No. 22-13129

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

U.S. SECURITIES & EXCHANGE COMMISSION,
Plaintiff-Appellee,
v.

SPARTAN SECURITIES GROUP, LTD., ET AL.,
Defendants-Appellants.

On Appeal from the United States District Court
for the Middle District of Florida, Tampa Division
District Judge Virginia M. Hernandez Covington
(No. 8:19-cv-00448-VMC-CPT)

BRIEF OF AMICUS CURIAE INVESTOR CHOICE ADVOCATES NETWORK IN SUPPORT OF DEFENDANTS-APPELLANTS' OPENING BRIEF

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CORPORATE DISCLOSURE STATEMENT AND CERTIFICATE OF INTERESTED PERSONS

Under FRAP 26.1, Amicus Curiae Investor Choice Advocates Network ("ICAN") states it does not have a parent corporation, is not a publicly held corporation, and no publicly held corporation has 10% or more ownership of it.

Under Circuit Rule 26.1-1, ICAN adopts the Certificate of Interested Persons filed by Appellants and makes the following additions:

1. Gray Reed, Counsel for Amicus Curiae.
2. Paul Hastings, LLP, Counsel for Amicus Curiae.

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STATEMENT OF INTEREST

Amicus Curiae Investor Choice Advocates Network ("ICAN") is a non-profit organization seeking to expand investor opportunities to participate in the capital markets and reduce regulatory barriers to entry to those markets. ICAN is concerned that the district court's rulings will (perhaps inadvertently) create just such a barrier. By failing to identify a harm suffered by actual investors, while increasing monetary remedies against intermediaries such as brokers and transfer agents, the net effect of the rulings will be to chill legal conduct without any corresponding benefit.

No party's counsel authored this brief in whole or in part. No party's counsel or any other person other than Amicus Curiae or its counsel contributed money that was intended to fund preparing or submitting the brief. ICAN has no ownership or affiliate relationship with any of the parties to this case and has no knowledge concerning the interested persons in this matter.

All parties have consented to the filing of this brief.

SUMMARY OF AMICUS ARGUMENT

The judgment imposed by the district court requires the payment of disgorgement unrelated to harm suffered by any investors. Because Appellee Securities and Exchange Commission ("SEC") failed to establish a causal connection between Appellants' violations and harm to any investor, the district court ordered Appellants to pay disgorgement to the United States Treasury. Requiring market intermediaries such as brokers and dealers to disgorge funds in connection with activity that causes no investor harm may itself harm investors by reducing the number of legitimate investment opportunities available to investors. Such a result would be contrary to public policy and contrary to the SEC's stated mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

Particularly because this is a case of first impression in this Circuit on this issue, ICAN respectfully urges this Court to reverse the portion of the district court's judgment awarding disgorgement considering the SEC's failure to identify any investors harmed by Appellants' violations.

ARGUMENT

I. PUBLIC POLICY SUPPORTS LIMITING DISGORGEMENT TO CASES IN WHICH IT IS "NECESSARY FOR THE BENEFIT OF INVESTORS."

In their opening brief, Appellants explain why the Supreme Court's decision in *Liu v. SEC*,15 U.S.C. § 78(u)(d)(5), and § 78(u)(d)(7), when read together, do not

permit the ordering of disgorgement paid to the Treasury because when not "for the benefit of investors" as required by the Securities Exchange Act of 1934. (Opening Brief for Appellant at 41-48 *discussing Liu v. SEC*, 140 S. Ct. 1936 (2020)). Amicus Curiae will not repeat those points here.

However, ICAN submits that the Court should consider this issue from an investor's perspective—a perspective the parties may not address.

In his dissenting opinion in *Liu*, Justice Thomas predicted the harms that would arise if the SEC were permitted to award disgorgement not "necessary for the benefit of investors." *Liu*, 140 S. Ct. at 1950. Specifically, Justice Thomas observed:

> One need look no further than the SEC's use of disgorgement to see the pitfalls of the majority's acquiescence in its continued use as a remedy. . . . in the case before us today, just a half century later, disgorgement has expanded even further. . . . not only is it not guaranteed to be used to compensate victims, but the imposition of over $26 million in disgorgement and approximately $8 million in civil monetary penalties in this case seems to ensure that victims will be unable to recover anything in their own actions. As long as courts continue to award "disgorgement," both courts and the SEC will continue to have license to expand their own power. . . .
>
> The majority's treatment of disgorgement as an equitable remedy threatens great mischief. The term disgorgement itself invites abuse because it is a word with no fixed meaning. The majority sees "parallels" between accounting and disgorgement, but parallels are by definition not the same. Even if they were, the traditional remedy of an accounting—which compels a party to repay profits that belong to a plaintiff—has important conceptual limitations that disgorgement does not. An accounting connotes the relationship between a plaintiff and a defendant. In the words of one scholar, "it is an accounting by A to B." But disgorgement connotes no relationship and so is not naturally limited to net profits and compensation of victims. It simply "is A disgorging." Further, the traditional remedy of a constructive trust or

> an equitable lien requires that the "money or property identified as belonging in good conscience to the plaintiff . . . clearly be traced to particular funds or property in the defendant's possession."

