No. 22-687

In the Supreme Court of the United States

RANDALL S. GOULDING, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the district court committed clear error in calculating net unjustified proceeds supporting the disgorgement award in this case.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-10) is reported at 40 F.4th 558. The magistrate judge's findings of fact and conclusions of law (Pet. App. 13-95) are unpublished.

JURISDICTION

The judgment of the court of appeals was entered on July 7, 2022. A petition for rehearing was denied on September 7, 2022 (Pet. App. 123). On November 28, 2022, Justice Barrett extended the time within which to file a petition for a writ of certiorari to and including January 20, 2023, and the petition was filed on that day. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner defrauded clients of his investment advisory firm, The Nutmeg Group, LLC (Nutmeg). By the time he was caught, petitioner had diverted at least $1.2 million in client funds for his personal benefit, transferred client assets worth more than $4 million to friends and family members, and left his client accounts with negative cash balances. Pet. App. 60. In 2009, the Securities and Exchange Commission (SEC or Commission) brought this civil enforcement action, alleging that petitioner had violated provisions of the Investment Advisers Act of 1940 (Advisers Act), ch. 686, Tit. II, 54 Stat. 847 (15 U.S.C. 80b-1 *et seq.*), and Commission rules promulgated thereunder. The parties consented to have proceedings conducted by a magistrate judge. After granting partial summary judgment to the Commission and conducting a bench trial on the remaining issues, the magistrate judge found petitioner liable for multiple violations. Among other remedies, the magistrate judge ordered petitioner to disgorge $642,422 (plus interest), which represented a measure of his ill-gotten gains during the relevant period. Pet. App. 99. The court of appeals affirmed the liability findings and disgorgement award. *Id.* at 1-10.

1. Congress enacted the Advisers Act "to establish federal fiduciary standards for investment advisers." *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462, 471 n.11 (1977); see *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-188 (1963). Section 206 of the Act prohibits investment advisers from, *inter alia*, "employ[ing] any device, scheme, or artifice to defraud any client or prospective client," or "engag[ing] in any act, practice, or course of business which is fraudulent, deceptive, or manipulative." 15 U.S.C. 80b-6(1) and (4).

Commission Rule 206(4)-8, which is among the rules implementing Section 206, provides that "[i]t shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business" under the statute for "any investment adviser to a pooled investment vehicle" to "[m]ake any untrue statement of a material fact" to "any investor or prospective investor in the pooled investment vehicle" or to mislead such an investor by material omission. 17 C.F.R. 275.206(4)-8(a). Rule 206(4)-2 also prohibits an investment adviser from commingling client assets and requires an annual audit. 17 C.F.R. 275.206(4)-2.

Finally, Section 204 of the Advisers Act and Commission rules promulgated thereunder impose various record-keeping requirements on investment advisers. 15 U.S.C. 80b-4; 17 C.F.R. 275.204-2(a) (records of cash receipts and disbursements, maintenance of a general ledger, and other financial records).

2. Between 2006 and 2009, petitioner was the sole owner and managing member of Nutmeg, which served as both investment adviser to 15 investment funds and general partner of 13 of those funds. Pet. App. 14-19. Collectively, the funds contained approximately $32 million in investments from 328 investors. *Id.* at 14-15. Nutmeg earned fees based on, *inter alia*, the value of assets under management and the performance of fund investments. *Id.* at 23-24.

Petitioner directed Nutmeg's strategy of investing client assets in small companies through private investment in public equity (PIPE) transactions.[1] Pet. App.

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[1] In a PIPE transaction, a public company sells a security directly to a private investor rather than through a public offering. The selling company generally offers a fixed number of shares at a discount

16, 19-20. Nutmeg obtained the investments at heavily discounted prices by focusing on companies that faced a high risk of financial distress and accepting notes that could at best be converted into restricted, rather than freely tradable, stock. *Id.* at 17, 42-43, 49, 55-57. Petitioner nevertheless prepared and approved offering documents that falsely told investors that the managed funds were investing directly in publicly traded stocks. *Id.* at 42-43. At petitioner's direction, Nutmeg also falsely valued the investments in the convertible notes as if they were less-risky unrestricted stock, thereby inflating Nutmeg's management and performance fees while misinforming investors as to the value of their investments. *Id.* at 46-47, 53-57. Those fraudulent valuation and accounting methods conflicted with the methods that Nutmeg's offering documents had told investors Nutmeg would follow. *Id.* at 42-43, 53-57.

