VI. TIME TO RETHINK SEBI'S DISGORGEMENT: AN EMPIRICAL ANALYSIS OF ITS EFFECTIVENESS

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ABSTRACT

Disgorgement is often described as an equitable remedy that is aimed at deterring wrongdoers from unjust enrichment through their illegal conduct. SEBI, since 2003 has widely used its power to issue disgorgement orders to claw back any ill-gotten gains resulting from the violation of securities laws. This Article expounds on whether disgorgement is an 'effective, equitable remedy' or is just a mere façade of equity.

In order to gauge its effectiveness, the Article seeks to answer two pertinent questions through empirical data- (a) Whether the disgorged amounts credited to the SEBI Investor Protection and Education Fund are being utilised for compensating the harmed investors through restitution, and (b) Whether through disgorgement, SEBI actually reverts the wrongdoer to the status quo and not a worse off position. For the first question, the authors argue that by retaining the disgorged amounts and not compensating the harmed investors, SEBI violates the fundamental principles of unjust enrichment as given under the Indian Contracts Act, of 1872. Further, the Securities Appellate Tribunal has also held that "disgorgement without restitution does not serve any purpose". For the second question, the authors argue that the primary justification behind disgorgement is to revert the wrongdoer to the status quo and no worse, or else it shall take the colour of a penalty. However, by analysing several SEBI orders on disgorgement, the authors have found that there were no orders that gave out the fact that the wrongdoer has actually been reverted to the status quo. Moreover, in certain cases, disgorgement orders have put the wrongdoer in a worse-off position than they were before committing the act.

Thus, this Article has analysed the effectiveness of disgorgement as an 'equitable' remedy by attempting to answer the above questions and has further suggested policy recommendations for the manner of utilisation of disgorged amounts to compensate the harmed investors.

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I. INTRODUCTION

Disgorgement, refers to the idea of forfeiting income or assets that were obtained illegally. It is a regulatory power widely exercised by securities market regulators across various jurisdictions to square off any unjust enrichment in the capital market.[1] The underlying idea behind this is that no one should make gains from their own wrongdoings by putting others in a worse position. In general parlance, disgorgement means forcibly giving up any illegal gains or profits.[2] Black's Law Dictionary has defined disgorgement as *"the act of giving up something (such as profits illegally obtained) on demand or by legal compulsion."*[3] The primary objective is to strip the wrongdoer of any profits illegally obtained from violating the law. A landmark

[1] Vidhi Shah, 'Determining Disgorgement in Securities Law', (2019) 10 THE LAW REVIEW GLC 138-139.
[2] Sumit Agrawal & Robin Joseph Baby, *Agarwal and Baby on SEBI Act 207* (Taxmann 2011).
[3] Henry Campbell Black, Black's Law Dictionary 554 (8th ed.)

judgement delivered by the Supreme Court of the United States of America ("**USA**") in the case of Huntington v. Attrill[4] stated that *"disgorgement is a pecuniary penalty imposed and enforced by the State, for a crime or offences against the laws".* By disgorging illicit profits, the securities regulators maintain a deterrent effect of their enforcement actions against other such violators.[5] It also enables the regulators to restore the *status quo ante*.[6]

In India, the Securities & Exchange Board of India ("**SEBI**") acts as a primary regulator for capital markets and exercises all three powers; administrative, legislative (through delegated legislation), and quasi-judicial. The preamble of the SEBI Act, 1992[7] envisages two-fold objectives for establishing SEBI- (a) protection of investors; and (b) development & regulation of the securities market. This obliges SEBI to maintain investor confidence and establish a level playing field for retail and institutional investors. In order to effectively regulate the securities market, provisions under the SEBI Act have provided various enforcement powers such as-

- Issuing directions and levying penalties (including the power to order for disgorgement);[8]
- Adjudicatory powers;[9]
- Enquiry proceedings;[10]
- Criminal proceedings.[11]

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[4] *Huntington v. Attrill*, [1892] U.S. 146 (U.S.) 657, 667.
[5] *Kokesh v. SEC* [2017] US 581 U 3.
[6] Shruti Rajan & Jitesh Maheshwari, The Science and Art of Disgorgement under Securities Law, (*BAR AND BENCH,* Aug. 15 2023) <https://www.barandbench.com.> accessed 25 February 2024.
[7] The Securities and Exchange Board of India Act 1992 (SEBI 1992).
[8] SEBI 1992, s. 11(4) and s. 11B.
[9] SEBI 1992, s. 15.
[10] SEBI 1992, s. 12(3).
[11] SEBI 1992, s. 24.

Disgorgement is a widely used remedy by various regulators in India and can be found in the Companies Act[12] as well as in the Competition Act.[13] With respect to the securities market, explanation to Section 11B[14] of the SEBI Act is the key provision that grants SEBI the power to order for disgorgement of ill-gotten gains.

The primary objectives of disgorgement can be widely categorized into:

- ***Prevention & Deterrence***

The purpose of disgorgement is to prevent potential wrongdoers from engaging in dishonest or fraudulent conduct. Market participants are deterred from engaging in behaviour that could result in monetary gains through illegal means by the possibility of the regulator forfeiting such profits.

- ***Maintaining Market Integrity***

Maintaining market integrity is crucial for bolstering investor confidence and drawing money to the securities market. Disgorgement acts as a safeguard against manipulative practices, fraudulent schemes, and insider trading, all of which have the potential to undermine market confidence and create an uneven playing field.

