IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. MARK MEGALLI, Defendant.	: : : : : : : : : : :	CIVIL ACTION NO. 1:13-cv-3783-AT

ORDER

This case is before the Court on a post-summary judgment hearing on remedies in a civil insider trading enforcement action brought by the Securities and Exchange Commission ("SEC"). On September 24, 2015, the Court granted summary judgment to the SEC on the question of whether or not Defendant Mark Megalli was civilly liable for engaging in insider trading in Carter's, Inc. ("Carter's") stock after he pled guilty to criminal insider trading charges based on the same conduct. However, the Court deferred ruling on the question of remedies.

On October 27, 2015, the Court held a hearing on the question of relief and heard testimony from Megalli and argument from both parties. The SEC seeks three kinds of relief for Megalli's civil insider trading violations. First, it seeks disgorgement of his ill-gotten gains. Second, it seeks civil penalties. Finally, it

seeks injunctive relief. The Parties have already indicated their intent to consent to an injunction,

A. Disgorgement.

Disgorgement is an equitable remedy intended to deprive a defendant who engages in insider trading of his ill-gotten gains. *S.E.C. v. Huff*, 758 F. Supp. 2d 1288, 1358 (S.D. Fla. 2010) (citing *S.E.C. v. ETS Payphones, Inc.*, 408 F.3d 727, 734 n.6 (11th Cir. 2005).

A court may order disgorgement if the SEC demonstrates a "reasonable approximation" of the ill-gotten gains that are "causally connected to the violation." *Huff*, 758 F. Supp. 2d at 1358. (citations omitted). "In making such an approximation, courts broadly construe the phrase 'causally connected' to accomplish the goals of equity." *Id.* (citations and quotations omitted). Exactitude is not a requirement; "[s]o long as the measure of disgorgement is reasonable, any risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty." *S.E.C. v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004) (citing *S.E.C. v. Warde*, 151 F.3d 42, 50 (2d Cir. 1998). Once the SEC produces a "reasonable approximation" of the illegal gains, the burden shifts to the defendant to show that the estimate is unreasonable. *Calvo*, 378 F.3d at 1217.

In its Motion for Summary Judgment, the SEC sought disgorgement against Megalli for the total profits gained and losses avoided by his former employer, the hedge fund Level Global, as a result of his illegal trades. This amount totaled nearly $2,700,000.00. Megalli, for his part, advanced the

position that his trades in Carter's stock were only a small portion of his overall trading on behalf of Level Global, and as a result he had only received approximately $1,945.00 in bonus money that was fairly traceable to his illegal trades.

This Court held that it was bound by *S.E.C. v. Blatt*, a former Fifth Circuit case (binding on the Eleventh Circuit), which permits a court to order disgorgement in a SEC civil enforcement proceeding only "to the extent of 'the amount of the fee realized by each defendant for his assistance in executing the fraud'" because "disgorgement is remedial and not punitive." 583 F.2d 1325, 1335 (5th Cir. 1978). The Court therefore declined to order disgorgement of the entirety of Level Global's admitted realized profits and avoided losses. In so holding, the Court noted that a recent Second Circuit case, *SEC v. Contorinis*, had recognized that *Blatt* stood for the proposition that disgorgement against an individual is capped at the amount personally realized by the defendant. 743 F.3d 296, 305 n. 5 (declining to follow *Blatt*).[1] However, the Court also noted that it was not persuaded by Megalli's position that he had gained only

[1] The Exchange Act's remedial scheme is a set of moving parts that includes the levers of disgorgement, civil penalties, and injunctive relief to work in tandem in reaching an overall just result. Here, as a result of his insider trading, Mr. Megalli faces a substantial civil penalty of nearly $40,000.00 in addition to disgorgement (and interest) of roughly $20,000.00. The Court believes this result is fair and reasonable.

And after hearing evidence from the Parties, this result would be the same whether *Blatt* or *Contorinis* controls. As the *Contorinis* court noted, it would not *require* district courts to award disgorgement of a hedge fund's profits against a single trader – it would only *permit* such an award. 743 F.3d at 304 ("[w]e do not conclude that district courts *must* impose disgorgement liability for insider trading upon wrongdoers when the gains accrue to innocent third parties, but rather that the district courts *may* elect to do so in appropriate circumstances.") This Court would have declined to impose a higher amount of disgorgement even if it was operating under the auspices of *Contorinis*.

$1,945.00, in part because he had failed to introduce sufficient evidence to establish that there was no genuine dispute of fact about the personal gain traceable to his illegal trading.

