DETERMINING DISGORGEMENT IN SECURITIES LAW†

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I. INTRODUCTION

A regulatory power frequently exercised by securities commissions across various jurisdictions, disgorgement is an indispensible tool to square off unjust enrichment availed by any participant in the capital markets. The Black’s Law Dictionary defines disgorgement as ‘the act of giving up something (such as profits illegally obtained) on demand or by legal compulsion.’

The primary purpose of disgorgement is to deter violations of securities laws by depriving violators of their ill-gotten gains. To disgorge means to deprive a person of the value by which he has been unjustly enriched. Unjust enrichment, in turn, refers to the retention of certain benefits, which is not legally justifiable. Therefore, disgorgement as a remedial measure in securities law involves a wrongdoer being stripped of the unlawful profits or wrongful gains made by him. The underlying idea and purpose behind this remedial measure is that no person should be permitted the opportunity to profit from his wrongdoing. Therefore, even before any punishment or penalty is levied, it is quintessential to deprive a wrongdoer of the fruits of his misconduct or wrongdoing. In this sense, disgorgement may be understood as a primary and basic remedy. Put in simple terms, the objective of disgorgement is to restore status quo ante, ie, the situation and conditions which existed prior to the commission of the legal contravention.

† This article reflects the position of law as on 24 February 2019.
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Today, while the legitimacy of disgorgement as a remedy has received acceptance in the securities enforcement context, regulatory commissions are left to decide what must be included in the quantification of disgorgement and how disgorgement must be quantified. Globally, securities commissions have developed and employed varied methods for the calculation of disgorgement. A perusal of these methods highlights the equitable characteristics which are inherent in disgorgement as a form of remedy for the violation of securities law. Thus, the objective of this article is to understand the nature of disgorgement in the context of its evolution, its constituents and its calculation by regulatory commissions. For the purpose of this article, the author will rely on securities law in the United States of America (USA) as a reference model in view of the sophistication and maturity of the securities market and law in USA and extensive reliance by Indian authorities thereon.3

Part II of this article traces the evolution of disgorgement in USA and India. Part III analyses disgorgement as a distinct and unique remedy. Part IV examines the jurisprudence governing the constituents of disgorgement and its quantification by the Securities Exchange Commission (SEC) in USA. Part V expounds the jurisprudence on the constituents and computation of disgorgement as adopted by the Securities and Exchange Board of India (SEBI). Part VI seeks to explore and develop certain standards for the calculation of disgorgement. Part VII concludes.

II. EVOLUTION OF DISGORGEMENT IN INDIA AND USA

A. Evolution of Disgorgement in USA

In its year of enactment, the Securities Exchange Act, 19344 did not include any separate statutory provision for disgorgement. The remedies, which it provided for, inter alia included injunctions and civil penalties. The law was rooted in the rule that equity ought

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not to intervene where an adequate legal remedy exists.\(^5\) In 1971, disgorgement or rather ‘restitution of unlawful gains’ was considered and upheld in \textit{Securities Exchange Commission v. Texas Gulf} (\textit{Texas Gulf}).\(^6\) In this case, it was argued that the SEC was not conferred with the general equitable power of ordering ‘restitution of illegal profits’. It could only order injunctive relief and such other ancillary remedy as may be necessary to enforce such injunctive relief.\(^7\) Therefore, ordering restitution of unlawful profits would in essence constitute a ‘penalty’.\(^8\) However, the court dismissed the argument on the ground that it would defeat the purposes of the \textit{Securities Exchange Act, 1934} if a violator of Rule 10b-5\(^9\) were allowed to retain the profits from his violation.\(^10\) This marked an essential departure from the previously outlawed claim of the SEC to order disgorgement. As a consequence of \textit{Texas Gulf}, courts came to accept as truism, the notion that disgorgement is inherently an ancillary equitable remedy.\(^11\) In the year 1990, the US Congress conferred statutory sanction on the remedy of

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\(^7\) \textit{Texas Gulf}, 1307.

\(^8\) \textit{Texas Gulf}, 1308.

\(^9\) § 240.10b-5, Employment of manipulative and deceptive devices: ‘It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange

\(\text{(a)}\) To employ any device, scheme, or artifice to defraud

\(\text{(b)}\) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

\(\text{(c)}\) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.’

\(^10\) \textit{See} § 240.10b-5.

disgorgement by the enactment of the Security Enforcement Remedies and Penny Stock Reform Act, 1990.\textsuperscript{12}

Subsequently, disgorgement has matured as an effective and frequently employed remedy by the SEC, particularly in the context of securities fraud and insider trading.\textsuperscript{13} It may be noted that in suits where the SEC seeks enforcement of securities law, the SEC acts in its capacity as a statutory regulator to protect and secure public interest. Hence, in such cases, it is the threshold of public interest and not private litigation that measures the propriety and need for equitable relief.\textsuperscript{14}

\textbf{B. Evolution of Disgorgement in India}

Six years after the enactment of the Securities and Exchange Board of India Act, 1992 (SEBI Act), SEBI made its first unsuccessful attempt to direct disgorgement in the matter of Hindustan Lever Limited v. SEBI.\textsuperscript{15} It endeavored to expand the ambit of its regulatory powers to direct disgorgement through another unsuccessful attempt in Rakesh Agarwal v. SEBI.\textsuperscript{16} SEBI made yet another attempt at disgorgement in the Roopal Ben Panchal scam,\textsuperscript{17} cautious this time, to term it as ‘a useful equitable remedy because it strips the perpetrator of the fruits of his unlawful activity and returns him to the position, he was in, before he broke the law.’\textsuperscript{18} The Roopal Ben Panchal scam, as referred

\begin{footnotesize}
\begin{enumerate}
\item[16] See Rakesh Agarwal v. SEBI (SAT Appeal No. 33 of 2001) Order dated 03.11.2003.
\item[17] SEBI order in the matter of investigations into initial public offerings dated 21.11.2006.
\item[18] Ibid.
\end{enumerate}
\end{footnotesize}
to in common market parlance, involved the cornering of retail category shares in certain initial public offers and was different in being characterised as a ‘useful compensatory remedy’. Subsequently, disgorgement was directed by SEBI and upheld by the Securities Appellate Tribunal (SAT) in a multitude of cases. SAT has further clarified that since the chief purpose of disgorgement is to make sure that the wrongdoers do not profit from their wrongdoing, the disgorgement amount should not exceed the total profits realised as a result of the unlawful activity. The burden of proving that the amount sought to be disgorged ‘reasonably approximates’ the amount of unjust enrichment lies on SEBI.

However, it was only in the year 2014, that section 11B of the SEBI Act was amended to incorporate and establish disgorgement as an

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19 Supra n. 15.
21 Karvy Stock Broking Ltd. v. SEBI (SAT Appeal No. 6 of 2007) Order dated 02.05.2008.
22 Karvy Stock Broking Ltd. v. SEBI; Sumit Agrawal and Robin Joseph Baby, SEBI ACT: A Legal Commentary on Securities And Exchange Board of India Act, 1992 (Taxmann Publication 2011).
23 SEBI Act, 1992, section 11B Power to issue directions: (before the 2014 amendment) ‘Save as otherwise provided in section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary,—

(i) in the interest of investors, or orderly development of securities market; or
(ii) to prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interest of investors or securities market; or
(iii) to secure the proper management of any such intermediary or person, it may issue such directions,—
(a) to any person or class of persons referred to in section 12, or associated with the securities market; or
(b) to any company in respect of matters specified in section 11A, as may be appropriate in the interests of investors in securities and the securities market.’
explicit power of SEBI. The explanation to section 11B embodies the statutory sanction to disgorgement and reads as follows:

“For the removal of doubts, it is hereby declared that the power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention.”

