UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Securities and Exchange Commission,	:	
	:	
Plaintiff,	:	**13 Civ. 3837**
	:	
- against -	:	
	:	**MEMORANDUM & ORDER**
Laidlaw Energy Group, Inc. et al.,	:	
	:	
Defendants,	:	

ANDREW L. CARTER, JR., District Judge:

I. INTRODUCTION

The Securities and Exchange Commission ("SEC") accused Laidlaw Energy Group, Inc. ("Laidlaw") and its CEO and sole director Michael Bartoszek (collectively, "the defendants") of unregistered securities sales, misrepresentation before regulatory authorities, and insider trading. The defendants conceded the truth of the allegations for the purposes of a motion to impose civil monetary penalties, disgorgement, and prejudgment interest and the SEC now moves for a final judgment ordering such. For the reasons stated below, the SEC's motion is GRANTED in part and DENIED in part.

II. BACKGROUND

Bartoszek founded Laidlaw in 2002, serving as its CEO and sole director. Complaint ¶ 17. Between August 2006 and January 2010, Laidlaw issued approximately 2 billion shares, more than 80% of its outstanding common stock, at a deep discount to three buyers. Id. ¶¶ 22, 24. In an attempt to skirt SEC regulations that require registration for sales of securities of over $1,000,000, Laidlaw issued the shares in 35 tranches, at intervals of weeks or a few months. Id. ¶¶ 26, 36. The defendants now concede that the 35 tranches comprised a single, integrated

offering. Id. ¶ 5. The profit from that offering was $1,259,550 and it represented nearly all of Laidlaw's revenue during that time period. Id. ¶ 26.

Within days or weeks of purchasing the discounted shares, the buyers resold them on the market for hundreds of thousands of dollars in profit. Id. ¶ 30. This diluted the value of shares previously purchased by investors, who had not been informed of the large blocks of discounted stock that Laidlaw sold to the three buyers. Id. Bartoszek knew of the buyers' plans to quickly resell the discounted stock and worked with them to structure Laidlaw's sales in tranches so as to avoid regulatory limits on resale of shares representing more than 10% of a company's outstanding common stock. Id. ¶¶ 36-37. He was also aware that the buyers did, in fact, sell their shares on an ongoing basis. Id. ¶ 37. In an email exchange discussing the 10% limit with an employee of one of the buyers, for example, Bartoszek acknowledged that the buyer had already divested itself of much of the stock it had acquired. Id.

In October 2010, in conjunction with an application to register a stock offering with the SEC, Bartoszek received a list of beneficial owners of Laidlaw stock. Id. ¶ 41. None of the three buyers appeared on the list, confirming that they had all resold the discounted shares they purchased between 2006 and January 2010. Id. Yet in 2012, Laidlaw filed two forms with the SEC that falsely represented the buyers as the beneficial owners of over 80% of the company's common stock. Id. ¶ 44, 51.

Finally, Bartoszek himself engaged in insider trading by selling over 118 million Laidlaw shares between 2009 and 2011 while withholding nonpublic information on the company's true financial condition and business prospects. Id. ¶¶ 53, 67. Specifically, he withheld from the public information from audited financial statements in 2006 and part of 2007 that recorded

Laidlaw's substantial deficits and lack of revenue beyond share sales and expressed "substantial doubt as to the Company's ability to continue as a going concern." Id. ¶ 58.

Before signing consent orders declaring partial judgment on the SEC's charges, the defendants informed the Court that they would submit to the SEC sworn financial statements regarding their net worth and ability to satisfy a monetary judgment. SEC Declaration in Support of Motion, Ex. 2 at 1. Subsequent to entry of the consent orders, the defendants failed to provide the SEC with any financial information. By order in April 2015, Magistrate Judge Maas directed the defendants to produce financial disclosure information and any documents concerning a defense that Bartoszek may have relied on counsel as to the legality of the defendants' security sales. Id. Ex. 7. By the terms of Magistrate Judge Maas's order, failure to submit such information would preclude the defendants from using it as evidence to mitigate a monetary judgment. Id. Defendants failed to produce any such information.

III. DISCUSSION

The SEC seeks three remedies for Bartoszek's and Laidlaw's conceded violations of securities laws: (1) disgorgement of ill-gotten gains received from Laidlaw's sale of unregistered securities and Bartoszek's insider trading, (2) prejudgment interest on all disgorged amounts, and (3) civil penalties for the unregistered stock offering, subsequent material misrepresentations before the SEC, and insider trading. Notwithstanding the defendants' concession of liability, the scant evidentiary record submitted to the Court justifies only a partial grant of the requested relief.