At the October 27, 2015 hearing, the SEC largely stuck to its guns that the correct disgorgement amount is the total profits gained and losses avoided by Level Global – not Megalli. Megalli, for his part, also largely persisted in advancing his original argument that only $1,945.00 is the amount of personal gain traceable to his illegal trading. However, "[a]s an alternative measure of disgorgement . . . Mr. Megalli testified that the 1.65% of Level Global consumer portfolio profitability represented by the $648,655 in Carter's short sale profits contributed $19,790 to [Megalli's] 2010 bonus (*i.e.*, 0.00165 x $1,195,936 (Mr. Megalli's total incentive-based compensation for 2010))." (Doc. 61 at 4 n.3.)

After reviewing the evidence, and considering the circumstances of this case, the Court finds that Megalli's alternative proposal of disgorgement in the amount of $19,790.00 is an appropriate and reasonable approximation of the personal gain accruing to him as a result of his illegal conduct. Megalli's bonus compensation was based on the profitability of the Consumer Portfolio that he managed. The better that portfolio performed, the higher his bonus could be. (Doc. 53-2 at 4-5.)

As Megalli testified, his illegal trades in Carter's stock netted $648,655.00 in profits for Level Global in July of 2010. Megalli's Consumer Portfolio's returned profits in 2010 totaling $39,198,356.00. Megalli's illegal Carter's trades

therefore equaled 1.65 percent of the Consumer Portfolio's overall profitability ($648,655.00 divided by $39,198,356.00). As discussed above, the Consumer Portfolio's profitability – and the Carter's trades' contribution to that profitability – directly impacted Megalli's 2010 bonus compensation.[2] Accordingly, 1.65 percent of Megalli's total bonus compensation in 2010, representing the contribution of the illegal Carter's trades to the profitability of the Consumer Portfolio, is a "reasonable approximation" of his unlawful gains and thus an appropriate target for disgorgement. (Def.'s Ex. 8 to Oct. 27, 2015 hearing, Doc. 53-3 at 55); (Doc. 53-2 at 4.) That amount is $19,790.00.

This "approximation" remains on the low end, but there is insufficient evidence to establish a higher award. The disgorgement amount does not include any disgorgement related to the illegal trades Megalli made in the fall of 2009, shortly after he joined Level Global, because (1) Megalli earned no performance-based bonus compensation in 2009 that could be causally connected to his 2009 illegal trades and (2) the SEC (and Megalli) offered no other evidence or proposed amounts that the Court could consider as a reasonable approximation of his illicit personal gains in 2009.

And it does not include disgorgement of any amount of Megalli's salary. The Court can imagine a scenario where some (likely small) portion of Megalli's

[2] Some of this amount is from the Level Radar fund, a portfolio that Megalli was not directly involved in but from which he was also entitled bonus compensation. The method for determining Mr. Megalli's entitlement to a bonus drawn from that fund was, based on the evidence before the Court, largely or entirely the same as that for the Level Global fund. (Doc. 53-2 at 5.) In other words, Megalli still had to perform in his role as manager of the Consumer Portfolio in order to obtain a Level Radar bonus.

salary could be a proper target for disgorgement, *see S.E.C. v. Merchant Capital, LLC*, 486 Fed. Appx. 93, 96-97 (11th Cir. 2012) (ordering disgorgement of salaries in non-insider trading context), but it lacks any evidence or testimony from the SEC that would support such an order – despite this Court's open invitation in its Order on summary judgment that it would consider such evidence. (Doc. 48 at 25.)

Finally, the Court notes that limiting disgorgement to the "amount . . . realized by [a] defendant for his assistance in executing the fraud" hardly means that hedge funds and other financial institutions may be able to walk away scot-free with the benefits of their misbehaving employees still in hand. *Blatt*, 583 F.3d at 1335. The SEC is free to sue those institutions that participate in and encourage their employees' insider trading. And even when a financial institution is unaware that its young gun or old hand traders are engaging in monkey business, the SEC may seek to impose disgorgement against that institution if it can establish that it "possesses illegally obtained profits but has no legitimate claim to them." *S.E.C. v. Huff*, 758 F. Supp. 2d 1288, 1361 (S.D. Fla. 2010) (Rosenbaum, J.). The SEC did neither of those things here for an obvious reason: Megalli's employer, Level Global, had totally collapsed.

