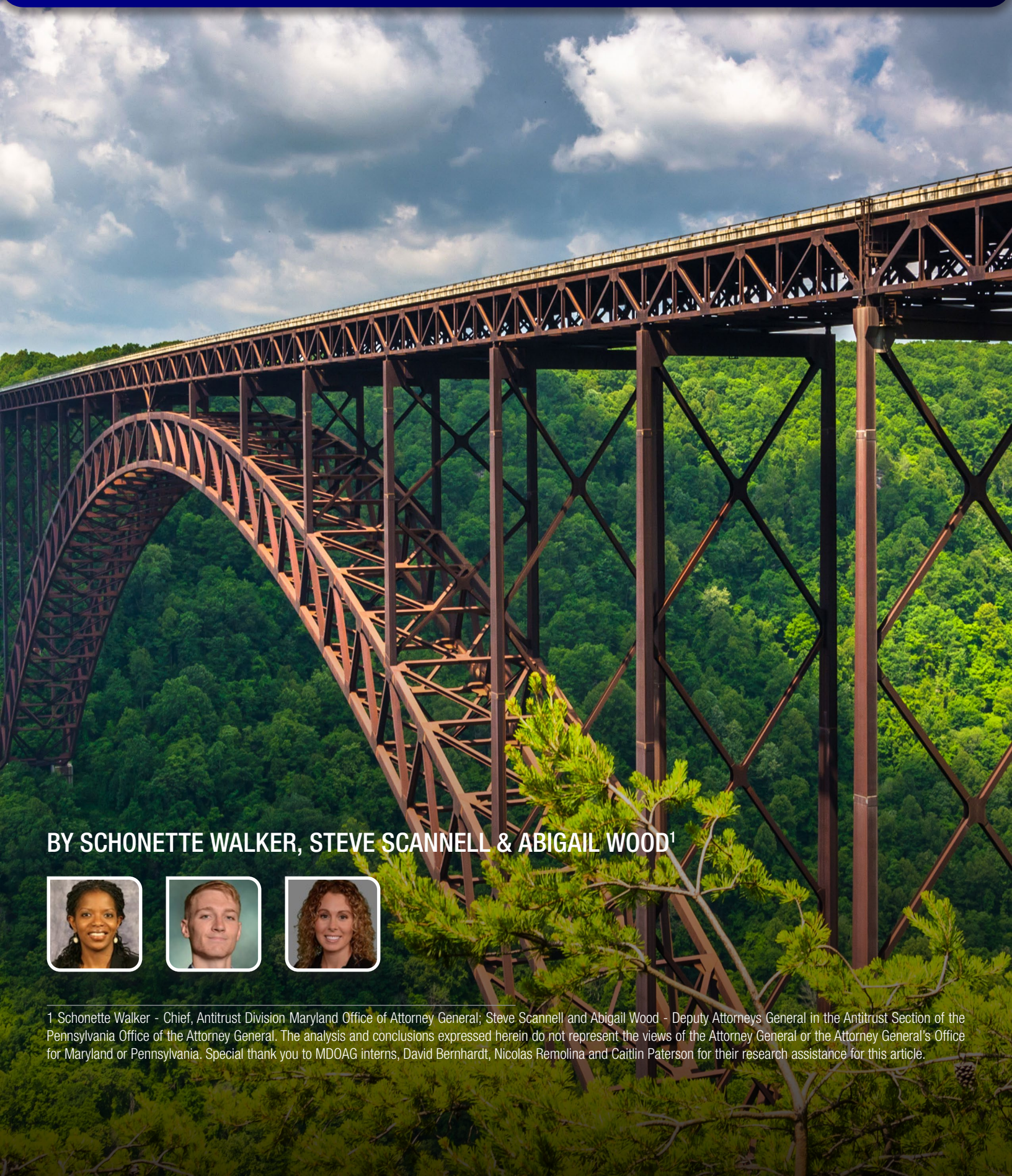
BRIDGING THE GORGE: STATES PREVENT RETENTION OF ILL-GOTTEN PROFITS THROUGH DISGORGEMENT



