. 1991), *aff'd* 12 F.3d 214 (6th Cir. 1993).

[239] *Id.* at 214–15.

[240] Both *First City Financial Corp.*, 890 F.2d at 1232–33 n. 24, and *Litton Industries, Inc. v. Lehman Brothers Kuhn Loeb Inc.*, 734 F. Supp. 1071, 1076 n. 3 (S.D.N.Y.), recognize that the standard to be applied differs when the commission appears, as here, as . . . the statutory guardian charged with safeguarding the public interest in enforcing the securities laws . . . .

Id. at n.22 (internal quotation marks omitted).

[241] *Great Lakes Equity Co.*, 775 F. Supp. at 215 n.22.

[242] *See supra* Part VII.

litigants, but it is not the purpose for which the securities laws were enacted when the SEC is bringing suit. Nevertheless, the court in *Thomas James Associates* said, because the evidence supporting the SEC's disgorgement calculation had only been testimonial, "it provides no basis for real dollar restitution."[243] This conclusion by the court was plainly erroneous for three glaring reasons. First, the learned judge misconstrued the evidentiary standard and burden placed upon the SEC. Second, in light of how statutory purpose shapes equitable remedies, the common law principle of real dollar restitution had been long since abandoned. Finally, disgorgement in SEC enforcement actions is clearly not restitution.

To the first point: In *Commodity Futures Trading Commission v. British American Commodity Options Corp.*,[244] the federal court was specifically explicating the doctrine of disgorgement within the context of regulatory enforcement.[245] In doing so, it considered the role disgorgement played in both CFTC and SEC enforcement actions, drawing no distinctions between the two.[246] There, the court held a dollar for dollar accounting was not required.[247] Secondly, as Part III of this article clearly evinces, the doctrine of regulatory equity embodied in the securities laws is not a codification of the common law principles that guide courts adjudicating disputes between private parties. And, finally, if not exasperatingly, disgorgement is not restitution.[248] Thus, the court in *Thomas James Associates* was misguided when it used the real dollar restitution standard.

iv. The Ellsworth Article

Believing it was rightly applying the common law doctrine of restitution, the court in *Thomas James Associates* granted an offset on the basis there were sufficient deleterious effects of the ensuing action that would likely be within the court's discretion to acknowledge.[249] The court deemed injunctions, bad publicity, and harmed reputation to be such factors:[250]

> I also find it appropriate to reduce the amount of disgorgement to be paid by the defendants in view of the other terms and conditions for resolving this case which the SEC has demanded and to which the

243 Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88, 92 (W.D.N.Y. 1990).

244 788 F.2d 92 (2d Cir. 1986) [hereinafter *CFTC*].

245 *Id.* at 93–94.

246 *Id.*

247 *Id.* at 93.

248 *See supra* Part II.B.3.

249 *See* Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88, 94 (W.D.N.Y. 1990).

250 *CFTC*, 788 F.2d at 92. This article does not pass on the propriety of taking into consideration these factors in a private suit between private litigants.

> defendants have acceded. Defendants TJA, Villa, and Thomas are permanently enjoined from future violations of the federal securities laws; any violation in the future will expose the defendants not only to the renewed scrutiny of the SEC but also to potential charges of contempt.†.†. . . The defendants' professional and personal reputations have [also] been called into question by this litigation .†.†. .[251]

Realizing it had no primary support for its position, the court had to rely, not only on the irrelevant trademark law analogy, but on an antiquated and out of province non-binding secondary source.[252] Ellsworth's article suggested injunctions, bad publicity, and harmed reputation were legitimate ameliorative factors to be considered when issuing a disgorgement order.[253] However, reliance on the Ellsworth article is immediately suspect because it was written a mere six years following the seminal case in our disgorgement jurisprudence, a time of doctrinal confusion.[254] And more specifically, it is suspect because the doctrinal confusion surrounding the Commission's new remedy centered primarily on whether disgorgement was restitution, which we know now it is not.[255]

Accordingly, this non-binding secondary source was already antiquated and out of province by the time the court relied upon it in *Thomas James Associates*. Furthermore, another thirteen years of doctrinal development after its publication had provided the courts with ample opportunity to address disgorgement in a variety of securities violations. During that period, the D.C. Circuit and the Supreme Court, both exceedingly persuasive primary authorities, made it clear the remedial purposes of the securities laws did not seek to codify common law notions of equity and restitution.[256] Further still, in the mid 1980s, cases expressly held disgorgement in the SEC enforcement context was not restitution.[257] Therefore, where bad facts make bad law, so too do bad sources.

c. Reliance on the Defendant's Industry Niche

Interestingly, the court reasoned offsetting disgorgement was further supported because the securities firm filled "a niche in the capital markets as a

---

[251] *Id.*

[252] In fact, the court never cited to any primary authority where the SEC's disgorgement request was offset by business expenses and factors such as the nine enumerated at the beginning of Part VII.

