Securities and Exchange Commission v. Cuban

A Trial of Insider Trading

Marc I. Steinberg

Radford Professor of Law
SMU Dedman School of Law

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TWELVE TABLES PRESS
XII

ISBN: 978-1-946074-24-9

Twelve Tables Press
P.O. Box 568
Northport, New York 11768
www.twelvetablespress.com

Dedication

I am delighted to dedicate this book to U.S. District Court Judge (ret.) Stanley Sporkin. Judge Sporkin is having a superlative career—as the Director of the SEC's Division of Enforcement, General Counsel of the CIA, a federal district court judge, and an attorney in the private sector representing high profile clients. As SEC Enforcement Director, Judge Sporkin presided over the Division during the period that the Division may well have been most revered.

A couple of years after my graduation from law school, Judge Sporkin hired me as an enforcement attorney in the SEC's home office in Washington, D.C. That position commenced my career in securities law, one of which I have thoroughly enjoyed. Through the journey in the decades that followed, Judge Sporkin has been a wonderful mentor and good friend.

It is fitting that this book is dedicated to Judge Sporkin. After all, this case focuses on an SEC enforcement action for alleged violation of the insider trading prohibition. During Judge Sporkin's tenure as SEC enforcement director, the Commission pursued alleged insider trading violators with vigor. Thus, a book that focuses on this subject is deservedly dedicated to Judge Stanley Sporkin.

Thank you Stan for all of your friendship, mentoring, and support through the years.

About the Author

Marc I. Steinberg is the Rupert and Lillian Radford Professor of Law at the Southern Methodist University (SMU) Dedman School of Law. He is the Director of SMU's Corporate Directors' Institute, the Director of the SMU Corporate Counsel Externship Program, the former Senior Associate Dean for Academics, and the former Senior Associate Dean for Research at the Law School. Prior to becoming the Radford Professor, Professor Steinberg taught at the University of Maryland School of Law, the Wharton School of the University of Pennsylvania, the National Law Center of the George Washington University, and the Georgetown University Law Center. His experience includes appointments as a Visiting Professor, Scholar and Fellow at law schools outside of the United States, including at Universities in Argentina, Australia, China, England, Finland, Germany, Israel, Italy, Japan, New Zealand, Scotland, South Africa, and Sweden. In addition, he has been retained as an expert witness in several significant matters, including Mark Cuban, Enron, Martha Stewart, and Belnick (Tyco).

In addition to his University appointments, Professor Steinberg has lectured extensively both in the United States and abroad, including at the Lauterpacht Centre of International Law at the University of Cambridge, the Aresty Institute of Executive Education at the University of Pennsylvania, The American Bar Association's Annual Meeting, the PLI Annual Institute on Securities Regulation, the University of Texas Annual Securities Law Conference, the International Development Law Institute in Rome, the Hong Kong Securities and Futures Commission, the Taiwan "SEC" in Taipei, the New Zealand Securities Commission, the Australian Law Council Section on International Law in Melbourne, the David Hume Institute in Edinburgh, the German-American Lawyers' Association in Munich, the International Law Society of South Africa, the Buenos Aires Stock Exchange, the Finnish Banking Lawyers Association in Helsinki, the Swedish Banking Lawyers Association in Stockholm, and the Ministry of Internal Affairs, Economic Crimes Department of the Russian Federation in Moscow. He also has served as a member of the FINRA National Adjudicatory Council (NAC).

Professor Steinberg received his undergraduate degree at the University of Michigan and his law degrees at the University of California, Los Angeles (J.D.) and Yale University (LL.M.). He clerked for Judge Stanley N. Barnes of the U.S. Court of Appeals for the Ninth Circuit, extern clerked for Judge Anthony J. Celebrezze of the Sixth Circuit, was legislative counsel to U.S. Senator Robert P. Griffin and served as the adviser to former U.S. Supreme

Court Justice Arthur J. Goldberg for the Federal Advisory Committee Report on Tender Offers.

Professor Steinberg was an enforcement attorney at the U.S. Securities and Exchange Commission, and thereafter became special projects counsel. In that position, he directly assisted the SEC's General Counsel in a wide variety of projects and served as the General Counsel's confidential legal adviser.