Section 12A of the Securities Contract Regulation Act, 1956 (SCRA) and section 19 of the Depositories Act, 1996 are identical to section 11B of the SEBI Act. The concerned sections 12A and 19 were also amended vide the Securities Law Amendment Act to include the same explanation, which defines and confers legislative sanction to disgorgement. Therefore, in Indian securities law, the power of SEBI to order disgorgement now stems from statutory provisions embedded in the SEBI Act, the SCRA, 1956 and the Depositories Act, 1996.

The amount of money disgorged was earlier credited to the Consolidated Fund of India. It is now credited to the Investor Protection and Education Fund and used in accordance with the SEBI (Investor Protection and Education Fund) Regulations, 2009 to first,
provide restitution to eligible and identifiable investors,\textsuperscript{28} who have suffered losses as a consequence of violation of securities law and then use such funds along with interest thereon for the purpose of investor welfare and education.\textsuperscript{29} SEBI extensively uses this power to direct disgorgement in cases of violations of securities law.

\section*{III. Disgorgement: A Unique Remedy}

This part of the article seeks to elucidate the nature of disgorgement as a remedy for the enforcement of securities law. The purpose of understanding the nature of disgorgement is twofold. First, to understand the nuances between disgorgement \textit{vis-à-vis} other powers of the regulator to remedy a violation of securities law. Second, to determine the constituents of disgorgement. This would be crucial for the calculation of disgorgement.

\subsection*{A. Disgorgement as an equitable remedy or a penal measure?}

Before commencing the discussion on whether disgorgement is an equitable remedy or a penalty, it would be essential to understand why this distinction is important. In a multitude of cases, securities commissions or regulators order injunctions or debar wrongdoers from dealing in the securities market for a statutorily stipulated number of years. In addition, they also direct disgorgement and penalties. The classification of disgorgement as a penalty would have a significant impact on its calculation. In the given context, it would now be useful to understand the distinction between penalty and disgorgement.

\textsuperscript{28} The investors affected by a securities law violation are not always identifiable. For instance, in cases of insider trading, it may not be possible to identify any particular person who has suffered loss. However, the act is prejudicial to the interests of the investors in the securities market as a whole. In such cases, it may not be possible to grant restitution to specific individuals from the amount credited to the Investor Protection and Education Fund (IPEF). However, in certain cases of Initial Public Offer (IPO) irregularities, it may be possible to identify affected investors, who may be the unsuccessful applicants in an IPO. \textit{See also} SEBI Press Release dated 17.12.2015, ‘SEBI distributes disgorgement amount to the investors affected by IPO irregularities’, PR No. 295/2015 and SEBI Press Release dated 12.04.2010, ‘SEBI commences disbursement process of disgorgement amount’, PR No. 93/2010.

\textsuperscript{29} \textit{See SEBI (IPEF) Regs}, 2009, regulations 4 and 5.
The term ‘penalty’ denotes a punitive action, whether corporal or pecuniary, imposed and enforced by the State for a crime or offence against its laws.30 Mere contravention of the law suffices an invocation of such provisions. Across various jurisdictions, the judicial trend has been to distinguish the concept of penalty from that of disgorgement. To ascertain whether a law is penal, it is important to understand whether the wrong sought to be redressed is a public wrong or a private wrong.31 While penal laws ordinarily govern public wrongs only, a pecuniary sanction would operate as a penalty if the objective is to punish the wrongdoer and deter the public at large, ie, compensating a victim for loss caused to him.32 If the liability imposed is compensatory in nature and paid entirely to a private plaintiff to redress a private injury only, then it would not constitute a penalty.33

Traditionally, in India and USA, it has been held that disgorgement is not a punishment, and nor is it concerned with the damages sustained by the victims of the unlawful conduct.34 Disgorgement is merely a monetarily equitable remedy,35 and not a punitive measure36, 37. The purpose of penalty is to punish and therefore, penalty by its very nature is retributive whereas the purpose of disgorgement is to strip the wrongdoer to the limited extent of unjust enrichment.38

30 Huntington v. Attrill, 146 U. S. 657, 667 (1892). It may be noted that in the Indian context, although penalty is perceived to be punitive in nature, there is no requirement to prove mens rea for the purpose of imposing penalty on account of breach of civil obligations. See Shriram Mutual Fund v. SEBI (2006) 5 SCC 361. Alternatively, it can be argued that mere absence of mens rea will not change the punitive nature of a penalty imposed.
31 Huntington v. Attrill, 668.
34 Karvy Stock Broking Ltd. v. SEBI [2008] 84 SCL 208.
35 Karvy Stock Broking Ltd. v. SEBI.
36 SEC v. Blatt, 583 F.2d 1325, 1327-1336 (5th Cir. 1978).
Interestingly, the approach of the legislature and the courts now seems to be to dilute the fine but thin distinction between penalty and disgorgement. This shift was recently witnessed in USA in its recent decision in *Kokesh v. SEC*.\(^{39}\) In this case, the question was whether the limitation period of 5 years, which is applicable to civil penalties in USA,\(^{40}\) would also be applicable to the disgorgement amount directed in the securities enforcement context. The Supreme Court of USA (US SC) held that ‘disgorgement’ would classify as a ‘penalty’ within the meaning of §2462 of the *United States Code*\(^{41}\). This is because first, disgorgement is a remedy seeking to redress a public wrong or a wrong against the state as against providing redressal to an aggrieved investor in the securities market. For the purpose of disgorgement, the regulatory commission would act in public interest rather than put itself in the shoes of particular injured parties. Second, an inherent objective of disgorgement is to achieve deterrence of securities law violations.\(^{42}\) Lastly, disgorgement is not always compensatory in nature. This is generally in cases where aggrieved investors cannot be identified. A classic example of this would be a case of insider trading wherein it is the securities market which suffers as a whole on account of such unlawful conduct. In such cases, compensation cannot be granted to particular individuals or persons, as the investors to whom loss has occurred are not identifiable. Citing *Porter v. Warner Holding Company*,\(^{43}\) the US SC held that payment of a non-compensatory sanction to the government as a consequence of legal violation causes disgorgement to operate as a penalty.\(^{44}\) Further, it explained that a civil sanction may have more than one purpose. It may be compensatory in nature and deterrent or retributive at the

\(^{39}\) *Kokesh v. SEC*.

\(^{40}\) Judiciary and Judicial Procedure, (25 June 1948) 28 U.S.C. § 2462 (United States) reads as: ‘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.’

\(^{41}\) 28 U. S. C. §2462.

\(^{42}\) *SEC v. Fischbach Corp.*, 133 F. 3d 170, 175 (CA2 1997) and *SEC v. First Jersey Securities, Inc.*, 101 F. 3d 1450, 1474 (CA2 1996); *SEC v. Rind*, 991 F. 2d, 1491.

\(^{43}\) 328 U. S. 395, 402 (1946).

\(^{44}\) *Kokesh v. SEC*; Distinguishing between restitution paid to an aggrieved party and penalties paid to the Government.
same time. Considering that in a number of cases, disgorgement goes beyond mere compensation and imposes punishment, disgorgement would constitute a penalty. In holding so, the US SC has attenuated the distinction between penalty and disgorgement to a considerable extent.

Similarly, in India, certain legislative changes have been recently introduced in the SEBI Act by way of The Finance Act, 2018\(^{45}\), which also appear to have watered down the distinction between disgorgement and penalty to some extent. For this purpose, it would be essential to understand section 11B of the SEBI Act.\(^{46}\) It may be useful to break down this section on the basis of its purpose for the ease of understanding. Section 11B comprises of the following three parts:

(i) Circumstances which necessitate SEBI’s intervention (such as protection of investors, need to secure proper management, etc)

(ii) To whom SEBI may issue directions (companies, stock brokers, persons associated with securities market, etc)\(^{47}\)

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\(^{45}\) The Finance Act, 2018.