[253] *Id.* at 661 (suggesting effect of adverse publicity is a cost to be charged off against disgorgement).

[254] *See* Sec. and Exch. Comm'n v. Tex. Gulf Sulphur Co., 446 F.2d 1301 (2d Cir. 1971).

[255] *See supra* Part II.B.3.

[256] *Id.*

[257] *Id.*

company willing to underwrite highly speculative, but credible, companies."[258] Though it goes without saying the micro and nano-cap markets[259] are crucial to a healthy capital market, it is precisely in this niche where smart and ethical securities professionals are needed the most. Yet, it is also where the greatest opportunity for unchecked fraud resides. Despite speaking with respect to the need for civil penalties, Congress identified the growing exposure to fraud in this niche market identified by the court in *Thomas James Associates*:

> The Committee believes that additional authority is needed to respond to increasing violations in such areas as the fraudulent sales techniques and price manipulation of the penny stock market, violations of beneficial ownership disclosure rules including "parking," and trading violations such as those that occurred during the market break of 1987.[260]

Significantly, it was precisely those trading violations that occurred in *Thomas James Associates* that the Congress aimed its legislative efforts at deterring. Thus, instead of the niche market being a reason to limit the deterrent effect of the securities laws, it should be a reason to give them life.

On the other hand, we see in *Securities and Exchange Commission v. JT Wallenbrock & Assoc.*,[261] a Court lending credence to *Thomas James Associates* based upon the rationale the customers would have faced regular markup expenses if the fraudulent markups were not perpetrated.[262] However, this analysis ignores the fact the SEC does not stand in the shoes of victimized participants of the investment industry.[263] For support, *JT Wallenbrock* suspiciously cited to *Litton Industries, Inc. v. Lehman Bros.*, a case adjudicating a dispute as between two private litigants.[264] Whenever a court adjudicating an SEC enforcement action cites to *Litton Industries, Inc. v. Lehman Bros.* to support an offset for either flavor of business expenses,[265] as we have seen many opinions do, we would have evidence the Courts are applying equitable principles as applied to private litigants and not those regulatory equitable principles ordered by the Supreme Court to be applied

---

[258] Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88, 93 (W.D.N.Y. 1990).

[259] Micro and nano-caps markets are those in which market capitalization are usually less than three hundred million dollars and fifty million dollars respectively. These entities are often associated with the penny stock market.

[260] H.R. REP. No. 101-616, at 19 (1990), *reprinted in* 1990 U.S.C.C.A.N. 1379, 19. Note SERPSRA went into effect in October of 1990, and the *Thomas James Associates* opinion came down in May of the same year.

[261] *See* 440 F.3d 1109 (9th Cir. 2006).

[262] *Id.* at 1114–15.

[263] *See supra* Part III.D.

[264] 440 F.3d at 1114–15.

[265] *JT Wallenbrock* does, but *Thomas Jones Associates* does not.

when the SEC brings suit pursuant to its law enforcement authority. Consequently, the limited acceptance of *Thomas James Associates* by *JT Wallenbrock* is neither persuasive nor binding.

Furthermore, the Supreme Court in *Capital Gains Research* explained Congress intended to establish a broad remedial scheme to deter securities violations, thereby promoting the highest standards of ethics and professionalism.[266] Best practices and principles were intended by Congress said the Supreme Court,[267] and it is in those very instances of start-up companies where we need ethical and competent professionals. But, it is in this very segment of the industry where fraud metastasizes so readily. Unlike what *Thomas James Associates* suggests, the necessity of those willing to underwrite high risk public offerings are no more deserving of a break from the deterrent jostles of the securities laws than the bedrock financial institutions of Wall Street.

d. Reliance Upon Egregiousness

Earlier, we touched upon the relevance of egregiousness when determining disgorgement in the SEC enforcement context. There, it was argued to be inapposite. Nevertheless, *Thomas James Associates* incorporated egregiousness into its reasoning when holding offsets to be appropriate.

