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Disgorgement in Insider Trading Cases: FY2005-FY2015

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DISGORGEMENT IN INSIDER TRADING CASES: FY2005-FY2015

Verity Winship*

ABSTRACT

For about 50 years—at least since Texas Gulf Sulphur—the SEC has ordered defendants to disgorge their profits from transactions that violated the securities laws. Despite disgorgement’s long history, in its 2017 opinion in Kokesh v. SEC, the U.S. Supreme Court put two aspects of the remedy on the table. It applied a five-year statute of limitations to disgorgement. It also reopened old questions about agencies’ power to seek remedies not specified in statute. This article provides data to inform these debates over the agency’s use of disgorgement and the effects of Kokesh. It reports the results of an empirical study of ten years of the remedies ordered by the SEC in insider trading actions, with particular emphasis on the agency’s reliance on disgorgement. It finds widespread reliance on disgorgement, but also identifies aspects of its use that may limit Kokesh’s effects in this area.

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A team of geologists, engineers, and geophysicists from Texas Gulf Sulphur (TGS) first noticed promising anomalies in a tract of seemingly barren and swampy land in eastern Canada.¹ Quietly, this initial promise was confirmed to be the discovery of a lifetime.² As rumors of a major ore strike bubbled up, TGS tamped them down with a discouraging press release.³ But results from core samples were unprecedented, and the company ultimately announced its discovery to the public.

Engineer and geophysicist Richard H. Clayton was part of the original TGS survey team. The day before the announcement, Clayton bought 200 shares of TGS stock, taking advantage of a share price that rocketed after the discovery was made public.⁴ He made money but did not hold onto it for long. The Securities and Exchange Commission (SEC) sued Clayton, TGS, and other individual insider defendants in federal court.⁵ Ultimately, the court ordered Clayton to give up the money he made from trading on this information. Clayton was not alone. Several of the *Texas Gulf Sulphur* individual defendants had to relinquish the gains of their wrongful conduct—disgorge their insider trading profits.⁶

Just as *Texas Gulf Sulphur* has reached its fiftieth anniversary, so has the SEC's use of the disgorgement remedy. The case was one of the first judicial recognitions of the SEC's disgorgement authority, which became a staple of SEC enforcement in insider trading cases and beyond.⁷ Nonetheless, in its 2017 opinion in *Kokesh v. SEC*, the U.S. Supreme Court reopened old debates over agencies' power to seek remedies not specified in statute.⁸ In the process, the Court pointed to *Texas Gulf Sulphur* as the starting point of this remedial power and used its description of the remedy's purpose to support its holding.⁹

This article provides data to inform these debates over the agency's use of disgorgement and this part of *Texas Gulf Sulphur's* legacy. It reports the results of an empirical study of ten years of the remedies ordered by the SEC in insider trading cases, with particular emphasis on the agency's reliance on disgorgement. This article adds granularity to available information, providing a detailed account of SEC practice in the particular

1. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 843 (2d Cir. 1968); *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 269 (S.D.N.Y. 1966), *aff'd in part, rev'd in part*, 401 F.2d 833 (2d Cir. 1968).

2. *Texas Gulf Sulphur Co.*, 401 F.2d at 843.

3. Newspapers headlines reported "Copper Rumor Deflated." *See id.* at 846 (quoting N.Y. HERALD TRIB., Apr. 13, 1964).

4. *Texas Gulf Sulphur Co.*, 401 F.2d at 847.

5. *Texas Gulf Sulphur Co.*, 258 F. Supp. at 267–69.

6. *See id.*; *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1307 (2d Cir. 1971).

7. John D. Ellsworth, *Disgorgement in Securities Fraud Actions Brought by the SEC*, 1977 DUKE L. J. 641, 642 (1977); *Kokesh v. SEC*, 137 S. Ct. 1635, 1643 (2017) (pointing to *Texas Gulf Sulphur* as "one of the first cases requiring disgorgement in SEC proceedings").

8. *Kokesh*, 137 S. Ct. at 1641.

9. *Id.* at 1643.

area of insider trading, suggesting some implications of these patterns, and identifying areas for further study.

The article begins by tracing the connections between *Texas Gulf Sulphur* and *Kokesh*, and by outlining the legal framework for the SEC's insider trading remedies. The article then reports the results of the underlying study of how the SEC used the disgorgement remedy in insider trading cases from SEC FY2005 to FY2015. Finally, the article considers some of the implications of these data and briefly concludes.

I. FROM TEXAS GULF SULPHUR TO KOKESH

Texas Gulf Sulphur was one of the first cases to recognize the power of the court to require defendants to give up their profits from transactions that violated the securities laws.¹⁰ The trial court that ordered this remedy pointed to the court's "inherent equity power to grant relief ancillary to an injunction" when "such relief has been necessary for the protection of the investing public."¹¹ The Court of Appeals for the Second Circuit agreed that "[i]t would severely defeat the purposes of the Act if a violator of Rule 10b-5 were allowed to retain the profits from his violation," and allowed the remedy as part of the trial court's "equity powers."¹² In doing so, it approved a remedy that the SEC had not previously sought in federal court, although it had obtained it in a few prior settlements.¹³ The court's conclusion had implications beyond insider trading: disgorgement and other "ancillary" remedies soon became key tools for the SEC and other agencies.

The U.S. Supreme Court revisited disgorgement's origin story in 2017. In a suit brought by the SEC, "[a] jury found that [Charles] Kokesh had committed securities fraud by siphoning off millions of dollars from investors" between 1995 and 2009.¹⁴ Kokesh had been taking this money for more than a decade, but civil actions that seek penalties, fines, or forfeitures are subject to a five-year statute of limitations.¹⁵ Kokesh could be fined only for what he had done in the last five years, but how many years of wrongful profits did he have to disgorge? The Court had to de-

10. SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 91 (S.D.N.Y. 1970), *aff'd in part, rev'd in part*, 446 F.2d 1301 (2d Cir. 1971).

