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Insider Trading - SEC v. Mark Cuban - A Litigation Saga

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THE 2019 WILLIAM MARSHALL BULLITT LECTURE

INSIDER TRADING — SEC V. MARK CUBAN — A LITIGATION SAGA

*Marc I. Steinberg**

I. SETTING THE STAGE

The Securities and Exchange Commission's (SEC) enforcement action against Mark Cuban for allegedly engaging in illegal insider trading was far from standard fare. Unlike the vast majority of SEC enforcement actions that are settled pursuant to the consent negotiation process, whereby the defendant neither admits nor denies the Commission's allegations of misconduct,¹ Mr. Cuban declined overtures of settlement and proceeded to trial. After years of contentious litigation, where he incurred legal fees of \$12 million,² Mr. Cuban emerged victorious with a favorable jury verdict.³ The Commission's case against Mr. Cuban raises questions regarding the scope of our insider trading laws, the strategic decisions made, the high costs of defending one's good name, and the appropriate limits of governmental prosecutorial discretion.

* Rupert and Lillian Radford Professor of Law, SMU Dedman School of Law. Director, SMU Corporate Externship Program. This article is derived from my presentation of the William Marshall Bullitt Lecture delivered on February 28, 2019. I thank Dean Colin Crawford, Professor Manning Warren, the faculty and students of the Louis D. Brandeis School of Law, and the Louisville legal community for hosting my visit and helping to make my experience so very enjoyable.

¹ See MARC I. STEINBERG & RALPH C. FERRARA, SECURITIES PRACTICE: FEDERAL AND STATE ENFORCEMENT § 3:60 (2d ed. 2001 & Supp. 2018–2019) (stating that as high as ninety percent of SEC enforcement actions are settled); William R. McLucas, Scott M. Litvinoff, & William F. Osberghaus, Jr., "Neither Admit Nor Deny" Settlements from the Stanley Sporkin Era: *Wise Policy or Outdated Enforcement Notion?*, 43 SEC. REG. L. J. 29 (2015) ("Over the last 40 years, the Commission's standard approach has been to permit defendants to enter into a settlement without admitting or denying the allegations against them (i.e., on a 'neither admit nor deny' basis)."). See generally Frank Razzano, *To Cooperate with the Securities and Exchange Commission or Not to Cooperate — That Is the Question*, 31 SEC. REG. L. J. 410 (2003).

² See Dana ElBoghdady, *Billionaire Mark Cuban Takes on the SEC*, WASH. POST (Nov. 20, 2013), https://www.washingtonpost.com/business/economy/billionaire-mark-cuban-takes-on-the-sec/2013/11/20/2b67134a-4a7c-11e3-be6b-d3d28122e6d4_story.html?utm_term=.257a8bb164ff (reporting Mr. Cuban's assertion that he "paid \$12 million in legal fees to defend himself").

³ *Id.* See also Renae Merle, *Cuban on His Crusade against the SEC — And When He'll Be Satisfied*, WASH. POST (Mar. 17, 2016), https://www.washingtonpost.com/business/economy/cuban-on-his-crusade-against-the-sec--and-when-hell-be-satisfied/2016/03/17/619d9e9a-ebae-11e5-b0fd-073d5930a7b7_story.html?utm_term=.2fe6d94ee659.

In my recent book, *Securities and Exchange Commission v. Cuban — A Trial of Insider Trading*,⁴ the many complexities of this litigation saga are addressed. As an experiential resource, the book contains excerpts of key documents comprising this litigation from the SEC investigative stage through the jury verdict and entering of judgment. Refreshingly, these documents—including pleadings, motions, witness testimony, oral arguments, and jury instructions—are instructive and interesting. This portrayal emanates from the contentious nature of the litigation and the identity of the named defendant Mark Cuban, a well-known entrepreneur and investor whose interests include ownership of the National Basketball Association's (NBA) Dallas Mavericks⁵ and being one of the principal investors on the reality television program "Shark Tank."⁶

Being retained as an expert witness on Mr. Cuban's behalf in this litigation, I saw this litigation unfold from the "playing field" rather than as a spectator.⁷ I had the opportunity to work with Mr. Cuban's legal defense team comprised of preeminent securities litigators.⁸ As a former SEC attorney, including in the Division of Enforcement,⁹ I continue to have high respect for the integrity and dedication of the Commission. Nonetheless, in this litigation, questionable decisions were made by the SEC that significantly contributed to its defeat.¹⁰ In addition, the Commission's broad use of the misappropriation theory,¹¹ while receiving evident approbation from the U.S. Court of Appeals for the Fifth Circuit,¹² generates concern about whether this construction is consistent with U.S. Supreme Court precedent.¹³ The next Section will explore the government's invocation of the misappropriation theory in the context of this litigation and the broader public policy issues raised.

⁴ MARC I. STEINBERG, *THE SECURITIES AND EXCHANGE COMMISSION v. CUBAN — A TRIAL OF INSIDER TRADING* (2019).

⁵ *Id.* at 1.

⁶ *Id.*

⁷ *Id.* at 74–75 (discussing my expert witness report in this litigation).

⁸ One of Mr. Cuban's attorneys, Mr. George Anhang, authored the Foreword for STEINBERG, *supra* note 4; *see id.* at xv–xix.

⁹ I worked at the SEC for four years, including in the Division of Enforcement. During that time period, the Honorable Stanley Sporkin, retired U.S. federal district judge, was the Enforcement Director. Judge Sporkin, to whom the book is dedicated, is my mentor and has enjoyed a superlative career.

¹⁰ *See* discussion *infra* notes 64–97 and accompanying text.

¹¹ The government alleged that the entering into of an oral confidentiality agreement was sufficient to subject Mr. Cuban to liability under the misappropriation theory. *See* discussion *infra* notes 42–51 and accompanying text.

¹² SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010). *See* discussion *infra* notes 46–51 and accompanying text.

¹³ *See* discussion *infra* notes 14–63 and accompanying text.

