IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

SECURITIES AND EXCHANGE COMMISSION,	§	
	§	
Plaintiff,	§	Civil Action No.
	§	
v.	§	3:04-CV-1320-K
	§	
CONRAD P. SEGHERS,	§	
	§	
Defendant.	§	

ORDER

Pursuant to the Fifth Circuit's revised opinion in *Sec. & Exch. Comm'n v. Seghers*, No. 06-11146 (5th Cir. Oct. 28, 2008) (revised Jan. 16, 2009), the Court reconsiders its denial of disgorgement of gains from Defendant Conrad P. Seghers's fraudulent activity. Additionally, Seghers requests reconsideration of a $50,000 civil penalty assessed against him.

Because the SEC has failed to reasonably approximate the profits causally connected to the violation, the Court orders no disgorgement. The $50,000 fine imposed by the Court remains unchanged.

I. Factual and Procedural Background

In March 2006, a jury in this Court found that Defendant Conrad P. Seghers ("Seghers") committed securities fraud in violation of Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act and Rule 10b–5, and Section 206 of the Investment Advisers Act.

The fraud arose from Seghers' participation and involvement with three hedge funds: Integral Hedging, L.P., Integral Arbitrage, L.P.; and Integral Equity, L.P. (collectively the "Funds"). The Government proved to the jury that Seghers fraudulently caused the Funds to overstate the value of the investments to investors. The evidence showed Seghers did this by overstating the value of the funds, causing erroneous monthly and quarterly statements to be submitted to investors based on his fraudulent overstatements.

After the jury's verdict, this Court denied Seghers's motion for judgment as a matter of law. The Court also permanently enjoined Seghers from further securities violations and ordered him to pay a civil penalty of $50,000. The Securities and Exchange Commission ("SEC") further requested disgorgement of Defendant's purported profits, yet the Court ordered no disgorgement:

> Because Seghers lost over $900,000 of his own money with the investors, he was not unjustly enriched by any ill-gotten gains. The Court finds that the Permanent Injunction will sufficiently deter Seghers from committing further securities fraud, and the imposition of a Civil Penalty will sufficiently punish him for the securities violations proved at trial. The Court, therefore, **DENIES** the Government's motion to order disgorgement.

Sec. & Exch. Comm'n v. Seghers, 2006 WL 2661138, at *5, No. 3:04-CV-1320-K (N.D. Tex. Sept. 14, 2006).

Seghers appealed the jury verdict and the Court's judgment in favor of the SEC. The Commission cross-appealed, seeking reversal of the Court's ruling that Seghers was

not liable for the entire period alleged. The Commission further sought reversal of the Court's denial of disgorgement of the gains from Seghers's fraudulent activity.

The Fifth Circuit affirmed the judgment against Seghers. Yet it vacated the Court's finding that limited the period of Seghers's liability and the denial of disgorgement and remanded the case for further proceedings.

Accordingly, this Court ordered the parties to submit any additional material they wished the Court to consider on the issue of disgorgement and evidence of any profits, fees, and other compensation derived from wrongdoing by Seghers in this case.

II. The Fifth Circuit's Ruling

In its opinion, the Fifth Circuit found this Court "erred in finding that Seghers was not unjustly enriched merely because he lost money in the Integral Funds." *Sec. & Exch. Comm'n v. Seghers*, No. 06-11146, slip op. at 29 (5th Cir. Oct. 28, 2008) (revised Jan. 16, 2009). Although the circuit panel made "no conclusion as to whether he actually did profit from fraud," it also stated that "if the district court finds that Seghers did, in fact, profit from the securities fraud for which he is liable, any such profits may be subject to disgorgement." *Id.*

"If the Commission shows a causal relationship between the defendant's wrongdoing and the amount by which he was unjustly enriched, that amount of money may be disgorged even if the defendant has otherwise disposed of, reinvested, or spent the particular assets that he wrongfully obtained." *Id.* at 28 (citing *Sec. & Exch. Comm'n*

v. Banner Fund Int'l, 211 F.3d 602, 617 (D.C. Cir. 2000)). Further, on remand, the district court "will disregard its conclusion that Seghers was not liable before June 6, 2001." *Id.* at 29. The Commission alleged that Seghers committed fraud from June 1 through November 30, 2000, and March 1 through September 30, 2001. *Id.* at 4.

The Fifth Circuit's opinion initially included a footnote regarding the extent of this Court's discretion that read: "For example, the district court may, in its discretion, take into account Seghers's ability to pay a disgorgement order. *See Sec. & Exch. Comm'n v. Huffman*, 996 F.2d 800, 803 (5th Cir. 1993)." *Id.*; *see also Sec. & Exch. Comm'n v. Seghers*, 298 Fed. Appx. 319, 337 n.18 (5th Cir. 2008) (including the original language). This footnote was notably deleted from the revised circuit opinion.

