No.

IN THE

Supreme Court of the United States

ALFRED S. TEO, SR. AND MAAA TRUST,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

PETITION FOR A WRIT OF CERTIORARI

ERIC CORNGOLD
MARY E. MULLIGAN
MICHAEL S. PALMIERI
FRIEDMAN, KAPLAN, SEILER & ADELMAN
7 Times Square
New York, NY 10036
(212) 833-1100

THEODORE B. OLSON
Counsel of Record
AMIR C. TAYRANI
SCOTT G. STEWART
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 955-8500
tolson@gibsondunn.com

Counsel for Petitioners

QUESTION PRESENTED

Whether a court in a Securities and Exchange Commission civil enforcement action can order defendants to disgorge profits that were not attributable to their violations of the securities laws but were instead earned as a result of an intervening event unrelated to those violations.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

In addition to the parties named in the caption, Teren Seto Handelman, John D. Reier, Charles D. Fortune, Jerrold J. Johnston, Mark J. Lauzon, Philip Sacks, Mitchell L. Sacks, Richard A. Herron, Lawrence L. Rosen, David M. Ross, and James M. Ruffolo were defendants in the district court. The United States was an intervenor in the district court.

Pursuant to this Court's Rule 29.6, undersigned counsel state that petitioner MAAA Trust is not a corporation; it is an irrevocable trust, and has no parent corporation.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

REGULATIONS

OTHER AUTHORITIES

PETITION FOR A WRIT OF CERTIORARI

Petitioners Alfred S. Teo, Sr., and the MAAA Trust respectfully submit this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit.

OPINIONS BELOW

The opinion of the court of appeals is published at 746 F.3d 90. Pet. App. 1a. The court of appeals' order denying rehearing en banc is unreported. *Id.* at 83a. The opinion of the district court ordering disgorgement is unreported but is available at 2011 WL 4074085. *Id.* at 50a.

JURISDICTION

The court of appeals filed its opinion on February 10, 2014, and denied a timely petition for rehearing en banc on March 7, 2014. On May 21, 2014, Justice Alito granted an extension of time for filing a petition for a writ of certiorari until July 5, 2014. No. 13A1134. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

Sections 10(b) and 13(d) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78m(d), and Rules 10b-5, 13d-1, and 13d-2, all promulgated thereunder, 17 C.F.R. §§ 240.10b-5, 240.13d-1, 240.13d-2, are reproduced in the appendix to this petition.

STATEMENT

This case presents a frequently recurring question regarding the limitations on disgorgement in civil enforcement actions filed by the Securities and Exchange Commission ("SEC"). In the decision below, a divided panel of the Third Circuit upheld an order requiring petitioners to disgorge more than $17 million in profits earned as a result of a tender offer that was unconnected to petitioners' securities-law violations. According to the Third Circuit, disgorgement was "proper and fair" because petitioners earned their tender-offer profits while failing to make unrelated disclosures to the SEC about the extent of their stockholdings. Pet. App. 34a. That boundless understanding of disgorgement conflicts with the decisions of four other courts of appeals, which have held that the SEC cannot use disgorgement to recover profits attributable to an intervening event with no connection to the defendants' securities-law violations. It also disregards the equitable limitations on disgorgement repeatedly recognized by this Court, and vastly expands the liability of defendants in SEC civil enforcement actions, who are now confronted with the possible disgorgement of profits untainted by any violation of the securities laws. This Court should grant review to clarify the scope of disgorgement in SEC civil actions and to restore the longstanding equitable limitations on this potentially potent remedy.

1. Petitioner Alfred S. Teo, Sr., is a businessman and investor. Pet. App. 2a. Raised in China, Mr. Teo arrived in the United States more than 40 years ago; over the next several decades, he built a plastic manufacturing business that now encompasses 36 factories across North America. C.A. J.A. 659-60, 663-64.

In 1992, Mr. Teo established the MAAA Trust, also a petitioner here, for the benefit of his four sons. Pet. App. 2a; C.A. J.A. 671-72. During the time relevant to this case, Mr. Teo beneficially owned the Trust, which held various securities. Pet. App. 2a.

In the late 1990s, petitioners bought significant amounts of stock in Musicland, a publicly traded retailer of home entertainment products. Pet. App. 2a-3a; C.A. J.A. 665-66, 1435. Petitioners made those purchases at a time when electronic options for downloading music were surging, which caused many investors to lose confidence in music retailers. *See* C.A. J.A. 669. Despite the growing investor disfavor toward such retailers, Mr. Teo believed in the value of Musicland's stock, and petitioners continued to purchase additional Musicland shares over the course of several years. C.A. J.A. 195, 234, 668-69.

