

Federal Securities Law Blog

Published by

porterwright
PORTER WRIGHT MORRIS & ARTHUR LLP



INSIDER TRADING:

**A LOOK AT SOME OF THE KEY CIVIL
AND CRIMINAL CASES IN 2011**

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INTRODUCTION

The last few years have seen a remarkable number of insider trading cases brought by both the SEC and federal prosecutors. In the criminal cases, many Wall Street professionals and lawyers who have been very successful will now spend years in prison. On the civil side, the SEC has pursued defendants very aggressively, although in some cases, where the defendants have had the ability to fight back, they have vigorously defended themselves. This eBook will focus on several of these cases and the events in 2011 and discuss some of the trends that have developed.

First, we will look at the criminal cases by focusing on some of the Galleon Management and the "Expert Network" cases as examples where the prosecutors pursued, tried and convicted significant Wall Street players. In addition, we will review the recent increase in the length of prison sentences in these types of cases.

On the civil side, we look at Rajat Gupta (who was also part of the Galleon Management circle) who found himself in a different struggle, as the SEC brought an administrative case against him, which, according to his lawyers, was an effort to deny him a day in Court. He temporarily prevailed in the administrative case by getting the SEC to dismiss it (while reserving the right to file suit instead). However, he has now been indicted and faces civil charges from the SEC as well.

We will also examine the SEC's case against Mark Cuban, which is worth watching closely because he has fought the SEC every step of the way, raising a number of theories and utilizing different tactics. For example, Mr. Cuban, among other things, has attacked the Commission's investigative methods. To date, he has not been successful, and the case against him continues.

SECTION I: THE CRIMINAL CASES

Insider Trading Case With Wiretaps Results in Raj Rajaratnam's Conviction

May 11, 2011

In a case closely watched on Wall Street, a federal Jury in New York convicted Raj Rajaratnam, the Managing Member of Galleon Management, LLC, of five counts of conspiracy to commit securities fraud and nine counts of securities fraud, stemming from what [prosecutors called](#) "his involvement in the largest hedge fund insider trading scheme in history."

Prosecutors stated that Mr. Rajaratnam received non-public, material insider information through overlapping conspiracies from insiders and others at hedge funds, public companies, and investor relations firms, such as Goldman Sachs, Intel, IBM, McKinsey and others. Prosecutors argued that he then executed

trades in the stock of public companies, including Goldman Sachs, Clearwire, Akamai, AMD, Intel, Polycom, and PeopleSupport. The evidence in the eight-week trial included numerous recordings of wiretapped phone calls between Mr. Rajaratnam and co-conspirators (many of whom pled guilty). According to [media reports](#), defense counsel, who argued that Mr. Rajaratnam pieced together information from a variety of sources to reach a decision on investing, plans to appeal.

Each conspiracy conviction carries a maximum penalty of five years, while each insider trading charge carries a maximum of twenty years.

Prosecutors Use Wiretaps To Secure Another Insider Trading Conviction

June 14, 2011

Less than five weeks after the [insider trading conviction of Raj Rajaratnam](#), prosecutors in New York, again using wiretapped telephone conversations, obtained [a second significant conviction for insider trading, this time against Zvi Goffer and two other Wall Street professionals](#), who were found guilty of conspiracy and securities fraud charges.

Prosecutors stated that Mr. Goffer, who formerly worked at with the Schottenfeld Group LLC (part of Raj Rajaratnam's Galleon Group), his brother, defendant Emanuel Goffer, and a third defendant, Michael Kimelman, conspired with attorneys Arthur Cutillo and Brien Santarlas, (formerly of the Ropes & Gray

law firm) and others. Zvi Goffer and others paid the attorneys for inside information regarding mergers and acquisitions of public companies represented by the law firm. Media reports stated that Zvi Goffer was nicknamed "Octopussy" due to the number of connections he had. Like the Rajaratnam trial, the evidence in the four-week Goffer trial included numerous recordings of wiretapped phone calls, this time between Mr. Goffer and co-conspirators (many of whom pled guilty).

Each conspiracy conviction carries a maximum penalty of five years, while each securities fraud charge carries a maximum of twenty years.

Consultant Who Exploited Friendships With Financial Personnel at Public Companies Is Convicted For Insider Trading

June 21, 2011

On Monday June 20, a federal jury convicted a consultant at an expert networking firm, Winifred Jiau, of one count of conspiracy and one count of securities fraud for selling inside information she obtained through social relationships with sources from the finance departments at publicly traded companies. [According to the U.S. Attorney](#), "Wini Jiau gave new meaning to the concept of social networking. She used and exploited friends at public companies for the purpose of obtaining, and then selling, inside information."

