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# "Well, Now I'm Screwed. I Can't Sell." The Words That Will Take The SEC's Insider Trading Case Against Mark Cuban To Trial

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Recently, in *S.E.C. v. Cuban*, No. 08-CV-2050, 2013 WL 791405 (N.D. Tex. March 5, 2013), a federal district court denied Mark Cuban's motion for summary judgment. The court held that although the question was "in some respects a close one," there was sufficient dispute over the evidence entitling the SEC to present its case to a jury. Barring settlement, this highly publicized case – predicated on the "misappropriation" theory of insider trading – will now proceed to trial.

### Factual Background And The SEC's Claims

In November 2008, the SEC brought a civil enforcement action against Mark Cuban, the owner of the NBA's Dallas Mavericks franchise. The action arose from Cuban's June 2004 sale of his entire 6.3 percent ownership interest (600,000 shares) in Mamma.com Inc. (now Copernic, Inc.), a Canadian Internet search company.

According to the SEC's complaint, during the spring of 2004, Mamma.com's executives decided to initiate a so-called private investment in public equity ("PIPE") offering to raise additional capital. Given the tendency of such offerings to dilute the value of existing shares, the company expected Cuban, its largest known shareholder at the time, to be disappointed with the PIPE offering. The company's CEO telephoned Cuban and informed him of the PIPE offering. According to the SEC, Cuban agreed to keep the information regarding the PIPE offering confidential, but reacted negatively upon hearing the news, saying: "Well, now I'm screwed. I can't sell." Despite his reaction, following the telephone conversation with the CEO and another discussion with the investment bank conducting the PIPE offering, Cuban instructed his broker to sell his entire stake in Mamma.com. The next day, the company publicly announced the PIPE offering, an announcement that resulted in a decline in the price of Mamma.com stock. By selling, Cuban avoided over $750,000 in losses.

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The SEC alleged that by selling his shares, Cuban misappropriated information belonging to the company regarding the offering in violation of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934. The SEC has also asserted that Cuban's agreement to keep the information concerning the offering confidential gave rise to the predicate duty necessary for misappropriation liability, and that he could not trade once he agreed to keep the information confidential. In so arguing, the SEC relied upon Rule 10b5-2, which they asserted creates "a duty of trust of confidence" whenever "a person agrees to maintain information in confidence."

### Procedural History

Initially, the district court granted Cuban's motion to dismiss the SEC's complaint holding that a third party (such as Cuban) who accepts material, nonpublic information from an issuer on a confidential basis is not precluded from trading on that information absent a specific agreement with the issuer not to trade. *S.E.C. v. Cuban*, 2009 WL 2096166 (N.D. Tex. July 17, 2009).

The district court noted that at the heart of the case was "[t]he nature of the duty required to support misappropriation theory liability." Although the court dismissed the SEC's claims, it rejected Cuban's primary argument that "liability under the misappropriation theory depends upon the existence of a preexisting fiduciary or fiduciary-like relationship." Discussing the Supreme Court's ruling in *United States v. O'Hagan*, 521 U.S. 642 (1997) – the landmark decision recognizing the misappropriation theory – the district court reiterated that "the essence of the misappropriation theory is the trader's undisclosed use of material, nonpublic information that is the property of the source, in breach of a duty owed to the source to keep the information confidential

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and not to use it for personal benefit."

The court determined that "a duty sufficient to support liability under the misappropriation theory can arise by agreement absent a preexisting fiduciary or fiduciary-like relationship." The court noted that "[t]he goal of protecting the integrity of the securities markets and promoting investor confidence would be achieved just as effectively by enforcing duties of nondisclosure and non-use that arise by agreement as by enforcing duties that flow from the nature of the relationship between the information source and the misappropriator." Rejecting Cuban's argument that such a rule would constitute an impermissible extension of insider trading liability, the court held that "although the source of a duty adequate to support insider trading liability *can* be found in state law … it may be located elsewhere without violating the general rule against creating federal common law."

Nonetheless, in dismissing the complaint, the court found that to establish the duty necessary to support liability under the misappropriation theory, the agreement must have the "proper components." The agreement "must consist of more than an express or implied promise merely to keep the information confidential. It must also impose on the party who receives the information the legal duty to refrain from trading on or otherwise using the information for personal gain." According to the SEC's allegations, Cuban merely agreed to keep the information regarding the offering confidential - not to refrain from trading. Thus, his agreement with Mamma.com did not give rise to the duty necessary to support insider trading liability predicated upon misappropriation.