The Court also imposes prejudgment interest on the disgorgement amount, to be assessed at the IRS underpayment rate. *Kinnucan*, 9 F. Supp. 3d at 376-77 (endorsing use of IRS underpayment rate). The decision to impose prejudgment interest is left to the Court's sound discretion. *Blatt*, 583 F.3d at 1335 (a "court's

power to order disgorgement extends only to the amount *with interest* by which the defendant profited") (emphasis added); *S.E.C. v. Miller*, 744 F. Supp. 2d 1325, 1343-44 (N.D. Ga. 2010). Here, requiring "the payment of interest prevents [Megalli] from obtaining the benefit of what amounts to an interest free loan procured as a result of illegal activity," and is therefore appropriate. *Id.* (citations and quotations omitted).

B. Civil Penalties.

Courts may also impose a civil penalty of up to "three times the profit gained or loss avoided as a result of" insider trading. 15 U.S.C. § 78u-1(a)(2). The purpose of the civil penalty is deterrence. While disgorgement returns a defendant to his status quo before he violated the law, a civil penalty punishes the individual defendant and warns others against engaging in future securities violations. *S.E.C. v. Capital Solutions Monthly Income Fund, LP*, 28 F. Supp. 3d 887, 901 (D. Minn. 2014).

In determining whether to award civil penalties, courts consider "the egregiousness of the violation, the isolated or repeated nature of the violations, the degree of scienter involved, whether the defendant concealed his trading, and the deterrent effect given the defendant's financial worth." *Miller*, 744 F. Supp. 2d at 1344; The Court may also consider what other penalties were assessed as a result of the defendant's conduct. *S.E.C. v. Sargent*, 329 F.3d 34, 42 (1st Cir. 2003). The imposition of a civil penalty lies within the Court's discretion, and

depends on the facts and circumstances of the case. *S.E.C. v. Constantin*, 939 F. Supp. 2d 288, 311 (S.D. N.Y. 2013).

The Court finds that these factors weigh in favor of the imposition of a civil penalty here. Megalli's violations – despite his protests of "immateriality" – were serious. First, the very nature of insider trading tends to render it economically dangerous, because "insider trading is a flagrant, deliberate, and serious violation of the federal securities laws; in no sense is it merely technical." *S.E.C. v. Gunn*, No. 08-cv-1013, 2010 WL 3359465 at *4 (N.D. Tex. Aug. 25, 2010) (finding that a defendant who engaged in insider trading that netted him roughly $108,000.00 in profits had engaged in egregious behavior for the purposes of assessing a civil penalty); *see also S.E.C. v. JTWallenbrock & Associates*, 440 F.3d 1109, 1115 n. 12 (9th Cir. 2006) (discussing, in the context of disgorgement, the "arguably more egregious forms of securities fraud, such as insider trading") (quotations omitted). The idea of an equal playing field is hugely important to investor confidence and faith in the country's markets. As Judge Rakoff put it, "[a]s people have come to understand that insider trading is not only a sophisticated form of cheating but also a fundamental breach of trust and confidence, they have increasingly internalized their revulsion for its commission." Sentencing Hearing Transcript, Case No. 13-cr-0442-RWS, Doc. 31 at 31 (July 24, 2014) (*quoting U.S. v. Gupta*, 904 F. Supp. 2d 349, 355 (S.D. N.Y. 2012)).

In addition, Megalli's trading resulted in gains and losses that were significant. Nearly $2.7 million dollars in illegal profits and avoided losses for his

employer is no small sum. *See S.E.C. v. Marker*, 427 F. Supp. 2d 583, 590 (M.D. N.C. 2006) (imposing civil penalty of $500,000.00 in connection with offering of $4.6 million of unregistered notes over two year period). Although the SEC has not shown that Megalli's direct personal gain was inordinately large, this does not obviate the seriousness of his conduct. *Miller*, 744 F. Supp. 2d at 1345 (although defendant did not personally profit from scheme, his conduct was egregious because he stood to potentially gain a large amount and his conduct was not isolated).

Nor does the Court consider Megalli's conduct "isolated." Megalli violated securities laws on two occasions over roughly ten months. This was not a one-off occurrence, especially given Megalli's degree of scienter and financial sophistication. *See Miller*, 744 F. Supp. 2d at 1338 (where defendant's conduct caused company to misrepresent its earnings in three separate earnings reports, conduct was not isolated). Megalli knew what he was doing was wrong. He admitted that he knew he was receiving inside information, that trading on it was "wrong," and that he should have inquired more into the circumstances, but that he "consciously avoided" doing so. (Guilty Plea p. 25:7-15.) These factors thus also weigh in favor of a civil penalty.