Specifically, between 2006 and the end of 2008, Ms. Jiau obtained data regarding detailed financial earnings and other information from a number of publicly traded companies, which she then sold to portfolio managers at hedge funds, who then traded on the information. Three

hedge fund employees have previously pled guilty to similar charges, as did an insider at the finance department of one of the publicly traded companies.

Like the [Rajaratnam](#) and [Goffer](#) cases previously discussed, the Government's evidence included wiretapped telephone conversations between the participants. [According to the New York Times](#), her counsel argued that "while the information that Ms. Jiau obtained about companies may have been nonpublic, it was not material." The jury disagreed, taking six hours to convict her. The jury foreman [told reporters](#) that she "was despairing ... about what goes on in the system," adding that "I hope that hedge funds will be re-examined, because there's a lot of corruption."

Ms. Jiau faces up to twenty years in prison.

Sentences Handed Down In Two Insider Trading Cases, Others Await Fate

September 22, 2011

On Wednesday, September 21, two defendants who were convicted of conspiracy and insider trading charges in separate trials earlier this year were sentenced in federal court in New York. Zvi Goffer, who formerly worked at with the Schottenfeld Group LLC (part of Raj Rajaratnam's Galleon Group), was sentenced to ten years in prison, while Winifred Jiau, a consultant at Primary Global Research LLC (an expert networking firm), received a four year sentence. Like many of the recent high-profile insider trading cases, the Government's evidence included wiretapped telephone conversations between the participants in both cases. DOJ and the SEC continue to vigorously pursue and punish those participating in insider trading cases.

As previously [discussed here](#), Mr. Goffer, who was convicted in June, was nicknamed "Octopussy" due to the number of connections he had. The Government charged him for paying attorneys Arthur Cutillo and Brien Santarlas, (formerly of the Ropes & Gray law firm) for inside information regarding

mergers and acquisitions of public companies represented by the law firm. The 120-month sentence handed down on Wednesday is just below the length requested by the Government in a filing last week (where DOJ advocated a sentence within the Guidelines range of 121 to 151 months' imprisonment)

As [discussed here](#), Ms. Jiau was convicted in June of one count of conspiracy and one count of securities fraud for selling data regarding detailed financial earnings and other information she obtained through social relationships with sources from the finance departments at publicly traded companies. The 48-month sentence handed down on Wednesday fell well short of what the Government sought in a brief last week, where it argued that a sentence within or near the applicable Guidelines sentencing range of 97 to 121 months was appropriate.

With respect to Mr. Goffer, [U.S. Attorney Preet Bharara said](#) that his "sentence is a fitting conclusion to yet another sordid chapter in the illegal insider trading conspiracies that have become so

alarmingly pervasive. Unfortunately, it is not the final chapter." Two examples of these open "chapters" relating to Mr. Rajaratnam's Galleon Group were discussed in the [Wall Street Journal's Law Blog, in yesterday's post](#):

- Raj Rajaratnam (whose May conviction is [discussed here](#)) is scheduled to learn his fate on October 13, 2011, where the Government has argued for a 24-year sentence (which defendants have argued is "grotesquely severe"); and

- Rajat Gupta may yet be named in an Indictment and will very likely face civil charges from the SEC (who previously agreed to dismiss the administrative proceeding against him, but reserved the right to sue him in federal court, as [discussed here](#)).

DOJ does not appear to be done in the expert network field either, where James Fleishman, another consultant at Ms. Jiau's company, was [convicted on Tuesday](#) of conspiracy charges in connection with a scheme to provide material, nonpublic information to the Firm's clients.

Raj Rajaratnam Sentenced To Eleven Years in Prison for Insider Trading Scheme

October 13, 2011

Today, in a case closely watched on Wall Street, Judge Richard Holwell sentenced Raj Rajaratnam, the Managing Member of Galleon Management, LLC, to eleven years in prison. Although the sentence is the longest to date for anyone involved in the Galleon Group, it fell considerably short of the lengthy sentence sought by the Government.

Mr. Rajaratnam was convicted by a jury in May 2011 of five counts of conspiracy to commit securities fraud and nine counts of securities fraud, stemming from what prosecutors called "his involvement in the largest hedge fund insider trading scheme in history" (previously [discussed here](#)).