\(^{46}\) SEBI Act, 1992, section 11B: Power to issue directions and penalty:
‘Save as otherwise provided in section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary,—
(i) in the interest of investors, or orderly development of securities market; or
(ii) to prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interest of investors or securities market; or
(iii) to secure the proper management of any such intermediary or person, it may issue such directions,— (a) to any person or class of persons referred to in section 12, or associated with the securities market; or (b) to any company in respect of matters specified in section 11A, as may be appropriate in the interests of investors in securities and the securities market. Explanation — For the removal of doubts, it is hereby declared that the power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention.’

\(^{47}\) See Finance Act, 2018, section 12 read with SEBI Act, 1992, section 11B.
(iii) An explanation to the section, which statutorily empowers disgorgement.

Now, the table given below seeks to assist the reader in comprehending how the distinction between disgorgement and penalty may have been partially blurred *vide The Finance Act, 2018*.

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<thead>
<tr>
<th>Relevant Section</th>
<th>Prior to the Amendment(^{48})</th>
<th>After the Amendment</th>
<th>Comments</th>
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<tr>
<td>Marginal Note to section 11B of SEBI Act, 1992.</td>
<td>Power to issue directions.</td>
<td>Power to issue directions and penalty.(^{49})</td>
<td>SEBI’s power to direct disgorgement is manifested in section 11B. Section 11B, which originally dealt with the power to issue directions only, now confers on SEBI the power to levy penalties as well.</td>
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<td>Marginal Note to section 15J of SEBI Act, 1992.</td>
<td>Factors to be taken into account by the adjudicating officer.</td>
<td>Factors to be taken into account while adjudging the quantum of penalty (emphasis supplied).(^{50})</td>
<td>By way of this amendment, it is now clear that section 15J enumerates the factors to be considered in the determination of quantum of ‘penalty’.</td>
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\(^{48}\) Amendment in this table refers to the amendment to *SEBI Act, 1992* under *Finance Act, 2018*, Part X.  
\(^{49}\) *Finance Act, 2018*, section 180.  
\(^{50}\) *Finance Act, 2018*, section 185.
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| Section 15J of SEBI Act, 1992. | While adjudging quantum of penalty under section 15-I, the adjudicating officer shall have due regard to the following factors, namely:  
(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;  
(b) the amount of loss caused to an investor or group of investors as a result of the default;  
(c) the repetitive nature of the default. | While adjudging quantum of penalty under section 15-I or section 11 or section 11B, the Board or the adjudicating officer shall have due regard to the following factors, namely:  
(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;  
(b) the amount of loss caused to an investor or group of investors as a result of the default;  
(c) the repetitive nature of the default. | Section 15J has been further amended to provide for the determination of penalty, inter alia, under section 11B, which encapsulates the power to disgorge. |

51 Finance Act, 2018, section 185.
Let us consider a situation where a person who has been debarred from accessing and dealing in the securities market by SEBI has undertaken certain legal trades through connected companies during the period of debarment. In such a scenario, would the appropriate measure undertaken by the regulator be that of levying penalty under section 15HB of the SEBI Act, which envisages a maximum penalty of INR 1 crore or award disgorgement of unlawful gains, in which case, there is no cap to the maximum amount which can be disgorged. While both, penalty and disgorgement, may be awarded in cases of contravention of provisions of the SEBI Act or regulations made thereunder, the difference lies in determining whether the gains made from legal trades during the period of debarment would constitute wrongful gains. The author is of the opinion that when a person is debarred from accessing the securities market, any trade undertaken by him would be unlawful by virtue of the debarment itself and notwithstanding the legality inherent in the nature of the trade. Interestingly, recently SEBI has also chosen the latter route of directing disgorgement in a similar fact situation.

Further, unlike USA, there is no limitation period prescribed by the SEBI Act or the Limitation Act, 1963 in India for any enforcement action by SEBI. In fact, in Vaman Madhav Apte v. SEBI, SAT

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52 SEBI Act, 1992, section 15HB, Penalty for Contravention where No Separate Penalty has been provided: ‘Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.’


54 Vaman Madhav Apte & Ors. v. SEBI (SAT Appeal No. 449 of 2014) Order dated 04.03.2016. This order was given by SAT in an appeal against the order of SEBI dated 31.10.2014. In the facts of the case, the Appellants acted in violation of Regulation 10 of the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997 on account of failure to make a public announcement for the acquisition of shares. When the appellants argued that there was inordinate delay on the part of SEBI in taking action, the Whole Time Member of SEBI observed that such violation of securities law was a continuous violation giving rise to a fresh cause of action each day during which the failure continued.
has explicitly held that neither the SEBI Act nor any regulations thereunder stipulate a maximum time period within which (i) proceedings shall be initiated by the regulator, or (ii) on the expiry of which, action by the regulator against the violator shall be barred. In the absence of any such provisions, the doctrine of delay and laches cannot be invoked in a securities enforcement action by the regulator. Although the doctrine of laches is an equitable principle commonly accepted by courts of law in India, the courts are unlikely to accept it in the securities enforcement context, considering that the objective of such action is to serve a public purpose by protecting the interests of investors and preserving the integrity of the securities market.\(^{55}\)

**B. Disgorgement distinguished from Impounding**

Section 11(4)(d) of the SEBI Act empowers SEBI to impound and retain proceeds or securities in respect of any transaction, which is under investigation. The term ‘impound’ means:

‘1. To place (something such as car or personal property) in the custody of the police or the court, often with the understanding that it will be returned intact at the end of the proceeding. 2. To take and retain possession of (something, such as a forged document to be produced as evidence) in preparation of a criminal prosecution.’\(^{56}\)

From the above, it can be discerned that impounding is an interim measure in the hands of SEBI during the pendency of the process of investigation and before the final adjudication of guilt. This power enables SEBI to retain the approximate proceeds by which the wrongdoer has been unjustly enriched. Impounding can also operate as an effective instrument against diversion of funds and erosion of value of assets pending investigation.\(^{57}\) On the contrary, disgorgement

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\(^{55}\) This would be subject to the facts and circumstances of every case. In a given case, if the regulator, having known about the violation of securities law, acts after a considerable amount of time without reasonable cause, in such a case, the court may choose to reject such action on the ground of delay and laches.


\(^{57}\) See SEBI order in the matter of Beejay Investment & Financial Consultants Pvt Ltd dated 27.03.2017. See also SEBI order in the matter of Abhijit Rajan dated 21.03.2016.
is a final remedy available to SEBI. Using this power, SEBI can permanently deprive the wrongdoer to the extent of the unjust enrichment availed by him. It may be noted that while impounding is generally ordered vide an interim order, disgorgement cannot be ordered at the interim stage. Disgorgement, being a permanent remedy, can be directed only by way of a final order.\(^{58}\)

C. Disgorgement and Restitution

Restitution means to return or restore wealth received by the defendant from the claimant as it amounts to unjust enrichment at the expense of the claimant.\(^{59}\) Disgorgement means relinquishing gains made by the defendant as a consequence of some wrongdoing to the claimant, where such gains have been received from a third party.\(^{60}\) While multiple attempts have been made to distinguish restitution from disgorgement, this distinction faces a multitude of practical challenges. To demonstrate a few: (i) when disgorgement is computed as loss averted, there may not be any real gain accruing to any person (if the computation is based only on a notional gain) or (ii) when wrong has not been caused to any ‘particular identifiable person’. Recently, in \textit{Kokesh v. SEC}, the US SC held that ‘disgorgement is a form of restitution measured by the defendant’s wrongful gain.’\(^{61}\) Hence, the distinction between restitution and disgorgement appears to be considerably convoluted.

