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SEC Briefs Disgorgement and Investor Harm in *Navellier v. SEC*

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In the recent Supreme Court case, *Navellier & Associates, Inc. v. Securities and Exchange Commission* (SEC), the petitioners sought a writ of certiorari challenging the decisions of the lower courts regarding the scope of disgorgement and the materiality standard applied in securities fraud cases. On May 5, the SEC filed its brief in opposition to the petition.

Background

The SEC initiated legal action against Navellier & Associates, Inc., a registered investment advisor, alleging violations of § 206 of the Investment Advisers Act of 1940. This section mandates fiduciary standards for investment advisers and prohibits fraudulent activities. The crux of the SEC's argument was that Navellier & Associates had misrepresented the performance of certain investment strategies. Specifically, in 2009, Navellier & Associates licensed certain investment strategies from another investment adviser and recommended those strategies to clients, touting the data ostensibly showing that the strategies had helped other investors avoid the previous two bear markets. According to the SEC, Navellier & Associates understood that the data did not reflect actual performance, but instead showed, with the benefit of "hindsight," how "hypothetical" investors would have performed if they had used the strategies.

The district court ruled in favor of the SEC, ordering Navellier & Associates to disgorge profits obtained through these misrepresentations in the amount of $22,734,487 plus pre-judgment interest. The court of appeals affirmed this decision, leading to the petitioners' appeal to the U.S. Supreme Court.

Questions Presented in Cert Petition

Whether, in seeking an order requiring registered investment advisers to disgorge profits obtained through fraud, the SEC must show that the adviser's clients suffered pecuniary harm.

Whether the court of appeals applied the correct materiality standard in affirming the district court's award of summary judgment to the SEC.

SEC's Brief

The SEC argues that disgorgement is fundamentally an equitable remedy, emphasizing that it is designed to strip wrongdoers of their ill-gotten gains, irrespective of direct financial harm to investors. The brief highlights that "the availability of disgorgement turns on whether the violator has made a profit, not on whether the victim has suffered a loss." This principle is rooted in the notion that a wrongdoer should not "make a profit out of his own wrong."

The petitioners, however, challenge this perspective, arguing that the SEC must demonstrate that the adviser's clients suffered pecuniary harm to justify disgorgement. They assert that without evidence of direct financial loss to investors, the disgorgement award is unwarranted. The petitioners contend that their clients did not lose advisory fees and that there was no evidence of clients being "induced" to pay fees based on the alleged misrepresentations.

The SEC counters this by asserting that the investors did suffer direct financial harm. The brief highlights that the district court found petitioners' clients had been "induced into paying advisory fees" due to the misrepresentations, resulting in a tangible financial impact. The SEC argues that these advisory fees, totaling $22,775,867, represent a direct harm to the investors, reinforcing the appropriateness of the disgorgement award.

Regarding materiality, the SEC maintains that the misrepresentations made by Navellier & Associates were significant enough to influence a reasonable investor's decision-making process. The brief argues that the hypothetical nature of the investment performance data was a critical omission, and thus, material under established legal standards. The SEC emphasizes that materiality is determined by the importance a reasonable investor would place on the misrepresented information and asserts that the omission of the hypothetical nature of the data was a substantial factor that would affect investment decisions.

The petitioners, on the other hand, argue that the evidence created a genuine dispute as to the materiality of their misrepresentations, suggesting that the district court should not have granted summary judgment to the SEC. They contend that the court of appeals applied an incorrect materiality standard, which they believe should require proof that investors actually relied on the misrepresentation.

The SEC's brief ultimately seeks to uphold the lower courts' decisions, arguing that both the disgorgement and materiality standards were correctly applied in this case. We will continue to monitor this litigation and provide updates.

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