Prior to the sentencing, the [Wall Street Journal's Law Blog provided a time line of the events](#) in this case and the related cases since the jury convicted Mr. Rajaratnam. As [discussed here](#), prior to today, the longest sentence imposed was in the case against Zvi Goffer, who formerly worked at with the Schottenfeld Group LLC which was part of Mr.

Rajaratnam's Galleon Group. Mr. Goffer, who was convicted in June and nicknamed "Octopussy" due to the number of connections he had, was sentenced to ten years in prison.

Given Mr. Rajaratnam's role in the conspiracy, the Government had argued that Mr. Rajaratnam should be given a sentence "within the applicable Guidelines range of 235 to 293 months" (in other words between approximately 19 to 24 years. Mr. Rajaratnam has argued that such a sentence was "grotesquely severe," and pointed out that the average sentence imposed in 2010 for violent crimes were far less – the average sentence for manslaughter was 73 months, for example.

The [Wall Street Journal reported](#) that during today's hearing Judge Holwell said Mr. Rajaratnam's ill health (he is suffering from advanced diabetes and likely to require a kidney transplant) justified some leniency in sentencing.

Recent Article Discusses Trends in Securities Enforcement: Increasing Sentences in Insider Trading Cases

October 14, 2011

An article appeared this week that traced a trend in a particular area of securities enforcement. [The Wall Street Journal presented data](#) showing an increase in the length of sentences in insider trading cases over the last eighteen years.

The piece from the Wall Street Journal listed the data regarding sentences in 108 insider trading cases from the Eastern District and Southern District of New York since 1993. It is interesting to note that during the first seven years, no defendant received a sentence of longer than two years in prison, a trend which ended in 2000 when Vincent Napolitano was sentenced to six years. The sentences remained brief (less than three and one-half years) for six more years, with one exception (Sam Waskal, who was sentenced to 87 months – a little over seven years – in 2003). But from 2006 to

the present, the Journal identified nine defendants who were sentenced five years or more in prison. Moreover, in 2011 alone, 14 defendants were sentenced to jail terms in the Eastern and Southern Districts.

The Journal's article appeared before yesterday's sentencing of Raj Rajaratnam, who was sentenced to eleven years in prison (as [discussed here](#)), longer than any other defendant on chart. Given that Mr. Rajaratnam was the central defendant in the largest insider trading scheme in some years, he may hold the distinction of the longest sentence until the next insider trading scandal. Whether Mr. Rajaratnam's sentence continues to be the longest or not, the article clearly reflects the trend for individuals who take risks like him.

**SECTION II:
THE PROCEEDINGS AGAINST
RAJAT GUPTA**

Can Dodd-Frank Act Provisions Be Applied Retroactively? The SEC Moves to Dismiss a Complaint on That Topic, Arguing That the Issue's Not Ripe

April 5, 2010

In March 2011, an individual accused of participating in an insider trading scheme filed a Complaint against the SEC in federal court in New York, arguing, among other things, that the SEC should be enjoined from retroactively applying the provisions of the Dodd-Frank Act in an administrative proceeding against him. On Friday April 1, 2011, the SEC filed a brief requesting that the Court dismiss that complaint for lack of subject matter jurisdiction, arguing, in part, that the retroactivity claim was not "ripe" and the individual had not exhausted his administrative remedies. In short, the Commission argued that the federal court cannot consider this issue until the administrative proceeding is completed and the SEC decides whether or not to impose civil penalties under the Act.

On March 1, 2011, the SEC commenced an Administrative Proceeding against Rajat Gupta, the former Managing Director of McKinsey & Company and board member at Goldman Sachs and

Procter & Gamble. *In the Matter of Gutpa*, Administrative Proceeding File No. 3-14279. The SEC alleged that Mr. Gupta engaged in an insider trading scheme by providing nonpublic material information to Raj Rajaratnam of Galleon Management (whose own criminal insider trading trial commenced in New York in March) between June 2008 and January 2009. In the Administrative Proceeding, the SEC seeks to recover civil penalties from Mr. Gupta under Section 929P of the Dodd-Frank Act, which was not passed until 18 months after the conduct in question.

On March 18, 2011, Mr. Gupta filed a complaint in federal court against the Commission seeking a declaratory judgment and injunctive relief. *Gupta v. SEC*, 11-cv-1900 (S.D.N.Y.). In his Complaint, Mr. Gupta alleged that, by seeking civil penalties through the retroactive application of the Dodd-Frank Act in the Administrative Proceeding (as opposed to in a federal court), the SEC

unconstitutionally deprived him to a jury trial in federal court (pointing out that the SEC has filed all of its cases related to Mr. Rajaratnam and Galleon in federal court). He argued that the it was necessary to have the question of whether the Dodd-Frank Act provisions could be applied retroactively decided in federal court.