IV. Constituents of Disgorgement and Its Computation by the SEC and Courts in USA

A. \textit{US} Jurisprudence on Constituents of Disgorgement

In view of James Tyler Kirk’s article titled ‘Deranged Disgorgement’,\(^{62}\) the author seeks to highlight certain elements which should either be

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\(^{58}\) \textit{See National Securities Depository Ltd. v. SEBI} (SAT Appeal No. 147 of 2006) Order dated 22.11.2007.


\(^{60}\) \textit{Ibid}.

\(^{61}\) Restatement (Third) of Restitution and Unjust Enrichment §51, Comment at 204 (2010) (Restatement (Third)) as cited in \textit{Kokesh v. SEC} at 2.

included or excluded from the broad parameters of disgorgement. An understanding of the constituents of disgorgement would assist one in arriving at the reasonably accurate quantification of disgorgement. In his article, Kirk has formulated what he calls ‘the theory of regulatory equity’.

He emphasises the crucial distinction between unlawful ‘profits’ *vis-à-vis* unlawful ‘benefits or gains’. He advocates that the doctrine of unjust enrichment should include unlawful gains or benefits rather than profits only. The essential distinction between the two is that while unlawful profits connote a prerequisite monetary dimension, an unlawful gain or benefit may occur even in the absence of any monetary profits. Put simply, Kirk advocates that an unjust enrichment can occur in the securities context, even in the absence of a monetary gain.63 Alternatively, unjust enrichment is not merely restricted to what remains in the pockets of the wrongdoer in the aftermath of a fraud, but rather includes the ‘value of the other benefits’ which accrue to the wrongdoer through a scheme.64 These benefits may be in the form of interest free loans, improved reputation, cost defrayments, etc.65

Example: A tipper (also an insider) who shares unpublished price sensitive information (UPSI) may not necessarily make a monetary gain but he becomes a coveted tipper by future and potential tippees.66

Kirk has further proposed that ‘to give effect to the deterrent purposes of disgorgement, the remedial scheme must have a way to neutralise secondary and tertiary benefits flowing from the securities violation.’

However, disgorgement of benefits, other than monetary benefits, is likely to entail a plenitude of legal challenges, as disgorgement is fundamentally perceived as a monetarily equitable measure and not as a punitive measure.

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63 James Tyler Kirk at 156; *See SEC v. Yun*, 148 F. Supp. 2d 1287 (M.D. Fla. 2001); *Texas Gulf Sulphur*. Here, the tippers were made liable to disgorge without any monetary gain.

64 *See SEC v. Great Lakes Equity*, 775 F. Supp. 211.

65 James Tyler Kirk at 158; *SEC v. Great Lakes Equity*, 215.

Kirk further analyses that while direct transactional costs, such as brokerage fees, may be offset in the calculation of disgorgement, the general and legitimate business expenses incurred in the process of acquiring the unlawful gains cannot be offset while calculating disgorgement and therefore, such general business expenses must be lawfully included in the amount to be disgorged.67

B. Computation of Disgorgement in USA

The computation of disgorgement extends only to the amount with interest by which, the defendant profited from his wrongdoing.68 Any further sum would constitute a penalty assessment.69 Thus, it becomes essential that where benefits are derived from lawful and unlawful conduct, the party seeking disgorgement must distinguish between legally and illegally derived profits.70 In cases of systematic and pervasive fraud, where it is difficult to find any lawful activity, all profits may be construed as unlawful in nature and therefore, required to be disgorged.71 However, the rules for calculating disgorgement must recognise that separating legal from illegal profits, may at times, be a near impossible task.72 Accordingly, disgorgement need only be a ‘reasonable approximation of profits causally connected to the violation’.73 The SEC bears the ultimate burden of persuasion that its disgorgement figure reasonably approximates the amount of unjust enrichment.74 It is then for the defendant to show that the disgorgement figure is a not a reasonable approximation.75

68 § 240.10b-5.
69 § 240.10b-5.
72 Eklind v. Ligett Myers Inc., 635 F.2d 156, 171 (2d Cir. 1980).
73 SEC v. First Financial City Corp. Ltd. 890 F.2d 1215, 1217-1233 (D.C. Cir. 1989).
74 SEC v. First Financial City Corp. Ltd.
75 SEC v. First Financial City Corp. Ltd.
An analysis of multiple judgments of the courts of law in USA yields three important patterns adopted in the computation of disgorgement. Although, these judgments are in the context of shares, they may be considered under the broader ambit of securities traded in the cash segment of stock exchanges. They are as follows:

1. Consideration of ‘Cost Basis’

In this method of computing the amount of disgorgement, reasonable approximation of profits is calculated as the difference between the price at which shares were sold and the cost of acquiring such shares. Simply put, it works on the basic formula, which has been set out as follows:

\[ \text{Profits} = \text{Selling Price} - \text{Cost Price} \]

In *SEC v. MacDonald*,\(^{76}\) an officer purchased shares of a trust, while in possession of material, non-public information. In this case, though the determination of the disgorgement amount was remanded back to the commission, the Court ruled that the correct computation would involve a difference between the sale value of shares and the price at which, such shares were purchased.

The following table is an explanatory example, which clarifies the use of ‘cost of acquisition’, in computing the amount of disgorgement.\(^{77}\)

<table>
<thead>
<tr>
<th>Situation</th>
<th>Cost Basis (Purchase Price)</th>
<th>Selling Price</th>
<th>Profits (Selling Price - Purchase Price)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insider sold it</td>
<td>$4</td>
<td>$5</td>
<td>$1</td>
</tr>
<tr>
<td>The stock rose and the Insider sold it</td>
<td>$4</td>
<td>$10</td>
<td>$6</td>
</tr>
</tbody>
</table>

2. Consideration of Market Value of Shares at the Relevant Date of Sale Instead of Cost Basis

In this method, the amount of disgorgement is calculated as the difference between the value of shares at the date of sale, while in

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\(^{76}\) *SEC v. MacDonald* 699 F.2d 47, 49-58 (1st Cir. 1983).

\(^{77}\) *See SEC v. MacDonald.*
possession of material non-public information, and the value of shares, a reasonable time after such information is made known to the public.

An analysis of case law demonstrates a trend that this method is generally employed, in cases where there is a sale of shares while in possession of material non-public information, which is likely to cause a decline in the value of shares. Alternatively, this method of computing disgorgement is largely employed in cases where losses are sought to be unlawfully averted rather than a situation where gains are unlawfully or wrongly made.

In *SEC v. Happ*, the Appeals Court held that in an insider trading case, the proper amount of disgorgement is generally the difference between the value of the shares when the insider sold them, while in possession of material non-public information, and their market value, ‘a reasonable time after public dissemination of the inside information.’ In this case, the appellant explicitly argued that disgorgement must be calculated on the basis of cost, ie, it must be calculated as the difference between the value of sale of shares, and its cost of acquisition, which would enable the SEC to determine his unlawful gains. He unsuccessfully contended that the SEC was, in fact, proceeding on a ‘wrong footing’ by equating the amount of disgorgement to the ‘loss averted’ by him instead of proceeding on the lines of ‘unlawful gains made’ to determine unjust enrichment.

Where the securities market is manipulated to mulct the public, there is no justification to give the offender any credit for the fact that such person had not succeeded in avoiding losses. For example, loss may be unlawfully averted in cases of negotiated deals and circular trading to stabilise the price of certain shares.