When petitioners' beneficial ownership in Musicland exceeded five percent, they were required, under Section 13(d) of the Securities Exchange Act, 15 U.S.C. § 78m(d), to report information about their holdings in a Schedule 13D filing with the SEC. Pet. App. 3a & n.1. Schedule 13D requires filers to disclose, among other things, the identity of the purchaser (including beneficial owners) of the stock; the purpose of the purchases, including any plans or proposals to change the board of directors or to cause an extraordinary corporate transaction; and the interest of those making the filing. 17 C.F.R. § 240.13d-101.

In accordance with Section 13(d), Mr. Teo properly disclosed his Musicland holdings until July 1998. Pet. App. 3a. On July 30, 1998, he filed an amended Schedule 13D stating that he no longer possessed investment powers for the Trust. *Id.* Mr. Teo, however, continued to invest in Musicland on the Trust's behalf, and a jury subsequently found that, in the period after July 30, 1998, he underreported his ownership percentage in Musicland, both petitioners filed false Schedule 13D disclosures, and petitioners did not make required Schedule 13D disclosures. *Id.* at 3a-4a.

During that underreporting period, Musicland had a shareholder rights plan (or "poison pill") that, if triggered, would have enabled shareholders to buy stock at a lower price to dilute a potential hostile buyer's holdings. Pet. App. 3a. Musicland's board of directors could activate the poison pill when an individual or group came to own 17.5 percent of the company's stock. *Id.* In SEC filings, Mr. Teo stated that his ownership percentage in Musicland remained below the 17.5-percent threshold, even though petitioners' holdings eventually exceeded that amount. *See id.* at 3a-4a. Musicland did not activate its poison pill. *Id.* at 4a.

In approximately August 2000, executives from Musicland and Best Buy Co. began speaking about a potential acquisition of Musicland by Best Buy. *See* C.A. J.A. 318. Mr. Teo did not learn about the potential acquisition until later. *See id.* The two companies ultimately negotiated a tender-offer agreement under which Best Buy would pay a substantial premium for Musicland shares if at least two-thirds of outstanding shares were tendered. Pet. App. 5a; C.A. J.A. 338. Mr. Teo was not involved in negotiating that agreement. *See* C.A. J.A. 318.

Musicland publicly disclosed the tender-offer agreement in December 2000. Pet. App. 5a; C.A. J.A. 337, 1663. After that announcement, Musicland's stock price increased by more than fifty percent. Pet. App. 5a; *compare* C.A. J.A. 1663 (tender-offer price of $12.55 per share), *with* C.A. S.A. 110 (pre-tender-offer price of $8.00 per share). The next month, Best Buy acquired all of Musicland's shares. Pet. App. 5a. Like other shareholders who had invested in Musicland before the tender offer was announced, petitioners made substantial profits from selling their holdings in connection with the tender offer. *See id.*

2. In April 2004, the SEC filed a civil enforcement action against petitioners, alleging violations of (among other provisions) Sections 10(b) and 13(d) of the Exchange Act and rules implementing those provisions. Pet. App. 5a. (The federal government had previously abandoned criminal counts charging Mr. Teo with violating Section 13(d). *See* Plea Agreement, Dkt. Entry 184, at 1, *United States v. Teo*, No. 04-CR-583 (KSH) (D.N.J.).) A jury found that, among other things, Mr. Teo violated Section 10(b) and Rule 10b-5, and that both petitioners violated Section 13(d), Rule 13d-1, and Rule 13d-2. Pet. App. 5a.

On the SEC's motion, the district court ordered petitioners to disgorge $17,422,054—their full profits (less, primarily, margin interest) earned in connection with the Best Buy tender offer from shares acquired after July 30, 1998, the date of the first reporting violation. *See* Pet. App. 6a & n.4, 77a-79a. The district court rejected petitioners' argument that disgorgement was improper because petitioners' profits were not attributable to their securities-law violations but were instead caused by an intervening event unrelated to those violations—the Best Buy tender offer. *See id.* at 62a-63a. The district court also granted injunctive relief, ordered petitioners to pay $14,649,035 in pre-judgment interest on the disgorged profits, and ordered petitioners to pay a civil penalty equal to the disgorgement amount—a further $17,422,054. *Id.* at 78a-79a.

3. A divided panel of the Third Circuit affirmed. The majority held that intervening-causation princi-

ples apply only "with considerable qualification" to disgorgement in SEC civil enforcement actions. Pet. App. 23a. In particular, the majority concluded that "evidence of an intervening cause . . . is not dispositive" of whether a defendant may be required to disgorge profits earned after a securities-law violation. *Id.* at 31a. Instead, "giving consideration to the elimination of unjust enrichment and the deterrent impact this action might have in furthering future compliance with the Securities Exchange Act," a district court may, "in equity," "attribut[e]" a defendant's profits to the securities-law violation even where the profits were earned as a result of an intervening event. *Id.* at 31a, 34a.

