UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.: 2:20-cv-03271-SB-KS	Date: July 29, 2022

Title: *Securities & Exchange Commission v. Bradley C. Davis*

Present: The Honorable **STANLEY BLUMENFELD, JR., U.S. District Judge**

Proceedings: ORDER RE: PLAINTIFF'S REQUEST FOR INJUNCTIVE AND MONETARY RELIEF [Dkt. No. 146]

Plaintiff Securities & Exchange Commission (SEC) brought this civil enforcement action against Defendant Bradley C. Davis for insider trading in violation of § 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder. In June 2022, a jury unanimously found Defendant liable for insider trading. Dkt. No. 141. The SEC now requests the Court impose the following remedies: (1) injunctive relief, (2) disgorgement, and (3) civil penalties. SEC Brief, Dkt. No. 146. The Court grants relief as stated below.

BACKGROUND

Defendant was employed by Nordson Corporation as a vice president in the company's Adhesives Dispensing Systems (ADS) division. ADS was further subdivided into two units, Polymers and Core Adhesives.

Defendant traded Nordson securities on three occasions in 2016. Each of those trades was made prior to Nordson's financial announcements for the first, second, and third quarters of that year. Defendant regularly received two internal financial documents for Core Adhesives, a biweekly revenue analysis and a weekly backlog report. At trial, the SEC presented evidence that these two reports contained material nonpublic information (MNPI) to which Defendant had access before making the 2016 trades. The SEC also presented evidence that Defendant

knew he was in possession of MNPI, including evidence of consciousness of guilt (e.g., spoliation).

The jury unanimously found Defendant liable for insider trading, in violation of § 10(b) of the Exchange Act and Rule 10b-5 thereunder, because he knowingly or recklessly made the 2016 trades on the basis of MNPI (the Core Adhesives reports).

DISCUSSION

The SEC seeks three remedies: a permanent injunction, disgorgement (including prejudgment interest), and civil penalties. The Court addresses each in turn.

1. Permanent Injunction

The SEC seeks to permanently enjoin Defendant from violating § 10(b) of the Exchange Act and Rule 10b-5 thereunder. Under § 21(d) of the Exchange Act, courts are authorized to enter permanent injunctions for violations of the securities laws. 15 U.S.C. § 78u(d)(1). Defendant does not oppose the issuance of a permanent injunction. Def. Brief, Dkt. No. 147, at 1. Accordingly, the SEC's request is granted as to the injunctive relief.

2. Disgorgement and Prejudgment Interest

The equitable relief provision of 15 U.S.C. § 78u(d)(7) authorizes courts to impose disgorgement "[i]n any action or proceeding brought by the [SEC] under any provision of the securities laws." The SEC seeks disgorgement of $795,447.25—the mark-to-market profits from Defendant's trading minus $6,509.97 in transaction costs—plus $217,616.03 in prejudgment interest.

Defendant argues that he should only be required to disgorge profits that were based on an "improper advantage." Def. Brief at 2. More specifically, he argues that "much of the profit he realized had nothing to do with the [inside] information" he possessed because it related to the financial performance of only Core Adhesives. *Id*. at 4. This argument appears to be little more than a variation on his unsuccessful trial theory that the information he had about Core Adhesives was not material because it provided no insight into the performance of the company's other business segments. Defendant does not explain, however, how this repackaged argument can be used to avoid disgorgement of the profits he made

from trading on the basis of MNPI. The point of disgorgement here is that Defendant should not have made the trades *at all* based on MNPI. The jury found that he did so. All the profits from these trades are therefore ill-gotten gains.

Defendant further argues that, while the SEC's estimation of his mark-to-market profits and transaction costs are correct, the Court should deduct the capital gains taxes he paid for profits on the 2016 trades and the income taxes he anticipates paying when he withdraws money from his 401(k) account to satisfy the disgorgement award. *Id*. at 2–3. The Court finds that it is appropriate to deduct the capital gains tax but not the income tax.

