Private State Actions to Disgorge the Wrongful Gains of Insider Trading

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Jeanne L. Schroeder, *Taking Misappropriation Seriously: State Common Law Disgorgement Actions for Insider Trading* (Feb. 11, 2021) Cardozo Legal Stud. Rsch. Paper No. 625, available at SSRN.

The disgorgement remedy strips a defendant of unjust profits. Disgorgement is gaining prominence as a civil remedy across a varied body of substantive laws, including intellectual property, contracts, fiduciary duties, as well as in government enforcement litigation to battle fraud and corruption. Disgorgement's provenance ties to restitution and the equitable accounting for profits remedy. Even as memory of its equitable history fades, modern and novel applications of disgorgement flourish. Disgorgement relies on restitutionary principles because its primary goal is to undo unjust gain. It also deters opportunism and disincentivizes misconduct.

But if not applied properly, the danger is that disgorgement may punish, which is explicitly not a goal of the law of unjust enrichment and restitution. The Securities and Exchange Commission (SEC) has faced, and continues to face, an array of criticisms for aggressive uses of its disgorgement remedy pursuant to statutory authorization. Such concerns led to several Supreme Court rulings requiring adjustments to the SEC's approach to disgorgement—most recently in *Kokesh v. SEC*, 137 S. Ct. 1635 (2017) and *Liu v. SEC*, 140 S. Ct. 1936 (2020). Congress subsequently amended the remedy to solidify the SEC's authority to seek disgorgement, though the clarification oddly appears to classify the statutory disgorgement remedy as legal rather than equitable. This congressional revision is housed in a massive piece of unrelated legislation, the 2021 National Defense Authorization Act ("NDAA"), which Congress passed over a presidential veto. A parallel expansion of disgorgement remedies by the Federal Trade Commission (FTC) faced increased judicial scrutiny and ultimately a rebuff by the Supreme Court in AMG v. FTC, No. 19-508 (April 22, 2021) (narrowly interpreting the statute's injunction power as not encompassing FTC authority to seek equitable disgorgement), with congressional restoration of full disgorgement power anticipated.

Much is changing rapidly, and it is unclear how successful the SEC will be at navigating new strictures while advancing enforcement goals. To be clear, the landscape is complex. In a forthcoming article, *Taking Misappropriation Seriously: State Common Law Disgorgement Actions for Insider Trading*, Professor Jeanne Schroeder seeks a solution to the complexities. She advances private state common law actions for disgorgement as a cleaner way to remedy insider trading violations. The potential advantages of private state-based litigation with application of the disgorgement remedy are worth serious consideration. And the notion of parallel pursuit of state common law remedies may well be a wise approach for other governmental enforcement regimes.

To lend credence to this proposal, Professor Schroeder argues that a state common law disgorgement action would align with the Supreme Court's "largely property-based theory of insider trading." Regardless of the asserted narrative fit, Professor Schroeder offers six compelling reasons why an action at common law for restitution would avoid many of the complexities of federal insider trading enforcement actions. For example, the Supreme Court's insider trading jurisprudence requires fraud,

violation of a fiduciary duty, as well as misappropriation of information. Under state law, each of those elements provides an independent ground for private redress.

The common law of restitution therefore streamlines the inquiry to "the person to whom the duty is owed or the owner of the information who should have a cause of action." In highlighting such improvements, Professor Schroeder provides a useful, thorough overview of federal and state insider trading jurisprudence. According to Professor Schroeder, state common law of restitution would simplify remedying insider trading wrongs. Specifically, a state disgorgement approach would eliminate the Supreme Court's multi-factor standard for insider trading and provide much greater flexibility in proof thresholds. For restitution and disgorgement, state common law standards are less onerous than federal statutory requirements and the Supreme Court's strictures. Still, federal law leaves space for concurrent jurisdiction and the continuation of common law efforts to disgorge improper gains.

Of course, to suggest that this alternative approach could replace the SEC's enforcement regime would be extreme. Professor Schroeder wisely notes that her solution of private disgorgement actions should ***supplement*** SEC enforcement, not ***supplant*** it entirely. The SEC would remain responsible for a host of remedial efforts including injunctions, bars, suspensions, penalties, and more. Meanwhile, state courts could continue to develop the contours of the common law of restitution and the important remedy of disgorgement.

The force of Professor Schroeder's approach is that it offers viable alternatives with much simpler proof requirements. Additional benefits may flow from a state common law restitution approach. Such benefits are not the focal point of the article but include the potential avoidance of *Liu* constraints. For example, a state law approach would obviate the mandate to present evidence of concerted wrongdoing in order to obtain joint and several disgorgement liability as well as the Supreme Court's directive to return funds to victims, both of which present unique challenges in insider trading cases.

Still, it is worth considering whether the Supreme Court's commands are wise policy. Though not bound by those strictures, state common law decisions would be free to engage in parallel tightening. But any such efforts can vary by state and would tie to the goals of restitution and unjust enrichment rather than the language of federal statutes. No matter what the underlying frame of the cause of action and remedy sought, courts must balance the law's mission against concerns about overreach, plaintiff windfalls, and punitive results.

Professor Schroeder emphasizes a core restitution principle: that her approach will restore the private claimant to the *status quo ante*. In some of these cases though, courts should conduct more refined analysis to evaluate whether the application of restitution works if the property—material nonpublic information—is of less value when it is not traded than when it is. In some cases, the inside trader's proceeds may not be "the fungible equivalent of personal property previously transferred to the other party," because material nonpublic information *that has not been traded upon* does not (yet) have monetary value to the issuer. Still, as Professor Schroeder's work demonstrates, meaningful and powerful remedies for wrongdoing such as insider trading are worthy state law aims. Thus, Professor Schroeder's work will still resonate as the state common law continues to honor the goals of restitution while working in the shadows of federal statutes.

Professor Schroeder's scholarship is vital in that it reminds readers to consider forgotten remedies and lesser worn paths. Federal enforcement should not be the sole vehicle to strip gain, deter wrongdoing, and benefit victims. If private litigants can effectively pursue remedies on the state level, the SEC may be able to direct its resources to more challenging or important targets. Not only might those paths be easier in the pursuit, but the seeker may also more likely reach the ultimate goal of disgorging the improper gain from insider trading.

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