11. *Id.*

12. SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971).

13. See Ellsworth, *supra* note 7, at 642; Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors*, 60 FLA. L. REV. 1103, 1111–14 (2008) (tracing the history of the SEC's use of disgorgement as a remedy for securities violations).

14. See Federal Court Imposes \$55 Million Final Judgment Against Investment Adviser CEO, Exchange Act Release No. 23228 (Apr. 2, 2015), <https://www.sec.gov/litigation/litreleases/2015/lr23228.htm> [<https://perma.cc/YX2Q-9UZC>]. See generally Verity Winship, *Punishment Without a Crime*, ILL. PUB. MEDIA (Sept. 18, 2017), <https://will.illinois.edu/legalissuesinthenews/program/punishment-without-a-crime> [<https://perma.cc/H49W-EMY6>].

15. 28 U.S.C. § 2462 (2012) ("Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued.").

cide whether the statutory time limit also applied to disgorgement.¹⁶

In *Kokesh*, the U.S. Supreme Court responded by putting two aspects of the disgorgement remedy on the table. First, it classified disgorgement as a “penalty” for the purposes of 28 U.S.C. § 2462 and its five-year statute of limitations.¹⁷ It supported its argument in part by quoting the *Texas Gulf Sulphur* trial court’s description of disgorgement’s function.¹⁸ Not only did disgorgement “remove any monetary reward for violating securities laws,” but it also “provid[ed] an effective deterrent to future violations.”¹⁹ According to the *Kokesh* Court, this deterrent function was evidence that disgorgement was punitive and therefore a “penalty.”²⁰ It therefore concluded that the five-year statute of limitations applied to disgorgement.

Second, and more broadly, the *Kokesh* opinion potentially destabilized the SEC’s use of “ancillary” remedies such as disgorgement. The devil is in the details, or in the case of the U.S. Supreme Court, in the footnotes. In footnote three of *Kokesh*, the Court disclaimed any opinion on “whether courts possess authority to order disgorgement in SEC enforcement proceedings.”²¹ By making this disclaimer rather than treating the issue as settled and obvious, the Court suggested that the SEC’s authority to order disgorgement might be up for debate.²² This implication was not lost on litigants and triggered challenges to the SEC’s power to order this and other remedies “ancillary” to the injunctions that were specifically provided for by statute.²³

16. *Kokesh v. SEC*, 137 S. Ct. 1635, 1638 (2017).

17. *Id.* at 1639.

18. *Id.* at 1643.

19. *Id.* at 1640 (quoting *SEC v. Texas Gulf Sulphur*, 312 F. Supp. 77, 92 (S.D.N.Y. 1970)).

20. *Id.* at 1642. *Kokesh* seems in tension with the fact that the appeals court in *Texas Gulf Sulphur* had explicitly rejected appellants’ argument that the requested remedy was a penalty assessment. See *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971) (rejecting the contention that “the required restitution is indeed a penalty assessment,” even where the remedy required disgorgement of the profits of the tippees). For an example of the—then unsuccessful—argument that the remedy in TGS “would constitute a penalty which the Court does not have jurisdiction to impose,” see Trial Memorandum for Defendant Coates at 34, *SEC v. Texas Gulf Sulphur*, No. 65-cv-1182 (S.D.N.Y. Apr. 29, 1966).

21. 137 S. Ct. at 1642 n.3.

22. For a detailed examination of the statutory support for disgorgement orders in SEC enforcement actions, see Donna M. Nagy, *The Statutory Authority for Court-Ordered Disgorgement in SEC Enforcement Actions*, 71 SMU L. REV. (2018). A nuanced analysis of the *Kokesh* footnote can be found in Daniel R. Walfish, *Other People’s Money: SEC Disgorgement After Kokesh*, N.Y.L.J. (Sept. 7, 2017), <https://www.milbank.com/images/content/9/1/v3/91867/NYLJ-SEC-Disgorgement-After-Kokesh-Sept-2017.pdf> (arguing that *Kokesh*’s footnote three presages more attention to the scope of disgorgement).

23. See *SEC v. Sample*, No. 3:14-CV-1218-B, 2017 WL 5569873, at *2 (N.D. Tex. Nov. 20, 2017) (mem. op.); *SEC v. Jammin Java Corp.*, No. 15-CV-08921, 2017 WL 4286180, at *3 (C.D. Cal. Sept. 14, 2017). See generally Matthew C. Solomon et al., *Kokesh v. SEC: Half a Year On*, CLEARLY ENFORCEMENT WATCH, (Jan. 11, 2018), <https://www.clearlyenforcementwatch.com/2018/01/kokesh-v-sec-half-year/> [<https://perma.cc/NQ7U-SSDL>]. Cf. *CFTC v. Reisinger*, No. 11-CV-08567, 2017 WL 4164197, at *3 (N.D. Ill. Sept. 19, 2017); *FTC v. J. Williams Enters., LLC*, No. 6:16-CV-2123-Orl-31DCI, 2017 WL 4776669, at *2 (M.D. Fla. Oct. 23, 2017).