Professor Steinberg has authored approximately 40 books and 150 law review articles, is editor-in-chief of The International Lawyer, editor-in-chief of The Securities Regulation Law Journal, and is an adviser to The Journal of Corporation Law. Professor Steinberg is a member of the American Law Institute.

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Note from the Author

Given that the materials generated in *Securities and Exchange Commission v. Mark Cuban* amounted to thousands of pages, a challenge was presented to condense these materials in a meaningful manner. In undertaking this endeavor, I have attempted to preserve the flavor of the contentious litigation that occurred—from the SEC's investigation through the conclusion of trial. I have included excerpts of many of the pleadings and motions that were made by the parties as well as excerpts of the testimony of each witness who testified at trial.

Due to the need to condense these thousands of pages, hopefully to make the book user-friendly and to enhance consistency, I have made certain modifications. These editorial modifications include for example: using excerpts of testimony given as well as other materials that were filed or otherwise made available; using multiple periods (. . . .) after a sentence or answer to a question when other words or paragraphs that follow are not included in the book due to being omitted in the editing process; and using an individual's correct name where the record reflected inconsistencies (such as Fauré, not Faure).

The Foreword to the book that follows is written by Mr. George Anhang who served as one of Mr. Cuban's attorneys. I thank Mr. Anhang for authoring this Foreword. For disclosure and fairness purposes, members of the SEC staff who were involved in this litigation and Mr. Cuban separately were invited to author a Foreword—they declined the invitation.

In the analysis set forth in this book, the views expressed herein solely are my own. Readers understandably may disagree with a number of my positions. Throughout this process, particularly recognizing that I served as an expert witness on Mr. Cuban's behalf, I diligently have sought to maintain an objective perspective.

I hope that the book proves to be enjoyable and worthwhile—both as an experiential resource and as a scintillating account of one of the foremost sagas of securities litigation.

Foreword

BY GEORGE ANHANG[1]

Securities and Exchange Commission v. Mark Cuban was an improbable case. There was *no* judicial precedent for the SEC's insider trading claim against Mark Cuban, *no* support for it in the plain meaning of governing federal statutes, and *no* solid evidence in the record for the factual allegations on which the claim depended—yet the SEC pushed on against Cuban nonetheless. That the SEC's claim lacked legal and factual basis is not only what Cuban and his legal team thought. It is what the presiding federal district judge apparently thought when he initially threw out the case. And it is what the members of the jury clearly all thought, given they deliberated and reached a complete verdict in Cuban's favor so swiftly.

It likewise was improbable that the SEC's lawsuit would be litigated for as long as it was—1,795 days, to be exact—and took a trial to resolve. Confronted with the might of the SEC, and the burdens (financial and otherwise) of drawn-out litigation against the government, many defendants submit to a negotiated settlement early on, even if it means forfeiting the chance to clear their name.

Not only was the case's length extraordinary, its prehistory was almost as long. The SEC's case was built upon an eight-minute phone call between Mark Cuban and Mamma.com CEO Guy Fauré that took place on June 28, 2004. The SEC did not file its complaint against Cuban until more than four years later. Of note, at the trial that took place almost five years after that, Fauré was nowhere to be found, despite the SEC's claim that Cuban had defrauded him and Mamma.com. Victims of fraud are usually eager to help bring the perpetrator to justice. Fauré's unwillingness to fly to Dallas to testify at trial—and submit to cross-examination before the jury—spoke volumes.

That one may think that *SEC v. Cuban* should not have been filed in the first place, or that once filed, should have reached an earlier or different resolution, makes the need for this book no less compelling. On the contrary, that such a case *was* filed and then could *not* be resolved except in the manner it was, makes this book with all its illuminating power that much *more*

1. George Anhang represented Mark Cuban in *SEC v. Cuban*. He is Counsel at Shearman & Sterling LLP, a global law firm, where he is resident in the Washington, DC office. The views he expresses herein are his own.

essential. I hope that many will read it. Those who do may be surprised at what they learn.