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Bridging the Gorge: States Prevent Retention of Ill-Gotten Profits Through Disgorgement

By Schonette Walker, Steve Scannell & Abigail Wood

Disgorgement of ill-gotten gains is a crucial equitable remedy utilized by State Attorneys General. This is especially true in the context of antitrust cases because of the complexity of the industries where antitrust violations are prone to occur. The State Attorneys General seek to uphold the law, which goes beyond compensating those who have been harmed, in order to deter anticompetitive conduct. Disgorgement, unlike damages, focuses on the wrongdoer's actions and windfall, rather than damages to an individual or entity. Damages calculations can be tricky and complex in the antitrust world, as some buyers pass along price increases to their customers and many times the ultimate victim does not even have standing to sue. As law enforcers, the State Attorneys' General key goal is not to get money, but to uphold the law, seek justice on the victim's behalf, and deter future anticompetitive conduct. Wrongdoers should not profit from illegal conduct and disgorgement ensures that does not happen.

I. INTRODUCTION

Private antitrust actions are increasingly inadequate in bringing about meaningful change among industry participants who have engaged in anticompetitive conduct. That is where the State Attorneys General must step in because their goals differ from those in the private actions. State Enforcers are looking to hold wrongdoers accountable for violations of the law, deter others from engaging in the same or similar illegal activity, and ensure that the wrongdoer does not profit from their illegal activity. These goals go beyond providing relief to any one person but seek to provide remedy to all consumers and ensure competition is maintained for everyone. The cases brought by State Enforcers are done in the interest of the public. While there are many methods to accomplish the goals above, we focus on one method in this article: disgorgement, which has become increasingly important among State Enforcers in antitrust cases because disgorgement offers a level of deterrence that damages does not.

Disgorgement is an equitable remedy, designed to deter future anticompetitive conduct. This deterrence is achieved because disgorgement deprives the wrongdoer from any profit resulting from their anticompetitive conduct. Fundamentally, disgorgement focuses on the wrongdoer, not the victims. In this way, disgorgement's strongest parallel is unjust enrichment – not restitution. Black's Law Dictionary explains, "instances of unjust enrichment typically arise when property is transferred by an act of wrongdoing…the resulting claim of unjust enrichment seeks to recover the defendant's gains." In that connection, what is sought is the "non-restitutionary" disgorgement of the wrongdoer's unlawful gains. And when defendants are faced with the prospect of forfeiting their unlawful gains, they will think twice before engaging in conduct that violates state and federal laws and harms the consuming public.

State Attorneys General have the authority and seek to do exactly this – require defendants forfeit that which they have unlawfully gained on the backs of victims in their states. And while individual victims may not find specific relief, State Attorneys General bring enforcement actions to stop anticompetitive conduct at large, deter future similar actions, and prevent unjust enrichment by defendants engaged in illegal conduct. Disgorgement accomplishes all of these goals but without complicating factors such as pass-through analysis, *Illinois Brick* standing issues, etc. that come with damages and/or restitution actions and that could ultimately leave defendants retaining some of their illegal profits.

II. DISGORGEMENT – A BRIEF OVERVIEW

As an equitable remedy disgorgement results in an action required by the court to achieve a measure of "justice" when a legal remedy would be inadequate; a legal remedy primarily focuses on a financial award such as damages. The court's order of disgorgement divests a wrongdoer of ill-gotten gains[2] and is designed to deter similar conduct.[3] Generally, federal courts have the power to order "the act of disgorgement" due to their broad equitable powers.[4] State Enforcers may seek equitable relief for federal antitrust violations under Section 16 of the Clayton Act, which entitles "[a]ny person, firm, corporation, or association," to sue for injunctive relief "against *threatened* loss or damage…when under the same conditions and principles as injunctive relief against *threatened* conduct that will cause loss or damage is granted by courts of equity."[5] According to *Porter*, and as applied in *Keyspan*, unless there is specific language which divests a court of its equitable powers, they are able to assert these powers to the fullest extent.[6] There is no language under Section 16 of the Clayton Act which divests a court of its powers to provide full equitable relief. Importantly, State Enforcers seeking disgorgement are *solely* focused on the public interest. As articulated in *Porter*, where a suit involves the public interest and not merely a private controversy, courts' "equitable powers assume an even broader and more flexible character."[7] Often, State Enforcers' seeking disgorgement of excess ill-gotten profits is the only way the public can hold accountable those engaged in dishonest and anticompetitive business practices and bring about meaningful change to a corrupt business or industry.