Finally, Megalli has sufficient accumulated resources to easily cover the civil penalty and will not be rendered destitute by the penalty. At the evidentiary hearing, he testified that he owns an apartment with an unknown amount of equity in New York City, and has other assets totaling well over $500,000.00. In

addition, though it is unlikely Megalli will ever return to the securities industry, he has three degrees from Yale (a B.A., J.D., and M.B.A.). It is plain that Megalli is a bright, promising man with much to offer this country, even though he made several significant mistakes of professional and moral judgment. Those mistakes have cost him dearly. But the Court is doubtful that those mistakes will prevent him from making a reasonable living in the future. Because almost every factor[3] militates in favor of a civil penalty, the Court finds that a penalty is justified.

The last issue to determine is whether the lodestar amount for the civil penalty is Megalli's personal gain (i.e., the amount imposed herein by disgorgement) or the institutional gain of his employer, Level Global. The Court recognizes that the statutory language of Section 21A is ambiguous on this issue. It allows the imposition of a penalty "on the person who committed [a] violation . . . [that] shall not exceed three times the profit gained or loss avoided as a result of such unlawful purchase, sale, or communication." 15 U.S.C. § 78u-1(a)(2). This language does not necessarily limit the penalty to a trader's personal gain – but nor is it a clarion call requiring the imposition of a penalty based on the institutional gain of the trader's employer. Unsurprisingly, given this ambiguity, it appears that different courts have taken different approaches. On the one

[3] The Court does not find that Megalli made an effort to conceal his trading "through dummy accounts, covert phone calls, or otherwise." *S.E.C. v. Ginsburg*, No. 99-cv-8694, 2002 WL 1835810 at *5 (S.D. Fla. July 8, 2002) (imposing civil penalty of one million dollars (equal to roughly two-thirds of the profits realized) against tipper who did not attempt to conceal his trading). Although the SEC argues that Megalli attempted to "silence" the individual who tipped him (Mr. Martin) by telling him "We never talked," the record simply does not support such an assertion.

hand, in *S.E.C. v. Rajaratnam*, 822 F. Supp. 2d 432, 436 (S.D.N.Y. 2011) the Court rejected limiting the civil penalty amount to a defendant's personal gain. On the other hand, Megalli's exhibits at the evidentiary hearing make plain that many courts, at least as a matter of practice, limit their penalty to no more than three times the individual's personal gain. (Doc. 56-1.)

Moreover, those cases where a court has imposed a civil penalty against an individual based upon the profit accruing to the institution that employed that individual tend to involve situations where that individual exercised a large degree of control over the institution. *E.g.*, *S.E.C. v. Kinnucan*, 9 F. Supp. 3d 370, 377 (S.D. N.Y. 2014) (imposing civil penalty equal to three times the institutional defendant's gain when individual defendant was "responsible for the activities of [the institutional defendant]" because he was its president). While Megalli was hardly ordering coffees and running errands, the testimony at the hearing tended to show that he was a mid-level portfolio manager of Level Global.

In the end, the Court need not decide the issue of whether 15 U.S.C. § 78u-1(a)(2) permits the imposition of a penalty equal to three times the institutional gain of an insider trader's employer. Most (but not all) of the civil penalty factors weigh in favor of imposing a significant penalty, but not at a treble damages level. The Court declines to order the maximum treble damages penalty (or a penalty based on institutional gain) because it seems that most cases where the court imposed such a penalty involved (1) more protracted or frequent illegal activity,

(2) larger sums of money at stake, (3) insider trading by more senior management figures, or (4) other exacerbating factors not present here. *E.g.*, *Rajaratnam*, 822 F. Supp. 2d 432, 436 (S.D.N.Y. 2011) (imposing a treble civil penalty where defendant engaged in a "huge and brazen . . . insider trading scheme, which, even by his own estimate, netted tens of millions of dollars and continued for years.") Under the "facts and circumstances" of this case, a civil penalty equal to two times the disgorgement amount is justified and sufficient to fulfill the prerogatives of the penalty provision by deterring future wrongdoing. The Court therefore **ORDERS** that Megalli pay a civil penalty of $39,580.00.

C. Injunctive Relief.

Finally, the Parties have agreed to language concerning an injunction against Megalli (though Megalli does not concede his summary judgment arguments with respect to liability). The Court will enter an injunction by separate order.

D. Conclusion.

The Court **ORDERS** that Megalli pay disgorgement in the amount of $19,790.00 to the United States Treasury, along with prejudgment interest on that amount based on the IRS rate for unpaid taxes (subject to the Court's approval). The Court further **ORDERS** Megalli to pay a civil penalty of $39,580.00. The SEC is **DIRECTED** to submit a proposed calculation of prejudgment interest on the disgorgement amount, supported by affidavit, by December 17, 2015.

IT IS SO ORDERED this 15th day of December, 2015.

Amy Totenberg
United States District Judge