A. Disgorgement is granted for the full profits received from the sale of unregistered securities but denied for the full profits received from insider trading.

"Disgorgement is an equitable remedy, imposed to force a defendant to give up the amount by which he was unjustly enriched." S.E.C. v. Contorinis, 743 F.3d 296, 301 (2d Cir.

2014) cert. dismissed, 136 S. Ct. 531, 193 L. Ed. 2d 419 (2015) (internal quotations and alterations omitted). In doing so, it "serves to remedy securities law violations by depriving violators of the fruits of their illegal conduct," id., otherwise known as "ill-gotten gains." S.E.C. v. First Jersey Sec., Inc., 101 F.3d 1450, 1474 (2d Cir. 1996). Disgorgement also has the incidental "effect of deterring subsequent fraud." SEC v. Cavanagh, 445 F.3d 105, 117 (2d Cir.2006). But "disgorgement's underlying purpose is to make lawbreaking unprofitable for the law-breaker," full stop; it is not punitive, so "it satisfies its design when the lawbreaker returns the fruits of his misdeeds, regardless of any other ends it may or may not accomplish." Cotorinis, 743 F.3d at 301. Because it is not punitive, "the disgorgement amount may not exceed the amount obtained through the wrongdoing." Id.

"[I]n order to establish a proper disgorgement amount, the party seeking disgorgement must distinguish between the legally and illegally derived profits[] so that disgorgement is ordered only with respect to those that were illegally derived." S.E.C. v. Razmilovic, 738 F.3d 14, 31 (2d Cir. 2013) (internal quotations omitted). That task presents special difficulty when considering "profits from transactions in securities whose market price has been affected by . . . frauds" because of uncertainty as to a security's fair value absent the fraud. Id. Put another way, a seller may pocket a fraudulently elevated profit on a securities sale because she misled the buyer as to its deflated fair value. But the only amount properly subject to disgorgement would be the difference between the security's fair value and the inflated, fraudulent value—not the entire profit made on the security's sale.

Such hindsight calculations of hypothetical values are necessarily inexact. For that reason, "the amount of disgorgement ordered need only be a reasonable approximation of profits causally connected to the violation," and "any risk of uncertainty in calculating disgorgement

should fall on the wrongdoer whose illegal conduct created that uncertainty." S.E.C. v. First Jersey Sec., Inc., 101 F.3d 1450, 1475 (2d Cir. 1996) (internal quotations and alterations omitted). That is not to say, however, that the party seeking disgorgement must merely ask in order to receive. Instead she bears "the burden to establish *both* a reasonable approximation of profits *and* the causal connection between the approximation and the violations." S.E.C. v. Wyly, 56 F. Supp. 3d 260, 268 (S.D.N.Y. 2014) (emphasis in original). If met, "the burden shifts to the defendant to show that his gains were unaffected by his offenses." Razmilovic, 738 F.3d at 31 (internal quotations removed).

The SEC seeks disgorgement of the total amount of profits made from Laidlaw's unregistered, integrated sale of securities to the three buyers and the total amount of profits made from Bartoszek's sale of securities while in possession of nonpublic, material information. In the Second Circuit, only the first of these applications represents a reasonable approximation of profits causally connected to a securities violation.

The defendants concede that the integrated offering violated sections 5(a) and 5(c) of the Securities Act, 15 U.S.C. §§ 77(c), (e). Yet they insist that the profits they retained from it do not represent "unjust enrichment" subject to disgorgement because the three buyers actually received securities, no fraud was committed to induce them to purchase, and no evidence exists that Laidlaw used the funds for illegitimate, nonbusiness objectives. The defendants read the term "unjust" too narrowly. For one, their profit was unjust by virtue of its illegality. The "[Securities] Act is specifically designed to protect investors," Pinter v. Dahl, 486 U.S. 622, 638 (1988), and its violation harms them, even assuming the profits of a violation are afterward turned toward legitimate business ends. See S.E.C. v. Universal Exp., Inc., 646 F. Supp. 2d 552, 564 (S.D.N.Y. 2009) aff'd, 438 F. App'x 23 (2d Cir. 2011) (noting that "it is irrelevant for disgorgement

purposes, how the defendant chose to dispose of the ill-gotten gains"). In this sense, though Laidlaw may not have defrauded the three buyers themselves, its unregistered sale unjustly harmed other shareholders who suffered dilution of their securities and were denied the protections of full and fair disclosure of Laidlaw's securities offers. Disgorgement of the full profits of the integrated offering is therefore appropriate.

