UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 92-1363

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee-Cross-Appellant,

v.

MAXWELL C. HUFFMAN, JR.; JAMES T. HENRY; JOHN J. FORSBERG, et al.,

Defendants-Cross-Appellees,

JAMES F. STEWART,

Defendant-Appellant-Cross-Appellee.

On Appeal from the United States District Court
for the Northern District of Texas

REPLY BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, APPELLEE-CROSS-APPELLANT

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ARGUMENT

THE DEFENDANTS OFFER NO BASIS FOR INCLUDING A DISGORGEMENT ORDER IN A SECURITIES AND EXCHANGE COMMISSION ENFORCEMENT ACTION WITHIN THE TERM "DEBT" UNDER THE DEBT ACT.

The sole legal issue in this case is whether a disgorgement order entered in a case brought by the Securities and Exchange Commission is a "debt" as defined in the Federal Debt Collection Procedures Act ("Debt Act"). 1/ As explained in our opening

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1/ Huffman misstates the nature of this case by asserting (Br. 6) that the Commission, by arguing that the Debt Act does
(continued...)

brief, it is not. Disgorgement is not among the items specifically included within the definition of the term "debt" in the Debt Act. Although the defendants argue that disgorgement is the same as "restitution" or a "penalty," two of the specific items in the definition, clear authority of this Court and other courts holds otherwise. Nor do the defendants offer any cogent reason for deeming disgorgement a "debt" under the Debt Act as an "other source of indebtedness." This Court and other courts have held that disgorgement is not what is commonly understood to be a debt. The defendants seek to brush that authority aside by incorrectly arguing that because those cases arose in a different procedural context their substantive holding is irrelevant here. They suggest that, rather than apply its own precedent, this Court should look to the broad and very different definitions of debt used in another statute or in the dictionary, definitions Congress did not adopt in the Debt Act. There is no basis for this Court to ignore the Debt Act's precise language and to include under the coverage of the Debt Act a remedy that Congress did not see fit to include.

A. The District Court's Holding that the Debt Act Applies to Commission Disgorgement Orders Is Subject to De Novo Review.

As a threshold matter, Huffman misstates the standard of

1/(...continued)
not apply, seeks "to exempt itself from all of the restrictions to which every other administrative agency and arm of the United States is subject." The Commission in fact acknowledged in its opening brief (Br. 10) that the Debt Act applies to an independent agency of the United States government such as the Commission.

review applicable to this issue. He argues (Br. 3, 5, 7-8) that the district court, in applying the Debt Act to exclude certain assets from his disgorgement payment, made a factual determination that can be reversed only if it is clearly erroneous. But in fact the applicability of the Debt Act to this proceeding is a legal determination subject to de novo review by this Court. See, e.g., Schmueser v. Burkburnett Bank, 937 F.2d 1025, 1028 (5th Cir. 1991). 2/

Huffman argues (Br. 3, 5, 7) that this was a factual finding, subject to the clearly erroneous standard of review, by repeatedly asserting that the Magistrate (whose findings and conclusions were adopted by the district court) only used the Debt Act as a "guide" in determining his ability to pay disgorgement. That is not the case. The Magistrate concluded that she was compelled to apply the property exemptions in the Debt Act, despite her dissatisfaction with the result. The Magistrate stated (CR 108 at 14) that the amount Huffman is required to pay -- $7,500 -- is "wholly inadequate" given that he has been ordered to disgorge $113,000, and that such payment "serves neither the interests of equity nor the objectives of

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2/ Huffman incorrectly claims (Br. 8) that the amount he is required to pay is not at issue in this appeal because the Commission did not argue that the factual findings as to Huffman are clearly erroneous. The Commission did not so argue because the factual findings as to Huffman encompass only the nature and amount of his assets, which the Commission does not dispute. What the Commission does dispute is whether the Debt Act applies to allow Huffman to shield those assets from disgorgement. That is a legal issue, not a factual one.

disgorgement." The Magistrate concluded, however, that a payment of only $7,500 is "mandated" by application of the Debt Act.