Applying those principles, the majority upheld the disgorgement order in its entirety—despite record evidence showing that Musicland's "stock price rose after the [Best Buy] tender offer announcement," Pet. App. 5a, and that petitioners "did not bring [the tender offer] about," *id.* at 33a. The majority reasoned that, "in the context of an SEC civil enforcement action, whether [petitioners'] profit resulted directly—from a causal perspective—from the wrongdoing or from the operation of dumb luck is not dispositive on the question of whether it is proper and fair to regard those profits as tainted by the wrongdoing." *Id.* at 34a. According to the majority, "the District Court guarded against an overreach that would have transformed the award into a punitive measure" by limiting disgorgement to profits on shares acquired after petitioners' first reporting violation. *Id.* at 35a.

Dissenting in part, Judge Jordan argued that the disgorgement order was improper. "Because there is no legitimate dispute that Best Buy's tender offer was independent of [petitioners'] securities law violations," Judge Jordan explained, "the profits on their sale of Musicland stock that are solely attributable to Best Buy's tender offer should not be subject to disgorgement." Pet. App. 38a (Jordan, J., dissenting in part). Disgorgement, he emphasized, "is not an all-or-nothing matter": "only the extent of profits with a causal connection to the wrongdoing—*i.e.*, the ill-gotten gains—are subject to disgorgement." *Id.* at 41a. The majority and the district court, Judge Jordan explained, did not "appropriately accoun[t] for the Best Buy tender offer," which caused an "admitted premium" on Musicland shares, *id.* at 42a, 43a, and bore "no relationship to [petitioners'] securities violations," *id.* at 44a. "[B]y failing to limit disgorgement to ill-gotten gains," Judge Jordan concluded, the majority "effectively endorse[d] a penalty assessment." *Id.* at 49a.

4. The Third Circuit denied rehearing en banc. Pet. App. 84a. Judges Ambro and Jordan would have granted rehearing en banc. *Id.*

REASONS FOR GRANTING THE PETITION

The Third Circuit's decision endorses a limitless conception of disgorgement that conflicts with the decisions of four other circuits, disregards the settled equitable limitations on disgorgement, and exposes defendants in SEC civil enforcement actions to staggering liability untethered to the scope of their violations.

The circuits have adopted sharply different views on the question whether defendants in SEC civil enforcement actions can be ordered to disgorge profits earned as a result of intervening events unrelated to their securities-law violations. Four courts of appeals—the First, Second, Tenth, and D.C. Circuits—have held that district courts cannot disgorge profits attributable to intervening events that break the causal connection between the defendants' securities-law violations and their profits. *See*, *e.g.*, *SEC v. MacDonald*, 699 F.2d 47, 54 (1st Cir. 1983) (en banc). The Third Circuit, in contrast, has held that intervening causes are "not dispositive on the question of whether it is proper and fair to regard [a defendant's] profits as tainted by the wrongdoing," Pet. App. 34a, and ordered petitioners to disgorge profits earned as a result of a tender offer that had *no connection* to their securities-law violations.

That holding not only conflicts with the decisions of other courts of appeals, but also fails to adhere to the longstanding equitable limitations on disgorgement recognized by this Court and other courts. This Court has emphasized that disgorgement is "restitutionary," *Chauffeurs, Teamsters & Helpers Local No. 391 v. Terry*, 494 U.S. 558, 570 (1990), and may not be used to "exac[t] punishment." *Tull v. United States*, 481 U.S. 412, 422 n.7 (1987). Lower courts have similarly explained that disgorgement is "focused on remedying the effects of past conduct," rather than deterring future wrongdoing. *United States v. Philip Morris USA Inc.*, 396 F.3d 1190, 1198 (D.C. Cir. 2005). The Third Circuit, however, upheld the disgorgement order in this case not to remedy the effects of petitioners' Section 13(d) disclosure violations, but to promote "the deterrent impact [of] this action." Pet. App. 34a. In so doing, the Third Circuit imposed a punitive sanction that extracts millions of dollars of petitioners' legitimately earned profits.

The permissible scope of disgorgement has profound financial implications for the hundreds of defendants that the SEC targets each year in civil enforcement actions, which annually yield hundreds of millions of dollars in disgorgement recoveries for the SEC. This Court has repeatedly emphasized the need for well-defined limits on actions enforcing the federal securities laws. *See*, *e.g.*, *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177-78, 191 (1994). Such limits are particularly important in the disgorgement setting, where it is critical for lower courts to know what gains qualify as ill-gotten and may be disgorged—and what gains a defendant is entitled to keep. The general equitable limitations on disgorgement, however, have proven to be an inadequate guide for lower courts and have failed to prevent the SEC from using disgorgement to recover profits unconnected to any violation of the securities laws. Indeed, the Third Circuit purported to agree in this case with the well-settled principle that disgorgement may not be used punitively, but nevertheless upheld an onerous disgorgement order that deprives petitioners of their lawfully earned, untainted profits. Only this Court can restore reasonable, nationally uniform limitations on the scope of disgorgement in SEC civil actions.