2 Disgorgement can result in the taking of either monetary or non-monetary gains from a wrongdoer.

3 See, e.g. *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989) (Disgorgement is an equitable remedy designed to deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws.).

4 See *Porter v. Warner Holding Co.*, 328 U.S. 395, 398 (1946) ("Unless otherwise provided by statute, all the inherent equitable powers of the District Court are available for the proper and complete exercise of that jurisdiction, and [where] the public interest is involved…those equitable powers assume an even broader and more flexible character than when only a private controversy is at stake.").

5 15 U.S.C. § 26 (emphasis added). See *Hawaii v. Standard Oil Co. of Cal.*, 405 U.S. 251, 261 (1972).

6 See *U.S. v. Keyspan Corp.*, 763 F.Supp.2d 633, 639 (S.D.N.Y. 2011).

7 *Porter v. Warner Holding Co., 328 U.S.* at 398.

Moreover, it is most important to remember that disgorgement focuses on the actions of the wrongdoer while damages focuses on the harm to the victim. This is not a distinction without a difference. The damages remedy at law has been effectively eviscerated by courts over the past half-century. The Supreme Court's decision in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), left most of the downstream consumers who are *truly* affected by anticompetitive conduct without standing. The Court held that indirect purchasers did not have standing to sue for *damages* under Federal law. Premised on the fear of duplicative recovery, the Court's decision has led to crater-sized holes in the viability of vigorous antitrust enforcement. State Attorneys General have an obligation to fill these gaps in antitrust enforcement that have left consumers holding the bag; some direct purchasers pass supra-competitive costs down the supply chain, inevitably landing on the end consumer. Disgorgement is a key tool the Government has to address anticompetitive conduct and provides the most certainty that the conduct will not be repeated in the future. It is difficult to question the likely deterrent effect disgorgement has on potential defendants.[8]

In addition to authority under federal law, many state laws provide even broader equitable authority than the Clayton Act, providing the state Attorneys General with further authority to seek disgorgement through the courts. For example, the court in *In re TFT-LCD (Flat Panel) Antitrust Litig.*,[9] found that because disgorgement was authorized under the Sherman Act, and because Oregon's Antitrust Statute provided an expansive grant of authority to seek equitable relief, Oregon had authority to seek disgorgement under state law.[10] Additionally, many other states authorize broad equitable remedies, which may include disgorgement, as a remedy for anticompetitive conduct.[11] So while State Attorney's General have ample authority to seek disgorgement under federal law, state laws remain a strong complement in many cases to ensure defendants are forced to give up supra-competitive profits gained as a result of their anticompetitive conduct.

III. DISGORGEMENT PROPERLY FOCUSES ON THE CONDUCT OF THE WRONG-DOER

Disgorgement is arguably the most practical and logical enforcement remedy to utilize because it focuses on the conduct of the wrongdoer. The analysis of disgorgement asks one simple question: "how much did the wrongdoer profit from their illegal conduct?" It is truly that simple.