The SEC has moved to dismiss Mr. Gupta's complaint, arguing that the Court lacked subject matter jurisdiction. The SEC filed a legal brief on April 1, 2011, arguing, in part, that the "retroactivity claim ... will not be ripe unless and until there has been a finding [in the Administrative Proceeding against Mr. Gupta] and a decision that penalties under the provisions added by Dodd-Frank are warranted." The Commission also argued

that Mr. Gupta had not exhausted his administrative remedies, stating that the Administrative Proceeding should go forward, and, if the SEC determines that Mr. Gupta violated the securities laws and that civil penalties under the Dodd-Frank Act should be applied, he could seek a review in the Court of Appeals.

Gupta v. SEC has been assigned to the Honorable Jed S. Rakoff in the Southern District of New York. In recent years, the SEC seen Judge Rakoff reject a proposed settlement submitted by the SEC in *SEC v. Bank of America* and question whether the Court can approve settlements where the parties "neither admit nor deny" the allegations in *SEC v. Vitesse Semiconductor Corporation*.

Gupta Complaint Against the SEC Survives Motion to Dismiss On Equal Protection Grounds

July 12, 2011

On Monday, July 11, 2011, New York federal Judge Jed Rakoff denied the SEC's Motion to Dismiss in *Gupta v. SEC*, No. 11-cv-1900 (S.D.N.Y.). The Plaintiff, Rajat Gupta, a former director at Goldman Sachs, has been accused by the SEC of having provided material nonpublic information to Raj Rajaratnam of Galleon Management, who was recently convicted of insider trading ([discussed here](#)). Unlike the 28 other defendants named in lawsuits relating to Galleon, the SEC commenced an Administrative Proceeding against Mr. Gupta. Mr. Gupta's complaint in federal court ([discussed here](#)) alleged that the SEC unconstitutionally deprived him to a jury trial in federal court and that it was necessary to have the question of whether the Dodd-Frank Act provisions could be applied retroactively (which the SEC seeks to do in the Administrative Proceeding) decided in federal court. By denying the SEC's motion to dismiss, Judge Rakoff allowed Mr. Gupta's case to proceed, but ruled that "the theory of the Complaint is narrowed to one of equal protection."

On March 1, 2011, the SEC commenced an Administrative Proceeding against Mr. Gupta, alleging that he engaged in an insider trading scheme by providing information to Mr. Rajaratnam between June 2008 and January 2009. *In the Matter of Gupta*, Administrative Proceeding File No. 3-14279. The Court described the SEC's Administrative Proceeding as a "seeming exercise in foreign shopping," noting that the Order instituting the proceeding was not materially different from the complaints filed in federal court against the 28 others Galleon-related defendants. However, in the Administrative Proceeding, the SEC seeks to recover civil penalties from Mr. Gupta under Section 929P of the Dodd-Frank Act, which was not passed until 18 months after the conduct in question.

On March 18, 2011, Mr. Gupta filed a complaint in federal court against the Commission seeking a declaratory judgment and injunctive relief, alleging that by seeking civil penalties through the retroactive application of the Dodd-Frank Act in the Administrative Proceeding, the

SEC unconstitutionally deprived him to a jury trial in federal court (pointing out that the SEC has filed all of its cases related to Mr. Rajaratnam and Galleon in federal court). He also alleged that it was necessary to have the question of whether the Dodd-Frank Act provisions could be applied retroactively decided in federal court.

On April 1, 2011, the SEC moved to dismiss the complaint ([also discussed here](#)) under several theories, including: (1) that no statutory basis exists for the Court's assertion of jurisdiction; (2) that Mr. Gupta's claims against the SEC are barred by the doctrine of sovereign immunity; (3) that the doctrines of exhaustion and ripeness bar Mr. Gupta's claims; and (4) that Section 25(a)(1) of the Exchange Act, when read together with Section 703 of the Administrative Procedure Act ("APA"), grants to the courts of appeal exclusive jurisdiction to review orders entered in SEC administrative proceedings.

Judge Rakoff rejected the SEC's arguments regarding jurisdiction (Mr. Gupta has argued constitutional violations, over which the Court has jurisdiction) and sovereign immunity (Section 702 of the APA "waives sovereign immunity for [any action against the Government] ... seeking relief

other than money damages."). He also rejected the arguments based on the doctrines of exhaustion and ripeness, noting that Mr. Gupta should not be required to exhaust his administrative remedies or await a ruling in the Administrative Proceeding when that proceeding is the very procedure he is attacking in his complaint.