In measuring the scope of illicit gains, the disgorgement remedy takes into account the wrongdoer's "net profits." Whether one labels the relief "disgorgement," an "accounting," or "restitution," this equitable remedy is "tethered to a wrongdoer's net unlawful profits" because, while he should not be permitted to "profit 'by his own wrong,'" he should not be forced to pay more than he actually gained. *Liu v. Sec. & Exch. Comm'n*, 140 S. Ct. 1936, 1942–43 (2020). (quoting *Tilghman v. Proctor*, 125 U.S. 136, 145–46 (1888)). "Net profits" therefore measures a wrongdoer's liability based on his "actual, not . . . possible, gains." *Tilghman*, 125 U.S. at 145. Courts calculate this amount by allowing "credits or deductions" that achieve the remedy's purpose—that is, "to eliminate profit from wrongdoing while avoiding, so far as possible, the imposition of a penalty." Restatement (3d) of Restitution & Unjust Enrichment § 51(4)–(5) (2011); *see also Providence Rubber Co. v. Goodyear*, 76 U.S. 788, 804 (1869) ("'Profit' is the gain made upon any business or investment, when both the receipts and payments are taken into the account.").

The SEC cites several cases that cursorily denied a defendant's request to deduct income taxes paid on the amount to be disgorged. *See, e.g.*, *U.S. Sec. & Exch. Comm'n v. Syndicated Food Serv. Int'l, Inc.*, No. 04 CIV. 1303 NGG VMS, 2014 WL 2884578, at *13 (E.D.N.Y. Feb. 14, 2014) (noting that courts have not deducted taxes from disgorgement awards); *U.S. Sec. & Exch. Comm'n v. Zwick*, No. 03 CIV 2742 JGK, 2007 WL 831812, at *24 (S.D.N.Y. Mar. 16, 2007) (same). None of these cases provides a rationale for disallowing credit for the payment of taxes on profits, and the SEC does not explain how these nonbinding cases are persuasive in the context of an enforcement action for insider trading. Absent any substantial analysis of whether the disallowance can be squared with the purpose of the disgorgement remedy, the Court declines to follow them.

The Restatement on Restitution offers more relevant guidance. It states the general rule that a "defendant is normally denied credit for income taxes paid," explaining: "[t]he reason is not to punish wrongdoers (as is sometimes stated), but to avoid a distortion resulting from the effect of the judgment on the defendant's future tax liability." Restatement (3d) of Restitution & Unjust Enrichment § 51 cmt. h. This distortion would occur because the Treasury Regulations already account for the prior tax payment by permitting a deduction for "amounts paid or incurred for restitution" in the year judgment is entered. Treas. Reg. § 1.162-21(b)(1) (2021). To allow a tax offset against the disgorgement award on top of the restitution tax deduction would therefore allow a wrongdoer to receive a net benefit from his wrongdoing. *See id*. The Restatement provides an illustration:

> A's conscious interference with B's rights yields net pre-tax profits of $100,000 to A. Both A and B pay income tax at a marginal rate of 30 percent. The amount of B's judgment against A will be taxable to B and deductible by A in the current tax year. Because A has previously paid $30,000 in income tax on his ill-gotten gains, A asks the court to allow a reduction of $30,000 in calculating A's disgorgement liability to B. The credit for income taxes will normally be denied. Under the tax regime supposed, A's liability in restitution after a reduction for tax paid ($70,000) would produce a current-year tax deduction worth $21,000 to A, resulting in a gain to A of $21,000 from the transaction as a whole ($100,000 profit less $30,000 tax paid less $70,000 liability in restitution plus $21,000 current-year tax reduction). By contrast, A's liability in restitution without the reduction ($100,000) strips A of the wrongful gain without imposing a penalty ($100,000 profit less $30,000 tax less $100,000 liability in restitution plus $30,000 current-year tax reduction).

Restatement (3d) of Restitution & Unjust Enrichment § 51 illus. 23.

The rationale underlying the disallowance of a disgorgement tax credit would not seem to apply to this enforcement action. The Treasury Regulations expressly exempt disgorgement awards "disbursed to the general account of the government or governmental entity for general enforcement efforts." Treas. Reg. § 1.162-21(e)(4)(i)(B). Because Defendant will pay the disgorgement award in this case to the U.S. Treasury, his payment will not be eligible for a tax deduction.[1] To

[1] The Court's assumption that Defendant is ineligible to receive, and will not seek, a tax deduction, credit, or refund based on the disgorged amount is central to its

credit the SEC's position in such a case would therefore result in a partial double payment to the government—first in taxes, and a second time in disgorgement. The SEC makes no attempt to square its position with the basic purpose of restitution, which is to return the illicit net profits, not to punish or deter.