Petitioner caused other misstatements and misleading non-disclosures to appear in Nutmeg's offering documents. For example, in a biography touting his legal practice and past employment with the Internal Revenue Service (IRS), petitioner did not disclose that the IRS had penalized him for his negligent preparation of tax returns; that he was later convicted of felonies, including mail fraud and tax fraud, for which he had served prison time; or that his law license had been suspended by the State of Illinois. Pet. App. 43-44.

Petitioner also mishandled the funds' assets and failed to maintain the records necessary to keep track of those assets as required under the Advisers Act. For example, petitioner commingled client money in bank accounts that also held Nutmeg's and petitioner's own

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below the current market price, and resale of those shares is restricted. Pet. App. 16.

money. Pet. App. 33-34. The magistrate judge found that petitioner had then treated those bank accounts "as his personal piggy bank," using them to pay personal expenses without regard to his legal entitlements and withdrawing substantial sums that were not his to withdraw. *Id.* at 58, 62. Petitioner further transferred more than $4 million in client assets to friends and family members and made additional payments to them using client funds. *Id.* at 29-33, 58, 62. Petitioner separately directed payments to his own law firm. *Id.* at 22-23.

Nutmeg often held client securities in its own name rather than in the names of its client funds, and it kept the securities at its office rather than depositing them with a broker. Pet. App. 34, 45. Nutmeg failed to maintain the books and records required by the Advisers Act and the Commission's implementing rules, and it did not conduct the required audits. *Id.* at 36-39. Nutmeg did not disclose any of those practices to investors, instead making false and misleading statements indicating that client assets were maintained as required. *Id.* at 42-43.

The SEC uncovered petitioner's wrongdoing while conducting a compliance examination in 2008. Pet. App. 47. By that point, petitioner had misappropriated more than $1.2 million dollars in client money for his personal benefit; Nutmeg had negative cash balances in its bank accounts; and Nutmeg owed the funds between $1 million and $1.4 million. *Id.* at 60-61.

3. In March 2009, the SEC brought this civil enforcement action in the United States District Court for the Northern District of Illinois, alleging that petitioner and Nutmeg were violating the Advisers Act and rules promulgated thereunder. D. Ct. Doc. 1 (Mar. 23, 2009). With the parties' consent, the case was later reassigned to a magistrate judge. D. Ct. Doc. 669 (Aug. 5, 2013).

In February 2016, the magistrate judge entered partial summary judgment for the Commission on some of the claims, finding petitioner and Nutmeg liable under, *inter alia*, Subsections 206(2) and (4) of the Advisers Act, 15 U.S.C. 80b-6(2) and (4), and Commission Rule 206(4)-8, 17 C.F.R. 275.206(4)-8. D. Ct. Doc. 795 (Feb. 18, 2016). In 2018, the court conducted an eleven-day bench trial to resolve the remaining issues and ultimately issued extensive post-trial findings of fact and conclusions of law. Pet. App. 13-95. Among other additional violations, the court found that petitioner had violated Section 206(1) of the Advisers Act, 15 U.S.C. 80b-6(1), by intentionally or recklessly commingling client assets, overstating asset values and fees, misappropriating assets, improperly transferring assets, and failing to disclose those practices to clients and investors. Pet. App. 78-79.

In determining remedies, the magistrate judge ordered petitioner to disgorge $642,422, finding that amount to be a reasonable approximation of petitioner's ill-gotten gains "derived from his wrongdoing during the relevant period." Pet. App. 90. That figure was based on the money petitioner "withdrew from Nutmeg's commingled bank accounts over and above what he deposited into those accounts," and it did not include the significant additional sums that Nutmeg had paid to petitioner's law firm and to others on petitioner's behalf. *Id.* at 61-64, 85-90, 149. The magistrate judge rejected petitioner's claim that those withdrawals consisted of profits he had earned, finding that petitioner had "introduced no evidence to support this argument other than his own say-so." *Id.* at 86. For the same reason, the magistrate judge rejected petitioner's claim that those withdrawals represented legitimate fees. *Ibid.*

The magistrate judge also found that petitioner's claimed fees were fraudulently inflated and that his commingling of assets made it "difficult or impossible to identify whether any legitimate * * * fees received by Nutmeg" were included in the withdrawals at issue. *Ibid.*

The magistrate judge subsequently denied a motion for reconsideration. Pet. App. 102-122.