I. THE COURTS OF APPEALS ARE DIVIDED OVER WHETHER AN INTERVENING CAUSE BETWEEN A SECURITIES-LAW VIOLATION AND A DEFENDANT'S PROFITS PRECLUDES DISGORGEMENT OF THOSE PROFITS.

The Third Circuit upheld an order requiring petitioners to disgorge all profits (less, primarily, margin costs) on the shares they acquired after their disclosure violations began on July 30, 1998, despite an intervening event—the Best Buy tender offer—that broke the causal connection between petitioners' violations and profits. That decision conflicts with the holdings of four other courts of appeals, which have held in SEC civil enforcement actions that district courts cannot order disgorgement of profits that were attributable to an intervening event unrelated to the defendant's securities-law violations. This Court's review is warranted to resolve that conflict.

A. The Second Circuit has long limited disgorgement in SEC civil enforcement actions based on principles of intervening causation. In *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972), the Second Circuit held that a district court erred in ordering the defendants to disgorge not only profits earned from violating the securities laws but also "income earned on such proceeds." *Id.* at 1104 (emphasis omitted). The defendants in that case had induced investors to buy shares in a nursing home by promising that their funds would be returned if all shares were not sold by a specified date. *Id.* at 1089-90. Through false transactions, the defendants made it appear that the full offering had been sold before the deadline. *Id.* at 1090-93. The defendants reaped substantial profits from the fraudulent offering, *id.* at 1093-94, and some of the defendants thereafter invested that money and earned additional profits on those investments. *Id.* at 1094, 1104-05. The district court ordered the defendants to disgorge all of their profits—including profits earned on the subsequent investments. *Id.* at 1103-04.

The Second Circuit held that the district court had authority to order the defendants to disgorge the initial profits they obtained from funds invested in the fraudulent offering, but refused to extend disgorgement to the income earned from investing those illegal profits. *Manor Nursing*, 458 F.2d at 1104. The court acknowledged that "compelling the transfer of the profits on the proceeds might add to the deterrent effect of the court's order," but concluded that this policy goal "d[id] not justify arbitrarily requiring those [defendants] who invested wisely to refund" their investment income. *Id.* at 1104-05. The Second Circuit therefore remanded for the district court to modify the disgorgement order to require the defendants to disgorge "only the proceeds received in connection with the . . . offering." *Id.* at 1105.

The First Circuit has likewise limited disgorgement to profits "causally related to [a defendant's] fraud" and excluded profits earned "because of other developments." *SEC v. MacDonald*, 699 F.2d 47, 52, 54 (1st Cir. 1983) (en banc) (internal quotation marks omitted). In *MacDonald*, the defendant bought stock in December 1975 based on illegal insider information—100 shares at $4.25 per share and 9500 shares at approximately $4.63 per share. *Id.* at 48. "[T]he essence of defendant's inside information was made public" later that same month, and thus "any changes in the market . . . a fairly reasonable period of time after [that point] were because of other developments." *Id.* at 52 (internal quotation marks omitted). The defendant held that stock until 1977, when he sold it at an average price of more than $10 per share. *Id.* at 49. The district court ordered the defendant to disgorge all profits made on that sale. *Id.* at 52.

The First Circuit, sitting en banc, reversed the disgorgement order and directed the district court on remand to limit disgorgement based on the price of the stock "a reasonable time after public dissemination of the inside information." *MacDonald*, 699 F.2d at 55. The First Circuit reasoned that "[w]hen a fraudulent buyer has reached the point of his full gain from the fraud"—"viz., the market price a reasonable time after the undisclosed information has become public"—"any consequence of a subsequent decision, be it to sell or to retain the stock, is . . . not causally related to the fraud." *Id.* at 54. Like the Second Circuit in *Manor Nursing*, the First Circuit "[g]ranted that it may add to the deterrent effect of the Act every time the Commission conceives of a ground for assessing greater liability," but concluded that requiring defendants to disgorge profits not causally related to their securities-law violations "does not . . . meet any definition of 'equitable.'" *Id.*

Similarly, in *SEC v. First City Financial Corp.*, 890 F.2d 1215 (D.C. Cir. 1989), the D.C. Circuit also held that disgorgement must be limited to account for intervening events. The defendants in *First City* bought shares in an issuer as part of a takeover effort, but violated Section 13(d) when they failed to file timely disclosures after they obtained more than five percent of the issuer's equity shares. *Id.* at 1217-20. After their takeover bid failed, the defendants agreed with the issuer to sell back their shares, which netted them $15.4 million in profits. *Id.* at 1220. The district court ordered the defendants to disgorge about $2.7 million of that amount, which represented all of the profits on the shares that they had acquired while violating Section 13(d). *Id.* at 1220-21.