II. REMEDIES IN SEC INSIDER TRADING ENFORCEMENT

For its first sixty years, the SEC relied only on injunctive relief. Since its inception, the SEC has had explicit statutory authority to seek injunctions “[w]hensoever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation” of the Exchange Act or related rules.²⁴

Although established much later, the agency’s power to seek monetary penalties is also authorized by statute.²⁵ The first steps to authorizing penalties were taken in the area of insider trading. In the 1980s, Congress enacted the Insider Trading Sanctions Act of 1984 (ITSA) and the Insider Trading and Securities Fraud Act of 1988 (ITSFEA), which authorized, and then expanded, penalty authority for this type of violation.²⁶ Several years later, Congress expanded this remedy beyond insider trading cases. The 1990 Securities Enforcement Remedies and Penny Stock Reform Act gave the SEC authorization to seek money penalties more broadly.²⁷ Over time, this power has been extended to cases brought in administrative proceedings as well.²⁸

Other remedies are based on the court’s equity jurisdiction. Although disgorgement is not mentioned by name, a statute allows the SEC to seek equitable relief in court: “In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.”²⁹ The SEC also has explicit statutory authorization to seek “accounting *and disgorgement*” in administrative proceedings.³⁰

Disgorgement amounts are not always easily calculated, but the key notion is that disgorgement is measured by the wrongful gains of the violators. It is not measured by the harm to any victims and thus differs from “restitution” which, at least in its modern law-enforcement usage, refers to a remedy aimed at compensating victims of an offense.³¹ Disgorge-

24. Securities and Exchange Act of 1934 § 21(d), 15 U.S.C. § 78(d)(1) (2012).

25. Although the *Kokesh* Court complicates the terminology in this area by classifying disgorgement as a penalty for the purposes of the statute of limitations, for convenience this article uses the term “monetary penalty” or “civil money penalty” in its traditional sense, in which it is akin to a fine and does not include disgorgement. *See, e.g.*, NICOLE A. BAKER ET AL., *THE SECURITIES ENFORCEMENT MANUAL: TACTICS AND STRATEGIES* 194–207 (Kirkpatrick & Lockhart LLP, 2d ed. 2007).

26. *See* Securities and Exchange Act of 1934 § 21A; Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984). SEC authority to seek money penalties in insider trading cases was later expanded to allow for penalties against controlling persons. Insider Trading and Securities Fraud Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (1988).

27. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, 15 U.S.C. § 77t(d) (2012).

28. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010).

29. 15 U.S.C. § 78u(d)(5).

30. 15 U.S.C. §§ 77h-1(e), 78u-3(e), 80b-3(k)(5).

31. *See generally* Winship, *supra* note 13, at 1112–13. Courts historically mixed the terms “disgorgement” and “restitution.” *Texas Gulf Sulphur* is an example. The terminol-

ment may be returned to investors, but this compensatory function is incidental to the remedy; it is not required, nor is it the measure of the amount.³²

For insider trading, unlawful profits and penalty amounts are explicitly linked by statute. ITSA allows civil money penalties of up to three times the profit gained or loss avoided.³³ That limit is a maximum, and the SEC long had a standard practice, at least in settled cases, of requiring insider trading defendants to disgorge the profits made (or losses avoided) plus a penalty equal to the disgorgement amount—the so-called one plus one formula.³⁴

III. STUDY OF DISGORGEMENT IN INSIDER TRADING: FY2005-FY2015

To what extent has the SEC sought disgorgement? In its legal briefs in *Kokesh*, the SEC indicated that it “seeks disgorgement in the majority of its enforcement actions.”³⁵ The agency has ordered several billions of dollars in disgorgement annually in recent years. In its FY2017 annual report, the agency reported that it ordered targets to pay \$2.9 billion in disgorgement, up from approximately \$2.8 billion the previous year.³⁶ In both years, the amount of disgorgement was two-to-three times the total civil money penalties ordered.³⁷ So disgorgement became an important tool for the SEC. This study adds granularity to these aggregate numbers, focusing on the disgorgement of profits from insider trading.

A. METHODOLOGY

The study tracks remedies ordered against defendants and respondents (collectively “defendants”) who resolved SEC civil insider trading actions

ogy is mixed, but the court distinguishes between the functions of giving up unlawful profits and compensating those harmed. *SEC v. Texas Gulf Sulphur*, 446 F.2d 1301, 1307–08 (2d Cir. 1971).

32. Disgorgement funds could traditionally be distributed to investors. See SEC, *Report Pursuant to Section 308(c) of the Sarbanes Oxley Act of 2002*. The statutory “Fair Funds” provision allows, but does not require, the SEC to distribute money collected from penalties to injured investors. See 15 U.S.C. § 7246; Winship, *supra* note 13, at 1103.

33. Securities and Exchange Act of 1934 § 21A, 15 U.S.C. § 78u-1.

34. Stephen M. Cutler, Dir., SEC Div. of Enf’t, Speech at the 24th Annual Ray Garrett Jr. Corporate & Securities Law Institute (Apr. 29, 2004) (describing the “one plus one” remedy, noting that this approach “was thought to enhance deterrence and streamline settlement negotiations” but also pointing to contemporary deviations from this formula); see generally NICOLE A. BAKER ET AL., *THE SECURITIES ENFORCEMENT MANUAL: TACTICS AND STRATEGIES* 201 (Kirkpatrick & Lockhart LLP, 2d ed. 2007).

35. Brief for Respondent at 10–11, *Kokesh v. SEC*, No. 16-529, 2016 WL 7210497 (U.S. Dec. 9, 2016) (citing Select SEC and Market Data Fiscal 2015, www.sec.gov/report-spubs/select-sec-and-market-data/secstats2015.pdf [https://perma.cc/Z9YR-G9EE] (last visited Dec. 9, 2016); H.R. Rep. No. 616, 101st Cong., 2d Sess. 17 (1990)).

36. SEC DIV. OF ENF’T, ANN. REP. FY2017, at 7, <https://www.sec.gov/files/enforcement-annual-report-2017.pdf> [https://perma.cc/XD7Q-A9DX] (explaining that disgorgement comprised 78% of the total money ordered in FY2017 and 69% of the total in FY2016). The SEC Annual Report does not indicate whether prejudgment interest is included.