Id. at 1953 (Thomas, J., dissenting) (internal citations omitted).

Although the Court in *Liu* permitted the SEC to seek disgorgement as an equitable remedy, this case highlights one type of "mischief" created by ordering disgorgement in the absence of any causal connection to investor harm: the SEC is free to pile on monetary remedies even if those remedies do not help (and may in fact harm) investors. To be sure, the Court's opinion in *Liu* did state that it is an open question whether, and to what extent, "the SEC's practice of depositing disgorgement funds with the Treasury may be justified where it is infeasible to distribute the collected funds to investors." *Id*. at 1948. However, the circumstances of this case in which the SEC failed to establish any connection between Appellant's conduct and harm to any investors does not justify the imposition of disgorgement in the first instance. Distribution to harmed investors is never "feasible" when there are no harmed investors.

II. THE SEC FAILED TO ESTABLISH ANY CONNECTION BETWEEN APPELLANTS' CONDUCT AND HARM TO INVESTORS.

The district court conflated two related issues: (1) the SEC's failure to identify harmed investors for purposes of disgorgement payments, and (2) the absence of any harm to investors caused by Appellants' conduct. An absence of investor harm caused by a defendant's conduct would foreclose the possibility that disgorgement

is "necessary for the benefit of investors." In this case, the SEC didn't merely fail to identify harmed investors, it failed to prove Appellants' conduct caused harm to any investors. That distinction makes all the difference for disgorgement purposes.

Here, the district court's order on remedies cites two district court opinions from federal courts in New York, both of which stand for the proposition that *Liu* permits the imposition of disgorgement absent the SEC's ability to *identify* harmed investors. *See SEC v. Spartan Sec. Group, Ltd*., No. 8:19-cv-00448-VMC-CPT (M.D. Fla. Aug. 10, 2022) (Order, Doc. No. 297 at 24-25) (citing *SEC v. Bronson*, No. 12-CV-6421 (KMK), 2022 WL 1287937, at *14 (S.D.N.Y. Apr. 29, 2022), and *SEC v. Laura*, No. 18-CV-5075 (NGG) (VMS), 2020 WL 8772252, at *5 (E.D.N.Y. Dec. 30, 2020)). Again, failure to *identify* harmed investors for distribution purposes is categorically different than failure to prove that a defendant's conduct caused harm to any investors, which is the situation in the present case. (*See* Order, Doc. No. 297 at 24-25). The district court's reliance on these two New York federal district court opinions is misplaced.

The district court did point to one district court opinion for the proposition that the SEC *need not* establish investor harm *caused* by a defendant's conduct in order to obtain disgorgement. (*See* Order Doc. No. 297 at 24) (citing *SEC v. Almagarby*, No. 17-62255-CIV-COOKE/HUNT, 2021 WL 4461831, at *3 (S.D. Fla. Aug. 16, 2021) (rejecting defendants' argument that disgorgement could not be awarded absent proximate causation between defendants' securities law violation

(failing to register as a dealer) and harm to investors)). The *Almagarby* Defendants have appealed the district court's ruling and the appeal is pending before this Court. *See Almagarby v. SEC*, Appeal No. 21-13755 (11th Cir. Oct. 28, 2021).

Here, there is no question the SEC failed to prove that conduct by Appellants caused harm to any investor. The SEC appears to concede this point in its pleadings filed with the district court: "identifying specific investors who were harmed or the amount by which any particular investor was harmed is not possible." *SEC v. Spartan Sec. Group, Ltd.*, No. 8:19-cv-00448-VMC-CPT (M.D. Fla. Apr. 13, 2022) (Pl.'s Mot. For Misc. Relief, Doc. No. 270 at 14).

The district court recognized this failure by the SEC when it concluded:

> The Court does not believe, however, that the SEC has demonstrated that the violations "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons" sufficient to support Tier Three penalties. The SEC has not pointed to any evidence showing that the violations "resulted in substantial losses." And while the Court has reviewed the trial evidence that the SEC relies on to argue that the violations "created a significant risk of substantial losses to other persons," the most that can be said is that: (1) one of the fraudsters testified that the people who bought the shell companies wanted unrestricted stock so they would "be in a position" to engage in pump and dump schemes; and (2) the fraudster was "aware" that "one or two" of those companies later became pump and dumps, though he could not say which ones. (Doc. No. 194 at 90-91).
>
> This is insufficient. "Although all Section 10(b) or Rule 10b-5 frauds could be said to create some 'risk' of some 'harm' to investors . . . , the Remedies Act reserves third-tier civil penalties for those frauds that create a significant risk of substantial losses." *SEC v. Madsen,* No. 17-CV-8300 (JMF), 2018 WL 5023945, at *4 (S.D.N.Y. Oct. 17, 2018). The SEC has not made that showing here.