II. A “MAGICAL” TRANSITION—A “NON-DISCLOSURE AGREEMENT” CREATING A RELATIONSHIP OF TRUST AND CONFIDENCE

In *United States v. O’Hagan*,¹⁴ the U.S. Supreme Court adopted the misappropriation theory under Section 10(b) of the Securities Exchange Act¹⁵ to hold subject persons liable for trading based on material and non-public information.¹⁶ Under the misappropriation theory, liability is premised upon such person’s breach of fiduciary duty or a relationship of trust and confidence to the *source* of the information.¹⁷ Deception by means of nondisclosure is a central tenet of the misappropriation theory, thereby focusing on the violator feigning fidelity to the information source.¹⁸ Because of this underlying rationale, the *O’Hagan* Court recognized that full disclosure to the source of the information precludes liability under this theory.¹⁹ Hence, if the subject person reveals to the information source that she plans to trade, no deception has been perpetrated within the confines of Section 10(b).²⁰ In such event, depending on the context, liability may be levied upon the misappropriator on other grounds, such as for breach of contract, violation of the duty of loyalty, or pursuant to the federal wire fraud statute.²¹

A fundamental principle of the misappropriation theory is that the violator owes a fiduciary duty or a relationship of trust and confidence to the *source* of the information.²² In situations involving an employee-employer or attorney-client relationship, this showing is met without difficulty.²³

¹⁴ 521 U.S. 642 (1997).

¹⁵ 15 U.S.C. § 78j(b) (2012).

¹⁶ *O’Hagan*, 521 U.S. at 651–66.

¹⁷ *Id.* at 652 (“The ‘misappropriation theory’ holds that a person commits fraud ‘in connection with’ a securities transaction, and thereby violates Section 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information.”).

¹⁸ *Id.* (“[T]he misappropriation theory premises liability on a fiduciary-turned-trader’s deception of those who entrusted him with access to confidential information.”).

¹⁹ *Id.* at 655 (“Because the deception essential to the misappropriation theory involves feigning fidelity to the source of the information, if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no ‘deceptive device’ and thus no Section 10(b) violation — although the fiduciary-turned-trader may remain liable under state law for breach of the duty of loyalty.”).

²⁰ *Id.*

²¹ *Id.*; see also *Carpenter v. United States*, 484 U.S. 19 (1987) (affirming defendant’s conviction pursuant to mail fraud statute); MARC I. STEINBERG & WILLIAM K.S. WANG, *INSIDER TRADING* § 5.4 (3d ed. 2010).

²² *O’Hagan*, 521 U.S. at 652.

²³ These principal-agent relationships are fiduciary in nature. See, e.g., *Upjohn Co. v. United States*, 449 U.S. 383 (1981); *Gelfand v. Horizon Corp.*, 675 F.2d 1108 (10th Cir. 1982) (interpreting New Mexico law). See generally Marc I. Steinberg & Logan J. Weissler, *The Litigation Privilege as a Shelter for Miscareant Legal Counsel*, 97 OR. L. REV. 1 (2018).

Enforcement dilemmas arise where the information source conveys the material non-public information to an individual with whom she has no such relationship.²⁴ Well aware of this shortcoming, the SEC promulgated Rule 10b5-2,²⁵ which sets forth three distinct circumstances that implicate a relationship of trust and confidence.²⁶ For our purposes here—*SEC v. Cuban*—such a relationship of trust and confidence arises under this rule when the recipient agrees to maintain the confidentiality of the subject information.²⁷

This provision was utilized by the SEC in its enforcement action against Mr. Cuban, who owned six percent of the common stock of a Nasdaq publicly-traded company, Mamma.com, based in Montreal.²⁸ Although being the company's largest shareholder, as recognized by the Commission, Mr. Cuban neither was a director nor officer of the company, nor was he otherwise an insider due to his relationship with the company's management.²⁹ He therefore was not a "classical"³⁰ or "temporary insider"³¹

²⁴ See *United States v. Chestman*, 947 F.2d 551, 567–68 (2d Cir. 1991) (holding that "a fiduciary duty cannot be imposed unilaterally by entrusting a person with confidential information" and that "marriage does not, without more, create a fiduciary relationship").

²⁵ 17 C.F.R. § 240.10b5-2 (2019). See also *Selective Disclosure and Insider Trading*, Securities Act Release No. 7881, Exchange Act Release No. 43154, 65 Fed. Reg. 51,716 (Aug. 15, 2000) (adopting 17 C.F.R. § 240.10b5-2).

²⁶ Under Rule 10b5-2, a duty of trust or confidence exists under Section 10(b) for purposes of the misappropriation theory in the following situations:

- (1) when such recipient agreed to maintain the confidentiality of the information; (2) when a reasonable expectation of confidentiality existed due to that the persons who had the communication(s) (including the misappropriator) enjoyed a history, practice, or pattern of sharing confidences; and (3) when the source of the information (i.e., the person providing such information) was a spouse, child, parent, or sibling of the person receiving the information, unless it can be established as an affirmative defense that on the facts and circumstances of the particular family relationship that no reasonable expectation of confidentiality existed.

MARC I. STEINBERG, *UNDERSTANDING SECURITIES LAW* 389 (7th ed. 2018).

²⁷ See § 240.10b5-2(b)(1) (stating that "[f]or purposes of this section, a 'duty of trust or confidence' exists in the following circumstances, among others: (1) Whenever a person agrees to maintain information in confidence").

²⁸ See Complaint para. 10, *SEC v. Cuban*, 634 F. Supp. 2d 713 (N.D. Tex. 2009) (No. 3:08-CV-2050-D) [hereinafter *SEC Complaint*] (setting forth that Cuban had a 6.3% stake in the company), reprinted in STEINBERG, *supra* note 4, at 35.

²⁹ See *SEC Complaint*, *supra* note 28, paras. 10–27.

³⁰ See generally *SEC v. Cuban*, 620 F.3d 551, 553 (5th Cir. 2010) ("The classical theory of insider trading prohibits a 'corporate insider' from trading on material nonpublic information obtained from his position within the corporation without disclosing the information").