- ***Corrective Justice***

Disgorgement is based on the doctrine of *Ex injuria jus non oritur*, which means that a person cannot take benefit of his own wrong. By

[12] The Companies Act 2013.
[13] The Competition Act 2002.
[14] SEBI (n 7).

disgorging ill-gotten gains, the regulator ensures that persons who have profited from his misconduct are not allowed to retain those benefits.

The principle of disgorgement has been well-recognised by securities market regulators globally, including the Securities Exchange Commission ("**SEC**") in the USA and SEBI in India. This Article seeks to determine the efficacy of such disgorgement orders passed by SEBI and whether the regulator is fulfilling its legislative mandate of protecting investors' interests. The authors argue that reconsideration is required for the justification given by SEBI while exercising its power of disgorgement. To analyse the effectiveness of disgorgement as a remedial action, the authors have relied on SEBI orders from 2018 to 2022, along with other empirical data available on the utilisation of SEBI Investor Protection and Education Fund. Part II attempts to lay down the distinction between disgorgement and other remedial actions like penalty, restitution, and forfeiture. Part III of the Article deals with the evolution and development of the principle of disgorgement in the USA and India. Analysis of the effectiveness of disgorgement as a remedy has been dealt with in two parts (Part IV & Part V).

Part IV of the Article deals with the effective utilisation of the disgorged money, and whether the same is actually used to compensate the harmed investors upon their identification. This is of utmost importance since a large amount of money has been collected by the SEBI through disgorgement in the recent past. As per Regulation 4(1)(h) of the SEBI (Investor Protection and Education Fund) Regulations, 2009 ("**SEBI IPEF Regulations**"), all amounts disgorged under Section 11B of the SEBI Act, 1992[15] should be

[15] ibid.

credited to the SEBI Investor Protection and Education Fund ("**IPEF Fund**"). The authors have analysed the inflows and outflows of the IPEF Fund from 2019 to 2023 from SEBI Annual Reports and have found that the Fund has never been utilised for compensating the harmed investors. The Article also argues that the collection and retention of the disgorged monies amount to 'unjust enrichment' on the part of the SEBI, which is violative of the fundamental principles enshrined under the Indian Contract Act, of 1872.[16]

Part V of the Article studies the justification given by SEBI for disgorgement and whether its usage by the regulator is fundamentally different from its theoretical understanding. Initially, the disgorgement power of SEBI was not explicitly recognised by the legislature. With time, the SEBI Act, 1992 was amended, and it was given statutory recognition. The justification given by SEBI for disgorgement was that it is an equitable remedy aimed at returning the wrongdoer to the *status quo* and, therefore, distinct from a penalty.[17] Through disgorgement, SEBI aims to return the wrongdoer to the *status quo* and no worse so as to ensure that it doesn't take the colour of a penalty. In this context, the authors have analysed the disgorgement orders of SEBI from 2018 to 2022 to determine whether such orders only take away the ill-gotten gains of the wrongdoer with an aim to return them to the *status quo*. We have found that in none of the orders during the given period, has there been an instance where the wrongdoer was brought back to the *status quo* and did not leave them worse off.

II. DISGORGEMENT *vis-à-vis* OTHER FORM OF REMEDIES

[16] Indian Contract Act 1872.
[17] Renuka Sane & S. Vivek, 'Reconsidering SEBI Disgorgement', (SSRN, 31 May 2022) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4124724> accessed 17 October 2023.

Disgorgement in its juridical evolution has been sobriquet under penalty, forfeiture and restitution. The application of securities regulatory bodies has time and again exercised disgorgement in a fashion similar to any punitive measure or civil remedy, specifically, penalty or forfeiture.

We saw this conundrum even in Kokesh v. SEC[18], "*JUSTICE ALITO: This case presents a unique challenge as we must determine whether the concept of "disgorgement" should be classified as a penalty or a forfeiture. To make this determination, it is crucial to comprehend the nature of disgorgement, which requires an understanding of its origin and the authority supporting it. The dilemma arises from the need to categorize it without a clear understanding of its form, origin, and exact characteristics."*

This requires to understand the nature of such remedies systematically. Disgorgement asserts the confiscation of ill-gotten gains or gains arising out of an activity that is in contravention of the law. This is based on the principle that profit should arise from ethical and legal practice, and any taint of illegality shall be corrected. The current understanding of disgorgement deals with payment of profits earned illegally to the person from whom they are earned, or those who suffered a notional injury. This understanding of disgorgement goes against the theoretical purpose of disgorgement. To understand the distinguished nature of disgorgement, the authors shall aim to differentiate it from penalty, restitution, and impounding.

A. Disgorgement vis-à-vis penalty

[18] *Kokesh v. SEC (*n 5).

Penalty, as we understand, is imposed by the state for any act in contravention of the law. The reason disgorgement is often categorised as a penalty is because of the twin test it satisfies. Firstly, it is a wrong against the public due to the largely unidentifiable nature of victims, and secondly, for the role it plays in creating deterrence.[19] Disgorgement is often levied for violation of public laws and, moreover, has an inherent punitive measure.[20] In the absence of a legislative mandate to distribute the amount recovered in the form of compensation to 'identified' victims, it presents itself in the form of a penalty.[21] The nature of a penalty is punitive and retributive, while that of disgorgement is to limit unjust enrichment; this leads to the distinction between the both.