4. The court of appeals affirmed in all relevant respects. Pet. App. 1-10.[2]

As to petitioner's violations, the court of appeals explained that "[t]he conflict of interest was staggering: a single person was investment adviser (through Nutmeg), investment manager, controller of the funds under management, disclosure-writer, lawyer * * * at both Nutmeg and each fund, accountant * * * , and chief financial officer." Pet. App. 4-5. Yet "[t]he documents furnished to investors did not reveal the extent of this self-dealing," and instead "contained both fraudulent statements (such as a promise to discount illiquid assets) and fraudulent material omissions (such as a neglect to mention [petitioner's] convictions for fraud and the commingling that gave him access to as much of the money as he pleased)." *Id.* at 5. The court found that the magistrate judge's factual findings, "far from being clearly erroneous, * * * are supported by extensive evidence." *Ibid.* (citations omitted). It held that "even if we were to review the record without deference, we would reach the same conclusions." *Id.* at 5-6.

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[2] In aspects of its ruling not at issue here, the court of appeals affirmed a separate civil penalty of $642,422, vacated an injunction, and remanded to the lower court with instructions to enter a new injunction. Pet. App. 7-10. On December 20, 2022, the magistrate judge entered a new injunction. D. Ct. Doc. 1162.

The court of appeals also rejected petitioner's argument that the disgorgement award was impermissible under this Court's decision in *Liu* v. *SEC*, 140 S. Ct. 1936 (2020). Pet. App. 6. The court held that the magistrate judge's disgorgement calculation was "a conservative estimate of the amount by which [petitioner's] withdrawals exceeded his contractual entitlements," which "is the definition of net unjustified proceeds" required by *Liu*. *Id.* at 6. The court further explained that petitioner's commingling of assets also undermined his challenge because "the wrongdoer * * * bears the consequence of [the] uncertainty" he created. *Id.* at 7.

ARGUMENT

Petitioner contends (Pet. 9-18) that the court of appeals erred in affirming the $642,422 disgorgement award imposed by the magistrate judge as part of the remedy for his extensive misconduct. The court of appeals correctly upheld that award, and its decision does not conflict with any decision of another court of appeals. Moreover, petitioner has forfeited some of the arguments that he now seeks to press in this Court. Further review is not warranted.

1. In *Liu* v. *SEC*, 140 S. Ct. 1936 (2020), this Court held that the "equitable relief" district courts are empowered to order in SEC enforcement suits brought under 15 U.S.C. 78u(d)(5) includes "a disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims." 140 S. Ct. at 1940. The court of appeals correctly held that the disgorgement award here, although entered before this Court's decision in *Liu*, meets that description because it reasonably approximated petitioner's "net unjustified proceeds" from wrongdoing. Pet. App. 6; see *id.* at 6-8.

Petitioner's contrary arguments (Pet. 9-18) lack merit. Petitioner first argues that the disgorgement amount included "legitimate business revenues" earned by either him or Nutmeg, Pet. 10, and therefore was not "'tethered to a wrongdoer's net unlawful profits,'" Pet. 9 (quoting *Liu*, 140 S. Ct. at 1943). But the court of appeals considered and correctly rejected that factbound argument, affirming the magistrate judge's finding that the $642,422 amount awarded represents "a conservative estimate of the amount by which [petitioner]'s withdrawals exceeded his contractual entitlements," the very "definition of net unjustified proceeds." Pet. App. 6; see *id.* at 90 (finding that "a disgorgement award of $642,422 is a reasonable approximation (and quite possibly at the low end of what is reasonable) of the ill-gotten gains [petitioner] derived from his wrongdoing during the relevant period").

"[F]ar from being clearly erroneous," the magistrate judge's award is backed by "extensive evidence." Pet. App. 5. The magistrate judge based the award on the net amount of direct payments to petitioner from Nutmeg's accounts, which consisted of client funds that were generated from petitioner's material misstatements, misleading omissions, and other unlawful or fraudulent acts. *Id.* at 78-79, 85-86, 90, 111-115.[3] The magistrate judge found no evidence other than petitioner's "own say-so" to indicate that any of the "money [petitioner] was paid by Nutmeg during the relevant time period came from management fees Nutmeg received as opposed to another source." *Id.* at 86, 111.