It is that simplicity which makes disgorgement an attractive enforcement tool. State Enforcers are distinct from private plaintiffs — we have an obligation to uphold the law, protect consumers, and hold corrupt businesses and individuals responsible for their actions. Disgorgement allows enforcers to keep the focus on the *conduct of the wrongdoer* without going down the far more complex and intricate path of damages. Additionally, unlike damages, disgorgement ensures that the wrongdoer does not profit a single ill-gotten dollar. There is in fact little disagreement among commentators about the propriety of disgorgement as an equitable antitrust remedy. *Keyspan* (citing Phillip E. Areeda et al., *Antitrust Law*, 325a (3d ed. 2007) ("[E]quity relief may include, where appropriate, the disgorgement of improperly obtained gains.")[12]; Einer Elhauge, *Disgorgement as an Antitrust Remedy*, 76 Antitrust L.J. 79 (2009) ("One's first reaction might well be that perhaps the rare usage reflects some underlying insecurity about whether disgorgement really is a permissible antitrust remedy. But there is surprisingly little doubt that equitable antitrust remedies include requiring violators to disgorge any illegally obtained profits.").

Like all good attorneys the initial inclination is to take something simple and turn it into something much more complex. This fatal error often occurs when attorneys and courts conflate disgorgement with damages, which are very distinct and different remedies under the law. Sometimes it is easier to understand unfamiliar theories with simple examples. So let's look at how disgorgement worked in the infamous lemonade price fixing conspiracy.

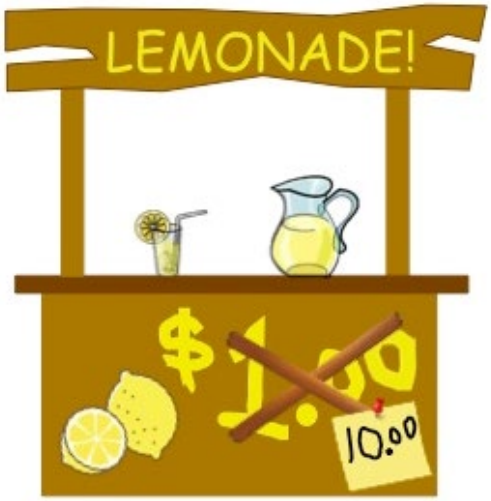
8 See e.g. *AMG Capital Management, LLC v. FTC*, 141 S.Ct. 1341 (2021)(payday lender fought disgorgement of over $*1.3 billion* it received in deceptive loan charges arguing that disgorgement not authorized); Kokesh v. SEC, 137 S.Ct. 1635 (2017)(defendant fought SEC disgorgement of nearly $35 million in ill-gotten gains).

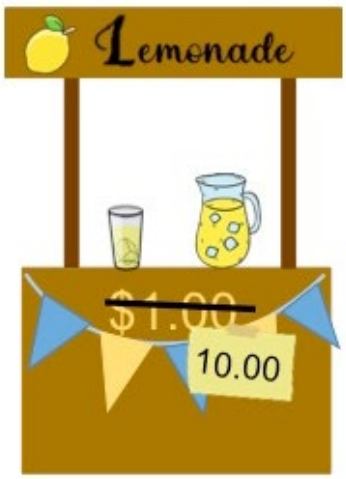
9 See In re TFT-LCD (Flat Panel) Antitrust Litig., 2011 WL 2790179, at *4 (N.D.Cal. July 12, 2011).

10 *Id.*

11 See e.g. a non-exhaustive list of states and their respective antitrust statutes under which they may seek disgorgement under broad equitable authority: CAL. BUS. & PROF. CODE § 16750(a) (West 2021); FLA. STAT. ANN. § 542.23 (West 2021); MD. CODE ANN., COM. LAW § 11-209 (West 2021); Mich. Comp. Laws § 445.711 (West 2021).