Not that the book sets out to prove a point about the case. It is one of its (many) virtues that it does not. Without advocating a position or sitting in judgment, the book methodically sets out the key filings, factual and legal issues, and procedural maneuverings in the case. The presentation of the subject matter benefits enormously from the intimacy of Marc Steinberg's knowledge of the suit (the result of his serving as one of Cuban's expert witnesses), and the subterranean depths of his expertise in insider trading law (Steinberg is one of the country's preeminent securities law scholars).

While this book is generally dispassionate about *SEC v. Cuban*, I am not. I was privileged to be on the team of lawyers that represented Mark Cuban.[2] That privilege was accompanied by an acute desire to do right by him. My belief that the SEC's suit was baseless, and not brought in good faith, also bred pressure. When you represent a client in a case you think had no business being filed, and your client should never have had to retain your services, winning seems like the least you should do.

I have referred to certain improbabilities—that *SEC v. Cuban* was filed at all, and once filed, was not resolved until years later. What explains them, in large part, is the identity of the defendant. Without a doubt, who Mark Cuban is factored into the SEC's decision to pursue a case against him. In the eyes of the SEC, Cuban was not just another investor. Hardly.

2. Other members of the defense team included, at the law firm where I practiced at the time, Lyle Roberts, and, at other law firms, lead trial counsel Thomas Melsheimer, Stephen Best, and Christopher Clark. I learned much from Lyle (who it is my good fortune to have as my colleague again, at Shearman & Sterling LLP), Tom, Steve, and Chris, and I am indebted to each of them.

Although, as I noted before, people who find themselves staring down the barrel of an SEC enforcement action are inclined to seek refuge in an early negotiated settlement, the SEC's pursuit of Cuban had no such effect upon him. Cuban believed, to the core of his being, that he had done nothing wrong. He was not about to enter into a settlement with the SEC that suggested otherwise. He also saw the litigation as capable of providing a window into certain excesses in SEC enforcement practices and policies. By vigorously defending the case, Cuban thought that he could bring into the open what he regarded as an abuse of enforcement authority by some within the SEC. Sunlight is the best disinfectant, he knew. All market participants, the public at large, even the SEC itself, stood to benefit.

Cuban's belief that the litigation could serve a salutary purpose reflected Cuban's high regard for the legal system, most especially the role of the jury.

Juries are complicated, and by reputation, unpredictable. In no jury trial would any sensible lawyer guarantee his or her client a particular outcome. No matter the strength of the evidence in one's favor, there is always an element of uncertainty. A negotiated settlement before trial is the only way to avoid that uncertainty. That is one of the main reasons settlements are as common as they are.

Cuban was a realist about the jury process, but at the same time supremely hopeful. Because, in a word, he *trusted* the jury in the case. He trusted the jury as much as he had come to *distrust* the SEC (which he believed, with reason, had targeted him unfairly). Cuban trusted the members of the jury to set aside preconceived notions they may have, and to consider all the evidence with an open mind. To be fair. To apply common sense. To spot the flaws in the SEC's case that the SEC sought strenuously to obscure. To faithfully apply governing law as the judge stated it, to the facts as the jury found them. In doing so, to reject the SEC's efforts to use the case to create new insider trading law, and deploy it retroactively to punish Cuban for conduct he would have reasonably understood at the time to be lawful.

I am referring here to the proposition that the SEC sought (without precedent) to advance in the case that securities *fraud*—which insider trading must amount to, the Supreme Court has held, in order to be actionable—can be established through the violation of a bare confidentiality agreement. The SEC could not seriously argue that when Mark Cuban sold his Mamma.com shares in 2004, he knew (or should have known) *then* that his stock sale ran afoul of the novel legal position that the SEC would pursue in a suit against him in 2008. In any event, the record in the case did *not* show that Cuban intended to make an agreement to keep information about the company whose stock he sold (Mamma.com) confidential, let alone that his stock sale would have violated an agreement of that kind. The case that the SEC presented to the jury thus fit neither existing law nor the established facts.

Cuban's trust in the jury was not misplaced. Once the case went to the jury, it deliberated only briefly before coming back with a complete verdict in Cuban's favor.