³¹ The "temporary" or "quasi" insider rationale was adopted by the U.S. Supreme Court in *Dirks v. SEC*, 463 U.S. 646 (1983). There, the Court stated:

Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant working for the corporation, those outsiders become fiduciaries of the shareholders. The basis for recognizing this fiduciary duty is not

owing a fiduciary duty to the subject corporation and its shareholders under U.S. Supreme Court precedent.³²

As alleged by the Commission, Mr. Cuban entered into an oral confidentiality agreement with the Chief Executive Officer of Mamma.com, Mr. Guy Fauré, who inquired whether Mr. Cuban was interested in subscribing to a forthcoming Mamma.com stock offering.³³ Pursuant to this alleged confidentiality agreement, Mr. Cuban agreed to refrain from selling his Mamma.com stock until after the company publicly disclosed the offering.³⁴ The offering, known as a PIPE offering,³⁵ was viewed by Mr. Cuban as dilutive to current Mamma.com shareholders and thereby antithetical to their financial interests.³⁶ After a brief phone conversation with Mr. Fauré,³⁷ followed by Mr. Cuban calling the company's placement agent situated in San Francisco (Merriman Curhan & Ford), a discussion lasting eight minutes,³⁸ Mr. Cuban sold his Mamma.com stock prior to the company's public announcement of the PIPE offering.³⁹

Insofar as whether improper tipping transpired, by communicating this information with the motivation to benefit the company, neither Mr. Fauré nor the placement agent did so for personal financial benefit or to provide a gift to Mr. Cuban.⁴⁰ Accordingly, as the SEC acknowledged, these communications were not within the tipper-tippee proscription of insider trading law.⁴¹ Nonetheless, because Mr. Cuban allegedly entered into a non-

simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes. . . . For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

Id. at 655 n.14.

³² See *Dirks v. SEC*, 463 U.S. 646 (1983); *Chiarella v. United States*, 445 U.S. 222 (1980).

³³ See SEC Complaint, *supra* note 28, paras. 12–16.

³⁴ See *id.* paras. 10–27.

³⁵ A PIPE offering refers to a private investment in public equity. Succinctly stated, “PIPEs are privately issued equity or equity-linked securities that are normally sold to ‘accredited investors’ [those investors meeting certain minimum financial thresholds] by public companies in a hybrid transaction typically involving a [SEC] Regulation D private placement followed by a registered public offering.” Marc I. Steinberg & Emmanuel U. Obi, *Examining the Pipeline: A Contemporary Assessment of Private Investments in Public Equity (“PIPEs”)*, 11 U. PA. J. BUS. L. 1, 3–5 (2008).

³⁶ See STEINBERG, *supra* note 4, at 3 (quoting Mark Cuban as asserting “I hate when companies do PIPES-type transactions to raise money [as they are] dilutive . . .”).

³⁷ See STEINBERG, *supra* note 4, at 175–76 (restating trial testimony of Guy Fauré, Chief Executive Officer of Mamma.com).

³⁸ See *id.* at 153–157 (restating trial testimony of Arnold Owen of Merriman Curhan Ford).

³⁹ See SEC Complaint, *supra* note 28, paras. 18–26.

⁴⁰ See *id.* paras. 12–20.

⁴¹ See STEINBERG, *supra* note 4, at 47–48 (restating SEC Memorandum of Law Opposing Cuban's Motion to Dismiss). As a Canadian issuer, Mamma.com was not subject to SEC Regulation FD. See 17 C.F.R. §§ 243.100–243.101 (2019). See generally Selective Disclosure and Insider Trading, Exchange

disclosure agreement (NDA) with the company,⁴² the Commission asserted that he misappropriated the information when he sold his Mamma.com stock prior to the company's public disclosure of the PIPE offering and, hence, engaged in fraudulent insider trading.⁴³ In his defense, among numerous other assertions, Mr. Cuban denied that he ever entered into a confidentiality agreement or NDA with Mamma.com or any agent of the company.⁴⁴ After the district court's dismissal of the complaint,⁴⁵ the Fifth Circuit reversed reasoning that sufficient allegations were set forth for the case to go forward to the discovery phase.⁴⁶

Act Release No. 43154, 73 SEC Docket 3 (Aug. 15, 2000) (adopting release). As summarized by the SEC: Regulation FD (Fair Disclosure) is a new issuer disclosure rule that addresses selective disclosure. The regulation provides that when an issuer, or person acting on its behalf, discloses material nonpublic information to certain enumerated persons (in general, securities market professionals and holders of the issuer's securities who may well trade on the basis of the information), it must make public disclosure of that information. The timing of the required public disclosure depends on whether the selective disclosure was intentional or non-intentional; for an intentional selective disclosure, the issuer must make public disclosure simultaneously; for a non-intentional disclosure, the issuer must make public disclosure promptly. Under the regulation, the required public disclosure may be made by filing or furnishing a Form 8-K, or by another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public.

Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, at 51,716 (Aug. 24, 2000) (to be codified at 17 C.F.R. pt. 240, 243, and 249). For further discussion of Regulation FD, see Marc I. Steinberg & Jason B. Myers, *Lurking in the Shadows: The Hidden Issues of the Securities and Exchange Commission's Regulation FD*, 27 J. CORP. L. 173 (2002).

⁴² See SEC Complaint, *supra* note 28, paras. 14–16.

⁴³ See STEINBERG, *supra* note 4, at 47–48 (restating SEC Memorandum of Law Opposing Cuban's Motion to Dismiss, which asserts that “[i]n reliance on Cuban's acceptance of a duty of confidentiality, the company conveyed material, nonpublic offering information to the defendant [and that accordingly under] well-settled law and a clear Commission rule [Rule 10b5-2], a confidentiality agreement establishes a duty under the misappropriation theory”).

⁴⁴ See STEINBERG, *supra* note 4, at 203, 213–15 (examining Mark Cuban's trial testimony).