37. *Id.*

during SEC fiscal years 2005 to 2015 (October 1, 2004, to September 30, 2015).³⁸

The initial search was conducted in the SEC defendant database in Lexis Securities Mosaic, narrowing the type of violation to insider trading and excluding criminal actions or pleas.³⁹ The resulting list included insider trading actions brought both in court and in administrative proceedings. The information included the remedies the SEC ordered in each action. Where the database was ambiguous or incomplete, the underlying litigation release or the underlying settlement agreement was obtained and reviewed.⁴⁰

One caveat about the data is that the SEC sometimes orders remedies jointly. Sometimes defendants were jointly and severally responsible for all of the remedies,⁴¹ but other times only disgorgement was joint, with

38. The actions were assigned a fiscal year based on when the SEC publicly announced them in a litigation release or administrative proceeding. Support for using this announcement date as a proxy for the resolution date can be found in other studies of SEC settlements. *See, e.g.,* Verity Winship & Jennifer K. Robbennolt, *An Empirical Study of Admissions in SEC Settlements*, 60 ARIZ. L. REV. 1, 8 n.34 (2018) (finding that SEC public announcements and agreement dates in the study's dataset were almost all within the same fiscal year, with almost half announced on the same day as the agreement was executed).

39. The study used Lexis Securities Mosaic's classification of violations and actions. Most entries identified through this search listed insider trading as the only violation type. Of the defendants who were ordered to pay some sort of monetary remedy, jointly or individually, 8% (58/748) listed other Lexis Securities Mosaic categories of violation in addition to insider trading, often sale of securities. Actions in which the only relief was an asset freeze were excluded because these were preliminary actions to bring suit and preserve assets, so they did not report a resolution. Actions were also excluded where the only relief was a suspension, a bar, or a bar lifted. These were excluded as follow-on actions: actions that do not identify any new conduct, but only impose additional sanctions (ordinarily a bar or suspension) for a prior injunction or guilty plea. *See, e.g., Select SEC and Market Data Fiscal 2016*, at 3 (last visited Apr. 9, 2017), <https://www.sec.gov/files/2017-03/secstats2016.pdf> [<https://perma.cc/8797-ZS7B>] (separately listing standalone and follow-on actions).

40. Extensive review was also required to eliminate duplicates. When defendants or disgorgement amounts were listed more than once, the underlying litigation release and/or settlement agreement was reviewed. If the entries were duplicates (same defendant, settlement and remedy in same matter), the duplicate(s) were eliminated, leaving only one entry. If, for instance, one disgorgement order was reported multiple times (e.g., once when the settlement was entered and once when the court approved it), the earlier instance was eliminated. If defendants were subject to multiple disgorgement orders in relation to separate conduct, these were retained, and each was counted separately in the total of defendants and calculations of disgorgement and other remedies. *See, e.g.,* Former Schottenfeld Proprietary Trader Gautham Shankar Settles SEC Insider Trading Charges, Exchange Act Release No. 22011 (June 21, 2011), <https://www.sec.gov/litigation/litreleases/2011/lr22011.htm> [<https://perma.cc/8V9P-6CTF>]; Former Schottenfeld Proprietary Trader Gautham Shankar Settles SEC Insider Trading Charges, Exchange Act Release No. 22010 (June 21, 2011), <https://www.sec.gov/litigation/litreleases/2011/lr22010.htm> [<https://perma.cc/BG7K-PTFV>] (detailing actions against same target for trading in different stock on different non-public information).

41. *See, e.g.,* Final Judgment As to Defendants Langly Partners, L.P., North Olmsted Partners, L.P., & Quantico Partners, L.P., SEC v. Langley Partners LP et al., Docket No. 06-cv-00467 (D.D.C. Mar. 20, 2006) (making defendants "jointly and severally liable" for disgorgement and prejudgment interest, and ordering them to "jointly and severally pay" a civil penalty). For limits on joint and several liability for civil monetary penalties, see *SEC v. Pentagon Capital Mgmt. PLC*, 725 F.3d 279, 287–88 (2d Cir. 2013) (reversing a penalty because it had been imposed jointly and severally).

civil money penalties imposed individually. So, for instance, in one insider trading case, two brothers were ordered to pay jointly a disgorgement amount of approximately \$180,000, with separate penalties of \$150,000 each.⁴² The results reported below specify when these joint remedies are included or excluded.

It is also worth noting that the study captures the remedies *ordered* in the SEC action. It does not take into account whether these were ever paid,⁴³ reductions because of financial condition,⁴⁴ or offsets against remedies ordered in other actions for the same conduct.⁴⁵

B. RESULTS

1. Monetary Remedies

The study identified 798 defendants who resolved SEC insider trading actions from FY2005 to FY2015.⁴⁶ Of these defendants, 748 (94%) were ordered to pay some sort of monetary remedy—disgorgement and/or money penalties—either individually or jointly.⁴⁷ The total disgorgement ordered for the full time period was \$987,356,081.⁴⁸ For the same period,

42. Previously Unknown Insider Traders in Heinz Agree to \$5 Million Settlement, Exchange Act Release No. 22841 (Oct. 10, 2013), <https://www.sec.gov/litigation/litreleases/2013/lr22841.htm> [<https://perma.cc/T75J-G9XB>].

43. See Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 948–49 (2016) (noting the gap between amounts ordered and amounts collected, and giving the example that the SEC collected half of the monetary penalties ordered in FY 2014).

44. See, e.g., Court Enters Final Judgments Against Ernesto V. Sibal, Doseph J. Shin, Chae Hyon Chin, Benjamin Y. Chiu and Pejman Sabet, Exchange Act Release No. 19328 (Aug. 8, 2005), <https://www.sec.gov/litigation/litreleases/lr19328.htm> [<https://perma.cc/D6A5-BYF3>] (noting that Chin consented to the entry of a judgment of more than \$125,000, but that the court waived payment of all but about \$74,000 because of financial condition).

