

UPDATE ON THE LAW OF DISGORGEMENT

Introduction

The Collin's Dictionary defines the verb disgorge as: if something disgorges its contents, it empties them out. In the field of law, the term disgorgement has been used to mean the identification, tracing of assets and then obtaining a Court order for the freezing of the asset and then transferring the property in the assets directly to the rightful legal owner or the monetising of the assets into cash and then transferring such cash to the rightful owner. The rightful owner can be a wide class, including e.g., innocent investors of a fraudulent fund arrangement, joint venture partners whose loss was caused by a breach of fiduciary duties committed by officers of the joint venture company or by other joint venture partners and the Government in the case of corruption cases.

Disgorgement is a remedy requiring a party to give up any profits they made because of illegal or wrongful conducts and returning it to the aggrieved party. Disgorgement is not a cause of action. Notwithstanding that a High Court Judge in Malaysia has stated that disgorgement is 'not of a legal pedigree'. It is submitted that disgorgement is recognized as a valid and enforceable mechanism by the Courts in, inter alia, the United States of America, the United Kingdom and Malaysia.

United States of America

Securities and Exchange Commission

Disgorgement is used widely as a remedy in terms of US Securities law. Claims are done by the U.S. Securities and Exchange Commission (SEC) based on disgorgement, forcing companies to repay any monies earned through illegal and dishonest means and then the monies recovered flow to innocent investors of the fraudulent transaction. The characterisation of the United States law was summarised in Paragraph 34 of the judgment in United States Securities and Exchange Commission v Glenn Anthony Manterfield [EWHC

2008]:

1. The act that governs disgorgement claims is the Securities Exchange Act 1934.
2. The long title of the 1934 Act states: 'An act to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes.'
3. Another legislation that declared and confirmed the SEC's position to claim for disgorgement is the Securities Enforcement Remedies and Penny Stocks Reform Act 1990 by stating in s78(u)(a) - "authority and discretion of Commission to investigate violations...", and s78(d)(5) - "Equitable relief" - In any action or proceeding brought or instituted by the Commission under any provisions of the securities law, the Commission may seek, and any Federal Court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.
4. The Securities Enforcement Remedies and Penny Stock Reform Act 1990 made express provision for the first time for the Commission to claim penalties in civil actions under the securities legislation.
5. In order to claim for any equitable relief (includes disgorgement), the SEC does not have to claim civil penalties.

In *Securities and Exchange Commission v Rati K Patel*, the United States Court of Appeal held where stock is purchased on the basis of inside information, the proper measure of damages is the difference between the price paid for shares at the time of purchase and the price of the shares shortly after the disclosure of the inside information. In that case, it was recognised that disgorgement of profits merely deprives the wrongdoers of the gains of their wrongful conduct.

Breach of fiduciary duty

Disgorgement of profits may also be awarded for breach of fiduciary duties (*Wimbledon Fin. Master Fund, Ltd. v Weston Capital Mgmt. LLC*, 2017 (N.Y. Sup. Ct. 2017)). Furthermore, disgorgement of profit is an appropriate remedy even if the corporation has not been damaged directly by the misconduct (*Howard v Pooler* (N.Y. App. Div. 2020)). The claimant can apply to the court for an order to freeze the assets of the defendant. Fiduciary duties are the obligations and legal responsibilities a party has to act in another party's best interest, for instance, duties to the employer. A breach of the duties occurs when the fiduciary acts in the interest of himself rather than in the best interest of the employer or company.

United Kingdom

United Kingdom Laws for the United Kingdom for disgorgement is seen applied in the case of *Financial Services Authority (FSA) v Anderson & Others* [2010] whereby carrying on a regulated activity without being an authorised or exempt person is in primary contravention

of section 19(1) of the Financial Services and Markets Act 2000. The regulated activity refers specifically to carrying on of investment business in the United Kingdom in accepting or purporting to accept deposits within the meaning of article 5 of the Financial Services and Markets Act 2000. Disgorgement of profits acquired by the contravener was held to be a protection of the investing public because such disgorgement discourages future contravention. In addition, it is appropriate that those engaging in an unlawful deposit-taking business should disgorge the profits that they made.