Judge Rakoff next turned to the Government's argument that that Section 25(a)(1) of the Exchange Act, when read together with section 703 of the APA, grants the courts of appeal exclusive jurisdiction to review orders in administrative proceedings. Focusing on the Supreme Court's ruling in *Free Enterprise Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138 (2010), Judge Rakoff examined three key factors to determine if Section 25(a) precluded judicial review of the Commission's order instituting the administrative proceeding: (1) whether the claims in the complaint were outside the SEC's expertise; (2) if the complaint was wholly collateral to the statute's review provisions; and (3) whether a finding of preclusion could foreclose all meaningful review.

The Court concluded that Mr. Gupta's complaint satisfied the first *Free Enterprise* element (regarding the SEC's expertise). The allegation that he will

suffer from constitutional violations if the provisions of the Dodd-Frank Act is an issue more commonly reviewed by district courts than the SEC. Judge Rakoff concluded his equal protection claim satisfied the second prong because even if the Commission's allegations against Mr. Gupta were true, his claim that he was arbitrarily and irrationally treated differently from the remaining Galleon defendants was wholly collateral to the securities claims. Judge Rakoff also concluded that Mr. Gupta's claim satisfied the last *Free Enterprise* element (whether a finding of jurisdictional preclusion would foreclose meaningful judicial review). The SEC's administrative machinery does not provide a reasonable mechanism for raising a claim, he ruled. In addition, Mr. Gupta's claim (whether

the Commission's decision to treat him differently from the other Galleon-related defendants was irrational, arbitrary and discriminatory) will not be resolved in the administrative proceeding and no record could be developed for review.

The Court concluded that "there is no reason not to address the equal protection claim here before Gupta suffers the very prosecution he alleges constitutes the act of unequal protection." The Court denied the motion to dismiss, but narrowed the theory of the complaint to one of equal protection.

Judge Rakoff ordered the parties to meet and confer regarding a case management plan to allow for discovery, subsequent motion practice and an evidentiary hearing within the next 4 months.

SEC Dismisses Insider Trading Administrative Proceeding Against Rajat Gupta, But Reserves Right To Sue Him In Federal Court

August 5, 2011

The SEC and Rajat Gupta have agreed to settle their dispute regarding the forum in which they should litigate the allegations of insider trading by the former Goldman Sachs director by dismissing the pending actions against each other. Specifically, the SEC has dismissed its Administrative Proceeding against Mr. Gupta alleging insider trading and the parties have advised Judge Jed Rakoff (who is presiding over the lawsuit filed in federal court in New York by Mr. Gupta against the Commission) that they will be entering a Joint Stipulation of Dismissal. In doing so, the parties agreed that, if the SEC elects to bring action against Mr. Gupta, it will do so in federal court in New York and designate it as related to the other Galleon cases pending before Judge Rakoff.

On March 1, 2011, the SEC commenced an Administrative Proceeding against Mr. Gupta, alleging that he engaged in an insider trading scheme by providing information to Raj Rajaratnam (whose

subsequent insider trading conviction is [discussed here](#)) between June 2008 and January 2009. *In the Matter of Gupta*, Administrative Proceeding File No. 3-14279.

On March 18, 2011, Mr. Gupta filed a complaint in federal court against the Commission seeking a declaratory judgment and injunctive relief, alleging that by seeking civil penalties through the retroactive application of the Dodd-Frank Act in the Administrative Proceeding, the SEC unconstitutionally deprived him to a jury trial in federal court (pointing out that the SEC has filed all of its cases related to Mr. Rajaratnam and Galleon in federal court). *Gupta v. SEC*, No. 11-cv-1900 (S.D.N.Y.). On April 1, 2011, the SEC moved to dismiss the *Gupta v. SEC* complaint ([discussed here](#)).

As previously [discussed here](#), on July 11, 2011, Judge Rakoff denied that motion. In doing so, the Court described the SEC's Administrative Proceeding as a "seeming

exercise in foreign shopping." By denying the SEC's motion to dismiss, Judge Rakoff allowed Mr. Gutpa's case to proceed, but ruled that "the theory of the Complaint is narrowed to one of equal protection."

Judge Rakoff also entered a Case Management Plan which set the case for a final pretrial conference on October 31, 2011.

After a series of extensions, the SEC's answer to Mr. Gutpa's complaint in federal court was due on August 3, 2011.