45. See, e.g., Former Trader Emanuel Goffer Settles SEC Insider Trading Charges, Exchange Act Release No. 22721 (June 11, 2013), <https://www.sec.gov/litigation/litreleases/2013/lr22721.htm> [<https://perma.cc/EC3R-WRAK>] (offsetting disgorgement ordered in the SEC action against forfeiture in a criminal action based on the same conduct); Final Judgment As To Defendant Sung Kook Hwang, SEC v. Tiger Asia Mgmt., LLC, 2012 WL 9508328 12-cv-7601 (DMC) (D.N.J. Dec. 14, 2012) (noting that disgorgement and prejudgment interest will be “credited dollar for dollar by the amount ordered to be paid in restitution” in a related criminal action); SEC Charges Former Chairman and Chief Executive Officer of Enron Energy Services with Insider Trading, Exchange Act Release No. 20658 (July 29, 2008), <https://www.sec.gov/litigation/litreleases/2008/lr20658.htm> [<https://perma.cc/R4JE-QR6A>] (noting that the defendant was entitled to a \$6 million offset based on the resolution of a related civil case in another court).

46. As noted above, the study relied on Lexis Securities Mosaic classifications of violation, using its identification in the first instance of insider trading actions. It also excluded duplicates, preliminary relief, and follow-ons. See LEXIS SEC. MOSAIC, <https://www.lexisnexis.com/en-us/products/lexis-securities-mosaic.page> [<https://perma.cc/4WUZ-5X4B>]. See *supra* notes 39–40.

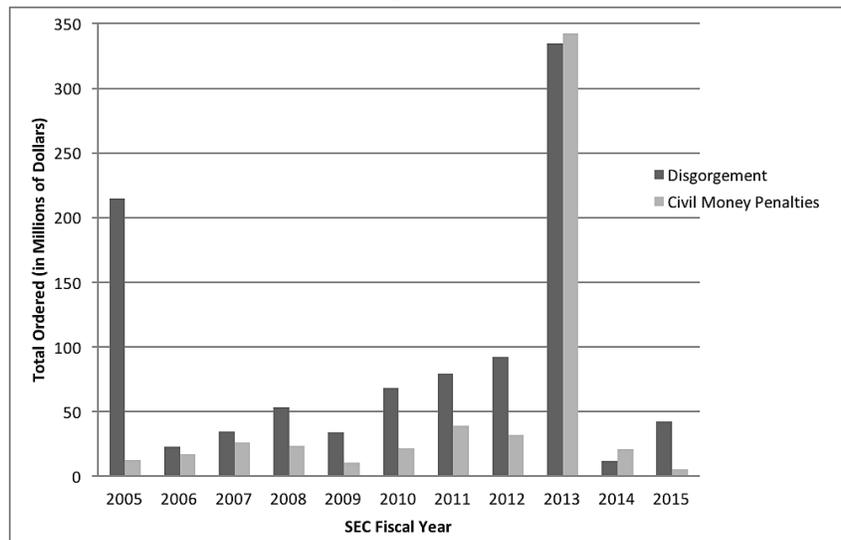
47. One defendant was ordered to pay prejudgment interest only, without disgorgement or a money penalty. See SEC Litig. Rel. 21185A (Aug. 27, 2009), SEC v. Marshall, Docket No. 08-CV-2527 (S.D.N.Y.), Final Judgment As To Alan L. Tucker (Aug. 31, 2009). This order is not included in the total.

48. To avoid overcounting, joint orders of disgorgement were counted only once. Joint orders were identified by reviewing the underlying documents for any nonzero duplicate disgorgement amounts that appeared in the initial Lexis Securities Mosaic list. See *supra*

the total amount of penalties ordered was \$549,735,769.⁴⁹ Figure 1 reports the annual totals, tracking how the SEC's use of the disgorgement remedy and money penalties has varied over time.

In most years, the total amount of disgorgement ordered exceeded the total civil money penalties ordered. The figure reflects a spike in the disgorgement amounts for FY2005 and a spike in both disgorgement and penalties in FY2013. The total for FY2005 includes the second highest disgorgement amount identified in the study (\$200M). No penalty was ordered in that action.⁵⁰ The total for FY2013 includes the highest disgorgement amount identified in the study (\$275M), which was accompanied by an equally large penalty (also \$275M).⁵¹

**Figure 1: Annual Monetary Remedies⁵²
(SEC Insider Trading Actions FY2005-FY2015)**



note 40 & accompanying text. This exclusion was important: a sum of the disgorgement amounts listed per defendant without excluding joint amounts would overcount the total by more than \$125 million.

49. To avoid overcounting, joint orders of money penalties were counted only once. Some of the joint disgorgement orders included separate individual penalty amounts. Each of these individual penalty amounts is included in this total.

50. SEC Litig. Rel. No. 19259 (June 9, 2005), *SEC v. Poyiadjis*, Docket No. 01-CV-8903 (S.D.N.Y.), Former Aremissoft Chief Executive Officer Consents to Permanent Injunctive Relief and Officer-and-Director Bar; Poyiadjis Pays Approximately \$200 Million.

51. The action was against CR Intrinsic Investors, a hedge fund advisory firm affiliated with SAC Capital. See SEC Litig. Rel. No. 22647 (Mar. 18, 2013), *SEC v. CR Intrinsic Investors LLC*, Civ. Act. No. 8466 (reporting that the settlement was “the largest ever in an insider trading case”). The third highest amount of disgorgement ordered during the time period of the study was \$45 million. SEC Litig. Rel. 21825 (Jan. 25, 2011), *SEC v. Nacchio*, Docket No. 05-cv-480-MSK-CBS (D. Co.), Court Enters Final Judgment Against Former CEO of Qwest Communications Int’l Joseph P. Nacchio.