The D.C. Circuit concluded that the SEC had reasonably approximated the amount by which the defendants had been unjustly enriched, but held that a defendant is entitled to rebut that showing "by pointing to intervening events from the time of the violation." *First City*, 890 F.2d at 1232. Relying on *Manor Nursing* and *MacDonald*, the D.C. Circuit explained that disgorgement must be limited where "the defendant demonstrated a clear break in or considerable attenuation of the causal connection between the illegality and the ultimate profits." *Id.*

The D.C. Circuit reasoned that, while "[t]he [disgorgement] remedy may well be a key to the SEC's efforts to deter others from violating the securities laws, . . . disgorgement may not be used punitively." *Id.* at 1231. Thus, a defendant may not be required to disgorge profits that are "independent of" his wrongdoing. *Id.* at 1232. Applying those principles, the D.C. Circuit upheld the disgorgement order because "none of the four factors" that the defendants posited as the cause of their profits was in fact "independent of the section 13(d) disclosure" violation. *Id.*

Most recently, the Tenth Circuit agreed that district courts must limit disgorgement in SEC civil enforcement actions based on intervening causes. In *SEC v. Maxxon, Inc.*, 465 F.3d 1174 (10th Cir. 2006), the district court ordered the defendants to disgorge profits obtained as a result of an increase in stock price caused by false statements the defendants made in an October 1998 press release. *Id.* at 1176-78. On appeal, the defendants argued that the district court did not account for principles of intervening causation because it did not set an end-date for their wrongdoing—and thus a date after which profits would be independent of their securities-law violations. *Id.* at 1179.

The Tenth Circuit agreed that "some . . . determination" of the "end-date" of a securities-law violation "is certainly necessary so that the defendant is not required to disgorge profits not causally connected to the violation." *Maxxon*, 465 F.3d at 1179 (internal quotation marks omitted). It nevertheless upheld the disgorgement order because "the district court *did* determine an end-date"—"the date on which it found [that the defendants] first sought to correct some of their misleading statements." *Id.* (internal quotation marks omitted). In so doing, the district court had properly limited disgorgement to the period before the "causa[l] connect[ion]" between the defendants' violations and their profits was broken. *Id.* (internal quotation marks omitted).

B. The Third Circuit, in contrast, has refused to limit disgorgement based on principles of intervening causation. The court of appeals upheld the district court's disgorgement order in this case despite petitioners' showing that they "did not bring [the Best Buy tender offer] about," Pet. App. 33a (majority opinion); *see also id.* at 38a (Jordan, J., dissenting in part), and that Musicland's "stock price rose after the tender offer announcement." *Id.* at 5a (majority opinion); *see also id.* at 42a-43a (Jordan, J., dissenting in part). Indeed, the court of appeals acknowledged that "[t]he Best Buy tender offer" was—at the very *least*—"likely one cause of [petitioners'] profits." *Id.* at 34a (majority opinion). Judge Jordan similarly emphasized that the Best Buy tender offer was "clearly an independent and intervening event" between petitioners' securities-law violations and their profits that "bears no relationship to [petitioners'] securities violations." *Id.* at 44a (Jordan, J., dissenting in part). The court of appeals nevertheless concluded that "evidence of an intervening cause . . . is not dispositive" of whether the SEC's estimated disgorgement amount is improper, and that a court may, "in equity," "attribut[e]" profits to the defendant's violations and order those profits disgorged based on "the deterrent impact this action might have in furthering future compliance with the Securities Exchange Act." *Id.* at 31a, 34a (majority opinion).

The First, Second, Tenth, and D.C. Circuits would have rejected the sweeping disgorgement order upheld by the Third Circuit. Each of those circuits would have held that petitioners could be required to disgorge "only the proceeds received in connection with" their securities-law violations, *Manor Nursing*, 458 F.2d at 1105, and thus that the district court erred in ordering them to disgorge profits that were earned "because of other developments." *MacDonald*, 699 F.2d at 52 (internal quotation marks omitted); *see also First City*, 890 F.2d at 1232; *Maxxon*, 465 F.3d at 1179. Defendants in the Third Circuit are therefore confronted with the specter of disgorgement orders that are far broader—and vastly more onerous—than those that the SEC could secure in other circuits. This Court should grant review to establish a single, nationally uniform rule governing the role of intervening cause in SEC disgorgement actions.