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78 See *SEC v. Patel* 61 F.3d 137, 139 (2d. Cir. 1995); *SEC v. Happ* 392 F.3d 12, 14-35 (1st Cir. 2004) and *SEC v. Shapiro* 494 F.2d 1301, 1303-1314 (2d Cir. 1974).


80 *SEC v. Happ* 392 F.3d 12, 14-35 (1st Cir. 2004)

81 See *SEC v. Common Wealth Chem. Sec. Inc.* 574 F.2d 90, 102 (2nd Cir. 1978); James Tyler Kirk.
In such cases, it is for the defendant to show that the loss avoided is not a reasonable approximation as made by the SEC.\(^{82}\) The onus is on the defendant to demonstrate ‘a clear break in or considerable attenuation for the causal link between the illegality and ultimate profits.’\(^{83}\) It may be relevant to note that the requirement of a causal relationship between a wrongful act and the property to be disgorged does not imply that a court may order a malefactor to disgorge only the actual property obtained by means of his wrongful act.\(^{84}\) Rather, the causal connection required is between the amount by which the defendant was unjustly enriched and the amount he can be required to disgorge.\(^{85}\) Disgorgement of only the actual assets would lead to abnormal results.\(^{86}\) An order to disgorge establishes a personal liability, which the defendant must satisfy regardless of whether he retains the selfsame proceeds of his wrongdoing.\(^{87}\) In any event, the risk of uncertainty in calculating the amount of disgorgement always falls on the wrongdoer.\(^{88}\)

Illustration: Mr. A buys 100 shares of company X in 2001 at $10 per share. On 30 January 2004, he sells all his shares at $15 per share, while in possession of material non-public information relating to certain fraudulent activities taking place in the company. This information becomes public on 7 February 2004 at 8.00 p.m., and on 8 February 2004, the price of shares of company X drops to $3 per share. Hence, disgorgement here, will be the loss averted, which is the difference between the value of shares on the date of sale and its value, a reasonable time after public dissemination of the insider information.

(The reason why we will not opt for the first method (cost basis) is that there is no rational relation between the cost of acquisition of

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83 SEC v. Happ.
87 SEC v. Banner Fund Int’l.
88 SEC v. Patel 61 F.3d 137, 139-142 (2d. Cir. 1995).
shares in 2001 and its selling price in 2004. In three years, due to constant movements in the securities market, a plethora of changes may occur in the valuation of shares.

<table>
<thead>
<tr>
<th>Cost of acquiring shares in 2001</th>
<th>Value of shares at the time of sale on 30 January 2004</th>
<th>Market value of shares, a reasonable time after public dissemination of insider information</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10</td>
<td>$15</td>
<td>$3</td>
</tr>
</tbody>
</table>

Disgorgement = $15 - $3 = $12 per share
Total amount of disgorgement = $1200 (for 100 shares)

In the given instance, if the share price further falls to $2.5 on 10 Feb 2004 on account of such fraudulent act, the defendant may have to disgorge a greater sum ($15 - $2.5 = $12.5 per share) unless he can prove that the further decline was not on account of the fraudulent activity in the company. As explained above, in calculating disgorgement, the risk of uncertainty is to be borne by the wrongdoer.

It would be useful to note that if we use the first method (cost basis), the amount of disgorgement would be quantified at $15 - $10 = $5 per share. Accordingly, the total amount of disgorgement under the first method would be $500 and under the present method, it has been valued at $1200. Hence, the method employed in the calculation of disgorgement can significantly impact the final quantification, which is why, it becomes very important to use the most equitable method in view of the facts of each case.

3. Percentage basis

This method requires the application of the following two steps:

a) Calculation of the percentage by which the value of shares increased or declined after the material non-public information became known to the public.

b) Application of the derived percentage to the total value of sale or purchase of shares to determine disgorgement.
This method was applied in SEC v. Patel\(^\text{89}\) and affirmed by the Appeals Court.

Illustration: A is an executive director in company X and holds 100 shares in the company at $2000 ($20 per share). He becomes aware of material non-public information regarding falsification of accounts in company X, and he sells his entire holding on 10 September 2016 for $2000. On 19 September 2016, the share price of company X was at $15 per share. This information became public on 20 September 2016. The price dropped to $5 per share.

Solution: The following table demonstrates the method to be employed in calculating disgorgement in the given illustration using the percentage method:

<table>
<thead>
<tr>
<th>Step 1:</th>
<th>Drop in the shares of company X from 19-20 September 2016</th>
<th>66.67%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 2:</td>
<td>Disgorgement amount = 66.67% of $2000</td>
<td>$1334.40</td>
</tr>
</tbody>
</table>

Thus, the aforesaid are three methods, which have been employed by the SEC in ascertaining the disgorgement amount, as is evident from various judgments.

V. Constituents of Disgorgement and Its Quantification by SEBI and Courts in India

A. Constituents of Disgorgement in India

In India, SEBI does not include taxes in the computation of disgorgement. The amount disgorged is exempt from income tax

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89 SEC v. Patel.
as well. Alternatively, if income tax has already been paid on the amount, the solution would be to claim a refund of the income tax from the concerned income tax authorities.\(^90\) Further, where an argument was made before both SEBI and SAT to exclude ‘other expenses’ from the ambit of disgorgement, such an argument was dismissed at the very threshold.\(^91\) On these lines, one could possibly argue that in India, expenses such as brokerage or relevant business expenses incurred for the purpose of contravening the law would not be excluded while calculating the amount of disgorgement. It also appears unlikely that inclusion of non-monetary benefits (like improved reputation) will be accepted by Indian law courts for the purpose of quantifying disgorgement.

In the given context, it would help to note that interest, which is awarded on disgorgement, is not a constituent of disgorgement. While SEBI directs disgorgement under section 11B of the SEBI Act, interest is ordered in terms of section 28A(1) of the SEBI Act\(^92\) read

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\(^90\) Purshottam Budhwani v. SEBI (SAT Appeal No. 91 of 2013) Order dated 15.01.2015.

\(^91\) See Purshottam Budhwani v. SEBI and SEBI order in the matter of IPO irregularities: Dealings of Purshottam Budhwani in IPOs dated 23.05.2011.

\(^92\) Income Tax Act, 1961, section 28A(1): Recovery of Amounts (Only the relevant part of the section has been carved out hereunder) ‘If a person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any direction of the Board for refund of monies or fails to comply with a direction of disgorgement order issued under section 11B or fails to pay any fees due to the Board, the Recovery Officer may draw up under his signature a statement in the specified form specifying the amount due from the person (such statement being hereafter in this Chapter referred to as certificate) and shall proceed to recover from such person the amount specified in the certificate by one or more of the following modes, namely:—

(a) attachment and sale of the person’s movable property; (b) attachment of the person’s bank accounts; (c) attachment and sale of the person’s immovable property; (d) arrest of the person and his detention in prison;

…

(e) appointing a receiver for the management of the person’s movable and immovable properties,

and for this purpose, the provisions of sections 220 to 227, 228A, 229, 232, the Second and Third Schedules to the Income-tax Act, 1961 and the Income-tax (Certificate Proceedings) Rules, 1962, as in force from time to time, in so far as may be, apply with necessary modifications as if the said provisions and the rules made thereunder were the provisions of this Act and referred to the amount due under this Act instead of to income-tax under the Income-tax Act, 1961.’
with section 220 of the *Income Tax Act, 1961*.\(^{93}\) Alternatively, awarding interest on disgorgement does not make the latter penal in nature

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\(^{93}\) *Income Tax Act, 1961*, section 220: When tax payable and when assessee deemed in default (Only the relevant part of the section has been carved out hereunder)

‘(1) Any amount, otherwise than by way of advance tax, specified as payable in a notice of demand under section 156 shall be paid within thirty days of the service of the notice at the place and to the person mentioned in the notice:

Provided that, where the Assessing Officer has any reason to believe that it will be detrimental to revenue if the full period of thirty days aforesaid is allowed, he may, with the previous approval of the Joint Commissioner, direct that the sum specified in the notice of demand shall be paid within such period being a period less than the period of thirty days aforesaid, as may be specified by him in the notice of demand.