It was clear from the verdict, and the speed with which it was rendered, that the jury rejected the SEC's case from top to bottom. It was especially evident from a form that the judge directed the jury to complete. To establish its insider trading claim, there were a number of discrete elements the SEC was required to prove. The jury was provided a form listing these elements, with an instruction from the judge to indicate, at the conclusion of its deliberations, whether the SEC had satisfied its burden of proof as to each element.

The jury found, and specified in the form, that the SEC failed to meet its burden as to every one of the contested elements of its insider trading claim. The jury concluded the SEC had not shown *any* of the following: that Mark Cuban received information from Mamma.com that was material and nonpublic;[3] *or* that he agreed to keep any such information confidential; *or* that he agreed not to trade on it, or otherwise use it for his own benefit; *or* that he traded on the information in the sale of his Mamma.com stock; *or* that before trading, he did not disclose to Mamma.com that he planned to trade; *or* that he engaged in improper conduct knowingly or with severe recklessness.

In short, the SEC failed to convince the jury of anything of significance to its case. The jury determined, and indicated in the jury form, that after litigating against Mark Cuban for almost five years (and investigating him for several years before that), all the SEC could show in support of its claim was that Cuban traded his shares of Mamma.com, and thereby engaged in interstate commerce. Of course, these were unremarkable facts that, standing on their own, were of no legal moment. Besides that, no case was even needed for them to become known. After selling his Mamma.com stock in June 2004, Cuban immediately disclosed to the SEC and the public that he had done so.

In my office is a photograph inscribed by Mark Cuban. It shows him and members of his legal team after the conclusion of the trial. At the bottom of the photo, Cuban signed his name and scrawled in large letters: "Trust the Jury!" Indeed.

* * *

I conclude with a disclaimer. I was not asked to suppress here the unfavorable view I have of the SEC's suit against Mark Cuban. I set out some observations above that reflect that view, in the hope they may be instructive. I am grateful for the opportunity to do so. Perhaps in giving me free rein in this regard, Marc Steinberg had in mind a line that a colleague of his at the SEC (and later of mine, coincidentally, in private practice)—Ralph Ferrara, the eminent former General Counsel of the SEC—was wont to quote: "you cannot do *Hamlet* without Hamlet." In other words, a book on *SEC v. Cuban* would seem fundamentally incomplete without an appearance from someone who was in Cuban's camp in the case. All the more so given that it was Cuban's

3. The SEC's specific allegation, which the jury rejected, was that in his June 28, 2004 telephone call with Guy Fauré, Cuban received material, non-public information about an impending Mamma.com transaction known as a "private investment in public equity," or "PIPE."

position that the jury adopted. In examining the jury's verdict, one should consider the views that informed and inspired it.

The disclaimer to be made is that those views are not necessarily shared by Marc Steinberg. He may even have opposing views. Whatever Steinberg's views are, as I noted before, he has chosen not to impose them upon the reader. He does not use the book to relitigate the case for the SEC (where he once served as an enforcement attorney), nor to be a champion of Cuban's cause. Like many great authors, Steinberg wants his readers to make up their own minds. In this book, Steinberg presents in ingenious and elegant fashion the substance that readers need to do just that. That is something on which both sides in the exceedingly contentious case to which the book is devoted could agree.

Acknowledgments

This has been an interesting and fun project. Its successful completion was facilitated by the input of several individuals who I wish to thank. First, I express my appreciation to my wonderful friend George Anhang, a superb attorney, who has authored the Foreword of this book. Mr. Anhang was instrumental in providing me with certain key public documents that otherwise would have been more challenging to access. Second, my research assistants are deserving of kudos—Miles Abell, G. Adrian Galvan, David Watson, and Logan Weissler. Third, I express my gratitude to the outstanding attorneys who provided comments on the manuscript—Roger Bivans, Robert Hart, and Frank Razzano. Fourth, I thank SMU Law School Dean Jennifer Collins for her support of my scholarship, Associate Dean for Library and Technology Greg Ivy for his research contributions, and Carolyn Yates for her excellent administrative assistance. And fifth, I received a generous research grant from the Fred E. Tucker Endowment for Faculty Excellence Fund for this book project for which I am appreciative.

I am delighted to be a faculty member of this outstanding law school. In these Acknowledgments, I thank SMU and the Law School for supporting my scholarship through the years.