II. THE DECISION BELOW DISREGARDS THE EQUITABLE LIMITATIONS ON DISGORGEMENT RECOGNIZED BY THIS COURT AND OTHER COURTS.

This Court has repeatedly instructed lower courts to "rejec[t]" "expansive view[s] of equity," and instead to take a "cautious approach to equitable powers, . . . leav[ing] any substantial expansion of past practice to Congress." *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 321, 329 (1999). The Third Circuit's limitless conception of disgorgement cannot be reconciled with the restrained "approach to equitable powers"—and to disgorgement, in particular—adopted by this Court and other courts.

This Court has expressly limited disgorgement to profits that are attributable to the defendants' wrongdoing. In *Sheldon v. Metro-Goldwyn Pictures Corp.*, 309 U.S. 390 (1940), for example, it upheld a judgment disgorging only twenty percent of the profits the defendants had earned on a movie that infringed the plaintiffs' copyright because the defendants' non-infringing efforts had generated the bulk of the profits. *See id.* at 398, 408-09. The Court dismissed the plaintiffs' position—that apportionment was inappropriate and full disgorgement was required—as "untenable" in light of settled equitable limitations on an "accounting" for profits (another term for a disgorgement demand, *see SEC v. Cavanagh*, 445 F.3d 105, 116 (2d Cir. 2006)). *Sheldon*, 309 U.S. at 398. The Court emphasized that such "relief had been given in accordance with the principles governing equity jurisdiction" and was ordered "not to inflict punishment but to prevent an unjust enrichment by allowing injured complainants to claim that which . . . is theirs, and nothing beyond this." *Id.* at 399 (internal quotation marks omitted).

The Court therefore rejected the proposition that "[a] court may make an award of profits which have been shown not to be due to the infringement." *Sheldon*, 309 U.S. at 405. Rather, a court can order recovery of "the profits which the infringer shall have made *from* [*the*] *infringement*," *id.* at 402 (emphasis added; internal quotation marks omitted), but not "profits which have been shown not to be due to the infringement," *id.* at 405. Allowing recovery of profits that resulted from the infringers' own ingenuity—the value that they legitimately added to the copyrighted work—"would be not to do equity but to inflict an unauthorized penalty." *Id.* "Equity," the Court emphasized, "is concerned with making a fair apportionment so that neither party will have what justly belongs to the other." *Id.* at 408. Indeed, it would be a "manifest injustice" to disgorge "all the profits made by the [defendant]" when not all of those profits are attributable to the defendant's wrongdoing. *Id.*

Since *Sheldon*, this Court has repeatedly reaffirmed that "disgorgement of improper profits . . . is a remedy only for restitution" and is therefore "limited to restoring the status quo and ordering the return of that which rightfully belongs to the [victim]." *Tull v. United States*, 481 U.S. 412, 424 (1987) (internal quotation marks omitted); *see also Chauffeurs, Teamsters & Helpers Local No. 391 v. Terry*, 494 U.S. 558, 570 (1990) (disgorgement is "restitutionary"). In ordering disgorgement, a court may not "exac[t] punishment"—by, for example, "further[ing] retribution and deterrence." *Tull*, 481 U.S. at 422 n.7, 423. The court is instead required to make an "equitable determinatio[n]" of "the profits gained from violations of the statute." *Id.* at 422.

Lower courts have similarly recognized that disgorgement is an equitable form of relief that is limited to remedying wrongdoing and does not extend to punishing wrongdoers. The D.C. Circuit has explained, for example, that disgorgement of ill-gotten gains "is a quintessentially backward-looking remedy focused on remedying the effects of past conduct." *United States v. Philip Morris USA Inc.*, 396 F.3d 1190, 1198 (D.C. Cir. 2005). Because disgorgement is designed to "restore the status quo," it "is measured by the amount of prior unlawful gains and is awarded without respect to whether the defendant will act unlawfully in the future." *Id.* (citing *Tull*, 481 U.S. at 424). Disgorgement is not, the D.C. Circuit has made clear, a deterrent measure but is instead "aimed at . . . *past* conduct." *Id.*

Emphasizing the remedial purpose of disgorgement, other courts of appeals have similarly recognized that a disgorgement order must "depriv[e]" wrongdoers only of "the gains of their wrongful conduct." *SEC v. Tex. Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir. 1971). As the Fifth Circuit has explained, "[t]he court's power to order disgorgement extends only to the amount with interest by which the defendant profited *from his wrongdoing*," *SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (emphasis added)—that is, the amount he "received for [his] role in the [wrongdoing]" (*id.* at 1336) and "by which he was" thus "unjustly enriched" (*id.* at 1335). A district court ordering disgorgement must therefore ensure that a defendant retains "all the profits" not attributable to his wrongdoing. *Tex. Gulf Sulphur Co.*, 446 F.2d at 1308.