(1A) Where any notice of demand has been served upon an assessee and any appeal or other proceeding, as the case may be, is filed or initiated in respect of the amount specified in the said notice of demand, then, such demand shall be deemed to be valid till the disposal of the appeal by the last appellate authority or disposal of the proceedings, as the case may be, and any such notice of demand shall have the effect as specified in section 3 of the Taxation Laws (Continuation and Validation of Recovery Proceedings) Act, 1964 (11 of 1964).

(2) If the amount specified in any notice of demand under section 156 is not paid within the period limited under sub-section (1), the assessee shall be liable to pay simple interest at one per cent for every month or part of a month comprised in the period commencing from the day immediately following the end of the period mentioned in sub-section (1) and ending with the day on which the amount is paid:

Provided that, where as a result of an order under section 154, or section 155, or section 250, or section 254, or section 260, or section 262, or section 264 or an order of the Settlement Commission under sub-section (4) of section 245D, the amount on which interest was payable under this section had been reduced, the interest shall be reduced accordingly and the excess interest paid, if any, shall be refunded:

Provided further that where as a result of an order under sections specified in the first proviso, the amount on which interest was payable under this section had been reduced and subsequently as a result of an order under said sections or section 263, the amount on which interest was payable under this section is increased, the assessee shall be liable to pay interest under sub-section (2) from the day immediately following the end of the period mentioned in the first notice of demand, referred to in sub-section (1) and ending with the day on which the amount is paid:

Provided also that in respect of any period commencing on or before the 31st day of March, 1989 and ending after that date, such interest shall, in respect of so much of such period as falls after that date, be calculated at the rate of one and one-half per cent for every month or part of a month.
because interest is not a constituent of disgorgement and the two remedies are directed under independent provisions of the SEBI Act.

B. Quantification of Disgorgement in India

It was nearly a decade ago that SEBI’s power to disgorge unlawful gains came to be recognised by SAT. Consequently, disgorgement as a directive power of SEBI is still in its nascent stage.

Interestingly, in *Dushyant Dalal v. SEBI*,94 a case dealing with the abuse and misuse of the Initial Public Offer (IPO) allotment process by cornering of shares in the retail category, SAT reaffirmed SEBI’s

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(2A) Notwithstanding anything contained in sub-section (2), the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner may reduce or waive the amount of interest paid or payable by an assessee under the said sub-section if he is satisfied that—

(i) payment of such amount has caused or would cause genuine hardship to the assessee;

(ii) default in the payment of the amount on which interest has been paid or was payable under the said sub-section was due to circumstances beyond the control of the assessee; and

(iii) the assessee has co-operated in any inquiry relating to the assessment or any proceeding for the recovery of any amount due from him:

Provided that the order accepting or rejecting the application of the assessee, either in full or in part, shall be passed within a period of twelve months from the end of the month in which the application is received:

Provided further that no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard:

Provided also that where any application is pending as on the 1st day of June, 2016, the order shall be passed on or before the 31st day of May, 2017.

(2B) Notwithstanding anything contained in sub-section (2), where interest is charged under sub-section (1A) of section 201 on the amount of tax specified in the intimation issued under sub-section (1) of section 200A for any period, then, no interest shall be charged under sub-section (2) on the same amount for the same period.

(2C) Notwithstanding anything contained in sub-section (2), where interest is charged under sub-section (7) of section 206C on the amount of tax specified in the intimation issued under sub-section (1) of section 206CB for any period, then, no interest shall be charged under sub-section (2) on the same amount for the same period...

stance that to compute disgorgement, unrealised gains on a notional basis can be included, even if there has been no real sale of the shares and therefore, no actual profits have been realised. In the case concerned, it further indicated its intention to abstain from interfering in the appropriate method to be adopted by the concerned Whole Time Member of SEBI in the quantification of disgorgement, unless the method applied was arbitrary or unfair in nature. Moreover, the SAT also upheld equal apportionment of the disgorgement amount, calculated on a fair and reasonable basis, ‘in the absence of material as to how the illegal gains were distributed’ between two persons.\footnote{Dhaval Mehta v. SEBI (SAT Appeal No. 155 of 2008) Order dated 08.09.2009.}

In India, the quantification of disgorgement by SEBI, ordinarily proceeds in the following manner:

(i) \( \text{Amount of Disgorgement} = \text{Value of Sale} - \text{Cost of Acquisition} \)

(ii) \( \text{Amount of Disgorgement} = \text{Listing Price} - \text{Cost of Acquisition} \) (useful to determine notional profits, where sale has not occurred)


(iii) \( \text{Amount of Impounding} = \text{Value of shares on the date of sale} - \text{Value of shares a reasonable time after the negative UPSI becomes public.} \)

The aforesaid method (iii) has been adopted by SEBI in relation to certain recent interim orders for impounding and may find acceptance in the final disgorgement order.\footnote{Prakash Shah v. SEBI (SAT Appeal No. 170 of 2017) SAT Order dated 10.08.2017 and SEBI order dated 02.08.2017 \textit{in the matter of Joseph Massey and 7 other persons for insider trading in MCX scrips.}}
Illustrations:

a) A owns 100 shares of company X as on 19 January 2016. On this date, he becomes privy to UPSI regarding company X’s takeover of a reputed company Y. He buys 100 shares on 20 January 2016 at INR 80 per share and a further 100 shares on 23 January 2016 at INR 100 per share. The UPSI becomes public on 10 February 2016. The market responds positively to the news of such takeover and the share price of company X booms to INR 150 per share on 11 February 2016. Immediately, A sells the shares of company X to make profits.

Hence, disgorgement can be calculated in the following manner:

<table>
<thead>
<tr>
<th>Date</th>
<th>Price/number of shares</th>
<th>Number of shares bought</th>
<th>Cost of acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>20.01.2016</td>
<td>INR 80</td>
<td>100</td>
<td>INR 8,000</td>
</tr>
<tr>
<td>23.01.2016</td>
<td>INR 100</td>
<td>100</td>
<td>INR 10,000</td>
</tr>
<tr>
<td>11.02.2016</td>
<td>INR 150</td>
<td>Value of 200 shares, which were purchased while in possession of UPSI</td>
<td>INR 30,000</td>
</tr>
</tbody>
</table>