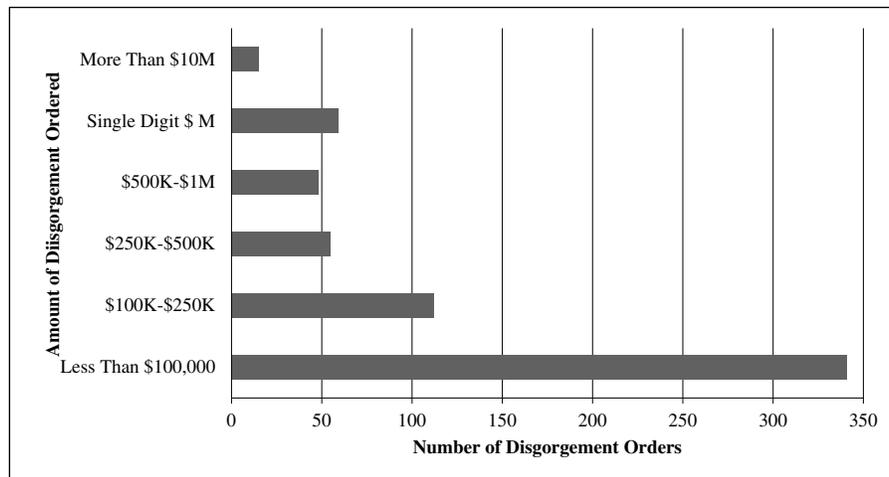
52. The SEC’s fiscal year is from October 1 to September 30. Where disgorgement was ordered jointly, only one disgorgement amount is included. Where civil money penalties were ordered jointly, only one penalty amount is included.

2. Patterns of Disgorgement

The study identified 695 defendants ordered to pay disgorgement, either individually or jointly. Disgorgement was ordered against 93% (695/748) of defendants who were ordered to pay any type of monetary remedy.

If joint disgorgement orders are counted only once, the total number of unique disgorgement orders is 630. The figure below shows the size of disgorgement orders in SEC insider trading actions from FY2005 to FY2015. Notably, the median disgorgement amount was \$62,756, which is indicative of the concentration of awards at the low end of the range.⁵³ Although the overall average disgorgement ordered was \$1,567,232,⁵⁴ more than half of the awards were under \$100,000 and only 12% were \$1 million or above. Moreover, the range was enormous: from \$1 to approximately \$275 million.⁵⁵

Figure 2: Disgorgement Amounts⁵⁶
(SEC Insider Trading Actions FY2005-FY2015)



53. In calculating the median, joint disgorgement orders were counted only once.

54. In calculating the average, joint disgorgement orders were counted only once. If jointly liable defendants are included, the average disgorgement was \$1,420,656: the \$987 million total disgorgement divided by the 695 defendants ordered to pay disgorgement, either individually or jointly.

55. During the time period between Fair Funds and Dodd-Frank, the SEC had to order disgorgement to trigger the creation of a fund to distribute to injured investors. The two \$1 disgorgement orders may be triggered by that. *See* U.S. Gov't ACCOUNTABILITY OFF., GAO-05-670, SEC AND CFTC PENALTIES: CONTINUED PROGRESS MADE IN COLLECTION EFFORTS, BUT GREATER SEC MANAGEMENT ATTENTION IS NEEDED 28 (2005) (indicating that internal SEC guidance at the time recommended seeking nominal disgorgement to trigger the Fair Funds provision). Even if those nominal amounts (anything below \$100, for instance) are eliminated, the next highest value is \$327.

56. The chart does not include insider trading defendants against whom no disgorgement was ordered. Joint disgorgement orders were counted only once.

3. Relationship Between Disgorgement and Money Penalties

As noted above, monetary remedies (disgorgement and/or civil money penalties) were ordered either individually or jointly against 748 defendants. Of these, both a penalty and disgorgement were ordered against 70% (527/748). Disgorgement was the only type of monetary relief ordered against 22% (168/748). And penalties were the only monetary relief ordered against 7% (53/748).⁵⁷

Although the study did not attempt to formally assess the SEC's rationale for the choice of remedy, some of the underlying documents provide examples. In particular, several indicated that the court ordered disgorgement without penalties because of payment of fines or restitution (or jail time) in parallel criminal actions based on the same conduct;⁵⁸ because of the defendant's cooperation with the SEC;⁵⁹ or because of the defendant's inability to pay.⁶⁰

The SEC ordered 527 defendants to pay both disgorgement and penalties, including defendants who were jointly liable. The penalty and disgorgement amounts were equal (1:1 ratio) for 56% (294/527). Disgorgement was larger than the penalty ordered for 23% (121/527), and the penalty was larger than disgorgement for 21% (112/527).

The statute permits penalties of up to three times the amount of profit (or loss avoided), but most defendants did not seem to max out the penalty amount.⁶¹ Of all the defendants who were ordered to pay both money penalties and disgorgement, 90% (475/527) paid penalties of less than three times the disgorgement amount.⁶²

The average ratio of penalty to disgorgement was 2.2 to 1, with a me-

57. These add to less than 100% because of rounding.

58. *See, e.g.*, Final Judgment As to Defendant Joseph A. Dawson at 6, SEC v. Joseph A. Dawson, No. 11-cv-1615 (D. ND Ill. Mar. 16, 2011) (“[N]o civil penalty shall be imposed upon Defendant in this civil action based upon the criminal sanctions imposed in *United States v. Joseph A. Dawson*,” a parallel criminal action.).

59. *See, e.g.*, Final Judgment As to Defendant Adam Smith at 3, SEC v. Smith, No. 11-cv-00535 (S.D.N.Y. May 31, 2011) (“[B]ased on Defendant's agreement to cooperate in a Commission investigation and/or related enforcement action, the Court is not ordering Defendant to pay a civil penalty.”).