12 See *Keyspan* 763 F.Supp.2d at 642.





Billy and Suzie lived in the same neighborhood three streets apart. Suzie had a lemonade stand and made a killing selling her lemonade for a $1.50 a glass. Then Billy decided to open a stand around the corner selling his lemonade for $1 a glass. Suzie started losing business to Billy, and dropped her price to $1 a glass as well. Suzie realized if this competition with Billy kept going her lemonade stand wouldn't be as profitable as it was in the past. Then Suzie had a great idea—instead of competing with Billy, what if she and Billy agreed not to compete? Suzie went to Billy and posed the idea to not compete. Billy agreed and said, "Hey why don't we actually raise the prices since we are the only two lemonade stands in the neighborhood." Suzie agreed and they began selling their lemonade for $10 a glass. Eventually their lemonade price fixing scheme was discovered, and they were charged with a violation of Section 1 of the Sherman Act. Between the two of them, Billy and Suzie sold 1,000 glasses of lemonade at $10 a glass earning them $10,000. The cost per glass to sell the lemonade was ten cents. This means that the cost is $100 to make 1,000 glasses of lemonade. After subtracting the $100 cost of production Suzie and Billy were able to take home $9,900 total from their price fixing scheme.

The competitive price of a glass of lemonade in their two-lemonade stand market was $1 so Suzie and Billy *should have* made $1,000 "but for" their lemonade price-fixing scheme, leaving them with a take home of $900 after their $100 cost to make the lemonade. In determining how much to disgorge from Suzie and Billy we only have to ask one question, "how much did Suzie and Billy profit from their illegal conduct?" It is actually very simple; all we have to do is subtract the amount Suzie and Billy should have earned in a competitive lemonade stand market selling 1,000 glasses ($900) from the amount they actually made ($9,900). The difference is how much Suzie and Billy profited from their illegal lemonade price fixing scheme, which was $9,000 and should be disgorged as net ill-gotten gains.

The ultimate decision about what to do with the disgorged monies is for the judge to decide. Here the judge decided to place the $9,000 of disgorged monies into a fund that would give loans to young entrepreneurs.

It is only fair that Suzie and Billy should not keep any of the money they made from their illegal conduct. While State Enforcers could hire an expert to utilize econometric analysis to determine how much individual lemonade purchasers were damaged by this scheme, in taking this route, it is quite possible that Suzie and Billy could end up keeping some of their illegal profits depending on the distribution of the product. This is because damages only considers how each individual was harmed, not how much Suzie and Billy actually stole. Disgorgement fixes that problem.

IV. RECENT ATTACK ON FEDERAL DISGORGEMENT DOES NOT AFFECT STATE ENFORCERS

In a recent case involving the Federal Trade Commission ("FTC") and its ability to seek disgorgement under the FTC Act, the Supreme Court dealt a significant blow to that agency. In *AMG Capital Management*, the Court unanimously decided that Section 13(b) of the FTC Act does not give the FTC authority to seek disgorgement in federal courts where it had not first fully exhausted its elaborate administrative process.[13] The *AMG Capital Management* Court decided a very discrete question – does the FTC, under Section 13(b) of the FTC Act, have the authority to obtain equitable monetary relief *directly* from federal courts? In answering no, the Supreme Court really focused on the FTC's elaborate statutory structure and administrative procedures. The Court explained that the FTC's administrative process begins with the FTC filing a complaint before an Administrative Law Judge, when the FTC has reason to believe someone is engaging in anticompetitive conduct and where the ALJ may issue a cease and desist order that is reviewable by the Commission and eventually a U.S. Court of Appeals.[14] Section 13(b) however, which was at issue in *AMG Capital Management*, allows the FTC to proceed *directly* to court to seek a "permanent injunction" without first going through that administrative process, in certain circumstances.[15] Since the 1990's the FTC and courts have taken the broad view of 13(b)'s "permanent injunction" authority in antitrust cases to include the pursuit of equitable monetary relief, such as restitution and disgorgement, without the prior use of traditional administrative proceedings.[16] This Section 13(b) jurisprudence and analysis is of course unique to FTC actions.