Huffman also mistakenly asserts (Br. 7) that the consent agreements as well as the orders entered by the district court demonstrate that the sole issue in this proceeding is a factual determination. However, nothing in the language of the consent agreements, or in the district court order appointing a magistrate to conduct a hearing to determine the defendants' ability to pay disgorgement (CR 82), or any other order, limits the Magistrate's role to making only factual determinations. 3/

B. Disgorgement Is Not a "Debt" as Defined in the Debt Act.

As explained in the Commission's opening brief, disgorgement is not a "debt" as that term is used in the Debt Act. Disgorgement is not one of the items specifically listed in the statutory definition as a "debt," and it differs in definitive respects from restitution, the only listed item to which it bears any resemblance. Furthermore, the statute's catch-all phrase "other source of indebtedness" does not include disgorgement

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3/ Huffman also incorrectly asserts (Br. 2-3) that the effect of the ability to pay hearing was to reduce the disgorgement amount owed by each defendant. Rather, the district court, consistent with the injunctive orders entered as to each defendant, only reduced the amount that must be paid at this time in satisfaction of the disgorgement amount owed. See, e.g., CR 77 at 5 (allowing the defendant to raise "as a defense to payment of disgorgement his financial inability to pay") (emphasis added). The defendants may at a future time be required to pay more, as reflected by the fact that the court ordered each defendant to return for an accounting (CR 114, 115, 116, 117), something which would be unnecessary if their disgorgement obligations were to be extinguished by these payments.

because the phrase properly includes only those obligations which have traditionally been viewed as being debts, and this Court and other courts have held that disgorgement is not within the common meaning of the term "debt." In seeking to bring disgorgement orders within the scope of the statute, Huffman and Stewart advance a variety of arguments, none of which has merit.

Huffman (Br. 9-13) and Stewart (Br. 6-9) argue that a disgorgement order is an "other source of indebtedness." They do not dispute that application of this term requires this Court to determine what "indebtedness" is. Nor do they dispute that this Court and other courts have held that disgorgement does not fall within the common understanding of the word "debt." 4/ Huffman (Br. 12-13) and Stewart (Br. 8) argue that these cases are irrelevant because, unlike this case, they involve contempt proceedings. But the cases, while arising in a different procedural posture, turned on determining whether the underlying disgorgement obligation was a "debt," precisely the same substantive issue as here. 5/

4/ See, e.g., Pierce v. Vision Investments, Inc., 779 F.2d 302 (5th Cir. 1986); Usery v. Fisher, 565 F.2d 137 (10th Cir. 1977); Donovan v. Sovereign Security Ltd., 726 F.2d 55 (2d Cir. 1984); Donovan v. Mazzola, 716 F.2d 1226, 1239 n.9 (9th Cir. 1983), cert. denied, 464 U.S. 1040 (1984).

5/ Specifically, the cases involved the issue whether holding a defendant in contempt for failure to pay disgorgement would contravene prohibitions on imprisonment for debt. This Court and other courts concluded that it would not, since disgorgement is not a debt. The cases, in short, turned on the nature of the underlying disgorgement order, exactly what is at issue here.

Huffman (Br. 10-11) argues that, instead of applying this clear authority, this Court should incorporate within the term "other source of indebtedness" the definition of debt used in the Bankruptcy Code (see 11 U.S.C. 101(5) and (12)). The Bankruptcy Code does contain a very broad definition of the term "debt," essentially equating it with any amount owing. The Debt Act, which was enacted subsequently to the Bankruptcy Code, does not borrow the Code's definition of "debt," but uses very different, more specific, and far narrower language. Had Congress wished to simply incorporate the broad Bankruptcy Code definition, it would have done so. For example, the Debt Act's definition of "exempt property" is borrowed directly from the Code. See 28 U.S.C. 3014(a)(1)(incorporating by reference Section 522(d) of the Bankruptcy Code); 28 U.S.C. 3014(a)(2)(A) and (B)(copying essentially verbatim Sections 522(b)(2)(A) and (B) of the Bankruptcy Code). 6/

In addition, the defendants assert (Huffman Br. 9-10, Stewart Br. 7) that the meaning of debt is best found by consulting a dictionary, which defines debt to include anything that is owing. Simply put, the dictionary definition is akin to the Bankruptcy Code's definition, and is one Congress could have

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6/ Huffman also argues (Br. 6) that, because the consent agreements entered into by the Commission and the defendants refer to the Commission's disgorgement "claim," the disgorgement orders in this case are "debts." The Debt Act does not, however, state that any "claim" by a government agency is a "debt."

chosen to adopt, but did not. 7/ Nor is it consistent with the view this Court has taken that disgorgement does not fit within the common understanding of the term debt.