"We do not hold that an order of disgorgement necessarily is required in this case, but only that the matter must be reconsidered by the district court. We repeat that the district court enjoys broad discretion to order and determine the amount of disgorgement." *Seghers*, No. 06-11146, at 29.

III. Analysis

After remand, the Court reconsiders its denial of disgorgement and reexamines the profits, fees, and other compensation derived from wrongdoing by Seghers. "The court's power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing." *Sec. & Exch. Comm'n v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978). "The district court has broad discretion not only in determining

whether or not to order disgorgement but also in calculating the amount to be disgorged." *Sec. & Exch. Comm'n v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1474–75 (2d Cir. 1996).

"[T]he primary purpose of disgorgement is not to compensate investors. Unlike damages, it is a method of forcing a defendant to give up the amount by which he was unjustly enriched." *Sec. & Exch. Comm'n v. Commonwealth Chem. Sec., Inc.*, 574 F.2d 90, 102 (2d Cir. 1978) (Friendly, J.). "Disgorgement wrests ill-gotten gains from the hands of a wrongdoer. It is an equitable remedy meant to prevent the wrongdoer from enriching himself by his wrongs." *Allstate Ins. Co. v. Receivable Fin. Co.*, 501 F.3d 398, 413 (5th Cir. 2007) (quoting *Sec. & Exch. Comm'n v. Huffman*, 996 F.2d 800, 802 (5th Cir. 1993)).

"The district court has broad discretion in fashioning the equitable remedy of a disgorgement order." *Huffman*, 996 F.2d at 803. "Because disgorgement is meant to be remedial and not punitive, it is limited to property *causally* related to the wrongdoing at issue." *Allstate Ins.*, 501 F.3d at 413 (emphasis added). "Accordingly, the party seeking disgorgement must distinguish between that which has been legally and illegally obtained." *Id.* "The court's power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing. Any further sum would constitute a penalty assessment." *Blatt*, 583 F.2d at 1335.

"In actions brought by the SEC involving a securities violation, 'disgorgement

need only be a reasonable approximation of profits causally connected to the violation.'" *Allstate Ins.*, 501 F.3d at 413 (quoting *Sec. & Exch. Comm'n v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989)). The SEC bears the burden of persuasion that its proposed disgorgement figure reasonably approximates the amount of unjust enrichment. *First City Fin.*, 890 F.2d at 1232. Courts do not require the SEC to trace every dollar of a defendant's ill-gotten gains. *Sec. & Exch. Comm'n v. First Pacific Bancorp.*, 142 F.3d 1186, 1192 n.6 (9th Cir. 1998). Once the SEC meets its burden of reasonably approximating the defendant's ill-gotten gains, the burden shifts to the defendant to "demonstrate that the disgorgement figure was not a reasonable approximation." *First City Fin.*, 890 F.2d at 1232. The SEC, however, "bears the ultimate burden of persuasion that its disgorgement figure reasonably approximates the amount of unjust enrichment." *Id.*

With the Fifth Circuit's revised ruling squarely in mind, the Court will not consider Seghers's own losses or his ability to pay a disgorgement order when assessing the amount—if any—he should forfeit. Much of Defendant's response concerns his current financial predicament. Defendant's submission, showing myriad collection notices and his family's need for Medicaid and food stamps, are irrelevant to any potential disgorgement. Regardless of Seghers's current inability to pay disgorgement, such an order would stand should he have future earnings to pay it.

The SEC calculates that the net payments to Seghers or for his benefit totaled

$952,896 from June 1, 2000, through December 31, 2001. The transactions, the SEC notes, "were made from entities he controlled which received investor funds, to him and his wife personally." Plf.'s Br. 2.

In its response to the Court's order seeking supplemental argument and documentation, the SEC relies upon the "voluminous evidence" it filed prior to the Court's previous denial of disgorgement. Plf.'s Br. 1. Much of the evidence was compiled by SEC accountant Nina Y. Yamamoto ("Yamamoto"). In her 2006 affidavit and supporting documentation, upon which the SEC here relies, Yamamoto shows payments from accounts tied to the fraud to Seghers. Based upon her review of a Comerica Bank account controlled by Seghers from the time period June 1, 2000, to December 31, 2001, Yamamoto "noted that investor deposits were made into this account." Yamamoto Decl. 3. Yamamoto then estimates the payments from the account to Seghers and his wife down to the dollar.

Seghers responds that the SEC has failed to establish any reasonable approximation of ill-gotten gains. For instance, nowhere in the SEC's voluminous filings does the government establish the *amount* of investor deposits made *into* the Comerica Bank account. Simply stating that a vague number of investor deposits were made into the account and then tracing withdrawals from the account does not establish Seghers's profits from the fraud to any reasonable degree. Whether or not "Seghers' memorandum is largely incoherent," as the SEC states, Seghers points out the SEC's own incoherence

in documenting the amount by which he profited from fraud is problematic.