The difference arises from the understanding that disgorgement, at least in theory, should not exceed the amount of profit. Courts have gone to a certain length and calculate net profit after removing transaction costs as well. Disgorgement is meant to return the wrongdoer to the *status quo*. The penalty is generally prescribed in the statute, and the adjudicatory authority has the discretion to levy any penalty between the prescribed limits. However, disgorgement operates differently and does not provide a similar discretion to adjudicatory authority in the presence of a systematically developed binding methodology for calculating the disgorgement amount. Moreover, disgorgement cannot be exercised if no profit or loss aversion materialises, while a penalty can be imposed on mere contravention of the law. The penalty would thus be over and above the disgorgement imposed by SEBI and form a

[19] *Huntington v. Attrill*, (n 4).
[20] *Bell v Wolfish* [1979] USSC 441 U.S. 520-539.
[21] *Porter v. Warner Holding Co.*, 328 U. S. 395- 402.

stricter deterrence than the one created by disgorgement alone in an ideal theoretical application.[22]

B. Disgorgement vis-à-vis restitution

The traditional outlook of disgorgement shares a remedial nature with restitution. Restitution refers restoration of wealth to the sufferer on account of the defendant's wrongdoing. Restitution's objective is to prevent unjust enrichment at the expense of the claimant.[23] The premise of restitution rests on the theoretical underpinning that the gain of one party is equivalent to the loss of another party. It can be noted *"that disgorgement without restitution does not serve any purpose"*, but there are still thin-line differences between disgorgement and restitution.[24]

Restitution and disgorgement both have an underlying aim which is compensation. Restitution in the form of compensation generally arises in the form of contractual remedy wherein the amount awarded to the plaintiff would provide him *status quo* or the position has he not entered the contract. Disgorgement gains its distinction based on this inherent nature. Firstly, disgorgement can also be imposed if losses are averted. Thus, while restitution would prevent unjust enrichment, disgorgement may operate to put a person worse off and suffer losses. Secondly, the jurisprudence until now inclines

[22] Buckberg, E. and Dunbar, F.C., Disgorgement: Punitive demands and remedial offers, (2008) 63 (2) Bus. Law. Rev. < https://www.jstor.org/stable/40688470> accessed 17 October 2023.
[23] Grantham, R.B. and Rickett, C.E., Disgorgement for unjust enrichment?, (2003) 62 (1) CLJ < https://www.cambridge.org/core/journals/cambridge-law-journal/article/abs/disgorgement-for-unjust-enrichment/BBFCFD53599524DFE39BA20573430C02> accessed 18 October 2023.
[24] Arnold S. Jacobs, Disgorgement, in 5E Disclosure and Remedies under the Securities Laws § 20.

towards the vanishing difference between restitution and disgorgement but fails to factor in how the anonymity of a capital market distinguishes it from a contract.[25] Let us assume, in a scenario an insider having a piece of positive material information, enters the secondary market for the acquisition of shares. Here the seller, who is a retail investor, is going to sell the shares immaterial of who is going to acquire them. The knowledge of an insider plays a role in his decision-making and not that of the seller, who is not concerned with the sale of shares to either an insider or any other ordinary retail investor. SEBI has provided a framework for assessing the loss suffered, but the same was in the case of an IPO[26] and not a secondary market. SEBI operates on an approximation basis. If the principle of restitution is applied to disgorgement, which is the loss of one party, then in several cases disgorgement would not be applicable. This is the reason that disgorgement functions on the discretionary level for the fact-finding of actual loss or harm which is otherwise indispensable in restitution. In a secondary market setup, a shareholder can sell shares to an insider and still make a profit or sell share to other ordinary retail investors and suffer losses. Thus, in such cases, by any stretch of judicial interpretation, the loss can only be notional, which cannot form the basis of restitution. This understanding is more apt for insider trading.[27]

[25] P. Loughlan, No Right to the Remedy? An Analysis of Judicial Discretion in the Imposition of Equitable Remedies, (1989) 17 M.U.L.R. 1.

[26] In the matter of investigations into initial public offerings, (*SEBI*, 21 November 2006) <https://www.sebi.gov.in/enforcement/orders/nov-2006/in-the-matter-of-investigation-into-initial-public-offerings_15056.html> accessed 15 September 2023.

[27] Thomas C. Mira, The Measure of Disgorgement in SEC Enforcement Actions against Inside Traders Under Rule 10b-5, (1985) 34 (2) Cath. U. L. Rev. <https://scholarship.law.edu/lawreview/vol34/iss2/8> accessed 15 September 2023.

Disgorgement is different from restitution on the major standpoint that restitution returns the plaintiff to the *status quo* while disgorgement returns the defendant to the *status quo*.[28] This is the reason that restitution can extract monetary amounts greater than the exclusive loss envisaged in the contract and extract losses caused, in subsequent non-exclusive business transactions, due to the ill-doing of the defendant. While in disgorgement the amount which is forfeited cannot exceed the net gains. Therefore, a wider scope enjoyed by SEBI in disgorgement amount because it is based on ill-gotten profits and not injury suffered by investors. This empowers SEBI to order disgorgement even in cases where the injured party are unidentifiable.[29] Hence, it can be understood that disgorgement and restitution are different remedies and have different cause and operation.[30]

C. Disgorgement vis-a-vis impounding and forfeiture

SEBI has the power to impound assets which means that until the fixation and confirmation of the charge, SEBI can retain assets to prevent unjust enrichment. Impounding is more of a preventive and interim remedy while disgorgement has finality and is remedial as well as deterrent in nature. Impounding aims at preserving the value of an asset while disgorgement is meant for stripping an offender of ill-gotten gains.[31] Similarly, forfeiture can be distinguished from disgorgement as disgorgement prescribes the