Hence, disgorgement = Selling Price – Cost of Acquisition
= INR 30,000 – (INR 8,000 + INR 10,000)
Disgorgement = INR 12,000

b) A company X makes a series of misleading corporate announcements from 2015-2016, which artificially increases the price of its shares and traded volume in the market. M, a director of company X, holding 70,000 shares in the company offloads his shareholding in the open market during the same period. In such a case, disgorgement may be calculated as follows:
<table>
<thead>
<tr>
<th>Dates</th>
<th>Shares acquired from market</th>
<th>Purchase Price/share</th>
<th>Purchase consideration per transaction</th>
<th>No. of shares sold</th>
<th>Selling Price per share</th>
<th>Sale consideration per transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>02.01.2015</td>
<td>5,000</td>
<td>INR 0.8</td>
<td>INR 4,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>06.01.2015</td>
<td>3,500</td>
<td>INR 0.8</td>
<td>INR 2,800</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>01.02.2015</td>
<td>5,200</td>
<td>INR 1</td>
<td>INR 5,200</td>
<td>2,000</td>
<td>INR 1.05</td>
<td>INR 2,100</td>
</tr>
<tr>
<td>13.02.2015</td>
<td>5,000</td>
<td>INR 0.95</td>
<td>INR 4,750</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>25.04.2015</td>
<td>17,500</td>
<td>INR 1.2</td>
<td>INR 21,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>03.05.2015</td>
<td>10,000</td>
<td>INR 1.25</td>
<td>INR 12,500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>08.08.2015</td>
<td>500</td>
<td>INR 1.3</td>
<td>INR 650</td>
<td>12,500</td>
<td>INR 1.32</td>
<td>INR 16,500</td>
</tr>
<tr>
<td>10.11.2015</td>
<td>1,500</td>
<td>INR 1.35</td>
<td>INR 2,025</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>05.01.2016</td>
<td>20,000</td>
<td>INR 1.60</td>
<td>INR 32,000</td>
<td>38,200</td>
<td>INR 1.60</td>
<td>INR 61,120</td>
</tr>
<tr>
<td>27.05.2016</td>
<td>1800</td>
<td>INR 1.72</td>
<td>INR 3096</td>
<td>8,000</td>
<td>INR 1.7</td>
<td>INR 13,600</td>
</tr>
<tr>
<td>29.06.2016</td>
<td></td>
<td></td>
<td></td>
<td>9,200</td>
<td>INR 1.65</td>
<td>INR 15,180</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>INR 1,08,500</td>
</tr>
</tbody>
</table>

Now using the weighted average method, we find:

Weighted average purchase price per share = \( \frac{88,021}{70,000} = \text{INR 1.25} \)

Weighted average sale price per share = \( \frac{1,08,500}{70,000} = \text{INR 1.55} \)

Disgorgement per share = Weighted average selling price per share – weighted average price per share = INR 0.3

Total disgorgement = 70,000 x 0.3

Disgorgement = INR 21,000

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100 Normally, when there are multiple transactions in the same scrip at different price points or the same scrip is traded on different stock exchanges, the weighted average method is better suited to secure accuracy.
c) Mr. A, the promoter of Company X subscribes for 100 shares in the retail category of the IPO through a façade of benami or fictitious accounts. The issue price of shares is INR 60 per share. Pursuant thereto, he is allotted 100 shares in the retail category. Their closing price on the first day of listing, 9 July 2013, is INR 62 per share. He then sells all 100 shares at INR 63 per share on 10 July 2013.

<table>
<thead>
<tr>
<th>Price</th>
<th>Price/share</th>
<th>Number of shares acquired/sold</th>
<th>Total value of shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Price</td>
<td>INR 60</td>
<td>100</td>
<td>INR 6000</td>
</tr>
<tr>
<td>Selling Price</td>
<td>INR 63</td>
<td>100</td>
<td>INR 6300</td>
</tr>
</tbody>
</table>

Issue price of shares in June 2013 = INR 6000

Sale value of shares = INR 6300

Disgorgement = Selling Price – Issue Price of shares

Disgorgement = INR 300

d) Mr. A, the promoter of Company X subscribes for 100 shares in the retail category of the IPO through a façade of benami or fictitious accounts. The issue price of shares is INR 60 per share on 1 July 2013. Pursuant thereto, he is allotted 100 shares in the retail category. Their closing price on the first day of listing, 4 July 2013 is INR 62 per share. He then sells 50 shares at INR 63 per share on 5 July 2013.

<table>
<thead>
<tr>
<th>Date</th>
<th>Price/share</th>
<th>Number of shares issued/sold/retained</th>
<th>Total value of shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 2013</td>
<td>INR 60</td>
<td>100</td>
<td>INR 6,000</td>
</tr>
<tr>
<td>4 July 2013</td>
<td>INR 62</td>
<td>100</td>
<td>INR 6,200 (INR 3,100 for 50 shares)</td>
</tr>
<tr>
<td>5 July 2013</td>
<td>INR 63</td>
<td>50</td>
<td>INR 3,150</td>
</tr>
</tbody>
</table>
Issue price of 50 shares = INR 3,000

Sale value of 50 shares = INR 3,150

Disgorgement in respect of the 50 shares sold = Selling Price – Issue Price

= INR 3,150 – INR 3,000

Disgorgement in respect of the 50 shares sold = INR 150

Number of shares retained = 50

Notional profits in respect of the 50 shares retained = Closing price of shares on the first day of listing – Issue Price

Notional profits = INR 3,100 – INR 3,000

Disgorgement in respect of the 50 shares retained = INR 100

Total disgorgement amount = Actual wrongful gains + notional wrongful gains

= INR 100 + INR 150

Total disgorgement amount = INR 250

It may be noted that for the purpose of example (d) mentioned hereinabove, we have followed the stance taken by SAT in *Dushyant Dalal v. SEBI*. In respect of the 50 shares retained, even though no actual profits have been realised by Mr. A and considering that there is no selling price to determine profits, the amount of disgorgement would be equal to the notional profits made by Mr. A in the given situation. Such determination of notional profits takes into account the difference between the closing price of the shares on the first day of listing and the Issue Price.
VI. Standards for Quantifying Disgorgement

With due regard to the fact that it may not be possible to establish a straitjacket formula, which can be used to determine and quantify disgorgement in every situation, this article seeks to develop certain standards for computing disgorgement in case of a violation of securities law with particular focus on the cash segment of the stock market. Though such standards may not cover every probable situation or may be inapplicable to an ordinary violation on account of the peculiar facts and circumstances of that case, they seek to serve as general standards for easy computation of disgorgement by securities commissions. These standards are characterised by a relative mixture of the computation methods discussed in the course of this article.

They are as follows:

(i) In case of insider trading, where the UPSI is of a positive nature, which boosts the market value of securities of a particular company, and shares are purchased before such UPSI becomes public knowledge, the clear motive seems to be making of unlawful profits.

Here,

\[ \text{Disgorgement} = \text{Sale Value of Shares (in case of a sale) or value of shares, a reasonable time after the information becomes public} - \text{Cost of Acquisition} \]

(ii) In case of insider trading, where the UPSI is of a negative nature, which leads to a decline in the value of securities of a particular company, and securities are sold before such UPSI becomes public knowledge, the intention is to avert losses. However, it could also be argued that the motivating factor for such sale is to make profits from the artificially high value of securities.

\[ \text{Disgorgement} = \text{Market Value of Shares on the date of Sale/Trade} - \text{Value of Shares, a reasonable time after such information becomes public} \]
(iii) In case of cornering of shares in an IPO to derive an unfair advantage of a higher listing price, the clear intention is to make unlawful profits.

\[ \text{a) Disgorgement} = \text{Value of Sale} - \text{Cost of Acquisition} \]

Or

\[ \text{b) Disgorgement} = \text{Listing Price} - \text{Cost of Acquisition} \text{ (to determine notional profits, where sale has not occurred)} \]

(iv) In case of a fraudulent advertisement, announcement or notice for buyback of securities or bonus issue of shares, the following method can be used to determine the amount of disgorgement:

\[ \text{Disgorgement} = \text{Average traded price a reasonable time after the announcement} - \text{Average traded price a reasonable time before such announcement.}^{102} \]

(v) In case of an unlawful preferential allotment (for instance, when the company itself provides capital for subscription to its shares in the garb of preferential allotment)

\[ \text{Disgorgement} = \text{Value or the amount contributed towards the legal contravention.}^{103} \]

For instance, in the above example, where the company itself has provided capital to the allottee for the purpose of subscribing to its shares, the company will be liable to disgorge the amount which has so been contributed towards its capital.