⁴⁵ In his Order granting Mr. Cuban's Motion to Dismiss (while allowing the SEC to replead), Judge Fitzwater held:

Because [SEC] Rule 10b5-2(b)(1) attempts to predicate misappropriation theory liability on a mere confidentiality agreement lacking a non-use component, the SEC cannot rely on it to establish Cuban's liability under the misappropriation theory. To permit liability based on Rule 10b5-2(b)(1) would exceed the SEC's § 10(b) authority to proscribe conduct that is deceptive. . . . Because the SEC has failed to allege that Cuban undertook a duty to refrain from trading on information about the impending PIPE offering, and because the SEC cannot rely on the duty imposed by Rule 10b5-2(b)(1) alone, Cuban cannot be held liable under the misappropriation theory of insider trading liability, even accepting all well-pleaded facts as true and viewing them in the light most favorable to the SEC. The court therefore grants Cuban's motion to dismiss the complaint under Rule 12(b)(6).

SEC v. Cuban, 634 F. Supp. 2d 713, 730–31 (N.D. Tex. 2009).

⁴⁶ SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010). Reversing and remanding, the Fifth Circuit reasoned: The allegations, taken in their entirety, provide more than a plausible basis to find that the understanding between the CEO and Cuban was that he was not to trade, that it was more than a simple confidentiality agreement. By contacting the sales representative to obtain the pricing

That a confidentiality agreement or NDA in the business setting is deemed to constitute a relationship of trust and confidence is contrary to commercial reality.⁴⁷ Parties to such agreements ordinarily “deal” at arm’s length, seeking to act in their individual or principal’s best interests.⁴⁸ Because the parties do not trust one another and do not enjoy a close relationship, they are mindful to implement written agreements to protect the confidentiality of their proprietary information.⁴⁹ Violation of such a confidentiality agreement or NDA gives rise to a breach of contract action and damages that may be proven due to such breach.⁵⁰ But a breach of contract suit is far different than the recognition of a relationship of trust and confidence. Under custom and practice, these agreements accordingly do not resemble a relationship of trust and confidence. The determination by the SEC and a number of courts that these agreements have that status belies commercial reality and contravenes Supreme Court precedent.⁵¹

information, Cuban was able to evaluate his potential losses or gains from his decision to either participate or refrain from participating in the PIPE offering. It is at least plausible that each of the parties understood, if only implicitly, that Mamma.com would only provide the terms and conditions of the offering to Cuban for the purpose of evaluating whether he would participate in the offering, and that Cuban could not use the information for his own personal benefit. It would require additional facts that have not been put before us for us to conclude that the parties could not plausibly have reached this shared understanding. Under Cuban’s reading, he was allowed to trade on the information but prohibited from telling others—in effect providing him an exclusive license to trade on the material nonpublic information. Perhaps this was the understanding, or perhaps Cuban misled the CEO regarding the timing of his sale in order to obtain a confidential look at the details of the PIPE. We say only that on this factually sparse record, it is at least equally plausible that all sides understood there was to be no trading before the PIPE. That both Cuban and the CEO expressed the belief that Cuban could not trade appears to reinforce the plausibility of this reading.

Id. at 557–58.

⁴⁷ This position is well stated by an amici curiae brief filed in this case by five distinguished law professors (Professors Steven Bainbridge, UCLA; Alan Bromberg, SMU; Allen Ferrell, Harvard; Todd Henderson, Chicago; and Jonathan Macey, Yale) wherein the following is stated:

In the context of a business relationship, a confidentiality agreement alone is insufficient to create a fiduciary or similar relationship of trust and confidence between the parties. Under both state and federal common law, a confidentiality agreement alone creates only an obligation to maintain the secrecy of the information, not a fiduciary or fiduciary-like duty to act loyally to the source of the information. In the absence of any other facts or circumstances indicating the existence of a fiduciary or similar relationship of trust and confidence, there can be no insider trading liability based on the misappropriation theory pursuant to Section 10(b).

STEINBERG, *supra* note 4, at 49 (restating the Brief of Amici Curiae).

⁴⁸ See STEINBERG, *supra* note 4, at 329 (asserting that “parties customarily enter into non-disclosure agreements because they deal at arms-length and do not trust one another”).

⁴⁹ See generally GERARDUS BLOKDYK, NON-DISCLOSURE AGREEMENT (3d ed. 2018).

⁵⁰ See STEINBERG, *supra* note 4, at 329 (“Noncompliance with such an agreement may well constitute a breach a contract; but a contractual breach is distinctly different from fiduciary transgression.”).

⁵¹ See *id.* at 49 (excerpting a brief of amici curiae in support of Mark Cuban’s Motion to Dismiss, which states: “Assuming that [SEC] Rule 10b5-2(b)(1) is even applicable to business relationships, a confidentiality agreement alone would be insufficient to establish the existence of a fiduciary or similar

That this seeming “fiction” has been embraced to this degree reflects a major shortcoming in our country’s insider trading laws. Developed securities markets outside of the United States have thoroughly rejected the U.S. approach regulating insider trading premised on the existence of a fiduciary duty or a relationship of trust and confidence.⁵² Rather, these countries adhere to an access or parity of information approach⁵³—the rationale that was implemented in the U.S. by such cases as the Second Circuit’s 1968 decision in *Texas Gulf Sulphur*⁵⁴ before the Supreme Court rejected it in *Chiarella v. United States*.⁵⁵

Under the approach embraced by these developed markets, a person may not trade on the basis of material non-public information if she has unequal access to such information⁵⁶ or otherwise knowingly possesses such material non-public information.⁵⁷ In the U.S., this broad prohibition applies only in the context of tender offers⁵⁸ where the SEC has adopted a broad parity of information rule: Rule 14e-3.⁵⁹ Hence, in this country, one can legally keep his profits under Supreme Court precedent if the transaction is structured as a merger, yet go to prison if that very same transaction is structured as a tender offer, thereby implicating the expansive parameters of Rule 14e-3.⁶⁰

relationship of trust and confidence.”).

⁵² For example, the parity of information rationale has been adopted by the European Union. See Council Regulation 596/2014, art. 7, 8, 10, 14, 17, 2014 O.J. (L 173) 2, 3, 4 (EU). See generally MARKET ABUSE REGULATION — COMMENTARY AND ANNOTATED GUIDE (Marco Ventoruzzo & Sebastian Mock eds., 2017). Likewise, Australia implements a parity of information approach. See Australia Corporations Act 2001 (Cth) s 1043A (Austl.). By comparison, Ontario adheres to the access test. See Province of Ontario Securities Act, R.S.O. 1990, c. S.5, § 76 (Can.).