[28] M. Mclnnes, Disgorgement for Wrongs: An Experiment in Alignment, (2000)8 R.L.R. <https://heinonline.org/HOL/Page?collection=journals&handle=hein.journals/restilwr8&id=581&men_tab=srchresults> accessed 16 September 2023.
[29] P. Birks, Unjust Enrichment and Wrongful Enrichment, (2001) 79 Texas. L.R.
[30] Alan R. Bromberg & Lewis D. Lowenfels, *Bromberg & Lowenfels on Securities Fraud Commodities Fraud* (2nd Ed., West Group 2007).
[31] S. Smith, Justifying the Law of Unjust Enrichment, (2001) 79 Texas L.R.

distribution of profits in case the parties that suffered loss can be identified, while forfeiture is loss of property for breach of contractual obligation.

III. EVOLUTION OF DISGORGEMENT IN THE USA AND INDIA

A. Evolution of Disgorgement in the USA

The paramount statute pertaining to securities law in the USA, which is the Securities Exchange Act, 1934, did not consist of any separate statutory provision for disgorgement initially. The purpose and scope of disgorgement have evolved through various case laws. It is pertinent to understand the development of jurisprudence concerning disgorgement in the USA in order to understand the underlying concept of its equitable nature and assess the manifestation of the same spirit in the application of the law.[32] Disgorgement was first exercised in 1968 in the *SEC v. Texas Gulf*.[33] In this case, disgorgement was exercised as *"restitution of ill-gotten gains."* The court ordered restitution of profits reaped by insiders to prevent unjust enrichment. Hence, the institution of disgorgement took birth in the form of a punitive measure, i.e., a penalty, on the grounds that insiders retaining profit would be in violation of the law even though it was envisaged to form an equitable remedy.

In *SEC v. Drexel Burnham Lambert Inc. (1989),*[34] defendants were ordered to disgorge remuneration earned as company directors through share parking, violating a standstill agreement. The court aimed to deter misconduct

[32] Ellsworth, J.D., Disgorgement in Securities Fraud Actions Brought by the SEC, (1977) Duke LJ 641.
[33] *SEC v. Texas Gulf*, 401 F.2d 833 (2d Cir. 1968).
[34] *SEC v. Drexel Burnham Lambert Inc*., 837 F. Supp. 587 (S.D.N.Y. 1993).

rather than provide an equitable remedy. Although acknowledging the need to return illicit profits, the court lacked a precise calculation method, approximating based on reason.[35] Pleas to return profits to the company were rejected due to ownership changes, benefiting the new holding company. The court suggested compensating minority shareholders but didn't implement it, prioritizing compensation for investors with actual losses.

In *SEC v. Manor Nursing Centers, Inc.,*[36] the court did not grant an extension of the disgorgement order over the income that was subsequently earned on the initial ill-gotten gains. It was established that there has to be a clear proximate nexus and cause-and-effect relationship between the illegality and the ultimate profits.

In *SEC v. First City Financial Corp.*,[37] the SEC created a distinction and pertinence to identify gains as lawful and unlawful. While observing that disgorgement is not meant to compensate investors, the nature of disgorgement was still essentially identified within the vague domain of penalty and restitution. In this case, the rise of scrip prices could be attributed to three different factors other than the disclosure of material information over which the insiders had acted, all of which provided different estimates of profits made by insiders ranging from zero dollars to eight hundred thousand dollars, disgorgement was ordered on the basis of violation of the law. Analysts even claimed that the insider was not liable to disgorgement. Thus, disgorgement was ordered as *"the line between restitution and penalty is unfortunately blurred."*

[35] *Elkind v. Liggett & Myers, Inc.,* 635 F.2d 156, 171 (2d Cir.1980).
[36] *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972).
[37] *SEC v. First City Financial Corporation*, 890 F.2d 1215 (D.C. Cir. 1989).

In *SEC v. Worldcom*,[38] the SEC provided a distribution plan of the amount disgorgement on account of financial fraud committed by the company. In *Liu v. SEC,*[39] the court identified that disgorgement is of remedial nature irrespective of the real victims of the offence and can be compensated due to the intricacies of tracing the actual victims and loss. Thus, the court has ruled that disgorgement should be limited to net profit or the ill-gotten gains of the accused.

B. Evolution of Disgorgement in India

The earliest attempts by SEBI for disgorgement appeared in 1998 in the case of *Hindustan Lever Limited v. SEBI,*[40] which was unsuccessful and was rejected by the appellate authority on the ground that there is no specific statutory provision in the parent legislation that provides for imposing such pecuniary burden. Another attempt was made in the case of *Rakesh Agarwal v. SEBI,*[41] where SEBI held that *"the power of direct disgorgement of alleged profits, to aggrieved investors is an equitable power which vests in SEBI, and that such a direction of disgorgement is compensatory in nature".* However, this contention was rejected by the Securities Appellate Tribunal ("**SAT**"), which stated that equitable powers of this nature cannot be exercised by quasi-judicial authorities like SEBI, and can only be exercised by the courts. It was also held that disgorgement of alleged profits is a deterrent measure and not compensatory and therefore is penal in nature, which cannot be undertaken without an express statutory provision for the same.