However, on that day, the parties submitted a two-page Agreement to the Court ([here, attached to Judge Rakoff's August 4, 2011 order described below](#)).

The Agreement provided that:

- the SEC would dismiss the Administrative Proceeding against Mr. Gutpa (although not on the merits) (and agree not to bring another administrative proceeding based against him on the same allegations);
- the *Gutpa v. SEC* lawsuit would become moot once the Administrative Proceeding was dismissed;
- the parties would stipulate to the dismissal of the *Gutpa v. SEC* lawsuit; and
- the parties agreed that any future action against Mr. Gutpa based on the same

allegations in the Administrative Proceeding "shall only be filed in the U.S. District Court for the Southern District of New York," and "the SEC will designate it as related ... to the other Galleon cases presently pending before the Honorable Jed S. Rakoff."

After receiving the Agreement, Judge Rakoff, on August 4, 2011, entered his [Order](#) staying the *Gutpa v. SEC* case to allow the parties time to prepare the Joint Stipulation of Dismissal. Also on Thursday, the SEC entered an [Order Dismissing Proceedings](#) in the Administrative Proceeding, stating: "The Commission has determined that it is in the public interest to dismiss these proceedings. Dismissing these proceedings will not prevent the Commission from filing an action against Mr. Gupta in United States District Court."

When Judge Rakoff denied the motion to dismiss in *Gutpa v. SEC*, he noted that the Order instituting the Administrative Proceeding was not materially different from the complaints filed in federal court against the 28 others Galleon-related defendants. The SEC may now file the suit against him in that forum. Mr. Gutpa has achieved his goal – if he has to defend himself against insider trading charges by the SEC, he will be able to do so in

federal court, where he will be able to conduct discovery and present his case to a jury. For the SEC, it will still be able to bring its claims in Court, but it will be interesting to see whether it seeks to

recover civil penalties from Mr. Gutpa under Section 929P of the Dodd-Frank Act, which was not passed until 18 months after the conduct in question, as it did in the Administrative Proceeding.

Rajat Gupta Will Get His Day in Court ... Twice

October 26, 2011

On Wednesday, October 26, 2011, both the SEC and the U.S. Attorney's Office for the Southern District of New York filed charges against Rajat Gupta, the former Managing Director of McKinsey & Company and board member at Goldman Sachs and Procter & Gamble. Mr. Gupta, who previously argued that an Administrative Proceeding brought by the SEC against him was unfair because he denied a trial before a jury will now have two opportunities to challenge the charges against him in Court.

Both the federal prosecutors and the SEC allege that Mr. Gupta engaged in an insider trading scheme by providing nonpublic material information to Raj Rajaratnam in 2008 and 2009. Specifically, Mr. Gupta provided information which he learned during board calls and in other communications and meetings relating to his official duties as a director of Goldman Sachs and Procter & Gamble. For example, [the SEC's Press Release](#) describes how Mr. Gupta learned certain information regarding Goldman Sachs' impending negative financial results during an

October 23, 2008 telephone call with Board members and that "[m]ere seconds after the board call ended," Mr. Gupta telephoned Mr. Rajaratnam, who arranged for certain Galleon funds to begin selling their Goldman Sachs holdings when the markets opened the following morning.

In the criminal case, Mr. Gupta was charged with one count of conspiracy to commit securities fraud and five counts of securities fraud. He faces up to five years in prison for the conspiracy count and up to 20 years for each securities fraud count.

The SEC's Complaint against Mr. Gupta charges him with violations of Section 10(b) of the Exchange Act and Rule 10b-5, as well as Section 17(a) of the Securities Act. The complaint seeks a final judgment permanently enjoining him from future violations, ordering him to disgorge ill-gotten gains, plus prejudgment interest, and ordering him to pay financial penalties. The complaint also seeks to permanently prohibit Mr. Gupta from acting as an officer or director of any registered public company, and to permanently enjoin him from associating

with any broker, dealer or investment adviser.

The SEC's complaint against Mr. Gupta also names Mr. Rajaratnam as a defendant, bringing new insider trading charges against him (adding to those charges originally brought against him in October 2009). Mr. Rajaratnam has been convicted on insider trading and sentenced to eleven years in prison, as [discussed here](#). The evidence in the eight-week trial against him included numerous recordings of wiretapped phone calls between Mr. Rajaratnam and co-conspirators (many of whom pled guilty) ([discussed here](#)).