On this point, *Thomas James Associates* conceded gross profits equaled proceeds and appropriate in *Securities and Exchange Commission v. R.J. Allen & Associates, Inc.*[268]:

> In holding that, when exercising its equity jurisdiction to order disgorgement of unjust enrichment, a court may consider as an offset the expenses incurred by defendant in garnering such unjust enrichment. I acknowledge that securities law violations may exist in which disgorgement is properly ordered in the amount of the total gross profits.[269]

The above passage suggests the calculation of ill-gotten gain is effected by the facts and circumstances of a defendant's fraud, such as egregiousness and the degree of scienter. While these factors may influence the imposition of civil penalties,[270] they do not reach into the pocket of the defendant to take back exactly

---

[266] Sec. and Exch. Comm'n v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186–87 (1963).

[267] *Id.*

[268] 386 F. Supp. 866 (S.D. Fla. 1974).

[269] Sec. and Exch. Comm'n v. Thomas James Assocs., Inc., 738 F. Supp. 88, 95 (W.D.N.Y. 1990).

[270] *See e.g.*, R.J. Allen & Assocs. Inc., 386 F. Supp. 866 (S.D. Fla. 1974) (ordering disgorgement of all proceeds received in a fraudulent scheme aimed at least in part at former prisoners of the Vietnam War who had accumulated, and lost, substantial sums of back pay). Egregiousness and scienter do play

what was taken.[271] Thus, the recognition of the gross proceeds theory of disgorgement by the court combined with the settled notion disgorgement is not restitution and ought to be enough to invalidate the holdings of *Thomas James Associates* and its progeny.

C. Critique of Securities and Exchange Commission v. Video Without Boundaries

Unfortunately, the holding in *Thomas James Associates* is gaining traction. In *Video Without Boundaries*, the Southern District of Florida chose to ignore decades of doctrinal development by endorsing the most flagrant and misguided decision in the disgorgement line of cases. By adopting *Thomas James Associates*, which relied upon a trademark infringement case between two private litigants, the Southern District of Florida inexplicably ignored relevant Eleventh Circuit case law. If the Southern District truly felt the question of offsetting was best explicated by cases between private litigants in lieu of persuasive anti-offsetting precedent, the court did not have to look to a recondite case from the Western District of New York. Rather, there was persuasive guidance locally dealing with securities fraud.

Consider *Pidcock v. Sunnyland America*.[272] Reviewing the principle action,[273] the Eleventh Circuit reversed and remanded, advising, contrary to allowing deductions, "it is more appropriate to give the defrauded party the benefit of even wind-falls than to let the fraudulent party keep them."[274] On remand in *Estate of Pidcock v. Sunnyland America*,[275] the district court dutifully denied deductions of any expenses or costs. This established precedent in the Eleventh Circuit, combined with the foregoing, makes the Southern District's subsequent adoption of *Thomas James Associates* even more erroneous in *Video Without Boundaries*, and likely willful.

---

an integral role when determining civil penalties under the securities laws in the insider trading context. *See* Sec. and Exch. Comm'n v. Chapnick, 1994 WL 113040 at 4 (S.D. Fla. Feb. 11, 1994); Sec. and Exch. Comm'n v. Brethan, 1992 WL 420867 at 25 (S.D. Ohio 1992).

[271] *See supra* Part IV.A (commenting egregiousness is only a factor to properly consider when determining civil penalties).

[272] Pidcock v. Sunnyland America, 682 F. Supp. 1563 (S.D. Ga. 1987) *rev'd*, 854 F.2d 443 (11th Cir. 1988).

[273] *Id.*

[274] Pidcock v. Sunnyland America, 854 F.2d 443, 446 (11th Cir. 1988) (quoting Janigan v. Taylor, 344 F.2d 781, 786 (1st Cir. 1965)) (emphasis added). The Eleventh Circuit held the district court erred in not considering the disgorgement remedy under *Janigan* and its progeny. *Id.* at 448.

[275] *See* 726 F. Supp. 1322 (S.D. Ga. 1989) (holding there were no circumstances to warrant crediting defrauding purchasers with any special efforts that would limit disgorgement).

D. Conclusion

It should now be clear the rationale of *Thomas James Associates* was grossly misguided, if not deliberately obtuse. Thankfully, the courts are not left without well-reasoned primary authority to guide them when ordering disgorgement in the SEC enforcement context. Specifically, *Great lakes Equity* cited to *Litton Industries*, and *Securities and Exchange Commission v. First City Financial Corp.*, when it followed the Sixth Circuit's position from *Blavin*, in the SEC enforcement context, disgorgement is not restitution.[276] Therefore, gross pecuniary benefits may not be offset even if they could be at common law.