[38] *SEC v. WorldCom, Inc*., 273 F. Supp. 2d 431 (S.D.N.Y. 2003).
[39] *Liu v. SEC*, 140 S. Ct. 1936.
[40] *Hindustan Lever Limited v. SEBI*, (1998) 18 SCVL 311 (AA).
[41] *Rakesh Agarwal v. SEBI*, (2004) 29 SCL 351 (SAT).

The first successful attempt came in the IPO scam case of 2006[42] (also referred to as *Roopalben Panchal Scam*). SAT recognised and upheld the power of SEBI to issue disgorgement orders. SEBI noted that:

> *"It is well established that the power of disgorgement is an equitable remedy and is not a penal or even a quasi-penal action. Unlike damages, it is a method of forcing a defendant to give up the amount by which he or she was unjustly enriched. Disgorgement is intended not to impose on defendants any demand not already imposed by law, but only to deprive them of the fruit of their illegal behaviour. It is designed to undo what could have been prevented had the defendants not outdistanced the investors in their unlawful project.*
>
> *Disgorgement merely discontinues an illegal arrangement and restores the status quo ante. It is a useful equitable remedy because it strips the perpetrator of the fruits of his unlawful activity and returns him to the position he was in before he broke the law."*

The above approach of SEBI is a significant departure from previous instances wherein the disgorgement order was classified as compensatory.

The jurisprudence on disgorgement was further strengthened in *Karvy Stock Broking Ltd. v. SEBI,*[43] where the SAT observed that:

> *"Disgorgement is a monetary equitable remedy that is designed to prevent a wrongdoer from unjustly enriching himself as a result of his illegal conduct. It is not a punishment, nor is it concerned with the damages sustained by the victims of unlawful conduct. Disgorgement*

[42] SEBI (n 26).
[43] *Karvy Stock Broking Ltd. v. SEBI*, (2008) 84 SCL 208 (SAT).

> *of ill-gotten gains may be ordered against one who has violated the securities laws/regulations, but it is not every violator who could be asked to disgorge. Only such wrongdoers who have made gains as a result of their illegal act(s) could be asked to do so. Since the chief purpose of ordering disgorgement is to make sure that the wrongdoers do not profit from their wrongdoing, it would follow that the disgorgement amount should not exceed the total profits realized as the result of the unlawful activity."*

In the case of *Dushyant N. Dalal and Anr. v. SEBI,*[44] disgorgement powers of the SEBI were challenged on the grounds that there does not exist any specific provision in the parent legislation providing for the same, and hence such orders cannot be issued. SAT observed that:

> *"Since disgorgement is not a punishment but only a monetary equitable remedy meant to prevent a wrongdoer from unjustly enriching himself as a result of his illegal conduct, we are of the view that there need be no specific provision in the Act in this regard and this power to order disgorgement inheres in the SEBI."*

It can be inferred from the above case laws that disgorgement has evolved from a compensatory nature in the *Hindustan Lever case*[45], then to equitable relief in the *Rakesh Agarwal case*[46] to the inherent power of SEBI in *Dushyant Dalal.*[47] The difficulty with respect to the characterisation of disgorgement as compensatory in nature is that

[44] *Dushyant N. Dalal and Anr. v. SEBI*, Appeal No. 182/2009, SAT Order dated 12.11.2010.
[45] *Hindustan Lever*, *(*n 40).
[46] *Rakesh Aggarwal*, (n 41).
[47] *Dushyant Dalal*, (n 44).

victim cannot always be clearly ascertainable and identifiable, due to the complexity of the securities market.[48]

All ambiguity with respect to the SEBI's power to pass an order for disgorgement has now been settled as the legislature in 2014 added a specific provision expressly recognising the power through the Securities Laws (Amendment) Act, 2014.[49] It expressly conferred SEBI with the power to issue a disgorgement order by inserting an explanation to Section 11B(1)[50] of the SEBI Act, which states that:

> *"For the removal of doubts, it is hereby declared that the power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention."*

Along with the SEBI Act, Section 21A of the Securities Contract (Regulation) Act, 1956 ("**SCRA**")[51] and Section 19 of the Depositories Act, 1996[52] was amended to expressly recognise the power of SEBI to issue an order for disgorgement. Therefore, in the Indian securities laws, disgorgement orders could be issued by the regulator, and the legislature expressly recognises such power in the SEBI Act, the SCRA, and the Depositories Act. The disgorged money is deposited in the IPEF Fund as per the SEBI IPEF

[48] *Agarwal and Baby* (n 2) at 211-212.
[49] The Securities and Exchange Board of India (Amendment) Act 2014.
[50] SEBI ACT (n 7) at s 11B (1).
[51] Securities Contracts (Regulation) Act 1956, s21A.
[52] The Depositories Act, 1996 s 19.

Regulations, unlike penalties which are deposited in the Consolidated Fund of India (in accordance with the SEBI Act, 1992).[53] The disgorged money that is deposited in the IPEF Fund is utilised as per the Regulations, and it also provides compensation to the victims where they are identifiable.[54] Currently, SEBI uses its power of disgorgement extensively in cases of violations of securities laws.