In regards to Bartoszek's insider trading, however, the SEC fails to shoulder its burden of establishing a reasonable approximation of profits subject to disgorgement. In the same context of disgorgement of profits made via insider trading, the Second Circuit has written that it "seems necessary to examine the movement of a stock's price after the relevant [insider] information is made public in order to determine the proper measure of the illicit profit (or loss avoided) to be charged to one who traded illegally while in possession of the material, non-public information." S.E.C. v. Patel, 61 F.3d 137, 140 (2d Cir. 1995).

The SEC provides no such comparative estimate of Laidlaw's stock value. At a conference to address its calculation of amounts subject to disgorgement, the SEC argued, without evidence, that the fair value of Laidlaw stock was nothing, so any profit made from Bartoszek's sales represented an ill-gotten gain. But by the terms of its own complaint, the SEC admits that Laidlaw had begun to generate revenue in 2010, the same period in which Bartoszek made at least part of the insider trades. Complaint ¶ 68. The SEC cites an unreported decision from this Court for the proposition that it is not required "to identify misappropriated monies which have been commingled." S.E.C. v. Lines, 2011 WL 3611350, at *4 (S.D.N.Y. June 7, 2011) report and recommendation adopted as modified, 2011 WL 3627695 (S.D.N.Y. Aug. 16, 2011) (internal quotations removed). That statement ultimately derived from an Eastern District of Michigan case. S.E.C. v. Great Lakes Equities Co., 775 F. Supp. 211, 214 (E.D. Mich. 1991)

aff'd, 12 F.3d 214 (6th Cir. 1993). It does not accurately describe the law of the Second Circuit, at least in regards to the specific context of disgorgement of insider trading profits. See Patel, 61 F.3d at 140.

A court's power to order disgorgement extends only as to illegally derived profits. To order the return of that portion of the profit from Laidlaw shares that was legally derived smacks of punishment, an objective that exceeds the equitable limits of disgorgement. Though some portion of the profit made on Bartoszek's insider trades was undoubtedly illegally derived, the burden is on the SEC to show a reasonable approximation of that amount. Their failure to do so leaves this Court no choice but to deny the motion for disgorgement of Bartoszek's insider trading profits.

That being said, Bartoszek does not escape liability for the amount disgorged from Laidlaw. "Where a firm has received gains through its unlawful conduct and where its owner and chief executive officer has collaborated in that conduct and has profited from the violations, courts may determine that the owner-officer too should be subject, on a joint and several basis, to the disgorgement order." S.E.C. v. First Jersey Sec., Inc., 101 F.3d at 1475. The SEC's complaint contains conceded allegations that Bartoszek, as CEO and sole director of Laidlaw, personally solicited securities purchases from the three buyers. Joint and several liability for the full disgorged amount from Laidlaw is therefore appropriate.

B. Prejudgment interest on the disgorged amounts is granted.

"The decision whether to grant prejudgment interest and the rate used if such interest is granted are matters confided to the district court's broad discretion . . . ." S.E.C. v. First Jersey Sec., Inc., 101 F.3d 1450, 1476 (2d Cir. 1996). In exercising that discretion, a court should consider "(i) the need to fully compensate the wronged party for actual damages suffered, (ii)

considerations of fairness and the relative equities of the award, (iii) the remedial purpose of the statute involved, and/or (iv) such other general principles as are deemed relevant by the court." Courts within the Second Circuit have noted that "[r]equiring the payment of interest prevents a defendant from obtaining the benefit of what amounts to an interest free loan procured as a result of illegal activity." S.E.C. v. Wyly, 56 F. Supp. 3d 394, 406 (S.D.N.Y. 2014) (internal quotations omitted). But prejudgment interest must be limited to "the period during which [a defendant] had the use of his unlawful gains." S.E.C. v. Razmilovic, 738 F.3d 14, 35-36 (2d Cir. 2013).

Because the SEC has not met its burden to establish a reasonable amount of disgorgement for Bartoszek's insider trading, the motion for interest on it is also denied. But the First Jersey factors weigh in favor of an order of prejudgment interest on the integrated offer. Contrary to defendants' contention that there are no uncompensated victims in this case, the shareholders whose stocks were diluted by the unregistered offering were victims; the SEC, however, has taken the position that calculating their number and the amount of their compensation is simply too difficult, given the multiple-year period in which the integrated offering took place. Memorandum in Support at 11 n.6 (ECF No. 44). Nonetheless, that extended period gave defendants ample opportunity to collect interest on the illegitimate proceeds of the unregistered offering. To allow the defendants to pocket those proceeds would be neither fair nor in line with the remedial purpose of the securities laws, making prejudgment interest especially appropriate in this case.