In sum, *Great Lakes Equity* should be the law because: (1) its reasoning is grounded upon binding and greatly persuasive precedent; (2) *Thomas James Associates* cites no precedent in the SEC enforcement context to support its position; rather, it expressly ignores precedent; (3) precedent has established by 1989 common law principles of equity within the enforcement context do not serve the remedial purposes of the securities laws, and a new regulatory equity had by then coalesced; (4) *Thomas James Associates* chose to recognize but ignore *R.J. Allen* for reasons inconsistent with the remedial purposes of the securities laws; and (5) *Great Lakes Equity*'s opinion was based on binding and persuasive primary sources of law, whereas *Thomas James Associates* was based on mere secondary sources and a misguided analogy to trademark law. Thus, *Great Lakes Equity*'s explicit rejection of *Thomas James Associates* is exceedingly credible.

VIII. SUMMATION

As we have seen, the chaotic application of disgorgement in SEC enforcement actions across the circuits is pernicious. Since the enactment of the securities laws, the courts have struggled with applying the remedial intentions of Congress. Circuits have recognized how other circuits differ considerably in their notions of equity within the context of SEC enforcement. One court has observed, unless the Supreme Court specifically addresses offsets to disgorgement, it would not even consider another circuit's contrary application as persuasive.[277] This article has tried to emphasize the *sui generis* nature of disgorgement when it is a remedy sought by the federal regulators of the investment industry. Thirty years

---

[276] *See* 775 F. Supp. 211 (E.D. Mich. 1991); 734 F. Supp. 1071 (S.D.N.Y. 1990); 890 F.2d 1215 (D.C. Cir. 1989); 760 F.2d 706 (6th Cir. 1985); *see also* Sec. and Exch. Comm'n v. Kenton Capital, Ltd., 69 F. Supp. 2d 1 (D.D.C. 1998) (damning the decision in *Thomas James Associates*); Sec. and Exch. Comm'n v. Mgmt. Dynamics, Inc., 515 F.2d 801 (2d Cir. 1975).

[277] "The case law cited by the defendants is neither binding precedent, nor persuasive. First the defendants' cases are not precedent because none of them are from the Sixth Circuit or Supreme Court." *Great Lakes Equity*, 775 F. Supp. at 215 n.22.

after the SEC's first organic authority was promulgated,[278] the Supreme Court held the equitable relief the courts had within their discretion to grant, served a broader remedial purpose than traditional common law remedies of equity and restitution.[279] Building upon this supreme declaration, the D.C. and Southern District of New York[280] have both stated the equitable standard to be applied changes when the Commission appears before them as the statutory guardian charged with safeguarding the public interest in enforcing the securities laws.[281] In application, however, the circuits have failed to exchange their traditional common law robes for the new fashion of equity approved by the Supreme Court and necessary to serve the remedial purposes of the securities laws. Since *Texas Gulf Sulfur* in 1971, the doctrine of disgorgement has been a tidal pool fueled by the ebb and flow of inter-jurisdiction confusion[282] and intra-jurisdiction uncertainty.[283]

Yet, securities fraud is one of the most atomic of the species, whose prevention enjoins a unique equitable approach:

> [The law has] come to regard fraud .†.†.as primarily a tort, and hedged about with stringent requirements, the chief of which was a strong moral, or rather immoral element, while equity regarded it, as it had all along regarded it, as a conveniently comprehensive word for the expression of a lapse from the high standard of conscientiousness that it exacted from any party occupying a certain contractual or fiduciary relation towards another party.[284]

> But:

> Fraud is infinite, and were a [c]ourt of [e]quity once to lay down rules,

---

[278] The Securities Act of 1933, 15 U.S.C. § 77(a) (2012).

[279] Sec. and Exch. Comm'n v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963) (stating Congress did not codify the common law of fraud and equity in the securities laws); s*ee also id.* at 194 (citing Ridgely v. Keene, 119 N.Y.S. 451 (N.Y. App. Div. 1909) (illustrating the continuing doctrinal development of fraud in the context of equity)).

[280] The D.C. Circuit and the Southern District of New York should be considered relatively persuasive authorities because of the frequency at which cases involving SEC enforcement come before them.

[281] Sec. and Exch. Comm'n v. First City Financial Corp., Ltd., 890 F.2d 1215, 1232–33 n.24 (D.C. Cir. 1989); Litton Industries, Inc. v. Lehman Brothers Kuhn Loeb Inc., 734 F. Supp. 1071, 1076 n.3 (S.D.N.Y.1990) (citing *Mgmt Dynamics, Inc.*, 515 F.2d at 808); *see also Great Lakes Equity*, 775 F. Supp. at 211; Sec. and Exch. Comm'n v. Penn Cent. Co., 450 F. Supp. 908 (E.D. Pa. 1978).