IV. DOES DISGORGEMENT PROTECTS INVESTOR?

The preamble of the SEBI Act, 1992 entrusts SEBI with the primary responsibility of protecting the interests of the investors. Perpetrators in the securities market, through their conduct, acquire ill-gotten gains, which harms the investors' interests. SEBI aims to promote healthy and orderly development of the securities market through its regulations and enhance investors' confidence.[55] An effective enforcement mechanism which creates deterrence in the securities market is essential so that it "*holds individuals and entities accountable and deters misconduct, promotes public confidence in financial services, creates an environment in which fair and efficient markets can thrive.*"[56]

Section 15JA of the SEBI Act[57] provides that sums realised by way of penalties must be credited to the consolidated fund of India, which can be utilised in the manner prescribed by the government. However, as per the SEBI IPEF Regulations, disgorged money should be credited to the SEBI IPEF

[53] SEBI ACT (n 7) at s 15JA.
[54] SEBI (Investor Protection and Education Fund) Regulations 2009, Regulation 5(3).
[55] *N. Narayanan v. Adjudicating Officer, SEBI*, (2013) 12 SCC 152.
[56] International Organization of Securities Commissions, Objective and Principles of Securities Regulation (2003).
[57] SEBI ACT (n 7) at s 15JA.

Fund. This shows the legislative intent that the Fund should provide for investor protection as well as investor education. The Article aims at highlighting a regulatory gap in the current functioning of the IPEF Fund, as the same is used for investor education but not for investor protection. In *Ram Kishori Gupta v. SEBI*[58], the SAT has aptly held that *"the basic idea behind disgorgement is restitution. As an investor protection measure, the appellants need to be compensated. Since disgorgement without restitution does not serve any purpose."*

A. Scope of Distribution of Disgorged Money and the Investor Protection Regime of India

Due to the ambiguity created by the SEBI Act and the statutes, legal aids of interpretation will have to be brought into use to resolve the same. The Supreme Court of India has held that *"the Court has to ascertain the object which the provision of law in question is to sub-serve and its design and the context in which it is enacted. If the object of the law will be defeated by non-compliance with it, it has to be regarded as mandatory."*[59] Regulation 5(3)[60] of the SEBI IPEF Regulations does provide for restitution of the disgorged money to compensate the identifiable victims, where the *'SEBI deems fit'*. This provides for broad discretionary power to SEBI in deciding whether the disgorged money should be restituted or not and thus leaves a wide room for ambiguity. This is in stark contrast to the provision under the Companies Act, 2013,[61] wherein the court is specifically authorised to distribute disgorged money out of the Investor Education and Protection Fund ("**IEPF**"), in cases

[58] *Ram Kishori Gupta v. SEBI*, 2019 SCC OnLine SAT 149.
[59] *Sharif-ud-Din v. Abdul Gani Lone*, (1980) 1 SCC 403.
[60] SEBI (Investor Protection and Education Fund) Regulations 2009, Regulation 5(3).
[61] Companies Act (n 14) at s 125(3)(c).

where the applicants who have suffered losses due to wrong actions by any person are identifiable. It is also pertinent to note that in the SEBI IPEF Regulations, the distribution of disgorged money is an administrative action giving the regulator a wider discretionary power, whereas, under the Companies Act,[62] the power is vested upon the court and is thus a judicial action.

Whilst there is no explanation provided for the creation of the IPEF Fund by SEBI, underlying intent could be imported from Section 308(a) of the Sarbanes-Oxley Act, 2022[63] ("**SOX Act**"), which provides for the creation of a Fair Fund and authorises the *"SEC to inter alia, utilise the disgorgement funds for the benefit of victims of securities law violation".* Further, SAT has held in the case of *Ram Kishori Gupta v. SEBI*[64] that the *"basic idea behind disgorgement is restitution*".

An analysis of various disgorgement orders and their recent rise shows that SEBI is increasingly resorting to disgorgement of 'ill-gotten gains' where the same could be quantified. In the recent past, the amount collected through disgorgement has exponentially increased.[65] Further, the Supreme Court in the case of *Sahara Real Estate Corp. Ltd. and Anr. v. SEBI*[66] held that the legislative mandate for the protection of investors' interests is best served when SEBI compensates the harmed investors.

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[62] ibid.
[63] Sarbanes-Oxley Act of 2022s 308, Pub. L. No. 107-204 (2002).
[64] *Ram Kishori Gupta (*n 58).
[65] Dr. S.N Ghosh, 'Protection of Harmed Investors: The Missing Link in the Disgorgement Orders of the SEBI', (2020) 14 NSLR < https://nslr.in/wp-content/uploads/2020/07/NSLR-Volume-XIV.pdf> accessed 10 September 2023.
[66] *Sahara Real Estate Corp. Ltd. and Anr. v. SEBI*, (2012) 172 Comp Cas 154 (SC).

B. Investor Protection & SEBI's Utilisation of the IPEF Fund

Regulation 5 of the SEBI IPEF Regulations deals with the utilisation of the IPEF Fund by SEBI. It could be used for purposes like:

- Educational activities, research, training and seminars[67];
- Investor awareness programmes[68];
- Aiding investors' associations to undertake legal proceedings[69];
- Expenses and travel for the members of the Committee[70];
- Restitution of amounts disgorged for compensating eligible and identifiable investors who have suffered from losses[71], among others.