Huffman (Br. 13-14) and Stewart (Br. 8-9) also argue that disgorgement is the same as "restitution," one of the specific terms included within the definition of debt, and therefore should be viewed as a "debt." However, as discussed in the Commission's opening brief, disgorgement and restitution, although similar in some respects, have significant differences. The primary purpose of restitution is directed at ensuring that, to the extent possible, the victim is made whole. See, e.g., First Penn Corp. v. FDIC, 793 F.2d 270, 272 (10th Cir. 1986). In contrast, the primary purpose of disgorgement, as this Court has held, "is not to compensate the victims of the fraud, but to deprive the wrongdoer of his ill-gotten gain." SEC v. Blatt, 583 F.2d 1325, 1335 (5th Cir. 1978). As explained in our opening

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7/ Such a broad definition is also inconsistent with Section 3001(c) of the Debt Act, which states that the Act does not apply to amounts owing that are not debts. In seeking to overcome that provision, the defendants argue (Huffman Br. 11-12, Stewart Br. 7) that Section 3001(c) was only intended to exclude amounts owing to the United States as a result of assignment to it of obligations originally owed to third parties -- as in cases where the Federal Deposit Insurance Corporation assumes receivership of a bank or where obligations are assigned to the United States. But as the defendants note, such assigned obligations are expressly excluded from the definition of "debt" under Section 3002(3)(B) of the Act. They do not explain why Congress would have felt it had to exclude such obligations from coverage of the Act twice. The more rational explanation of Section 3001(c) is that Congress wished to make clear that the term "debt" or "indebtedness" does not include all amounts owed, but rather only includes those commonly understood to fit within the term debt.

brief, disgorgement is owed regardless of whether any restitution is possible.

Moreover, the defendants argue (Huffman Br. 14, Stewart Br. 9) that a disgorgement order is penalty. They ignore the holdings of this Court and others that disgorgement, which only forces a wrongdoer to give up what he was not entitled to in the first place, does not impose punishment and is not a penalty. See, e.g., SEC v. Blatt, 583 F.2d at 1335; SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2d Cir. 1972); SEC v. MacDonald, 699 F.2d 47 (1st Cir. 1983)(en banc). 8/

Finally, Stewart argues (Br. 6-7) that to hold that disgorgement is not an "other source of indebtedness" would "violate" the principle of ejusdem generis. Ejusdem generis, however, is a principle of statutory construction providing that where a general term in a statute follows a list of specifically enumerated terms, a court may restrict the general term to include only those things that fall within the same classification as the specific terms. See, e.g., Hilton v. Southwestern Bell Telephone, 936 F.2d 823, 828 (5th Cir. 1991), cert. denied, 112 S. Ct. 913 (1992). Disgorgement is not like sixteen of the seventeen enumerated items listed as a "debt" and,

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8/ Huffman (Br. 15-16) and Stewart (Br. 9) also assert that disgorgement is not an injunction, and therefore the provision of the Debt Act excluding injunctive relief from its coverage does not apply. See 28 U.S.C. 3003(c)(7). However, the payment of money pursuant to a disgorgement order arising out of a violation of a federal statute is in the nature of injunctive relief, as this Court indicated in Wirtz v. Jones, 340 F.2d 901, 904 (5th Cir. 1965).

as discussed above, has critical differences from restitution, the only item to which it has any similarity. Applying the principle of ejusdem generis, therefore, leads to the conclusion that disgorgement is not a debt.

CONCLUSION

For the foregoing reasons, and the reasons stated in the Commission's opening brief, the orders of the district court applying the Federal Debt Collection Procedures Act of 1990 should be reversed, and the case should be remanded with instructions to recompute the disgorgement amounts without consideration of any exemptions under the Act.

Respectfully submitted,

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