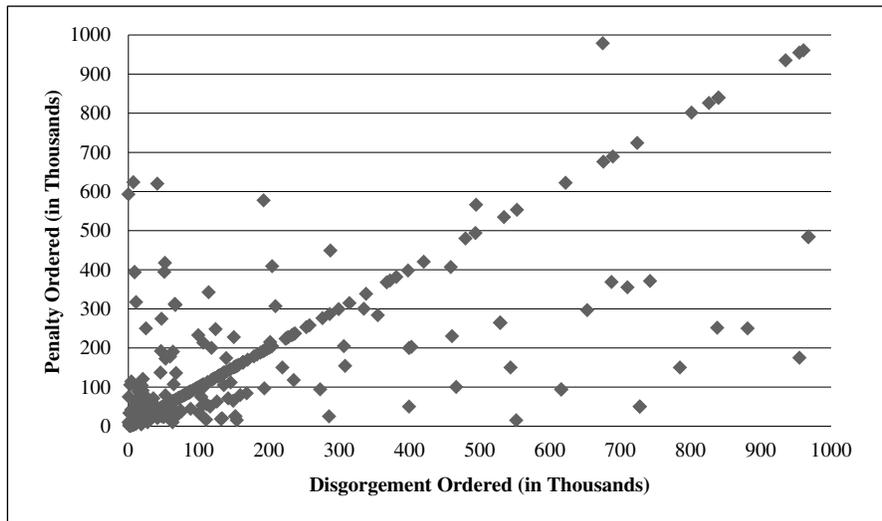
60. *See, e.g.*, Court Enters Final Judgment Against James J. McDermott and Kathryn B. Gannon, Exchange Act Release No. 19250 (June 7, 2005), <https://www.sec.gov/litigation/litreleases/lr19250.htm> [<https://perma.cc/YH9G-RZM6>] (holding Gannon liable for disgorgement and prejudgment interest, but noting that they “waived payment of disgorgement and prejudgment interest and did not order her to pay a civil penalty” because of financial condition); Final Judgment As to Defendant Robert Y. Joo at 5, SEC v. Sibal et al, No. 05-cv-3133 (C.D. Cal. Jan. 9, 2006). As noted above, the study captures the amount of disgorgement ordered, regardless of waiver or offset. *See supra* notes 43–45 & accompanying text.

61. One caveat is that this treats disgorgement as a good measure of profit (or loss avoided) without taking into account one peculiarity of disgorgement in the insider trading context: that a tipper may be required to disgorge tippees' profits. *Kokesh v. SEC*, 137 S. Ct. 1635, 1639 (2017); *SEC v. Contorinis*, 743 F.3d 296, 303–04 (2d Cir. 2014).

62. Eleven defendants were ordered to pay exactly three times the disgorgement amount.

dian ratio of 1:1 and a standard deviation of 8.5.⁶³ The chart below examines the relationship between the amount of disgorgement ordered against a defendant and the size of the money penalty ordered against that defendant in the same action. It depicts actions in which penalties and disgorgement were each \$1 million or under.⁶⁴ Each point (x,y) represents the monetary remedies ordered in an insider trading action. The disgorgement amount is x and the penalty amount ordered in the same action against the same defendant is y . The figure is limited to defendants who were ordered to pay both civil money penalties and disgorgement, including those who were jointly liable.⁶⁵ The diagonal line shows orders where the ratio of the penalty to disgorgement was 1:1. The concentration of points in the lower left reflects the large proportion of low value awards.

Figure 3: Relationship Between Money Penalties and Disgorgement ($\leq \$1M$)



63. Joint orders are included. Excluded from this calculation are three instances in which large penalties were ordered while disgorgement was ordered in a nominal amount (\$1, \$1, \$2), with ratios of penalty to disgorgement above 200,000 to 1. Excluding these amounts, the range was from a minimum ratio of .03 to 1 to a maximum of 147.1 to 1.

64. Approximately 87% (459/527) of all of the defendants ordered to pay both disgorgement and penalties (including jointly liable defendants) are in this category (disgorgement and penalty amounts of \$1 million or less). Figure 3 is limited to amounts of \$1 million or less so that the patterns are visible, but similar patterns are observed if all defendants are included.

65. Jointly liable defendants appear as a single point if disgorgement and money penalty were both ordered jointly. However, some defendants were ordered to pay disgorgement jointly but separate penalty amounts or vice versa. *See, e.g.*, supra note 41 & accompanying text. In these instances, defendants appear as separate points that reflect the respective disgorgement and penalty amounts.

4. Prejudgment Interest

SEC rules provide for payment of prejudgment interest “on any sum required to be paid pursuant to an order of disgorgement,” although there may be exceptions.⁶⁶ The rule also details how the interest should be calculated, including the interest rate and quarterly compounding.⁶⁷

In many instances, granular information about the disgorgement amount and the amount of prejudgment interest was available either from Lexis Securities Mosaic or from the underlying litigation release or settlement document.⁶⁸ The study identified specific non-zero amounts of prejudgment interest for 559 orders of disgorgement.⁶⁹

The specific information about the prejudgment interest and the related disgorgement amount permits a rough calculation of the time period for which interest was charged. Calculations of compound interest often focus on figuring out a final dollar amount based on what is known about the initial dollar amount, the rate of interest, the compounding method, and the time period over which the interest is paid. Here, the specific disgorgement and prejudgment interest amounts provide the initial and final amounts,⁷⁰ and SEC rules prescribe the interest rates and method of compounding. The only information missing is the time period for which interest was charged, but because all the other variables are known or can be estimated, that can be calculated using the equation for compound interest.⁷¹

The rough calculation using the data in this study suggests that when interest is charged, it is not generally being charged for periods going back beyond five years. By this measure, only 2% of the total interest reported appeared to reach back to periods over five years.⁷² These results have the potential to provide an approximate indication of the time between the conduct and the date of the disgorgement order: the SEC

66. SEC Rule of Practice 600, 17 C.F.R. § 201.600; 29A Fed. Proc., L. Ed. *Prejudgment Interest* § 70:420, Westlaw (2018).

67. The rule cross-references interest rates in the Internal Revenue Code. It uses the underpayment rate of interest: federal short term rate plus three percentage points. I.R.C. § 6621(a)(2) (1998). The IRS publishes its underpayment rates, including a chart of historic rates. See I.R.S. Rev. Rul. 2018-07.