[282] This inter-jurisdiction confusion is notably evident between the Sixth and Second Circuit.

[283] The Eleventh Circuit disallowing offsetting in *Securities and Exchange Commission v. R.J. Allen & Associates, Inc.*, 386 F. Supp. 866 (S.D. Fla. 1974), and then adopting offsetting in *Securities and Exchange Commission v. Video Without Boundaries, Inc.*, 2010 WL 5790684 (S.D. Fla. Dec. 8, 2010), through *Securities and Exchange Commission v. Thomas James Associates, Inc.*, 738 F. Supp. 88 (W.D.N.Y. 1990). *See also* Sec. and Exch. Comm'n v. United Monetary Servs., Inc., 1990 WL 91812 (S.D. Fla. May 19, 1990).

[284] HANBURY, MODERN EQUITY 643 (8th ed. 1962).

> how far they would go, and no farther, in extending their relief against it, or to define strictly the species or evidence of it, the jurisdiction would be cramped[] and perpetually eluded by new schemes which the fertility of man's invention would contrive.[285]

Today, the fertility of man's invention remains bountiful. Given the financial turmoil of 2008 and its persistence through 2011, much of the investing public has come to regard investment professionals as the pirates of Wall Street. Consequently, there are many who would not balk at sewing them up in their hammocks with a thirty-six-pound shot at their heads and heels.[286] Drunk on greed, securities fraudsters such as Mr. Madoff and Mr. Standford typify those men "born with a pen behind the ear and an inkstand in place of a heart."[287] Thus, courts must be obliged to re-center their jurisprudence in SEC enforcement actions, squaring it with the deterrent regulatory regime originally intended by Congress.

In 1914, Louis Brandeis penned one of the most abiding lines in the precept of the federal securities laws. He wrote, "Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[288] It is, therefore, incumbent upon the securities bar to shine light on the pernicious practice of offsetting in the SEC enforcement context. A disgorgement order, reasonably quantified, demands nothing less than the giving up of gross pecuniary gain.

Notwithstanding the doctrinal amorphousness, this article has attempted to distill disgorgement in the SEC enforcement context down to its constituent parts, identifying what it is and what it is not. Disgorgement is not restitution. Therefore, the adoption of the profit theory and offsetting principle in section 51 of the Restatement (Third) of Restitution does not apply. When congress codified the remedy of disgorgement in the securities laws, it defined unjust enrichment as being equal to a defendant's gross pecuniary gain. *Capital Gains Research* and its progeny are clear. The equitable scheme intended by Congress is broader than traditional equitable principles of restitution and other common law concepts of equity as between competing private interests. And, now that almost every known modern SEC enforcement action brought in federal court imposes prejudgment interest, the courthouse doors are definitively open to the benefit principle. Thus, the judiciary's continued acceptance of offsetting in SEC enforcement actions is

---

[285] *See* Letter of Lord Hardwicke to Lord Kames (June 30, 1759), *printed in* JOSEPH PARKES, HISTORY OF THE COURT OF CHANCERY 508 (1828) *quoted in* EDMUND HENRY TURNER SNELL, SNELL'S PRINCIPLES OF EQUITY 496 (25th ed. 1960); *see also Capital Gains Research Bureau*, 375 U.S. at 193 n. 41.

[286] ALEXANDER DUMAS, THE COUNT OF MONTE CRISTO (1888).

[287] *Id.*

[288] LOUIS D. BRANDEIS, *Chapter V: What Publicity Can Do*, OTHER PEOPLE'S MONEY, *available at* http://www.law.louisville.edu/library/collections/brandeis/node/196 (last visited Oct. 23, 2011).

illegitimate, willful, and unfaithful to the remedial scheme intended by Congress.

Finally, in the wake of the recent financial crisis, the investing public needs, as much now as it did in 1933, meaningful regulation of the investment industry. Uniformity and consistency in the application of disgorgement in SEC enforcement actions is the *sine qua non* of meaningful deterrence, which is after all one of the most fundamental purposes of the securities laws. If the judiciary persists along its present course, then the goals of regulating the securities markets, specific and general deterrence, will remain a chimera. Certainly, the manipulative purposes, which gave rise to securities regulation, would yield but only to the extent judicial enforcement was simply the cost of satisfying boundless cupidity.