After the court dismissed the action, the SEC appealed to the Fifth Circuit. Reviewing the district court's ruling *de novo*, the Fifth Circuit noted its disagreement with the lower court's interpretation of the facts. It commented that only *after* Cuban told the company's CEO "I can't sell" did the company send him more information about the PIPE offering. According to the appellate court, that factual allegation, among others, provided "more than a plausible basis to find that the understanding between the CEO and Cuban was that he was not to trade." The Fifth Circuit thus concluded that it was premature for the lower court to dismiss the action based on one plausible interpretation of the facts alleged in the SEC's complaint. In remanding the case to the district court, the court acknowledged the "paucity of jurisprudence" on the question of what constitutes a "relationship of trust and confidence" and the "inherently fact-bound nature of determining whether" Cuban's interaction with the company had created a duty to abstain from trading on nonpublic information. The Fifth Circuit also declined to "reach the validity of Rule 10b5-2(b)(1)," which the SEC argued imposed liability under the misappropriation theory based on an agreement to maintain information in confidence, without an agreement not to trade.

After remand to the district court and further discovery, Cuban sought summary judgment arguing that there was insufficient evidence justifying a trial.

## The District Court's Summary Judgment Ruling

The court first rejected Cuban's argument that to establish his agreement to keep information about the PIPE offering confidential and not trade, the SEC had to demonstrate that there was a "valid offer and acceptance plus a meeting of the minds supported by consideration" regarding such an agreement. The court held that the SEC need only show the existence of an *implicit* agreement to maintain the confidentiality of Mamma.com's material, nonpublic information and to not trade on that information. The court concluded that a reasonable jury could find from the "I can't sell" comment that Cuban considered himself foreclosed from trading because he believed he had agreed to keep the information confidential. The court also noted that there was evidence that Cuban requested more information about the PIPE offering following the phone call, which could also lead a reasonable jury to find that Cuban and Mamma.com implicitly agreed that Cuban would not use the information for his own personal benefit. However, the court also noted that "there is substantial record evidence that Cuban did *not* ask to see the terms and conditions" of the PIPE offering and that Mamma.com's CEO invited Cuban to contact the investment bankers. In reaching its conclusion on this aspect of the ruling, "the court emphasize[d] the closeness of this call."

Cuban also argued that because he disclosed his intention to trade on the PIPE offering information, he could not be liable under a misappropriation theory. Although the court confirmed that if Cuban had disclosed his intention to trade, there could be no liability, the evidence was not clear that Cuban had disclosed his intention to sell his shares *before* Mamma.com announced the PIPE transaction. Importantly, the district court rejected the SEC's argument that Cuban was obligated to provide Mamma.com "sufficient time to take action to prevent the recipient's trading on the information."

Finally, the court rejected Cuban's argument that the SEC could not prove that information about the PIPE offering was material and nonpublic. The court held that materiality was a question for the jury and that there was evidence – including expert opinion on the dilutive effects of the PIPE offering – that the information disclosed to Cuban was material. The court further found that there was evidence that the PIPE information was nonpublic because it was provided to only a limited number of prospective investors and was not broadly disclosed to the investing public.

In this regard, the court found significant that Cuban, Mamma.com's largest shareholder, was not aware of the PIPE offering until "the eve of the public announcement of the offering."

## Conclusion

The "closeness" of the call on the issue of whether Cuban agreed not to trade, as well as the disputed evidentiary record generally, suggests that the credibility of the witnesses will be critical at trial. In the end, however, the lesson of *S.E.C. v. Cuban*, is that persons in possession of what might be material, nonpublic information should exercise extreme caution before engaging in securities trading – even when there is no express agreement to keep the information confidential or otherwise restrict its use. The fact that an "implied" agreement not to trade or keep information confidential may be sufficient to trigger the insider trading laws is a sobering reminder that communications between corporate insiders and outsiders should be conducted with extreme care. Expectations should be made clear and memorialized in writing whenever possible to prevent a clash of recollections, often many years after the events in question.

Lastly, even after the upcoming jury trial, the Fifth Circuit may have to address issues that it did not rule on during the first appeal, such as the question of whether a promise to keep information confidential, rather than a specific agreement not to trade, is sufficient to create a duty under the misappropriation theory.