⁵³ See Marc I. Steinberg, *Texas Gulf Sulphur at Fifty — A Contemporary and Historical Perspective*, 71 SMU L. REV. 626 (2018); see also sources cited *supra* note 52.

⁵⁴ SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969). See Manning G. Warren III, *A Birthday Toast to Texas Gulf Sulphur*, 71 SMU L. REV. 987 (2018); Steinberg, *supra* note 53. See also MARC I. STEINBERG, *THE FEDERALIZATION OF CORPORATE GOVERNANCE* 115–33 (2018) (addressing the federalization of insider trading).

⁵⁵ *Chiarella v. United States*, 445 U.S. 222 (1980) (adopting the “classical” theory whereby one who possesses material non-public information must abstain from trading until adequate public disclosure of such information is made if she owes a fiduciary duty or has a relationship of trust and confidence to the corporation or to a party on the other side of the transaction).

⁵⁶ See Province of Ontario Securities Act, R.S.O. 1990, c. S.5, § 76 (Can.).

⁵⁷ See, e.g., Council Regulation 596/2014, art. 7, 8, 10, 14, 17, 2014 O.J. (L 173) 2, 3, 4 (EU); see also Australia Corporations Act 2001 (Cth) s 1043A (Austl.).

⁵⁸ Generally, a tender offer is a means used “to acquire control of a corporation characterized by active solicitation to purchase a substantial percentage of the target’s stock from the target’s shareholders at a premium over the market price, offered for a limited period of time and that may be contingent upon the tender of a specific number of shares.” STEINBERG, *supra* note 26, at 500.

⁵⁹ 17 C.F.R. § 240.14e-3 (2019) (generally prohibiting trading and tipping in the tender offer setting of the subject securities when a person is in possession of material and non-public information).

⁶⁰ See SEC v. Switzer, 590 F. Supp. 756, 766 (W.D. Okla. 1984) (holding that defendant was not liable for illegal insider trading under Section 10(b) because the corporate executive was unaware that respondent overheard the executive’s conversation with his wife revealing a forthcoming merger

Such an approach treats similarly situated actors in a significantly disparate fashion and understandably may be viewed as fundamentally unfair.⁶¹

Mr. Cuban's trading of Mamma.com stock occurred in the context of a company stock offering, thereby clearly not implicating Rule 14e-3. This is not to suggest that Mr. Cuban would have incurred liability if the parity of information approach of Rule 14e-3 were applicable. Indeed, Mr. Cuban would have been found not liable regardless of the insider trading framework applied as the jury found that the subject information involving the Mamma.com PIPE offering was neither material nor non-public.⁶² This finding of fact may strike some observers as surprising. It is better understood with the backdrop of key strategic decisions made by the SEC, a number of which contributed to the Commission's catastrophic defeat in this litigation.⁶³

III. THE SEC'S STRATEGIC DECISIONS—A CRITICAL ASSESSMENT

Playing the position of Monday-morning quarterback, it may be posited that the SEC made a number of strategic decisions that may be seriously questioned. The first is why the Commission elected to bring this litigation in Dallas where the U.S. District Court for the Northern District of Texas sits.⁶⁴ Dallas is Mr. Cuban's "home court"—a city where he is widely respected, viewed as an astute business person, and engaged in meaningful philanthropic causes.⁶⁵ Outside of Dallas, he may or may not be perceived as positively, particularly given the large number of fines levied by the NBA against Mr. Cuban for his criticism of the league's officiating and his demonstrative rooting for his Mavericks.⁶⁶

transaction).

⁶¹ The author has expressed this criticism on previous occasions. See, e.g., Marc I. Steinberg, *Insider Trading, Selective Disclosure, and Prompt Disclosure: A Comparative Analysis*, 22 U. PA. J. INT'L ECON. L. 635, 646 (2001) ("[S]uch inconsistency cannot be reconciled with market integrity, investor protection, or basic concepts of fair treatment among similar market participants.").

⁶² See STEINBERG, *supra* note 4, at 319.

⁶³ See discussion *infra* notes 64–95 and accompanying text.

⁶⁴ See STEINBERG, *supra* note 4, at 323–26.

⁶⁵ See, e.g., *Mark Cuban Launches an AI Bootcamp in Partnership with Microsoft and Walmart*, IBL NEWS (New York) (July 30, 2019), <https://iblnews.org/mark-cuban-launches-an-ai-bootcamp-in-partnership-with-microsoft-and-walmart/> (reporting on the inaugural "AI Bootcamp" program, which allows high school students in Dallas to learn skills in emerging technology).

⁶⁶ See, e.g., Jodie Valade, *Mark Cuban Does the Unexpected*, ESPNW (June 2, 2011), <http://www.espn.com/espnw/news/article/6615266/nba-finals-dallas-mavericks-owner-mark-cuban-does-unexpected> (reporting that, as of that time, Mr. Cuban had been levied fines of approximately \$1,665,000 by the NBA based on 13 incidents as owner of the Dallas Mavericks); Scott Cacciola, *Mavericks and Mark Cuban Sanctioned by N.B.A. Over Handling of Sexual Harassment*, N.Y. TIMES (Sept. 19, 2018), <https://www.nytimes.com/2018/09/19/sports/mark-cuban-mavericks-nba.html> (highlighting criticism of Mr. Cuban and the Dallas Mavericks for their alleged lack of sufficient oversight concerning acts of sexual harassment by certain Mavericks' employees).

A number of other alternative jurisdictions were available. One clearly was San Francisco, the Northern District of California. From Dallas, Mr. Cuban placed a phone call to the Merriman placement agent situated in San Francisco, thereby providing a sufficient nexus to file the case in that jurisdiction.⁶⁷ The Southern District of New York—New York City—also may have been available. Mamma.com's common stock was listed on the Nasdaq, the market site of which is situated in Manhattan.⁶⁸ In addition, to effectuate his trades, Mr. Cuban utilized the market intermediary UBS, whose U.S. headquarters are located in New York City,⁶⁹ thereby suggesting that those trades may have been routed through that office.⁷⁰ And, as a last possibility, there may have been a sufficient nexus with the District of New Jersey as Nasdaq's computerized data center where trades are effected is located in that state.⁷¹ Of course, as Mamma.com was a Canadian company,⁷² the SEC did not have the option of filing the case in another country.