The same analysis does not apply, however, to the income taxes that Defendant anticipates incurring by paying the disgorgement award from his 401(k) account. The disgorgement remedy does not take into account the personal circumstances of the wrongdoer in measuring the scope of illicit gains. *See* *Sec. & Exch. Comm'n v. Coldicutt*, No. CV 13-01865-RGK (VBKx), 2014 WL 12561072, at *7 (C.D. Cal. Aug. 8, 2014) (noting that "inability to pay is largely irrelevant to disgorgement liability"). Defendant is not required by law to withdraw the award from this account to pay the disgorgement award; rather, he has decided to do so based on his personal financial situation. Moreover, the taxes owed on those withdrawals is attributable to the pre-tax nature of the funds—an obligation that exists independent of the transactions that resulted in disgorgement in this case.

Accordingly, the Court finds that Defendant is entitled to deduct the capital gains taxes he paid on the 2016 trades, but not the taxes he will incur on the monies withdrawn from his 401(k) account. Defendant requests a deduction of $100,612 for capital gains taxes he paid on the 2016 trades. Def. Brief at 3. This request is supported by Defendant's tax returns, which show that he paid $100,612 in taxes for capital gains on the relevant trades. Davis Decl. Exs. A–B, Dkt. Nos. 147-8, 147-9. Thus, the Court deducts this amount from the $795,447.25 amount calculated by the SEC and orders disgorgement of $694,835.25 as a fair approximation of Defendant's net profits from the illegal transactions.

The SEC also requests an award of prejudgment interest. Awards of disgorgement typically "include prejudgment interest to ensure that the wrongdoer does not profit from the illegal activity." *Sec. & Exch. Comm'n v. Cross Fin. Servs., Inc.*, 908 F. Supp. 718, 734 (C.D. Cal. 1995). The SEC seeks interest measured by the same rate the Internal Revenue Service uses to calculate underpayment penalties. *See* *Sec. & Exch. Comm'n v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1099 (9th Cir. 2010) (approving this rate for prejudgment interest as a "reasonable proxy for the interest rate that would ordinarily be charged

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determination that Defendant is entitled to an offset for the taxes he paid on the 2016 trades.

on an unsecured loan").[2] Defendant argues prejudgment interest should not be awarded because he did not enjoy any benefit from his ill-gotten gains in light of the costs of this lawsuit. While the Court has no doubt about the substantial cost and serious impact of this lawsuit on Defendant, the decision whether to award prejudgment interest considers "the time-value of the avoided loss amount," not a defendant's personal costs arising from the lawsuit. *Sec. & Exch. Comm'n v. Henke*, 130 F. App'x 173, 174 (9th Cir. 2005).

Accordingly, the Court finds an award of prejudgment interest using the SEC's requested rate to be appropriate. However, the SEC calculated prejudgment interest based on a higher amount of disgorgement, which the Court has reduced to account for Defendant's capital gains taxes. Dkt. No. 146-2. The SEC is therefore ordered to recalculate prejudgment interest based on $694,835.25 in disgorgement.

3. Civil Penalties

The Insider Trading Sanctions Act of 1984 authorizes the imposition of a civil penalty in an amount "determined by the court in light of the facts and circumstances" surrounding the violation, up to three times "the profit gained or loss avoided." 15 U.S.C. § 78u-1(a)(2). The SEC seeks the maximum civil penalty (i.e., three times Defendant's ill-gotten gains). When considering a penalty under this statute, courts consider the following factors:

> (1) the egregiousness of the violations; (2) the isolated or repeated nature of the violations; (3) the defendant's financial worth; (4) whether the defendant concealed his trading; (5) what other penalties arise as the result of the defendant's conduct; and (6) whether the defendant is employed in the securities industry.

Sec. & Exch. Comm'n v. Gowrish, No. C 09-05883 SI, 2011 WL 2790482, at *9 (N.D. Cal. July 14, 2011) (quoting *Sec. & Exch. Comm'n v. Happ*, 392 F.3d 12, 32 (1st Cir. 2004)).

[2] Defendant does not contest the use of this floating rate but asks in a footnote that the Court freeze the rate in the third quarter of 2016. Def. Brief at 5–6 n.4. The Court declines to do so. Defendant fails to reconcile his request with the purpose of using a floating rate to calculate prejudgment interest over time.

