

Securities Regulation Daily Wrap Up, ENFORCEMENT—2d Cir.: \$64.2M judgment award mostly upheld, although a few issues must be reconsidered on remand, (Jun. 28, 2023)

Securities Regulation Daily Wrap Up

[Click to open document in a browser](#)

By [Mark S. Nelson, J.D.](#)

The case potentially puts the Second Circuit's view of "disgorgement" at odds with the Fifth Circuit's view in light of recent developments from the Supreme Court and a later pronouncement from Congress on the availability of disgorgement.

Iftikar Ahmed challenged an award of disgorgement obtained by the SEC in its fraud case against Ahmed and several family members, the latter being named as relief defendants. Ahmed's bid to have the amount of disgorgement recalculated was rebuffed by the appeals court, but the relief defendants were afforded a second chance to persuade the lower court on several issues. Perhaps the most notable aspect of the case is that, possibly, the Second Circuit's interpretation of "disgorgement" under the Exchange Act puts its opinion at odds with a Fifth Circuit opinion so as to create a circuit split that may eventually afford Ahmed a chance to obtain Supreme Court review. For now, the panel affirmed in part (primarily the disgorgement award) and vacated and remanded in part regarding issues primarily affecting the relief defendants ([SEC v. Ahmed](#), June 28, 2023, Park, M.).

Ahmed allegedly defrauded his employer and investors out of \$65 million over a ten-year period. The SEC eventually won summary judgment in its civil enforcement case against Ahmed and was initially awarded \$41.9 million in disgorgement and \$21 million in civil penalties; the agency also persuaded the lower court to treat Ahmed as the equitable owner of assets held by the nominee relief defendants (i.e., Ahmed's wife and children and various entities). The SEC ultimately, on an earlier remand, was allowed to recalculate disgorgement and was subsequently awarded disgorgement of \$64.2 million (the amount of pre-judgment interest applicable to the disgorgement award also was increased on the prior remand). Ahmed's latest appeal renewed his challenge to the calculation of disgorgement.

Emerging circuit split? The Second Circuit opened its disgorgement analysis by noting that the court and the parties assumed that recent Supreme Court opinions explaining securities law disgorgement principles survived subsequent Congressional enactment of a law that codified the SEC's right to seek disgorgement, and which also extended the limitations period on seeking disgorgement for cases involving scienter. In one of the cases pre-dating the new law ([Kokesh](#)), the Supreme Court held that disgorgement was a penalty for purposes of the general federal limitations period of five years. In a second case pre-dating the new law ([Liu](#)), the Supreme Court held that equitable disgorgement must be limited to a defendant's net profits and be awarded for victims.

The subsequent legislation added a provision to the Exchange Act also using the word "disgorgement." It is this latter use of "disgorgement" that the Second Circuit took to be the same as "equitable disgorgement" under the older Exchange Act provision that was the subject of the two Supreme Court cases. The Second Circuit in a footnote, however, flagged the Fifth Circuit case of [SEC v. Hallam](#), in which that court questioned whether the subsequent legislation created a new "legal" form of disgorgement that may have displaced the older form of "equitable" disgorgement. Said the Fifth Circuit: "As amended, Section 78u(d) authorizes disgorgement in a legal—not equitable—sense. In doing so, it ratifies the pre-*Liu* disgorgement framework used by every circuit court of appeals." As a result, the Fifth Circuit determined that it must "...apply the burden-shifting framework that prevailed before *Liu*." For purposes of Ahmed's appeal, the Second Circuit panel declined to adopt the Fifth Circuit's view.

Ahmed's disgorgement calculation. Ahmed made a two-pronged attack on the district court's award of disgorgement. First, Ahmed asserted that the district court erred in estimating net profits and, on a related note, failed to consider an offset for carried interest (this is a tax term referring to certain partnership interests that typically arise in the context of hedge funds and private equity).

The Second Circuit panel quickly concluded that the lower court reasonably approximated net profits as commanded by the Supreme Court's opinion in *Liu*. The lower court had based its calculation on the difference between the sale and purchase prices of certain transactions. The Second Circuit panel further explained that Ahmed had failed to disclose conflicts of interest (as opposed to misrepresenting purchase prices) and that meant the entirety of the affected transactions were tainted such that the entire amount of profit was the net profit.

With respect to carried interest, the Second Circuit panel explained that equity does not require an offset for an interest that is contingent on a defendant's relationship to his employer as set forth in a general partnership contract. More specifically, expectancy interests are not entitled to offset; the court described the contract thus: "So Ahmed's forfeited 'carried interest' is not an ill-gotten gain from his fraud but rather was his expectancy to a portion of Oak's profits conferred by the General Partnership Agreement."

Ahmed also asserted various other challenges to the disgorgement award including: (1) the SEC's failure to cross-appeal; (2) the reopening of a final judgment by the lower court; (3) the lack of retroactivity of the recently enacted disgorgement law; and (4) the Ex Post Facto Clause regarding the newly enacted disgorgement law. The panel easily dismissed all four, but the latter two perhaps deserve a brief explanation.

First, the panel noted that the amendments to the Exchange Act's disgorgement provisions were made explicitly retroactive to cases pending at the time of enactment. The court reasoned that the SEC sought disgorgement based on its then-existing statutory authority (albeit initially an authority that pre-dated the new law) and that the limitations period limit imposed by *Kokesh* did not come into existence until two years after the SEC brought suit against Ahmed, thus depriving him of the theory that he could rely on *Kokesh* to avoid Congress's extension of the limitations period for scienter-based offenses.

Moreover, the panel concluded that the Congressional change to the SEC's disgorgement statute did not function as an Ex Post Facto law. The legislative changes, said the panel, were civil remedies in nature and did not operate in such a punitive manner as to amount to a criminal penalty. The panel, thus, rejected Ahmed's theory that disgorgement is necessarily a penalty under *Kokesh* because the Supreme Court did not address that question in *Kokesh* and *Lui* later confirmed that equitable disgorgement that is limited to net profits and benefits victims is a remedy available to the SEC.

Lastly, the panel rejected Ahmed's theory that the differing limitation periods in the amended disgorgement law rendered the longer period for scienter-based offenses punitive. The panel said that, for purposes of the Ex Post Facto Clause of the Constitution, a nonpunitive explanation is more likely correct; that is, the longer limitations period is justifiable because scienter-based fraud is inherently harder to detect than other types of violations.

The case is [No. 21-1686](#).

Attorneys: John W. Avery for the SEC. Vincent Levy (Holwell Shuster & Goldberg LLP) for Iftikar A. Ahmed.

LitigationEnforcement: BeneficialOwnership Enforcement FedTracker Securities FraudManipulation GCNNews InvestmentAdvisers InvestorEducation ConnecticutNews NewYorkNews VermontNews