The authors have analysed SEBI Annual Reports for the past four financial years (2019-20, 2020-21, 2021-22, 2022-23) to ascertain whether SEBI actually utilises the disgorged money credited to the IPEF Fund for protecting investors' interests and compensating the victims. The findings are consolidated in the below-mentioned tables:

IPEF Expenses	Amount (in Rs. crore)
Financial Literacy	38.62
Seminar / Workshops by SMARTs	3.16
Seminars / Workshops by Investor Associations	1.72
Investor Education	15.08
Seminars / Workshop by CoTs	0.35
Capital Grants	0.06
Committee meetings	0.029
Others	0.412

[67] SEBI (Investor Protection and Education Fund) Regulations 2009, Regulation 5(2)(a).
[68] ibid at Regulation 5(2)(b).
[69] ibid at Regulation 5(2)(d).
[70] ibid at Regulation 5(2)(f).
[71] ibid at Regulation 5(3).

Table 1: Expense-wise Utilisation of IPEF Fund by SEBI from 2019-20 to 2022-23.[72]

Year	IPEF Inflow (in Rs. crores)	IPEF Outflow (in Rs. crores)	Utilisation of IPEF in %
2021-22	1,720.1	6.81	0.39%
2020-21	1,203.1	28.84	2.3%
2019-20	883.44	11.84	1.3%

Table 2: Year-wise utilisation of IPEF Fund by SEBI.[73]

From the above tables, it can be inferred that during the above period of study, SEBI never utilised the disgorged money credited to the IPEF Fund to compensate the harmed investors through restitution. It also shows that the majority of the expenditure incurred in the IPEF Fund is only with respect to 'investor education' and not 'investor protection'. Further, the overall utilisation rate of the IPEF Fund from 2019 to 2022 has remained abysmally low, averaging at 1.33%. This defeats the intent behind disgorgement, which aims to be an equitable remedy and to compensate the identifiable victims. In the authors' opinion, this is due to the fact that Regulation 5(3) of the SEBI IPEF Regulations does not prescribe any procedure to be followed by the regulator while utilising the disgorged amounts for restitution, and hence, leaves an expansive room for administrative discretion.

On the contrary, in the USA, the SEC has issued an elaborate "Rules of Practice and Rules on Fair Fund and Disgorgement Plans."[74] It mandates the creation of a fund for the disgorged amounts, which shall be used for the

[72] Securities & Exchange Board of India, Reports & Statistics- Annual Report 2022-23, Annual Report 2021-22, Annual Report 2020-21, Annual Report 2019-20, (*SEBI*, August 7, 2023) <https://www.sebi.gov.in> accessed 15 August 2023.
[73] ibid.
[74] U.S. Securities and Exchange Commission, Rules of Practice (*SEC*, 2018) <https://www.sec.gov/about/rules-of-practice-2018.pdf> accessed 15 August 2023.

benefit of the harmed investors. It also requires the regulator to have a plan for the distribution of funds in a disgorgement fund. The Rules further state that:

> *"Submit a plan for the administration and distribution of funds in a Fair Fund or disgorgement fund within 60 days. It will also contain a detailed plan for administration and distribution of funds to the harmed investors. The plan will include 'categories of persons potentially eligible to receive proceeds; procedures for providing notice to such persons of the existence of the fund and their potential eligibility to receive proceeds of the fund; procedures for making and approving claims, procedures for handling disputed claims, and a cut-off date for the making of claim; procedures for the administration of the fund, including selection, compensation; proposed date for the termination of the fund, including provision for the disposition of any funds not otherwise distributed and such other provisions as the Commission or the hearing officer may require."*

The authors suggest that a similar provision on the lines of the SEC's "Rules of Practice and Rules on Fair Fund and Disgorgement Plans" be enacted in India. It would streamline the process of distribution of disgorged amounts. Further, having a disgorgement plan in place will help in reducing administrative discretion that is involved in the process of determining harmed investors and the procedure for restitution of the disgorged amount. SEBI can also draw inspiration from the SEC and can have a dedicated 'Information for Harmed Investors' portal,[75] where harmed investors can fill out an 'Investor

[75] U.S. Securities and Exchange Commission, Information for Harmed Investors (SEC, 7 August 2021) <https://www.sec.gov/enforce/information-for-harmed-investors> accessed 15 August 2023.

Claim Form'. With advancements in surveillance mechanisms of the SEBI, tracing and identifying harmed investors is not as challenging as it used to be a decade ago.[76] All transactions in the capital markets are now routed digitally and leave a footprint and an audit trail. Therefore, validating claims of harmed investors will not be a herculean task for SEBI, and the same can be undertaken with the necessary systems in place.

V. DOES DISGORGEMENT ACTUALLY REVERTS THE WRONGDOER TO THE STATUS QUO?

The theoretical framework of disgorgement showcases the remedial nature of disgorgement and the intent of SEBI to create a market that protects the interest and confidence of investors. The primary intent of disgorgement is to return the wrongdoer to the *status quo*, by stripping the defendant off their ill-gotten gains. SEBI, has time and again, characterized disgorgement as a remedial action only aimed at returning the wrongdoer to the *status quo* and no worse, or else it would take the colour of a penalty.[77] Lest in practice, disgorgement does not provide the most equitable outcome. To assess the practicality of disgorgement, the authors have analysed SEBI orders from January 1, 2018, to July 15, 2022.

This consists of 551 orders against 46 companies and 60 noticees. Out of 551 orders, cases under SEBI (Prohibition of Fraudulent & Unfair Trade Practices) Regulations, 2003 ("**PFUTP**") constituted 80% of cases, SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT**") constituted 16% of cases, 3% cases included both PFUTP and PIT regulations and the

[76] *S.N. Ghosh (*n 65).
[77] *S. Vivek* (n 17).

remaining 1% were neither PFUTP nor PIT but other regulations like the SEBI (Substantial Acquisition of Shares & Takeover Regulations), 2011 ("**SAST**") etc. 226 cases (41%) had no direction of disgorgement and the remaining 325 cases (59%) had a direction for disgorgement. Out of the 325 cases, 194 cases (60%) had joint or several liability while 131 cases (40%) did not have joint or several liability.