District courts regularly grant motions for interest on disgorgement at the IRS underpayment rate at the time a securities law was violated. See e.g. S.E.C. v. First Jersey Sec., Inc., 101 F.3d 1450, 1476 (2d Cir. 1996). In this case, the defendants concede committing 35 discrete acts over a period of three years that collectively comprise a singular securities violation.

Though the full amount of the sale is properly subject to disgorgement, the staggered nature by which payments for it were made means that defendants did not have use of the full amount of $1,259,550 during those three years. To require interest on that amount from the date of the first payment would therefore punish defendants by extracting interest on profits that had yet to be made, an impermissible objective of a prejudgment interest award. See S.E.C. v. Universal Exp., Inc., 646 F. Supp. 2d 552, 566 (S.D.N.Y. 2009) aff'd, 438 F. App'x 23 (2d Cir. 2011) ("Awarding prejudgment interest, like the remedy of disgorgement itself, is meant to deprive wrongdoers of the fruits of their ill-gotten gains from violating securities laws.") (internal quotations removed).

The proper amount of prejudgment interest must therefore be calculated based on the 35 separate principal amounts that Laidlaw obtained during the three-year period in which the integrated sale was carried out. Those 35 separate interest amounts must then be summed to calculate the total amount of prejudgment interest on the entire integrated sale. The SEC is ordered to submit a proposed judgment calculating this amount, giving defendants the opportunity to challenge the result, but not the methodology, of that calculation.

C. Second-tier statutory penalties are imposed for violations other than insider trading.

In addition to the equitable remedies of disgorgement and prejudgment interest, the Court has discretion to impose for securities violations other than insider trading a "civil penalty not to exceed the greater of (1) the gross pecuniary gain to the defendants as a result of their unlawful conduct, or (2) a specified amount per violation where the amount depends on whether the violation is 'first-tier,' 'second-tier,' or 'third-tier.'" S.E.C. v. Simone, 2013 WL 4495664, at *3 (E.D.N.Y. Aug. 19, 2013) (citing 15 U.S.C. § 78u(d)(3)(B)). The SEC seeks third-tier penalties for the defendants' integrated, unregistered offering and the misrepresentations before the SEC. Those penalties are only available if the defendants' violations involved (1) "fraud, deceit,

manipulation, or deliberate or reckless disregard of a regulatory requirement" that (2) "resulted in substantial losses or created a significant risk of substantial losses." 15 U.S.C. § 77t(d)(2)(C)(I)-(II). For violations involving only the first prong above, second-tier penalties are appropriate. 15 U.S.C. § 77t(d)(2)(B).

Courts use a number of factors to assess the propriety and amount of civil penalties, including:

> (1) the egregiousness of the defendant's conduct; (2) the degree of the defendant's scienter; (3) whether the defendant's conduct created substantial losses or the risk of substantial losses to other persons; (4) whether the defendant's conduct was isolated or recurrent; and (5) whether the penalty should be reduced due to the defendant's demonstrated current and future financial condition.

S.E.C. v. Wyly, 56 F. Supp. 3d 394, 406-07 (S.D.N.Y. 2014).

The defendants submit a declaration from Bartoszek that refers tersely to financial and personal health difficulties, as well as to Bartoszek's reliance on legal counsel's advice that the integrated offering did not violate securities law. Given the clear terms of the Magistrate Judge's order that failure to submit to the SEC evidence of the defendants' current finances or reliance on legal counsel would preclude its later use as evidence on this motion, the Court declines to consider it here. At any rate, Bartoszek submits nothing "other than his own self-serving and conclusory assertions," leaving his declaration unpersuasive at best. S.E.C. v. Universal Exp., Inc., 646 F. Supp. 2d 552, 565 (S.D.N.Y. 2009).

The complaint's conceded allegations make clear that the integrated offer and material misrepresentations were parts of a single, long-term, and deceitful plan to skirt registration requirements. That plan required years of coordination and was executed with scienter from the start. The first prong for third-tier penalties is thus met.