Similar Remedies under Malaysian Law

Securities and Exchange Commission

Major acts equivalent to the United States Securities and Exchange Act 1934 are the Capital Market and Services Act 2007 and the Securities Commission Malaysia Act 1993. The statutory body having responsibility for the development and regulation of capital markets is the Securities Commission Malaysia. The remedy of disgorgement is recognized as a valid and enforceable mechanism by the Court - the Securities Commission has sued for insider trading in *Suruhanjaya Sekuriti Malaysia v Chan Soon Huat* [2018] and submitted that predicting stock market responses is a speculative exercise. Disgorgement of insider trading gains need only be a 'reasonable approximation' of the profit/loss avoided causally connected to the violation. The article 'SC Sues Seven Individuals for Market Manipulation, Seeks Disgorgement and Civil Penalty of RM7 Million' also indicates that disgorgement has been used as a remedy. The defendant had actively transacted in large volumes of APLI shares using other individuals trading accounts with the aim to manipulate the market causing an increase in share price. The disgorgement of all profits obtained by the defendants as a result of the manipulation, will be used to compensate affected investors.

Other relevant Act regarding the freeze, seizure, sale and vesting of property in the Government of Malaysia includes Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (Act 613) - Sections 56A to 58. English law, which includes the common law, rules of equity and legislation, is the predominant source of the Malaysian law and disgorgement is an equitable remedy claimable under the common law. The Malaysian legislation that allows common law to be applied in Malaysian cases is the Civil Law Act 1956 as stated in s3(1): Save so far as other provision has been made or may hereafter be made by any written law in force in Malaysia, the Court shall - (a) in Peninsular Malaysia or any part thereof, apply the common law of England and the rules of equity as administered in England on the 7 April 1956.

Fiduciary duty

It is submitted that disgorgement of profits (in this case through an account) is the appropriate remedy where a fiduciary profited from a breach (Paragraph 101) (*Kuan Pek Seng @ Alam Kuan v Robert Doran & Ors and other appeals* [2013] and Paragraph 104 of the judgment is an illustration of some of the items claimable under disgorgement:

(a) the raw material (RM5,398,830.33) less RM830,000,

- (b) the payments towards the machinery (RM2,883,284.01),
- (c) the difference between the sale price (RM1,043,000) and the resale price (RM650,000) of the movable property of defendant 22, and,
- (d) the sum of RM2,087,817.10 that was in the account of defendant 22 on 27 March 2008.

That would return RM9,932,931.40 to the plaintiffs, out of the total investment of RM23,894,588.47. Notwithstanding that a High Court Judge in Malaysia has stated that disgorgement is 'not of a legal pedigree' in *Transnational Express Sdn Bhd v Tan Chong Industrial Equipment Sdn Bhd* [2021]. However, it is submitted that disgorgement is recognised as a valid and enforceable mechanism. As to whether disgorgement of profits was the only remedy for breach of fiduciary duties, counsel for the landowner contended that, besides disgorgement, restitution and compensation were also remedies available. (*Newacres Sdn Bhd v Sri Alam Sdn Bhd* [2021]) The remedies given by the Court of Appeal in this case were basically to compensate for the loss suffered by the landowner as a result of the developer's aforesaid breach.

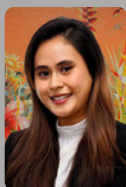
Trespass

Amsiah Rahim v Borneo Samudera Sdn Bhd [2021] was a case whereby the pleading was made on the ground of disgorgement. The plaintiff was claiming for whatever profits the Defendant had gotten from the use of land. The judge submitted that this is a claim termed as disgorgement of profits.

Conclusion

Ultimately, disgorgement is a remedy in the United States, United Kingdom and Malaysia. Malaysia has incorporated the remedy of disgorgement into its common law by bringing in United Kingdom common law through the Civil Law Act 1956.

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