

12-1723-cv
SEC v. Contorinis

DENNY CHIN, *Circuit Judge*:

In this case, the district court ordered defendant-appellant Joseph Contorinis to "disgorge" \$7.2 million in "profits." The profits were not his, however, and the monies were never in his possession or control. Instead they were earned by the fund by which he was employed (the "Fund"). The majority nonetheless affirms. I respectfully dissent, for the district court's order is, in my view, inconsistent with both the nature and purpose of disgorgement as well as our decision in the related criminal case, *United States v. Contorinis*, 692 F.3d 136 (2d Cir. 2012).

Disgorgement is an equitable remedy that requires "a defendant to *give up* the amount by which *he* was unjustly enriched." *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996) (emphases added). Its primary purpose "is to deprive violators of their ill-gotten gains." *Id.* at 1474; *accord SEC v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997) ("As an exercise of its equity powers, the court may order wrongdoers to disgorge their fraudulently obtained profits."). The amount of disgorgement "is determined by the amount of profit realized by the defendant." *SEC v. AbsoluteFuture.com*, 393 F.3d 94, 96 (2d Cir. 2004); *accord*

SEC v. Cavanagh, 445 F.3d 105, 116 (2d Cir. 2006) ("The remedy consists of . . . the amount of money acquired through wrongdoing."). Disgorgement thus should have the effect of returning a defendant to his status quo prior to the wrongdoing, *SEC v. Tome*, 833 F.2d 1086, 1096 (2d Cir. 1987) ("The paramount purpose of enforcing the prohibition against insider trading by ordering disgorgement is to make sure that wrongdoers will not profit from their wrongdoing."), and a court may not order disgorgement above "the amount of money acquired through wrongdoing." *Cavanagh*, 445 F.3d at 117.

Here, the district court ordered Contorinis to pay an amount substantially above what he acquired through his wrongdoing. The district court ordered him to disgorge funds he never had and to pay back profits he never received. Instead of returning Contorinis to his status quo prior to his wrongdoing, the district court's disgorgement order penalized him by requiring him to pay an amount equal to the \$7.2 million in profits earned by the Fund and an additional \$2.5 million in prejudgment interest.

Disgorgement, however, is not intended to be punitive; it is remedial in nature. *See Official Comm. of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 81 (2d Cir. 2006) ("Disgorgement merely requires the return of

wrongfully obtained profits; it does not result in any actual economic penalty") (quoting H.R. Rep. No. 101-616 (1990)); accord *Cavanagh*, 445 F.3d at 116, 117 n.25 ("Because the [disgorgement] remedy is remedial rather than punitive, the court may not order disgorgement above [the amount of money acquired through the wrongdoing]."); *SEC v. Wyly*, 860 F. Supp. 2d 275, 277 (S.D.N.Y. 2012) ("[A]wards that exceed the defendant's gains are punitive and beyond the court's equitable powers."). As the district court's order had the effect of punishing Contorinis for his wrongdoing, it went beyond the permissible scope of disgorgement. While Contorinis undeniably deserved to be punished, disgorgement was not the proper mechanism to be used to impose that punishment.

The district court's disgorgement order is also inconsistent with our decision in the related criminal case, *United States v. Contorinis*, 692 F.3d 136 (2d Cir. 2012). There, we held that Contorinis could not be required to forfeit profits that the Fund earned from his illegal use of inside information. Our holding rested on the principle that a defendant can be ordered to forfeit only the proceeds that he actually received or controlled. Because Contorinis never received or controlled the proceeds sought by the government, we concluded

that Contorinis could not be ordered to forfeit those proceeds. *Id.* at 147. Now, in this civil proceeding involving the same defendant, the same investment fund, and the same proceeds, the majority reaches the opposite result, holding that Contorinis must "disgorge" the Fund's profits and forfeit millions of dollars that he never received.