The SEC and Mr. Gupta have already faced each other in two different proceedings this year on these issues. On March 1, 2011, the SEC commenced an Administrative Proceeding against him. *In the Matter of Gupta*, Administrative Proceeding File No. 3-14279. In that case, the SEC also alleged that Mr. Gupta engaged in an insider trading scheme by providing nonpublic material information to Mr. Rajaratnam between June 2008 and January 2009. In the Administrative Proceeding, the SEC sought relief which included civil penalties from Mr. Gupta under Section 929P of the Dodd-Frank Act, which was not passed until 18 months after the conduct in question.

On March 18, 2011, Mr. Gupta filed a complaint in federal court against the Commission seeking a declaratory judgment and injunctive relief. *Gupta v. SEC*, 11-cv-1900 (S.D.N.Y.). Mr. Gupta alleged that, by seeking civil penalties through the retroactive application of the Dodd-Frank Act in the Administrative Proceeding (as opposed to in a federal court), the SEC unconstitutionally deprived him to a jury trial in federal court (pointing out that the SEC has filed all of its cases related to Mr. Rajaratnam and Galleon in federal court).

On April 1, 2011, the SEC moved to dismiss Mr. Gupta's lawsuit on the grounds it was not ripe (as [discussed here](#)). On July 11, 2011, Judge Rakoff denied that motion, but ruled that "the theory of the Complaint [was] narrowed to one of equal protection" ([see here](#)).

In August 2011, the parties agreed to settle their dispute regarding the forum in which they should litigate the SEC's allegations (as [described here](#)). Specifically, the SEC dismissed its Administrative Proceeding against Mr. Gupta and the parties filed a Joint Stipulation of Dismissal in the case before Judge Rakoff, stating that if the SEC elected to bring action against Mr. Gupta, it would do so in federal court in New York and designate it as related to

the other Galleon cases pending before Judge Rakoff.

One of the issues raised by Mr. Gupta in the earlier Administrative Proceeding and related litigation was that the SEC was seeking to use the enhanced enforcement

provisions of Section 929P of the Dodd-Frank Act to recover civil penalties, even though the Dodd-Frank Act was not passed until the following year. In [today's action](#) against Mr. Gupta, the SEC does not seek those same penalties.

SECTION III: THE SEC VS. MARK CUBAN

Texas Court Strikes Mark Cuban's Affirmative Defense of Unclean Hands in Case Against the SEC, Ruling That The Defense Is Permitted Only In Limited Circumstances

July 19, 2011

On Monday, July 18, 2011, a Federal Judge in Texas, Sidney Fitzwater, granted a Motion to Strike by the SEC in its case against Mark Cuban, the owner of the Dallas Mavericks, eliminating his affirmative defense of "unclean hands" in the Commission's case against him. Notably, although it did strike the defense in Mr. Cuban's case, the Court rejected the SEC's argument that the defense is barred in SEC enforcement actions as a matter of law, and held that it is available, but "only in strictly limited circumstances."

The SEC brought this insider trading case alleging that, when Mamma.com, Inc. was planning a PIPE offering, Mr. Cuban, its largest known shareholder, was contacted several times about the proposed offering (and that prior to information about the transaction was provided to him, Mr. Cuban agreed to maintain its confidentiality). Mr. Cuban declined to participate in the offering, and was reportedly upset because it would dilute

his interest. Before the public announcement of the offering, Mr. Cuban sold his entire stake in the company, avoiding what the SEC claims was potentially a \$750,000 loss. *SEC v. Cuban* No. 3-08-cv-2050 (N.D. Tex. filed Nov. 17, 2008). Mr. Cuban moved to dismiss the Complaint on the grounds that the SEC did not adequately allege that he owed Mamma.com a fiduciary or similar duty of trust and confidence. The Motion was granted in the District Court, but the Fifth Circuit Court of Appeals reversed and remanded the case to the District Court. *SEC v. Cuban*, No. 09-10996, slip op. (5th Cir. Sept. 21, 2010).

Back in the District Court, in his answer, Mr. Cuban asserted the affirmative defense that the SEC had "unclean hands." Mr. Cuban argued that: (1) the SEC staff members were committed to bringing the enforcement action against him while still investigating the matter; (2) the SEC staff deliberately undermined the Wells

process; and (3) the SEC Staff "engaged in acts of outright investigative and litigation misconduct" during the investigation. The SEC moved to strike the defense, arguing, among other things that the defense is unavailable as a matter of law in an SEC enforcement action.