The *AMG Capital Management* case does not address or implicate, directly or indirectly, State Attorneys General authority to seek disgorgement in federal lawsuits. Some have suggested though, that the reasoning in *AMG Capital Management* should apply with equal force to State Attorney General antitrust suits seeking disgorgement. This is wrong. State Enforcers seeking disgorgement do not raise the same concerns elicited by the FTC since State Enforcers cannot bring actions under Section 13 (b) of the FTC Act, thus these suggestions completely miss the mark. When it comes to equitable monetary remedies, like disgorgement, the State Attorneys General operate on a completely different statutory landscape. This is because, as previously noted, State Enforcers typically seek disgorgement under Section 16 of the Clayton Act (injunctive relief) and specific state laws, and not the FTC Act. When State Attorneys General seek disgorgement under Section 16 there are no concerns about failing to follow any elaborate administrative regime that Congress has put into place. Section 16 has no statutory structure or administrative process analogous to Section 13(b) that plaintiffs must pursue *before directly seeking equitable monetary relief from a court*. Indeed, the analysis in *AMG Capital Management* is pertinent only to the FTC's administrative framework.

Significantly, when state antitrust enforcers pursue equitable monetary relief under Section 16 of the Clayton Act, their authority is based on the court's broad equitable powers as outlined in the Supreme Court precedents, *Porter* and *Mitchell*, which note that federal courts have broad equity jurisdiction limited only by Congress' express restriction.[17] That broad equity jurisdiction allows a court to order a defendant to disgorge ill-gotten gains so long as the language of the statute the court is interpreting, does not limit the court's equity jurisdiction. Section 16 imposes no such equity jurisdiction limitation. And, even the *AMG Capital Management* Court which struck down the FTC's ability to seek disgorgement under 13(b)'s "permanent injunctive" language, acknowledged that *similar statutory language can be interpreted to encompass equitable monetary relief [i.e. disgorgement*].[18]

The *AMG Capital Management* Court discussed *Porter* and *Mitchell* approvingly and clarified that determining whether a grant of an "injunction" in a statutory scheme provides for equitable monetary relief remains a *case-by-case interpretation*. The Court did not say that injunction cannot be monetary but that this question is evaluated on the facts and circumstances of each particular case. *AMG Capital Management* is not a wholesale bar of the disgorgement remedy in antitrust cases.

And while *Porter* and *Mitchell* clearly stand for the proposition that a court's equitable powers are broad and left undisturbed absent some limitation pronounced by Congress, there are no antitrust cases deciding if that broad charge does or does not include forcing defendants to give

13 See *AMG Cap. Mgmt., LLC*, 141 S.Ct. at 1348-49 (Discussing the elaborate administrative process that proceeds FTC's seeking disgorgement in a court action).

14 *Id.* at 1346.

15 For example, if the FTC "has reason to believe someone is violating or about to violate" a provision of law enforced by the FTC. *Id.* at 1348.

16 *Id.* at 1347.

17 *Porter v. Warner Holding Co, 328* U.S. 395 (1946); *Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288 (1960).

18 *AMG Cap. Mgmt., LLC*, 141 S.Ct. at 1347, 1348 (Porter's 'permanent or temporary injunction' language encompasses equitable monetary relief).

up ill-gotten gains via a disgorgement remedy. This was true a decade ago and is still true today.[19] There is however acknowledgement that disgorgement is in line with the established principles of antitrust law.[20] This is important because for antitrust enforcers disgorgement is useful not only to stop an antitrust violator from continuing his unlawful conduct but also to deter him *and others* from similar conduct in the future. Fewer things will strike a violator's attention better than getting hit hard in the pocketbook. And when the blow is hard enough, and the wrongdoer is not able to profit from the wrongdoing, that which is relinquished is more than just the cost of doing business. The disgorgement message comes across loud and clear — not only to the wrongdoer himself, but to other would-be wrongdoers as well. Having to give up unlawful profits, the antitrust violator surely would realize that crime does not pay and be deterred from engaging in similar conduct in the future. Indeed, deterrence is a key goal of the disgorgement remedy. The FTC extracted nearly $725 million[21] in consumer redress or disgorgement of ill-gotten gains in 2019 and, from 2010 to 2019 USDOJ recovered over $26 million[22] in disgorgement. These amounts will certainly cause anyone even considering an antitrust violation to sit up and take notice.