The Third Circuit's decision defies these equitable limitations on disgorgement and improperly transforms this quintessentially equitable remedy into a punitive measure. The Third Circuit upheld an order that "exact[ed] punishment" on petitioners (*Tull*, 481 U.S. at 422 n.7) by requiring them to disgorge far more than the profits "made *from* [their securities-law violations]." *Sheldon*, 309 U.S. at 402 (emphasis added; internal quotation marks omitted); *see also Blatt*, 583 F.2d at 1335; *Tex. Gulf Sulphur Co.*, 446 F.2d at 1308. Although the Third Circuit insisted that the district court's disgorgement order was not punitive, Pet. App. 35a, it required petitioners to disgorge the profits they earned as a result of the Best Buy tender offer, an independent, intervening event unrelated to their failure to submit proper Schedule 13D disclosures. *Id.* at 34a-35a; *id.* at 38a, 44a (Jordan, J., dissenting in part). The Third Circuit therefore did not provide "a remedy only for restitution," *Tull*, 481 U.S. at 424, but instead "inflict[ed] an unauthorized penalty" that disgorged legitimate profits unconnected to a violation of the securities laws. *Sheldon*, 309 U.S. at 405.

The punitive nature of the disgorgement order in this case is underscored by the Third Circuit's reliance on deterrence as the principal justification for the order. The court of appeals maintained, for example, that deterrence "underl[ies] the disgorgement remedy" and "must always weigh heavily in the court's consideration of whether particular profits are legally attributable to the wrongdoing." Pet. App. 31a; *see also*, *e.g.*, *id.* at 34a (a court must "giv[e] consideration to . . . the deterrent impact [a disgorgement order] might have in furthering future compliance with the Securities Exchange Act"). This Court has made clear, however, that "[r]etribution and deterrence are *not* legitimate nonpunitive governmental objectives." *Bell v. Wolfish*, 441 U.S. 520, 539 n.20 (1979) (emphasis added). Rather, an effort "to further retribution and deterrence clearly evidences . . . more than a concern to provide equitable relief." *Tull*, 481 U.S. at 423. Because a court may not "exac[t] punishment" through disgorgement, *id.* at 422 n.7, the Third Circuit's deterrence-driven holding cannot be squared with the fundamental limitations on disgorgement that this Court and other courts have recognized.

III. THE QUESTION PRESENTED HAS PROFOUND IMPLICATIONS FOR DEFENDANTS IN SEC CIVIL ENFORCEMENT ACTIONS.

The permissible scope of disgorgement in SEC civil enforcement actions has far-reaching consequences for defendants targeted by the SEC, who—in the absence of intervention by this Court—will continue to face punitive exactions of legitimate profits unconnected to any violation of the securities laws.

This Court has repeatedly emphasized the importance of reasonable, well-defined limits on actions enforcing the federal securities laws. *See*, *e.g.*, *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177-78, 191 (1994); *Aaron v. SEC*, 446 U.S. 680, 695 (1980); *SEC v. Sloan*, 436 U.S. 103, 116 (1978). The Court has rarely had occasion, however, to address the limits on district courts' equitable authority in SEC civil enforcement actions—and has never had the opportunity to provide explicit guidance to lower courts regarding the scope of disgorgement that may be ordered in such suits. To be sure, lower courts have recognized—in accordance with this Court's decisions addressing equitable relief in other settings—that disgorgement may be ordered only "so long as such relief is remedial relief and is not a penalty assessment." *Tex. Gulf Sulphur Co.*, 446 F.2d at 1308; *see also First City*, 890 F.2d at 1231; *Manor Nursing*, 458 F.2d at 1104; *Blatt*, 583 F.2d at 1335 ("Disgorgement is remedial and not punitive."). But that abstract principle has proven to be an unsure guide. Indeed, the Third Circuit purported to agree here that "the amount to be disgorged must be remedial rather than punitive," Pet. App. 32a n.31, but it upheld a drastically more onerous disgorgement order than would have been allowed in other circuits.

Nor is there any reasonable prospect of the lower courts' resolving this uncertainty without this Court's guidance. The Exchange Act does not explicitly authorize disgorgement in SEC civil enforcement actions. As a result, there is no statutory text to guide the lower courts in crafting disgorgement orders and to help ensure that the remedy is not applied "more broadly" than is "reasonabl[e]." *Sloan*, 436 U.S. at 116.