Before delving into further analysis, we need to understand the applicability of disgorgement holistically. The Karvy case[78] provides a four-fold test for the same.

- ***Contravention of SEBI Act or regulations***

The first precondition is clearly laid down by the statute that there must be a contravention of any regulation. This implies that SEBI first must prove infringement like any private remedy. SEBI has taken a liberal approach in the interpretation and included SEBI circulars within the same ambit. In the period of the current study, a very small portion of orders were issued on the basis of circulars.

- ***Profit or loss averted by Noticee***

The statute expressly indicates the applicability of disgorgement when either profit was made, or loss was averted. Thus, there is an emphasis on gain, making it a defendant-oriented remedy.

- ***Such profit or loss to be in contravention of law***

[78] *Karvy Stock Broking Limited* (n 43).

` The statute further restricts the scope to acquiring the gain through any act which infringes the law. There is an express requirement for a reasonable nexus between contravention of law and wrongful gains made by the noticee.

- ***Return to the status quo***

As deciphered that disgorgement implies the status quo of the defendant, meaning, to put the defendant in a position before he acquired the wrongful gains or avoided losses. This indicates the non-penal nature of disgorgement.

A. Statistical Analysis of SEBI Disgorgement Order from 2018

When the orders of SEBI are analysed on these tests, it is found that in 9% of cases wherein disgorgement was ordered, the defendants made no profits or had averted no losses, which makes the application of disgorgement not only inequitable but also penal in nature by erasing the distinction between disgorgement and penalty. This would transform disgorgement virtually into a penalty. In the 295 cases where disgorgement was ordered on the basis of gains made in contravention of law, out of which in 180 cases, the order identified such gains as 'notional', while in 23 cases (8%), it was not clear. This indicates that SEBI imposed disgorgement on certain assumptions as in the majority of cases, the noticee did not generate any illegal gain. The complication with notional gains is that the calculations are based on assumptions, and the status quo cannot be assessed with precision. It is evident from the data that when notional profits/loss cannot be ascertained the disgorgement amounts are drastically higher. Further, through their analysis, the authors have also found that during the period of study, none of the cases have a finding that the direction of disgorgement only returns the wrongdoer back to the *status quo*

and not worse. An analysis of disgorgement orders from 2018 to 2021 is mentioned in the below table:

Regulation	Number of orders	Disgorgement Amount (Rs. Million)
Others	3	3604.75
PFUTP	221	10.94
PIT	72	127.96
SEBI Orders	23	5.90

Table 3: Analysis of SEBI Disgorgement orders with respect to various regulations

VI. CONCLUSION

The Article begins with understanding disgorgement as a remedial measure and traces its jurisprudential evolution through various case laws in the USA and India. It also lays down a distinction between disgorgement and other remedial actions like penalty, restitution and forfeiture. In the later part of the Article, the authors have attempted to study the effectiveness of disgorgement carried out by SEBI from two perspectives- firstly, whether the disgorged amounts credited to the SEBI IPEF Fund are being effectively utilised for restituting the harmed investors through compensation; and secondly, whether the disgorgement orders of SEBI actually revert the wrongdoer to the *status quo* and not a worse off position, which would paint it as a penalty.

In the first part, the authors have analysed the inflows and outflows to the IPEF Fund as provided in the SEBI Annual Reports from 2019 to 2023. It can be concluded that in the period of study, the regulator has never utilised the disgorged amount credited to the Fund for restituting the harmed investors. While on the other hand, it has collected more than Rs. 3,748 million through

the disgorgement of ill-gotten gains. Unutilised money collected through disgorgement amounts to unjust enrichment by the SEBI. The cardinal principle governing the law of restitution is that *"a person who has obtained a benefit at the expense of another should be liable to restitute the other from whom he has gained."*[79] It has also been held by SAT that *"disgorgement without restitution serves no purpose."*[80] In conclusion, specific guidelines should be provided in the SEBI IPEF Regulation wherein the disgorged amounts should be used for compensation of the harmed investors upon identification. The regulator can draw inspiration from the SEC's "Rules of Practice and Rules on Fair Fund and Disgorgement Plans".

In the second part, the authors have statistically analysed all SEBI orders for disgorgement from 2018 to 2022. The justification given by SEBI for categorising disgorgement as an 'equitable and remedial' power is that it only aims to return the wrongdoer back to the *status quo* and not worse. If the latter is the case, then it would become a penalising action. We have found that in none of the cases is there a direction that the wrongdoer has reverted to the *status quo* and is not worse off. Therefore, the critical element that qualified disgorgement as an equitable remedy is missing.

SEBI's power of disgorgement has failed on both the grounds mentioned above, and therefore the premise that disgorgement is always an equitable remedy is incorrect. The authors conclude by stating that disgorgement requires reconsideration from the legislature. Specific

[79] *Renusagar Power Co. Ltd. v. General Electric Co*., 1994 Supp (1) SCC 644.
[80] *Ram Kishori Gupta* (n 64).

guidelines must be prescribed for the utilisation of the disgorged amounts and curbing of the administrative discretion of SEBI in the same.