Thus, the question is presented why the Commission elected to bring this case in Dallas, Mr. Cuban's "home" court. This inquiry becomes even more poignant since the SEC's enforcement staff in its Washington, D.C., headquarters was the "team" most involved in this litigation, rather than the Commission's regional office staff in Fort Worth, Texas.⁷³ While a regional office ordinarily files actions in the region in which it is situated, the "home" office frequently brings suit in the jurisdiction that it deems most appropriate, even if much of the alleged misconduct occurred elsewhere.⁷⁴ In response,

⁶⁷ See Securities Act of 1933 § 22, 15 U.S.C. § 77v (2012) (authorizing the SEC to file suit in a federal district court where Mr. Cuban transacted business, resided, or "where the offer or sale took place, if [Mr. Cuban] participated therein"); see also Securities Act of 1933 § 2(a)(3), 15 U.S.C. § 77b(a)(3) (defining the term "offer to sell" in a broad manner); Securities Exchange Act of 1934 § 27, 15 U.S.C. § 78aa (authorizing the Commission to bring the action in a federal judicial district "wherein any act or transaction constituting the violation occurred"). SEC Complaint, *supra* note 28, paras. 17–18;

⁶⁸ SEC Complaint, *supra* note 28, para. 9; see also sources cited *supra* note 67.

⁶⁹ See STEINBERG, *supra* note 4, at 324.

⁷⁰ See STEINBERG, *supra* note 4, at 229–41 (restating the testimony of Mr. Cuban's broker, Mr. Charles McKinney of UBS).

⁷¹ Carteret, New Jersey is the locale of Nasdaq's Data Center. See generally sources cited *supra* note 67. Of course, Mr. Cuban likely would have filed a motion for a change in venue to the Northern District of Texas. See 28 U.S.C. § 1404(a) (2012) (providing that "for the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district where it might have been brought"). Whether Mr. Cuban would have succeeded with respect to such a motion is uncertain. Compare SEC v. Kearns, 2009 WL 2030235 (S.D.N.Y. 2009) (granting motion to transfer action), with SEC v. Thrasher, 1993 WL 37044 (S.D.N.Y. 1993) (denying motion for change of venue).

⁷² Mamma.com was based in Montreal, Quebec, Canada. See SEC Complaint, *supra* note 28, para. 9.

⁷³ See STEINBERG, *supra* note 4, at 323.

⁷⁴ With some frequency, the Commission files its enforcement actions in the federal district court in the Southern District of New York irrespective of the fact that far more significant contacts and conduct occurred in other jurisdictions. See, e.g., SEC v. Wyly, 788 F. Supp. 2d 92 (S.D.N.Y. 2011) (denying

SEC proponents advance that the Commission does not “game” the process and engages in fair play. Since Mamma.com was a Canadian company and nearly all of the conduct at issue transpired in the Northern District of Texas, that jurisdiction was the most suitable forum to file the lawsuit.⁷⁵ SEC critics, however, have a less gentle perspective: The Commission sought to thoroughly embarrass Mr. Cuban in order to induce him to swiftly enter into a meaningful settlement. Filing suit in Dallas where Mr. Cuban resides and is an active member of the community would generate significant adverse hubbub and thereby prompt him to expeditiously negotiate a settlement to resolve the case.⁷⁶ If that indeed was the Commission’s strategy, it was miscalculated. The end result was that the SEC litigated this proceeding on Mr. Cuban’s home court and suffered a huge defeat. Indeed, the jury returned its verdict in favor of Mr. Cuban after only three hours of deliberation.⁷⁷

This is not to suggest that the SEC would have been victorious if it had filed the case in a different jurisdiction. There were a number of other reasons contributing to the Commission’s stinging setback. As one striking example, the government’s key witness was Mr. Guy Fauré, the Chief Executive Officer of Mamma.com, who spoke and participated in the phone conversation where Mr. Cuban allegedly agreed, first, to maintain the confidentiality of the information relating to the forthcoming PIPE offering, and second, not to trade his stock until after that information became public.⁷⁸ The SEC’s dilemma was that Mr. Fauré resided in Canada and refused to come to Dallas to testify live at trial.⁷⁹ With Mr. Fauré beyond the court’s subpoena power,⁸⁰ the Commission’s only alternative was for Mr. Fauré to testify by means of his video deposition taken during the discovery stage of the litigation.⁸¹ In a case based largely on credibility, the prosecution’s “star” witness declining to physically appear at trial, and instead testifying by video, impaired the government’s case.⁸² Nonetheless, the SEC must have known

motion to dismiss); SEC v. Morton, No. 10-1720, 2011 WL 1344259 (S.D.N.Y. 2011) (order denying motion to dismiss); SEC v. 800America.com, Inc., No. 02-9046, 2006 WL 3422670 (S.D.N.Y. 2006) (denying motion to dismiss and granting SEC’s motion for summary judgment).

⁷⁵ See STEINBERG, *supra* note 4, at 325.

⁷⁶ See *id.* at 325 (noting the position of SEC critics that “[t]he Commission wanted to inflict as much pain and embarrassment upon Mr. Cuban as practicable when bringing suit, thereby perhaps inducing him to settle the proceeding — and the Northern District of Texas clearly met that objective”).

⁷⁷ See *id.* at 333. See also Merle, *supra* note 3.

⁷⁸ See SEC Complaint, *supra* note 28, paras. 12–16; STEINBERG, *supra* note 4, at 170–83 (restating the trial testimony of Guy Fauré).

⁷⁹ See STEINBERG, *supra* note 4, at 170.