It is easy to see that the disgorgement remedy works to both teach the wrongdoer a lesson and to deter similar conduct in the future, by both the wrongdoer and observers. Indeed, it seems like many defendants may feel the same way. The ongoing attacks on federal and state antitrust efforts to seek disgorgement shows that it has a significant impact; if defendants did not think so, perhaps they would not attack enforcement efforts seeking disgorgement with such vigor.

V. WHY DISGORGEMENT IS NECESSARY FOR EFFECTIVE ANTITRUST ENFORCEMENT

Much of the hostility toward disgorgement stems from the premise that private treble damages generally provide monetary relief that goes well beyond disgorgement, so disgorgement is unnecessary.[23] Yet, the practical reality paints a much different picture. Increasingly, private actions are inadequate in bringing about meaningful change among industry participants. Many cases involve direct purchaser intermediaries (like resellers) who pass on most if not all of the anticompetitive cost downstream and may be reluctant to challenge the *status quo*. This can be due to fear of retaliation, or even because they too share in the supra-competitive profits.[24] When practices are challenged and these direct purchasers do sue, the standards for certifying antitrust class actions are increasingly difficult to meet even for the most meritorious of cases.[25]

It is imperative therefore, that State Attorneys General continue to use their authority and seek disgorgement when legal remedies (like damages) are insufficient. Consumers every day are harmed by anticompetitive conduct with no *real* recourse. Forty years later, it is clear the Supreme Court's decision in *Illinois Brick* has undercut the exact goals it sought: vigorous antitrust enforcement and avoiding duplicative recovery. Industry is often able to pass through costs incurred as a result of anticompetitive conduct down the chain, ultimately landing on everyday consumers. Under *Illinois Brick*, these same consumers, as indirect purchasers, cannot challenge the illegal profit-making scheme. In practice, sometimes the only viable suits are from those who should challenge these practices in real-time (i.e. direct purchasers), but may decide not to. Instead, they sometimes acquiesce to the supra-competitive prices and may pass the additional costs down the chain, sometimes making a profit themselves. Consumers who cannot pass on costs further downstream could bring suit in some situations (i.e. under state antitrust laws), but their stakes are usually too low to make individual lawsuits feasible given the enormous costs that accompany antitrust litigation. In practice, there is a much higher likelihood that no recovery is made by these individuals than any potential duplicative recovery. It is no exaggeration that State Attorneys General are the last line of defense for most of the general public in preventing continuance of the *status quo*, when the *status quo* harms competition and consumers in our States.

19 In 2011 the district court noted in *Keyspan* that there had actually not been any decision handed down concerning a district court's power to order disgorgement to remedy a Sherman Act violation. See Keyspan, 763 F.Supp.2d at 638 (S.D.N.Y. 2011).

20 *Id.*

21 FED. TRADE COMM'N, FISCAL YEAR 2021 CONG. BUDGET JUSTIFICATION (2020) (https://www.ftc.gov/system/files/documents/reports/fy-2021-congressional-budget-justification/fy_2021_cbj_final.pdf).

22 U.S. DEP'T OF JUST., ANTITRUST DIV. WORKLOAD STAT. FY 2010-2019 (2019) (https://www.justice.gov/atr/file/788426/download).

23 See Einer Elhauge, *Disgorgement as an Antitrust Remedy*, 76 ANTITRUST L.J. No. 1 79, 82 (2009).

24 *Id.* at 83.

25 *Id.* at 83.

VI. CONCLUSION

Disgorgement is here to stay as an enforcement tool by the State Attorneys General. The mere fact that the defense bar has decided to focus on attacking disgorgement demonstrates the strength and power it wields at deterring illegal conduct. State Attorneys General will continue to press on in the endeavor to protect the public interest and hold those engaged in anticompetitive practices accountable through disgorgement of ill-gotten gains and not allow wrongdoers to profit from their illegal conduct.

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