Judge Fitzwater ruled that "under the present state of the law, the affirmative defense of unclean hands is not barred as a matter of law in an SEC enforcement action." However, the Court held that the defense is available in strictly limited circumstances and that

[t]he SEC's misconduct must be egregious, the misconduct must occur before the SEC files the enforcement action, and the misconduct must result in prejudice to the defense of the enforcement action that rises to a constitutional level and is established

through a direct nexus between the misconduct and the constitutional injury.

In doing so, Judge Fitzwater noted that the bar was set so high for asserting the defense because SEC enforcement actions are intended to promote the interests of the public, which should not be derailed except in narrow circumstances.

The Court summarily rejected two of Mr. Cuban's arguments, focusing instead on the accusation that the SEC Staff engaged in acts of misconduct during the investigation. Judge Fitzwater held that Mr. Cuban did not allege that the Commission's conduct resulted in any prejudice to his defense of the enforcement action, and, as a result, he had failed to adequately plead the defense. The Court granted the SEC's motion to strike and further ruled that it was not granting him leave to replead the defense.

SEC's Inspector General Rejects Claims of Misconduct in Mark Cuban Investigation

October 3, 2011

In a report released in late September, the SEC's Office of Inspector General ("OIG") stated that it "did not find sufficient evidence to substantiate any allegations of misconduct" by the SEC Division of Enforcement during its investigation of Mark Cuban. The OIG's Report (which is dated August 22, 2011, but not available until last week and is [available here](#)) is one of several investigations that were underway (as [previously discussed here](#)).

Following an investigation by the Division of Enforcement, the SEC brought an insider trading case against Mark Cuban in November 2008, alleging that, prior to the public announcement of Mamma.com's PIPE offering, Mr. Cuban, who was aware of the planned offering, sold his entire stake in the company, avoiding what the SEC claims was potentially a \$750,000 loss. *SEC v. Cuban*, No. 3-08-cv-2050 (N.D. Tex. filed Nov. 17, 2008). Mr. Cuban, one of the rare defendants who has the financial ability to mount a defense in such litigation, has vigorously defended himself, as [discussed here](#).

In January 2009, Mr. Cuban filed a complaint with the SEC OIG, alleging that: (1) Enforcement staff violated SEC policy when they notified Mr. Cuban that they intended to recommend insider trading charges against him before the investigation was substantially complete; (2) Enforcement staff showed a bias and predetermined agenda against Mr. Cuban and the investigation appeared to have been motivated by political bias; (3) Enforcement staff attempted to induce executives at Mamma.com to cooperate in the Cuban investigation by using the closure of an earlier investigation against it; and (4) a senior Enforcement official failed to properly report the misconduct of the another Enforcement attorney who was e-mailing Mr. Cuban from his SEC e-mail account during the ongoing investigation into Mr. Cuban's trading.

With respect to the first issue – where Mr. Cuban contended that the SEC intended to recommend charges before the investigation was complete – Mr. Cuban alleged that the investigation was not substantially completed until at least five months after the Wells notice (indicating

that Enforcement was recommending charges) was provided. However, the OIG Report found that Enforcement had conducted significant investigative work before the Wells notice was provided on May 23, 2007 and that conducting additional investigative work, and even testimony, after the Wells notice is provided, is not *per se* prohibited by the SEC's Enforcement Manual or internal guidance and Enforcement does on occasion do so. The OIG did not find sufficient evidence to substantiate any of the other claims.

Although the OIG did not find any wrongdoing in the Mr. Cuban's case, some commentators, such as [Tom Gorman of SECActions.com](#), have been critical for conducting this investigation regarding while the litigation against Mr. Cuban was still pending.

The OIG Report is one of several in recent weeks. A prior report ([discussed here](#)) found that the SEC's former General Counsel had a conflict of interest when he participated in matters relating to Bernie

Madoff because he had a personal financial interest by virtue of his inheritance of the proceeds of a Madoff account. As [discussed here](#), in testimony before Congress on these issues, former General Counsel David Becker was highly critical of the Inspector General. The OIG also issued a report ([available here](#)) regarding the financial package offered Henry Hu to head a new division, finding that the arrangement with him was contrary to guidance from the Office of Personnel Management and SEC practice, ultimately costing the SEC approximately \$100,000 more than it should have under that guidance and practice.

As for Mr. Cuban, he continues his aggressive defense in the case brought by the SEC – including the recent filing of a second motion to compel against the SEC (the supporting brief is [available here](#)) seeking the production of the non-privileged portions of the SEC's investigative file from (including the notes of the Enforcement attorneys taken during the investigations regarding Mr. Cuban and Mamma.com).