⁸⁰ Generally, U.S. courts lack authority to issue enforcement orders requiring non-U.S. residents to testify live in court. See 28 U.S.C. § 1783; FED. R. CIV. P. 45; STEINBERG, *supra* note 4, at 310–11 (restating Federal District Court’s Charge to the Jury).

⁸¹ See STEINBERG, *supra* note 4, at 170–84 (restating trial testimony of Guy Fauré).

⁸² See Erin Fuchs, *Why the SEC Lost Its Big Case Against Mark Cuban*, BUS. INSIDER (Oct. 17,

of this striking possibility and failed to adequately account for the detrimental impact that Mr. Fauré's absence would cause.

In view of this eventuality, it may be posited that the Commission overplayed the strength of its case in seeking to label Mr. Cuban a "fraudster." Even if Mr. Cuban were willing to consent to a settlement where he neither admitted nor denied the allegations set forth in the SEC's Complaint, a "fraudster" depiction was unacceptable. In view of Mr. Cuban's standing in the community and reported interests in perhaps purchasing a major league baseball team⁸³ or running for political office,⁸⁴ a "fraud" settlement was untenable. As an alternative, the Commission had, within its arsenal, an alternative statute that it could have invoked in this matter, namely, Section 17(a)(3) of the Securities Act of 1933.⁸⁵ That provision encompasses *negligent* "inside traders" who engage in sales of their securities.⁸⁶ Applied to this litigation, the SEC could have sought a settlement whereby Mr. Cuban would have agreed, without admitting or denying fault, to disgorge the loss he allegedly avoided (approximately \$750,000)⁸⁷ and to an order alleging violation of Section 17(a)(3). Although it is uncertain whether Mr. Cuban would have agreed to such a settlement offer, its attraction was evident—he would be putting this vexing matter "behind him" and would be consenting to a violation based on alleged negligence.⁸⁸ That

2013), <https://www.businessinsider.com/how-mark-cuban-defeated-the-sec-2013-10> (statement by defense attorney Stuart Slotnick).

⁸³ See Rob Neyer, *Mark Cuban Won't Be Buying an MLB Team, and Likely Never Will*, SB NATION (Feb. 3, 2011), <https://www.sbnation.com/mlb/2011/2/3/1972652/mark-cuban-won-t-be-buying-an-mlb-team-and-likely-never-will> (stating that over the "past four years, [Mr. Cuban] has entered the bidding for the Chicago Cubs and the Texas Rangers, only to walk away frustrated each time").

⁸⁴ Jacob Bogage, *Will Mark Cuban Run for President? "We'll See What Happens," He Says*, WASH. POST (Mar. 6, 2019), <https://www.washingtonpost.com/sports/2019/03/06/will-mark-cuban-run-for-president?hpid=hp-sports%3Amlb%3Astory%3Ahomepage%3Ahp-sports&hpid=hp-sports%3Amlb%3Astory%3Ahomepage%3Ahp-sports>.

⁸⁵ 15 U.S.C. § 77q(a)(3) (2012).

⁸⁶ Section 17(a)(3) provides:

It shall be unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly . . . to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

See Aaron v. SEC, 446 U.S. 680, 697 (1980) (holding that negligent conduct is actionable under Section 17(a)(3) in SEC enforcement actions); Marc I. Steinberg, *SEC and Other Permanent Injunctions — Standards for Their Imposition, Modification, and Dissolution*, 66 CORNELL L. REV. 27, 34–41 (1980) (discussing ramifications of the Supreme Court's decision in *Aaron*).

⁸⁷ *See* SEC Complaint, *supra* note 28, para. 24 ("By selling his Mamma.com shares prior to the public announcement of the PIPE, Cuban avoided losses in excess of \$750,000.").

⁸⁸ Occasionally, the SEC has invoked Section 17(a)(3) to settle cases involving alleged illegal insider trading. *See, e.g.*, Bolan, Securities Act Release No. 9795, Exchange Act Release No. 75066, 2015 WL 3413279 (May 28, 2015); Marc I. Steinberg & Abel Ramirez, Jr., *The SEC's Neglected Weapon: A Proposed Amendment to Section 17(a)(3) and the Application of Negligent Insider Trading*, 19 U. PA. J. BUS. L. 239, 282 (2017).

is a far cry from being coined a “fraudster.” With the uncertainties of the litigation process and trial by jury, Mr. Cuban may have been inclined to accept this proposal.⁸⁹

The most puzzling aspect of the trial involved Mr. Cuban’s expert witness, Dr. Erik Sirri, and the SEC’s expert witness, Dr. Clemens Sialm. At trial, Dr. Sirri, who formerly held high-level positions at the Commission,⁹⁰ testified that the forthcoming Mamma.com stock offering was publicly known and that the nine percent drop in Mamma.com’s stock price after the company publicly announced the completion of the offering was not statistically significant.⁹¹ In effect, Dr. Sirri’s testimony signaled that the information allegedly imparted by Mamma.com CEO Mr. Fauré to Mr. Cuban regarding the impending PIPE transaction was publicly known (rather than confidential) and was not material to reasonable investors.⁹² In his expert witness report and his deposition testimony, the SEC’s expert witness, Dr. Sialm, disagreed with Dr. Sirri’s position, opining that the information that Mr. Cuban allegedly received from Mr. Fauré was both material and non-public.⁹³

To the astonishment of many, however, the Commission declined to call Dr. Sialm as a witness either in its direct case or in its rebuttal to Dr. Sirri’s testimony. One can only ponder why: (1) Did Dr. Sialm change his mind and agree with Dr. Sirri? (2) Did the SEC believe that its cross-examination of Dr. Sirri was so effective that there was no need for Dr. Sialm to testify? (3) Did Dr. Sialm have previous writings and/or testimony that would have subjected him to severe impeachment by Mr. Cuban’s lawyers? (4) Was Dr. Sialm unavailable to testify due to personal reasons unrelated to this case? The answer to why Dr. Sialm did not testify at trial is not in the public domain. We do know that his absence meant that Dr. Sirri’s testimony was not contradicted by any other witness. And Dr. Sirri’s opinions were

⁸⁹ See STEINBERG, *supra* note 4, at 329–31.

