

Novel Analysis of Insider Trading Law in the Cuban Case Lives On

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On March 5, 2013, the U.S. District Court for the Northern District of Texas denied Mark Cuban's motion to dismiss a civil enforcement action brought by the SEC for insider trading. The enforcement action against Mr. Cuban, originally filed in 2008, accused him of selling his shares of Mamma.com while in possession of material, non-public information about a PIPE financing. Mr. Cuban allegedly avoided a loss of approximately \$750,000 by selling his shares ahead of the announcement of the financing.

The Cuban case has been noteworthy because in the court's 2009 ruling on Mr. Cuban's initial motion to dismiss the action, it rejected the SEC's long held position, reflected in Rule 10b5-2, that a duty of trust and confidence exists whenever a person agrees to keep information confidential. In general, insider trading liability exists when a person trades in securities while in possession of material non-public information in breach of a duty arising out of a fiduciary relationship or other relationship of trust and confidence. The court held that absent an agreement not to use the information, or some other fiduciary relationship with the source of the information, no duty arises and therefore no prohibited insider trading can occur.

In 2010, the Fifth Circuit Court of Appeals did not overrule the district court's analysis of insider trading law, but reversed the 2009 dismissal on the grounds that the SEC's complaint could be read to allege that Mr. Cuban had agreed not to trade. According to the SEC, Cuban implicitly agreed not to use the information by telling Mamma.com's CEO, upon learning of the PIPE offering from him, "Well, now I'm screwed. I can't sell." Mr. Cuban had not entered into a written confidentiality agreement with Mamma.com and, Mr. Cuban contends, he never otherwise agreed, explicitly or implicitly, to refrain from trading on the information.

In its March 5th ruling, the district court applied its 2009 analysis of insider trading law as the law of the case and concluded that the SEC was entitled to take its case to trial. In reaching this conclusion, the court found that a reasonable jury could infer from the facts and circumstances that Mr. Cuban implicitly agreed not to trade. If anything, the Cuban case underscores that the existence of an implicit agreement may be ambiguous unless the recipient expressly and clearly discloses his intention to continue trading before discussing or receiving non-public information with or from a company's management.

The court's opinion is also noteworthy because it indicates that material, non-public information need not be consistently treated as confidential by a company to establish insider trading



liability. In Cuban, information about the PIPE offering was widely distributed to potential investors without confidentiality restrictions. The court was not persuaded that Mamma.com's failure to consistently treat the non-public information as confidential meant that there could not have been a valid agreement to maintain its confidentiality or sufficient duty for purposes of the misappropriation theory.

What to take away from the Cuban case:

- The novel law of the case - that a recipient of non-public information who is not a fiduciary is not liable for insider trading as a result of an obligation to keep information confidential without a use restriction - survived appeal to the Fifth Circuit Court of Appeals and the remand to the district court.
- Notwithstanding the prior bullet point, recipients of information should be very wary of relying on the Cuban case. The case was decided at a trial court level and is not binding on other courts.
- The existence of an implicit agreement to maintain information in confidence and not to use that information as well as the materiality of non-public information will likely be decided by a trier of fact at trial and not by a judge in a motion for summary judgment.
- Even if material, non-public information is not consistently treated as confidential by the source of the information, trading while in possession of such material, non-public information is prohibited (so long as the other elements of an insider trading violation are also satisfied).

The case is SEC v. Cuban, U.S. District Court, Northern District of Texas, No. 08-02050.

To discuss further, please contact your primary Kleinberg Kaplan attorney or:

Stephen M. Schultz
212.880.9840
sschultz@kkwc.com

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