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[3] To arrive at a conservative estimate, the magistrate judge excluded any payments that could possibly be legitimate, including more than $500,000 that Nutmeg had transferred to petitioner's law firm or paid on his behalf. Pet. App. 61-64, 90, 149-150.

Petitioner contends (Pet. 4) that, because "Nutmeg was not an entirely fraudulent enterprise, it cannot be that *all* the cash flows to [petitioner] were ill-gotten." That argument ignores the magistrate judge's finding that Nutmeg owed the funds more than $1 million at the time petitioner's fraud was discovered. See Pet. App. 60. In those circumstances, the magistrate judge appropriately determined that the money petitioner withdrew "from Nutmeg's commingled bank accounts * * * belonged to the funds and ultimately to their investors." *Ibid.* No sound basis exists for overturning those findings as clearly erroneous. See *id.* at 5.

Petitioner next contends (Pet. 13) that the lower courts erred by "shifting the burden" of calculating net profits onto petitioner. See Pet. 12-15. That contention presumes that the courts below failed to conduct a net-profits analysis. For the reasons just discussed, however, that premise is incorrect. Petitioner acknowledges that the SEC need only "demonstrate that its disgorgement amount 'reasonably approximates the amount of unjust enrichment.'" Pet. 12 (quoting *SEC* v. *First City Fin. Corp.*, 890 F.2d 1215, 1232 (D.C. Cir. 1989)). The court of appeals' decision makes clear that the SEC made such a showing here. Pet. App. 6. And to the extent that the court of appeals and magistrate judge determined that petitioner could not overcome the SEC's showing because his own "wrongdoing makes it hard to determine his net unjustified withdrawals," *id.* at 7, that determination simply reflects the longstanding principle that a "wrongdoer shall bear the risk of the uncertainty which his own wrong has created." *Bigelow* v. *RKO Radio Pictures, Inc.*, 327 U.S. 251, 265 (1946).

Finally, petitioner contends (Pet. 15-18) that the disgorgement award must be set aside because it does not

specify that any funds the SEC collects must be distributed to the victims of petitioner's fraud. That contention, too, is misplaced. If petitioner ever disgorges any funds as ordered by the final judgment, the Commission will notify the district court and will seek to distribute those funds to the 328 known victims if such a distribution is feasible. Indeed, the district court retained jurisdiction over this matter so that it could address precisely those types of post-judgment issues. See Pet. App. 100.

2. Petitioner does not identify any conflict between the decision below and any decision of another court of appeals.

Petitioner cites (Pet. 11, 13-14) a handful of decisions in which courts of appeals (including the Seventh Circuit) remanded for recalculation of disgorgement after this Court's decision in *Liu*. None of those decisions held, however, that remand is categorically required in this circumstance. Rather, the cited cases involved pre-*Liu* proceedings in which district courts had denied defendants' requested deductions for legitimate business expenses. See *SEC* v. *Team Resources, Inc.*, No. 15-cv-1045, 2018 WL 6737675, at *2 (N.D. Tex. June 4, 2018), vacated by 815 Fed. Appx. 801 (5th Cir. 2020); *SEC* v. *Liu*, 262 F. Supp. 3d 957, 975 (C.D. Cal. 2017), vacated by 814 Fed. Appx. 311 (9th Cir. 2020); *CFPB* v. *Mortgage Law Grp., LLP*, 420 F. Supp. 3d 848, 853-854 (W.D. Wisc. 2019), aff'd in part and vacated in part by *CFPB* v. *Consumer First Legal Grp., LLC*, 6 F.4th 694 (7th Cir. 2021). No logical justification for remand exists where, as here, a court of appeals determines that the original disgorgement award is consistent with *Liu*. See Pet. App. 6.

3. This would be a poor vehicle for clarifying the manner in which disgorgement awards should be

calculated because petitioner failed to press in the court of appeals some of the arguments that he now asks this Court to consider. In particular, petitioner did not argue that the magistrate judge in calculating the disgorgement amount had wrongly "shift[ed] the burden" onto him, Pet. 13, or that the disgorgement award must be set aside because the district court did not specifically direct that any funds be distributed to the victims of petitioner's fraud, see Pet. 15-18. Petitioner identifies no sound reason for this Court to address those contentions in the first instance. See *Zivotofsky ex rel. Zivotofsky* v. *Clinton*, 566 U.S. 189, 201 (2012) (observing that this Court is "a court of final review and not first view") (citation omitted).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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