To be sure, as the majority discusses, there are differences between criminal forfeiture and civil disgorgement. But conceptually they are largely the same. We even used the terms together in *Contorinis* as we explained that: "Criminal forfeiture focuses on the *disgorgement* by a defendant of his 'ill-gotten gains.'" 692 F.3d at 146 (emphasis added) (*quoting United States v. Kalish*, 626 F.3d 165, 170 (2d Cir. 2010)); *see also United States v. Ursery*, 518 U.S. 267, 284 (1996) (forfeiture is "designed primarily to confiscate property used in violation of the law, and to require *disgorgement* of the fruits of illegal conduct") (emphasis added). Both forfeiture and disgorgement seek to force a defendant to give up -- that is, to forfeit or to disgorge -- what he has wrongfully gained. Thus, we held that the district court had erred in ordering Contorinis "to forfeit funds that were never possessed or controlled by himself or others acting in concert with him." 692 F.3d at 148; *see id.* at 147 ("[E]xtending the scope of a forfeiture to include

proceeds that have never been acquired either by a defendant or his joint actors would be at odds with the broadly accepted principle that forfeiture is calculated based on a defendant's gains.").

Contorinis is also instructive with respect to the majority's reliance on the tipper-tippee cases that hold that "[a] tippee's gains are attributable to the tipper, regardless whether benefit accrues to the tipper." *SEC v. Warde*, 151 F.3d 42, 49 (2d Cir. 1998). We acknowledged in *Contorinis* that "a court may order a defendant to forfeit proceeds received by others who participated jointly in the crime, provided the actions generating those proceeds were reasonably foreseeable to the defendant." 692 F.3d at 147. We observed that "[t]he extension of forfeiture to proceeds received by actors in concert with a defendant may be deemed to be based on the view that the proceeds of a crime jointly committed are within the possessory rights of each concerted actor." *Id.* We concluded, however, that "[t]his view does not support an extension to a situation where the proceeds go directly to an innocent third party and are never possessed by the defendant." *Id.* This reasoning applies with equal force here.

In the tipper-tippee situation, the tipper and tippee are concerted actors, jointly engaging in fraudulent activity -- the tipper breaches a fiduciary

duty by disclosing inside information; the tippee trades on that information, knowing of the breach and without disclosing what he knows; and the tipper obtains "a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings." *Dirks v. SEC*, 463 U.S. 646, 663 (1983); see also, e.g., *Warde*, 151 F.3d at 47 (SEC must establish that tippee "knew or should have known that [tipper] violated a relationship of trust by relaying [the] information"); *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 455 (3d Cir. 1997) ("Courts have held that joint-and-several liability is appropriate in securities cases when two or more individuals or entities collaborate or have close relationships in engaging in the illegal conduct."); *First Jersey Sec.*, 101 F.3d at 1475 (holding that owner-officer who collaborated in unlawful conduct of firm may be held jointly and severally liable with firm for disgorgement of unlawful gains received); *SEC v. Monarch Fund*, 608 F.2d 938, 942 (2d Cir. 1979) (distinguishing "tippee who knows or ought to know that he is trading on inside information" from "outsider who has no reason to know he is trading on the basis of such knowledge"). A tipper can be held responsible for the tippee's profits because both joint actors are deemed to be in possession or control of the proceeds of their concerted activity. *Contorinis*, 692 F.3d at 147.

We do not have a tipper-tippee relationship here. Contorinis was not a tipper. Nor is there any evidence that the Fund knew that Contorinis breached any duty when he made his investment decisions. As we concluded in the criminal case, the Fund did not act in concert with Contorinis in his criminal venture, and he never possessed or controlled its profits. *See* 692 F.3d at 147 ("we hold that the district court erred in ordering [Contorinis] to forfeit funds that were never possessed or controlled by himself or others acting in concert with him"). Hence, the Fund's gains were not properly included in the disgorgement calculation.

For all these reasons, I believe the district court abused its discretion in ordering Contorinis to disgorge the profits the Fund accrued as a result of his criminal activity. Accordingly, I would vacate and remand the judgment of the district court for recalculation of the amounts of disgorgement and pre-judgment interest.¹

¹ As we noted in *Contorinis*, the district court could require Contorinis to disgorge monies he acquired as a result of his criminal conduct, including "salaries, bonuses, dividends, or enhanced value of [his] equity in the Fund." 692 F.3d at 148 n.4. The Securities and Exchange Commission could also have sought disgorgement from the Fund on the theory that, even though the Fund engaged in no wrongdoing, it was the recipient of "ill-gotten funds" to which it did not have a legitimate claim. *See, e.g., SEC v. Cavanagh*, 155 F.3d 129, 136 (2d Cir. 1998).