Clarity is especially important in the disgorgement setting. Because disgorgement extends to the full "amount of prior unlawful gains," *Philip Morris USA Inc.*, 396 F.3d at 1198, it is essential for lower courts to know what gains qualify as unlawful and thus may be disgorged and what gains a defendant is entitled to keep. According to the Third Circuit—but not the First, Second, Tenth, or D.C. Circuits—a gain is unlawful and subject to disgorgement simply because it was earned at the time the defendant was in violation of the securities laws, even if some other event was the cause of those profits. *See* Pet. App. 34a ("whether [petitioners'] profit resulted directly—from a causal perspective—from the wrongdoing or from the operation of dumb luck is not dispositive on the question of whether it is proper and fair to regard those profits as tainted by the wrongdoing"). The Third Circuit's refusal to apply principles of intervening causation threatens to expand disgorgement dramatically beyond any reasonable bounds. The decision inevitably will make even more potent a measure that already yields hundreds of millions of dollars in annual recoveries for the SEC in the hundreds of civil-enforcement actions it files each year in a wide array of settings—including insider trading, market manipulation, securities-offering violations, and violations of the Foreign Corrupt Practices Act.[1]

[1] *See* Securities and Exchange Commission, Select SEC and Market Data, Fiscal 2013, at 2-3 tbls.1, 2, *available at* http://www.sec.gov/about/secstats2013.pdf (disgorgement orders totaled $2.3 billion in fiscal year for civil and administrative enforcement actions); Securities and Exchange Commission, Select SEC and Market Data, Fiscal 2012, at 2-3 tbls.1, 2, *available at* http://www.sec.gov/about/secstats2012.pdf ($2.1 billion); Securities and Exchange Commission, Select SEC and

Clear limits on disgorgement are particularly critical in the SEC civil enforcement setting because the SEC is not confined by many of the limits that govern private actions under Section 10(b) of the Exchange Act: the SEC does not need to show reliance or loss causation to establish liability, it can bring aiding-and-abetting claims, it does not need to be a buyer or seller of securities, it can pursue certain extraterritorial violations, and it faces a more forgiving statute of limitations than private plaintiffs do. *See Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988) (reliance); 15 U.S.C. § 78u-4(b)(4) (loss causation); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-46 (2005) (same); 15 U.S.C. § 78t(e) (aiding and abetting); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 158, 162 (2008) (same); *Cent. Bank*, 511 U.S. at 177-78, 191 (same); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (buyer or seller requirement); 15 U.S.C. § 78aa(b) (extraterritorial violations); *Morrison v. Nat'l Australia Bank Ltd.*, 130 S. Ct. 2869, 2883 (2010) (same); 28 U.S.C. §§ 1658(b), 2462 (statutes of limitations). The need for this Court's review is thus all the more urgent because the Third Circuit's decision disregards one of the comparatively few limits that do apply in SEC civil enforcement actions.

[Footnote continued from previous page]

Market Data, Fiscal 2011, 2-3 tbls.1, 2, *available at* http://www.sec.gov/about/secstats2011.pdf ($1.9 billion); Securities and Exchange Commission, Select SEC and Market Data, Fiscal 2010, at 2-3 tbsl.1, 2, *available at* http://www.sec.gov/about/secstats2010.pdf ($1.8 billion); Securities and Exchange Commission, Select SEC and Market Data, Fiscal 2009, at 2-3 tbls.1, 2, *available at* http://www.sec.gov/about/secstats2009.pdf ($2.1 billion).

This case starkly illustrates the unfairness of jettisoning the intervening-cause limitation on disgorgement in SEC civil actions. Although "there [was] no legitimate dispute that Best Buy's tender offer was independent of [petitioners'] securities law violations" or that the tender offer caused an "admitted premium" on Musicland shares, Pet. App. 38a, 43a (Jordan, J., dissenting in part), the Third Circuit held that petitioners could be required to disgorge *all* profits (less, primarily, margin interest) obtained from selling their shares acquired after the reporting violations began—more than $17 million. Thus, even in a case where the defendant's profits clearly resulted from an intervening event, the Third Circuit's limitless approach to disgorgement would still authorize a district court to "attribut[e]" those profits to the defendant's wrongdoing as long as the court deemed that result "proper and fair." *Id.* at 31a, 34a (majority opinion).

The prospect of such unwarranted sanctions will inevitably compel many defendants to settle with the SEC rather than risk the imposition of an onerous disgorgement order—even when those defendants have earned a substantial portion of their profits legitimately. Such a draconian approach falls far outside the bounds of anything that could reasonably be considered fair or equitable.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ERIC CORNGOLD
MARY E. MULLIGAN
MICHAEL S. PALMIERI
FRIEDMAN, KAPLAN, SEILER & ADELMAN
7 Times Square
New York, NY 10036
(212) 833-1100

THEODORE B. OLSON
Counsel of Record
AMIR C. TAYRANI
SCOTT G. STEWART
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 955-8500
tolson@gibsondunn.com

Counsel for Petitioners

July 3, 2014