But the SEC presents insufficient evidence to justify a finding of substantial losses or the significant risk thereof. The only attempt at showing that a substantial loss occurred comes in the form of a conceded allegation in the complaint that a user of a Laidlaw-related Internet message board posted a comment noting "the crazy dilution we saw in 2008 and 2009." Complaint ¶ 47. No monetary amounts were cited in conjunction with that allegation. At conference, the SEC suggested that in the case of offerings of unregistered shares, no quantification of loss is necessary for third-tier penalties because evidence of "significant risk" alone suffices to meet its burden and because selling an unregistered share creates a significant risk of substantial losses. That argument runs contrary to the plain language of the statute authorizing third-tier penalties, which requires "significant risk *of substantial losses*." 15 U.S.C. § 77t(d)(2)(C)(II) (emphasis added). Further, the SEC cites no authority for the proposition that unregistered offerings per se create a significant risk of substantial losses. Accordingly, second-tier penalties are appropriate in this case.

District courts use a variety of methodologies to assign the appropriate amount of civil penalties for securities violations other than insider trading, including: (1) multiplying the penalty amount by the number of violations committed, S.E.C. v. Pentagon Capital Mgmt. PLC, 725 F.3d 279, 288 n.7 (2d Cir. 2013); (2) multiplying the penalty amount by the number of laws violated, S.E.C. v. Shehyn, 2010 WL 3290977, at *8 (S.D.N.Y. Aug. 9, 2010); (3) multiplying the penalty amount by the number of victims, S.E.C. v. Glantz, 2009 WL 3335340, at *6 (S.D.N.Y. Oct. 13, 2009); and (4) assessing the full amount of unlawful gain, 15 U.S.C. § 77t(d)(2)(B)(ii) (authorizing the imposition of a penalty of "the gross amount of pecuniary gain to such defendant as a result of the violation").

The SEC presents no evidence of the number of victim shareholders, so the Court declines to use that methodology to calculate a civil penalty. The SEC suggests two factors by which the Court could multiply the statutory penalty if assessing the number of violations committed: 35 for the tranches comprising the integrated sale or six for the number of tranches occurring after the profits of the integrated sale actually reached the 1-million-dollar mark, at which point the obligation to register the integrated offer attached. Both of those options contradict the SEC's reliance elsewhere in its motion on the integrated nature of the 35 tranches to justify defendants' liability. The SEC suggests no principled reason why the tranches should be considered in the aggregate for purposes of liability but as discrete acts for purposes of punishment. Nevertheless, the coordinated, long-term nature of the defendants' illegal behavior, committed with scienter, justifies a substantial civil penalty. The Court therefore grants the SEC's motion for civil penalties for each of the defendants' four violations of the Securities Act: sections 5(a), 5(c), 10(b), and Rule 10b-5. The Court will award the statutory maximum of $75,000 per second-tier violation by any natural person and $375,000 per second-tier violation by any other person, brining Bartoszek's penalty amount to $300,000 and Laidlaw's to $1,500,000. See 17 C.F.R. § Pt. 201, Subpt. E, Tbl. IV (adjusting statutory civil penalties for inflation).

As for Bartoszek's insider trading, the Court finds its power to assign a civil penalty constrained once more due to the SEC's failure to submit supporting evidence. For insider trading, the maximum statutory penalty is "three times the profit gained or loss avoided *as a result* of such unlawful purchase, sale, or communication." 15 U.S.C. § 78u-1(1)(2) (emphasis added). The SEC provides only the total profit Bartoszek received through securities trades over the course of two years, submitting no evidence of the portion of the profit gained or loss

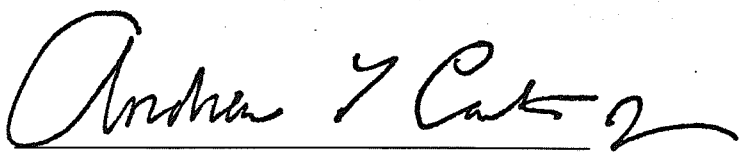
avoided traceable to Bartoszek's fraud. Its requested penalty of three times the total profit from Bartoszek's securities sales is therefore impermissible. The recurrent nature of the trades, made with an intent to evade securities laws, undoubtedly justifies a penalty. But were the Court to assign one without indication of the profit gained or loss avoided, it would risk exceeding the authority granted to it by Congress. Accordingly, the SEC's motion for civil penalties for insider trading is denied.

IV. CONCLUSION

For the foregoing reasons, the SEC's motion is GRANTED in part and DENIED in part. Defendants are to be disgorged, on a joint and several basis, of $1,259,550. Prejudgment interest on that amount is to be calculated by the SEC and submitted to the Court as described above. Additionally, Bartoszek is assessed a civil penalty of $300,000 and Laidlaw a civil penalty of $1,500,000. The SEC's proposed final order, along with evidence of the basis for its calculated amount, is due on or before April 7, 2016.

SO ORDERED.

Dated: **New York, New York**
March 31, 2016



ANDREW L. CARTER, JR.
United States District Judge