⁹⁰ Dr. Sirri previously held the high-level positions of chief economist and director of the division of trading and markets at the SEC. See STEINBERG, *supra* note 4, at 263 (restating trial testimony of Dr. Sirri).

⁹¹ See STEINBERG, *supra* note 4, at 264–73.

⁹² See *id.* at 264–73; SEC v. Mayhew, 121 F.3d 44, 50 (2d Cir. 1997) (citations omitted) (“Information becomes public when disclosed to achieve a broad dissemination to the investing public generally and without favoring any special person or group . . . or when, although known only by a few persons, their trading on it has caused the information to be fully impounded into the price of the particular stock.”).

⁹³ See STEINBERG, *supra* note 4, at 75–76 (describing Dr. Sialm’s deposition testimony); *id.* at 79 (court order denying Mr. Cuban’s motion to exclude Dr. Sialm from testifying and discussing Dr. Sialm’s “study of the announcement effect that PIPE offerings had on the price of the issuer’s common stock”). See also *id.* at 74 (discussing Dr. Sirri’s event study finding that the information relating to the forthcoming Mamma.com PIPE offering did not have significant price impact and was publicly available); *id.* at 83–87 (court order largely denying the SEC’s motion to exclude Dr. Sirri from testifying).

extremely significant, targeting the essence of the case—namely, that Mr. Cuban did not trade on either material or non-public information. Hence, the failure to counter Dr. Sirri’s testimony with an expert witness of its own (or by other effective means) proved disastrous for the Commission. Unless Dr. Sialm had a sudden realization of agreeing with Dr. Sirri (highly unlikely) or was unavailable due to personal reasons unrelated to this litigation, the Commission’s strategy remains perplexing.⁹⁴

Due to the factors above (and other less vivid factors described in the book),⁹⁵ the Commission suffered a significant defeat. After investigating and litigating Mr. Cuban’s alleged illegal insider trading for several years, the jury took a mere three hours to return a verdict in his favor.⁹⁶ Rather than appealing the jury’s verdict to the court of appeals, the SEC prudently folded its tent.⁹⁷

IV. CONCLUDING COMMENTS

The SEC’s enforcement action against Mr. Cuban may be viewed as a case of government overreaching.⁹⁸ It also may be viewed as a case that the Commission was justified in pursuing but made key strategic errors.⁹⁹ And last, it may be posited that under the law of other developed markets in the world, if the jury had determined that Mr. Fauré indeed had conveyed material and non-public information to Mr. Cuban concerning the forthcoming Mamma.com PIPE offering, Mr. Cuban’s trading of his stock prior to public revelation of this information would have been illegal.¹⁰⁰ Of

⁹⁴ *Mayhew*, 121 F.3d at 332–33.

⁹⁵ These factors included the murky insider trading law in the United States, the SEC’s failure to solidly present its “star” witnesses, and the Commission’s decision to call Mr. Cuban in presenting its case to the jury. *See id.* at 323–34.

⁹⁶ *See* STEINBERG, *supra* note 4, at 319.

⁹⁷ *See id.* at 333.

⁹⁸ *See* George Anhang, *Foreword to* MARCI STEINBERG, *THE SECURITIES AND EXCHANGE COMMISSION v. CUBAN — A TRIAL OF INSIDER TRADING*, xv–xix (2019). As one of Mr. Cuban’s attorneys, Mr. Anhang commences the Foreword as follows:

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.

Id. at xv (emphasis in original).

⁹⁹ *See* discussion *supra* notes 64–95 and accompanying text.

¹⁰⁰ *See* discussion *supra* notes 52–57 and accompanying text.

course, not so in this country unless the information related to a tender offer¹⁰¹ (which it did not) or that somehow an attenuated relationship of trust and confidence was established through the entering into of an alleged oral NDA.¹⁰² In this way, the *SEC-Cuban* litigation illustrates the deficiencies of our insider trading law framework.¹⁰³

The litigation also highlights the high costs of litigating with the government. In successfully defending his reputation, Mr. Cuban incurred \$12 million in attorneys' fees.¹⁰⁴ Tellingly, absent access to plentiful liquid assets or to an impressive insurance policy,¹⁰⁵ the viable recourse for targets of government enforcement actions often is to settle on the most feasible terms practicable.¹⁰⁶ Fortunately for Mr. Cuban, he had the personal tenacity and the financial resources to engage in this combat. Due to several factors—including the relatively weak facts upon which the SEC was relying on to prove its case, superb lawyering by Mr. Cuban's attorneys, solid trial testimony by Mr. Cuban, an outstanding expert witness in Dr. Sirri, and questionable SEC strategy—Mr. Cuban emerged victorious. From the outset to its culmination, the SEC's case was far from formidable. Nonetheless, the Commission chose to vigorously pursue this enforcement action and deservedly suffered a resounding defeat.¹⁰⁷

¹⁰¹ See *supra* notes 58, 61 and accompanying text; 17 C.F.R. § 240.14e-3 (2019); *SEC v. Switzer*, 590 F. Supp. 756 (W.D. Okla. 1984).

¹⁰² See *supra* notes 42–45, 47–51 and accompanying text; *SEC v. Cuban*, 620 F.3d 551 (5th Cir. 2010).

¹⁰³ See sources cited *supra* notes 52–53, 61.

¹⁰⁴ See ElBoghdady, *supra* note 2.

¹⁰⁵ An example of a successful defense after trial is the SEC's enforcement proceeding against the former general counsel of Ferris Baker Watts, Mr. Ted Urban. After a trial before an administrative law judge and appeal by the staff to the SEC, Mr. Urban prevailed. See Urban, Exchange Act Release No. 66259, 2012 WL 1454482 (ALJ Jan. 26, 2012). The existence of an insurance policy evidently enabled Mr. Urban to present a successful defense. See, e.g., Alexandra McLeod, *To Indemnify or Not to Indemnify? When CCO Insurance is the Answer*, 6 AM. U. BUS. L. REV. 325, 335–36 (2017).

¹⁰⁶ See sources cited *supra* note 1.

¹⁰⁷ See STEINBERG, *supra* note 4, at 333–34.