These factors do not support the substantial penalty sought by the SEC. Three of these factors weigh in favor of a penalty—the second factor for repeated violations, the fourth factor for concealment, and the fifth factor for consideration of other penalties. The jury reasonably found that Defendant knowingly traded on the basis of MNPI on several occasions; the evidence supported the conclusion Defendant tried to conceal his trading after the fact; and Defendant faces no criminal or other penalties (and the nonpunitive relief in this case, though substantial, does not fully address the concern for deterrence). *See* Sec. & Exch. Comm'n v. Rajaratnam, 918 F.3d 36, 44 (2d Cir. 2019) (noting the purpose of deterrence served by an appropriate civil penalty).

The remaining factors, however, weigh against a significant penalty. The violations themselves are not as egregious as the SEC contends, particularly when measured against the conduct in other cases. While each case must be decided on its own facts, the SEC's reliance on three cases to support its request for maximum penalties serves to show that its position is overly zealous here. *See* Sec. & Exch. Comm'n v. Kunnucan, 9 F. Supp. 3d 370 (S.D.N.Y. 2014); Sec. & Exch. Comm'n v. Lipson, 129 F. Supp. 2d 1148 (N.D. Ill. 2001), *aff'd*, 278 F.3d 656 (7th Cir. 2002); Sec. & Exch. Comm'n v. Patton, No. 02 CV 2564 SJ JMA, 2008 WL 2388261 (E.D.N.Y. June 11, 2008), *aff'd sub nom.* U.S. Sec. & Exch. Comm'n v. Stamoulis, 350 F. App'x 499 (2d Cir. 2009).

The facts and circumstances of Defendant's violations do not compare to those other SEC cases. In *Kunnucan*, the defendant engaged in conduct that triggered parallel criminal proceedings, and his allocution in the criminal case demonstrated that he engaged in a concerted scheme to obtain MNPI "in exchange for personal benefits" and knew his conduct was "wrong and illegal." 9 F. Supp. 3d at 373. In *Lipson*, the chairman and chief executive officer of Supercuts, Inc. sold over 300,000 shares of company stock before the company announced disappointing earnings to avoid over $600,000 in losses. 129 F. Supp. 2d at 1149–50. He was also warned not to trade by his personal attorney and violated company policy in doing so. *Id*. at 1156–57. The defendant also had a significant net worth of over $100 million, which dwarfed the maximum penalty awarded of less than $2 million. *Id*. at 1159. In *Patton*, the defendant purchased 10,000 shares of stock based on inside information about the sale of the company before a public announcement was made and sold the shares shortly after the announcement for a profit. 2008 WL 2388261, at *1. The treble penalty in that case amounted to $178,140. *Id*. at *2.

As to the third factor (financial worth), Defendant submitted detailed information about his financial condition, Dkt. No. 145, which weighs against a substantial penalty. *See Sec. & Exch. Comm'n v. Sargent*, 329 F.3d 34, 42 (1st Cir. 2003) (finding this factor weighed against a penalty because the defendant's "net worth [was] not so high as to require civil penalties"). Defendant's net worth will be seriously diminished by the nonpunitive remedies that will be imposed in this case and by the substantial costs of litigation. As to the sixth factor (employment), Defendant does not work in the securities industry.

Balancing these six factors, the Court finds that a penalty of $100,000 is appropriate. This amount accounts for the repetitive nature of Defendant's violations and his efforts to conceal the 2016 trades but also recognizes the relative severity of the violations, Defendant's financial condition and personal circumstances, and the consequences he otherwise faces as a result of this lawsuit.

CONCLUSION

For the foregoing reasons, the Court orders the following remedies:

1. Permanent Injunction: Defendant will be permanently enjoined from violating § 10(b) of the Exchange Act and Rule 10b-5 thereunder.
2. Disgorgement and Prejudgment Interest: Defendant shall disgorge the net profits from the 2016 trades, totaling $694,835.25, along with prejudgment interest. The SEC is ordered to provide the Court with a revised prejudgment interest calculation based on the amount to be disgorged.
3. Civil Penalty: The Court imposes a civil penalty of $100,000.

Defendant objects to some of the terms in the SEC's proposed judgment and desires to meet and confer with the SEC to see if the parties can come to an agreement over the proposed terms. Dkt. No. 149, at 1. Accordingly, the parties are ordered to meet and confer on terms for a final judgment that conforms the remedies to this Order. The Court expects the parties to act in good faith in conferring on the judgment and make all reasonable attempts to reach agreement. The parties shall file a stipulated judgment or, if necessary, separate judgments, by no later than August 5, 2022.