68. Information about the interest was not always included in the Lexis Securities Mosaic defendant database or the litigation release. See LEXIS SEC. MOSAIC, <https://www.lexisnexis.com/en-us/products/lexis-securities-mosaic.page> [<https://perma.cc/4WUZ-5X4B>]. Where the database said “no amount was given” or reported combined monetary remedies only, the underlying settlement agreement was reviewed.

69. Joint disgorgement orders were counted only once. For 67 instances when disgorgement was ordered (excluding joint orders), the amount of prejudgment interest was 0.

70. The disgorgement amount is the initial amount, and disgorgement plus prejudgment interest is the final amount.

71. This calculation uses this formula: $S_t = S_i(1+\bar{p})^N$ where S_t is the amount of disgorgement plus interest announced at the time of the disgorgement order; S_i is the amount of disgorgement ordered, \bar{p} is the average interest rate and N is the unit of time. To find the number of units of time that have passed, the formula $N\log(1+\bar{p}) = \log(S_t/S_i)$ is used.

72. Using a 3% average interest rate (the lowest IRS corporate underpayment rate for the whole period of the study, which accordingly results in the longest time frames), interest was charged for less than one year for 48% of defendants (270/559), for one to five years for 50% (279/559), and for over five years for only 2% of defendants (10/559).

rule measures interest from the first day of the month following the violation to the last day of the month before disgorgement is paid.⁷³

There are many caveats about this calculation: The interest rate used here is estimated and averaged. The SEC rule calls for interest to be calculated for the period between conduct and judgment, but this may not be coextensive with the time period at issue for other purposes—including the time period relevant to calculating the statute of limitations. The SEC may adjust interest amounts for other reasons.⁷⁴ Nonetheless, these prejudgment interest amounts may be a fruitful area for inquiry, either for what they indicate about the enforcement timeframe or what they suggest about agency practices.

IV. IMPLICATIONS AND CONCLUSION

The data confirm that disgorgement was ordered in the vast majority of SEC insider trading actions. As noted above, disgorgement was ordered against 93% of the defendants who had to pay monetary remedies⁷⁵ and 87% of all of the insider trading defendants who resolved actions during the study's time period.⁷⁶

The data also confirm that the practice of ordering equal amounts of disgorgement and money penalties (“one plus one”) was common. Where both disgorgement and penalties were ordered, more than half of the defendants (56%) were ordered to pay “one plus one.” This percentage suggests, however, that the practice was not uniform across the board.⁷⁷

The relationship between penalties and disgorgement may also shed light on one of the questions that *Kokesh* raises: If *Kokesh* were to destabilize the use of disgorgement altogether, could the agency reach the same result with penalties alone? In other words, could the agency reach the same amounts by using money penalties as a substitute?

In the insider trading context, the limit on penalties in district court is tagged to the amounts of profit (or loss avoided).⁷⁸ In particular, penalties may be up to three times the profit (or loss avoided).⁷⁹ Very few of the penalty amounts in this study were that high. If disgorgement is a good measure of the amount of profit or loss avoided,⁸⁰ that suggests that

73. SEC Rule of Practice 600, 17 C.F.R. § 201.600.

74. *See, e.g.*, Final Judgment As to Joseph J. Donohue, SEC v. Decinces, 11-cv-1168 (C.C. Ca. Aug. 9, 2011) (“[B]ased on defendant’s agreement to cooperate in a Commission investigation and/or related enforcement action, the Court is not ordering Defendant to pay prejudgment interest”).

75. The SEC ordered 748 defendants to pay monetary remedies; 695 of these were ordered to pay disgorgement, either jointly or individually.

76. The study identified 798 defendants who resolved SEC insider trading actions from SEC FY2005 to FY2015; 695 of these were ordered to pay disgorgement, either jointly or individually.

77. An examination of the relationship between the type of remedy ordered and the specific characteristics of the case or defendant—including the defendant’s place in the tipping chain—is beyond the scope of this study. It is a worthwhile area for further study.

78. Securities and Exchange Act of 1934 § 21A, 15 U.S.C. § 78u-1 (2012).

79. *Id.*

80. *See supra* note 61.

there may be room for increasing penalty amounts. This assumes, however, that *Kokesh's* application of the five-year limit to disgorgement does not affect the underlying benchmark for figuring out penalty amounts.⁸¹

Perhaps the agency could use money penalties as a substitute for disgorgement, maintaining the same payment amounts by shifting the category of monetary remedy. However, different remedies may trigger different collateral consequences for the defendant and for the agency (e.g., tax treatment,⁸² availability of funds for distribution to injured investors,⁸³ triggering prejudgment interest, etc.).

The second question raised by *Kokesh* is how much SEC practices would be affected by *Kokesh's* directive to apply the five-year statute of limitations to disgorgement. This study does not answer that directly, although it begins to map out a way to use the prejudgment interest amounts as an indicator of the timeframe. Preliminary calculations based on this measure suggest that the SEC charged very few defendants interest for more than five years.

In general, the study reported here provides a baseline for assessing what past agency practices may have to change in light of the newly imposed statute of limitations in *Kokesh*. And to map the path since disgorgement was first introduced in *Texas Gulf Sulphur*.

81. See *Kokesh v. SEC*, 137 S.Ct. 1635, 1638 (2017).

82. Disgorgement used to be deductible in taxes, but post-*Kokesh*, the IRS has signaled that it will revisit this question now that the U.S. Supreme Court has characterized both civil penalties and disgorgement as “penalties,” at least in the context of the statute of limitations.

83. Before a change in the law in Dodd-Frank, some disgorgement was required if the agency wanted to direct funds to injured investors so that they could create a disgorgement fund and aggregate the monetary penalties. See *supra* note 55.