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102 SEBI sought to adopt this method, as evinced from the order of SEBI in the matter of Harishchandra Gupta dated 01.04.2016. However, the matter was remanded to the Adjudicating Officer for the purpose of determining the exact figures of the ill-gotten gains.

103 Order of SEBI in the matter of Harishchandra Gupta.
(vi) In a recent case on front running, B was an employee in A’s company. A communicated his trade orders to B who placed them with the stock broker. B immediately purchased a certain quantity of shares for himself (lesser in quantity than A’s order) in the same scrips for which the trade orders were placed with the broker on behalf of A and he sought to match the trade. Consequently, a majority of his trades matched with A’s whereas some of them were offset in the market at large. Here, considering that front running is a fraud against the securities market as a whole, the profits accrued to B from squaring off shares in the market would be determined as the unlawful gain and not merely the profits accrued from the matched trades with A.

Hence, in cases of front running and subject to the peculiar facts of each case, disgorgement may be quantified as:

\[
\text{Disgorgement} = \text{Profits accrued by squaring off shares in the securities market, which shares were acquired by way of front running.}
\]

(vii) Where shares of a company are offloaded in the market by a person/entity involved in issuing false corporate announcements or disseminating any false news in respect of such company

\[\text{SEBI v. Kanaiyalal Baldevbhai Patel (2017) 15 SCC 1, the Supreme Court refers to the definition of ‘front running’ as used in the Black’s Law Dictionary.}\]

\[\text{SEBI order in front running transactions of Kamal Jitendra Katkoria dated 8.05.2018.}\]

\[\text{SEBI order in front running transactions of Kamal Jitendra Katkoria (Since A would have bought a bigger quantity, his trade would have a positive impact on the price of the scrip. Having knowledge of this trade, B bought shares from the market at a lesser price from common investors and reserved the price advantage for himself by incidentally or deliberately setting a last traded price in the scrip. For A’s order to match, the price should be equal to or more than the last traded price and hence, B succeeded in gaining profits wrongly).}\]


‘Front running: n. Securities. A broker’s or analyst’s use of non-public information to acquire securities or enter into options or futures contracts for his or her own benefit, knowing that when the information becomes public, the price of the securities will change in a predictable manner. This practice is illegal. Front-running can occur in many ways. For example, a broker or analyst who works for a brokerage firm may buy shares in a company that the firm is about to recommend as a strong buy or in which the firm is planning to buy a large block of shares.’
which results in an artificial increase in the price of the concerned scrip, the amount of disgorgement may be calculated as follows:

\[
\text{Disgorgement} = \text{Closing price of scrip on the day before such announcements were made or information was disseminated to the public} - \text{average traded price of the shares sold by the concerned person/entity until the falsity of such information or announcement is brought to public notice}. \tag{107}
\]

It would be useful to consider an example to understand the above method.

A person ‘M’ holding 12 per cent shares in a company X (listed on BSE) colludes with a stock market blogger and a media agency to write and publicise that inside sources have leaked that one of the top 50 listed companies in India is in talks with Company X for a proposed acquisition. The blog was published on 6 December 2015 and the media agency featured it in the newspaper on the morning of 7 December 2015. The price of the scrip increased by almost 20 per cent. By 10:30 am, M offloaded 11 per cent of his shareholding in the market and fetched a lucrative amount for the same. At 10:40 am, the Board of Company X issued a public statement through Bombay Stock Exchange (BSE) to the effect that there were no such ongoing talks between Company X and any other company. Pursuant thereto, the price of the scrip fell.

In such a scenario, the unlawful gains could be calculated as the difference between the closing price of the scrip on 6 December 2015 and the average price at which M traded his shares till 10:40 am multiplied by the total number of shares offloaded in the market. The reason why unlawful gains have been computed on the basis of trade till 10:40 am only is that, at that point, the falsity of the proposed acquisition news was brought to the knowledge of the public at large.

(viii) Interestingly, the percentage method adopted in \textit{SEC v. Patel}, is one which can be applied in practically all of the above cases. However, its employment by the SEC has been rather limited.

\[107 \text{ See SEBI order dated 22.03.2018 in } \textit{Re: Saimira Pyramid Theatre Limited}.\]
(ix) In case of pledge of shares, while in possession of negative UPSI, disgorgement would ordinarily be equal to the losses sustained by the pledgee, and the unlawful gains of the pledger. However, considering that the growing trend of pledging equity for the purpose of raising loans is subject to increased criticism by regulatory authorities in India, especially in the case of pledge of shares by promoters of companies, SEBI may want to opt for disgorgement of the entire amount of the loan.¹⁰⁸ This is because, such a loan would not have been granted in the first place, had the pledgee known the real value of the shares pledged. Hence, the grant of loan itself could be construed as an unlawful gain accrued to the pledger. The interesting question here would be whether disgorgement could be directed when there is full repayment of the loan. In my opinion, it may not be possible under the existing provisions of law and precedent, because though courts have recognised the concept of ‘notional profits’ to compute disgorgement, they may be reluctant to acknowledge ‘notional losses’ as a determinant for quantifying disgorgement.¹⁰⁹


¹⁰⁹ See Chintalapati Srinavasa Raju & Ors. v. SEBI, SRSR Holdings & Ors v. SEBI (Appeal Nos. 463, 451-453, 458-462 of 2015) SAT order dated 11.08.2017 read with Shri B. Ramalinga Raju & Ors v. SEBI (Appeal Nos. 282, 284, 285, 286 and 287 of 2014) SAT order dated 12.05.2017. In these matters, a pledge was made by the promoters of Satyam Computers Services Limited, Ramalinga Raju and Rama Raju through an entity called SRSR Holdings for a loan borrowed of approximately INR 1,258 crores. This pledge was later invoked and a large part of the loan amount was repaid. In the concerned matter, the SAT and SC upheld SEBI’s findings that SRSR Holdings would classify as an insider and therefore, relevant provisions of the Prohibition of Insider Trading (PIT Regulations) and SEBI Act were violated. However, SAT remanded the calculation of the amount of disgorgement to SEBI which was earlier quantified by SEBI as the entire loan amount of INR 1,258 crores. SEBI had ordered this amount to be paid jointly and severally by Ramalinga Raju, Rama Raju and SRSR Holdings. Hence, while it would be reasonable to presume that some amount of disgorgement will be awarded in case of pledge of shares while in possession of UPSI, the method, which will be employed by the regulator to quantify the amount, remains a question to be answered.
VII. Conclusion

The concept of disgorgement is now recognised in most jurisdictions. Securities commissions globally have been employing disgorgement as an effective and distinct enforcement tool for the dual purpose of protecting the interests of investors, and preserving the integrity of the capital markets. It cannot be denied that disgorgement is an equitable remedy, which has evolved against the background of legal lacuna that provided for injunctions and debarments but failed to deprive the wrongdoer of the primary unlawful fruits of his wrongdoing.

The method of computation or quantification of disgorgement differs not only among different jurisdictions but also within the approaches developed by a particular securities commission. There is no one method which can be described as ‘perfect’ or ‘apt’. In light of judicial pronouncements and legislation, it is pertinent to understand that a method is acceptable to the extent it performs the function of accurate estimation of unjust enrichment accrued to the wrongdoer. However, the method is likely to vary in view of the peculiar facts and circumstances of every case and the distinct strategies adopted by the wrongdoers to contravene securities law.

It is imperative that the amount of disgorgement be computed as the ‘reasonably approximate unlawful gains’ made by the party ordered to disgorge. Disgorgement, quantified as the reasonable approximation of profits wrongfully gained or losses wrongfully averted, causally connected to the violation(s), could rightfully be understood as the general standard to determine disgorgement in securities law.