The SEC has provided the Court with hundreds of pages of bank and brokerage account statements as well as photocopies of cancelled checks and deposit slips. Accompanying this sizeable submission is a brief, four-page declaration by Yamamoto to explain it all.

Delving into the nearly 600 pages of documents, the Court is unable to replicate the SEC's numbers to a degree of reasonableness that would support its burden of persuasion. This document dump left the Court rifling through poorly copied records—many of which are wholly illegible—with no roadmap or explanation beyond Yamamoto's conclusory affidavit.

A disgorgement figure must be a reasonable approximation, *see Allstate Ins.*, 501 F.3d at 413, yet the SEC has provided little more than an apparent guesstimate. Disgorgement "based on conjecture and speculation as to what amount the defendants obtained through [ ] fraud . . . cannot be sustained." *Id.* at 414. The Court need not engage in forensic accounting of its own to determine the approximate amount of investor funds that went into the accounts from which Seghers withdrew money. *See Sec. & Exch. Comm'n v. Jones*, 476 F. Supp. 2d 374, 386 (S.D.N.Y. 2007) ("[A]mong the hundreds of pages submitted as exhibits . . . , the Commission is unable to provide the Court with any guideposts for determining the proper amount . . . subject to disgorgement.").

In light of the Fifth Circuit's ruling, the Court invited the parties to submit additional argument and any supplemental material they wished the Court to consider on the issue of disgorgement (Doc. No. 265). Yamamoto's first declaration (Doc. No. 174) stating the $952,896 figure the SEC seeks in disgorgement dates from 2006. The SEC has argued this case on appeal. It has had ample time and opportunity to demonstrate the objective reasonableness of its approximation and a causal connection, yet it has failed to meet its burden. The Court is unwilling to simply suppose the figure is accurate or to take the SEC's word on faith when asked to order roughly $1 million in disgorgement.

Because the SEC has failed to meet its burden of persuading the Court that its figure is a reasonable approximation of the amount of the Defendant's ill-gotten gains, Seghers has no burden to demonstrate the SEC's figure is incorrect. "Importantly, because disgorgement is remedial and not punitive, a court cannot order disgorgement above the amount wrongfully acquired." *Jones*, 476 F. Supp. 2d at 387; *see also Sec. & Exch. Comm'n v. Cavanagh*, 445 F.3d 105, 166 n.25 (2d Cir. 2006) ("Because the remedy is remedial rather than punitive, the court may not order disgorgement above this amount."). The SEC has failed to reasonably approximate the amount Seghers wrongfully acquired, and this Court cannot order disgorgement in an amount above the ill-gotten gains.

Seghers additionally states that the "requested disgorgement would actually be

management fees" and "expenses for overhead." Def.'s Br. 2. His assertion with regard to expenses carries little weight, as business expenses in furtherance of a fraudulent scheme are not deductible: "the overwhelming weight of authority holds that securities law violators may not offset their disgorgement liability with business expenses." *Sec. & Exch. Comm'n v. United Energy Partners, Inc.*, 88 Fed. Appx. 744, 746–47 (5th Cir. 2004) (quoting *Sec. & Exch. Comm'n v. Kenton Capital, Ltd.*, 69 F. Supp. 2d 1, 16 (D.D.C. 1998)). Accordingly, any business expenses may not offset Seghers's disgorgement liability, if any. The SEC, however, effectively fails to specify when the "fees" it seeks to disallow were earned. Consequently, they may have been earned in months in which there was no fraud, such as December 2000. As Yamamoto's affidavit covers June 1, 2000, to December 31, 2001, some of the months included do not appear to fall within the time period in which Seghers was even alleged to have committed fraud.

In sum, the SEC has not provided a reasonable approximation, has not properly identified "property causally related to the wrongdoing at issue," nor has it distinguished "between that which has been legally and illegally obtained." *See Allstate Ins.*, 501 F.3d at 413. The SEC here effectively seeks an improper penalty assessment, *see Blatt*, 583 F.2d at 1335, something already accomplished through the $50,000 fine levied against Seghers by this Court.

Additionally, Seghers's argument to have the Court to reduce or eliminate the

$50,000 fine is unpersuasive. Seghers presents no legal authority or relevant facts that change this Court's prior analysis.

IV. Conclusion

For the foregoing reasons, the Court, in its discretion, orders no disgorgement. Seghers remains liable for the $50,000 civil penalty and permanently enjoined from future violations of the securities laws.

This is a final order.

SO ORDERED.

Signed August 17th, 2009.

Ed Kinkeade

ED KINKEADE
UNITED STATES DISTRICT JUDGE