(Order, Doc. No. 297 at 36-37) (noting "the inability of the SEC to identify any harmed investors").

Further, the SEC failed to establish that investor harm caused by other defendants should be attributable to Appellants. Specifically, the SEC failed to prove that Appellants participated in any scheme to defraud investors – the jury specifically rejected the notion that Appellants aided and abetted securities violations or participated in a scheme to defraud investors. *See SEC v. Spartan Sec. Group, Ltd.*, No. 8:19-cv-00448-VMC-CPT (M.D. Fla. July 30, 2021) (Jury Verdict, Doc. No. 250 and Clerk's Judgment, Doc. No. 256) (jury found no liability under Counts 1-3, 5, 7, and 11 for aiding and abetting violations or participating in schemes to defraud).

The SEC failed to establish that Appellants caused any investor harm, which is a legally significant failure for purposes of requiring Appellants to pay disgorgement.

III. REQUIRING DISGORGEMENT UNTETHERED TO INVESTOR HARM IS AGAINST PUBLIC POLICY AND MAY CHILL LEGITIMATE MARKET CONDUCT.

Identifying harmed investors in this case was not merely infeasible; identifying harmed investors was impossible because Appellants' conduct did not in fact harm investors. Rather than proving Appellants' conduct harmed investors, the SEC appears to have proved the opposite. The district court summarized Appellants' conduct as "enabling the purchase and sale of securities on the public market that should have been barred or more carefully vetted by FINRA." (Order, Doc. No. 297

at 4). That is, the district court and the SEC seem to acknowledge that Appellants' conduct benefited investors by *facilitating* transactions sought by investors.

If Appellants' conduct caused no investor harm, what impact did Appellants' conduct have on investors? Appellants' violations enabled investors to purchase shares on public markets that investors wanted to purchase. The SEC presented no evidence from investors who regretted purchasing shares that had been insufficiently "vetted by FINRA" or who regretted purchasing shares that should have borne a restricted legend. Similarly, the SEC presented no evidence from investors who would have preferred to have purchased shares in private transactions rather than in the public market.

The SEC sought, and the district court imposed, significant six-figure civil penalties against Appellants. (Order, Doc. No. 297 at 37-38). To the extent the District Court determined those civil penalty amounts were insufficient to deter future violations, the district court made clear that it could have imposed even higher civil penalties. *Id*.

If the civil penalties were sufficient to accomplish the public purpose of deterring future violations (as the district court concluded they were), compelling disgorgement of fees received for "submitting Form 211s to FINRA containing false information" in the absence of investor harm runs the risk of deterring future conduct that does not violate the law. And that may be by design. At various points in the case, the SEC communicated its dislike of public shell companies that merge with

private operating companies as "a relatively quick and cheap way for a private company to get access to the capital available in the public market." *SEC v. Spartan Sec. Group, Ltd.*, No. 8:19-cv-00448-VMC-CPT (M.D. Fla. Jan. 20, 2022) (Order on Defs.' Renewed Mot. for J. as a Matter of Law, Doc. No. 263 at 7). The SEC did not allege (and cannot allege) that these so called "reverse mergers" are illegal or improper in the absence of other factors. But by seeking disgorgement of broker and transfer agent fees above the amount necessary for deterrence (satisfied here by civil penalties) and in the absence of investor harm, the SEC (whether intentionally or not) may "chill" such legal conduct.

Chilling legal conduct is of course against public policy. If the SEC were successful in chilling legal reverse-merger activities, investors may be deprived of the opportunity to purchase the securities of their choice. Depriving investors of the opportunity to participate in legal investing activity (even if disfavored by the SEC) would harm investors – unlike Appellants' conduct. *See Chamber of Commerce of the United States of America v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005) (loss of opportunity to purchase mutual fund shares constituted a legally cognizable injury).

CONCLUSION

For the reasons stated in this brief, ICAN respectfully urges this Court to reverse the portion of the District Court's judgment awarding disgorgement in light of the SEC's failure to identify any investors harmed by Appellants' violations.

Dated: January 24, 2023. Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the type-volume limitations set forth in FRAP 32(a)(7)(B). This brief contains 2149 words, excluding the parts of the brief exempted by FRAP 32(f). It was prepared in a proportionally-spaced typeface using Microsoft Word in Times New Roman 14-point font.

/s/ Darin L. Brooks
Darin L. Brooks

CERTIFICATE OF SERVICE

I hereby certify that on January 24, 2023, I electronically filed the foregoing document with the Clerk of Court by using the appellate CM/ECF system, which will send notification to the attorneys of record for all parties to this suit.

/s/ Darin L. Brooks
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