WHAT'S COOKIN' IN DALLAS? COURT DISMISSES INSIDER TRADING CHARGES AGAINST MARK CUBAN

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To Our Clients and Friends:

On July 17, 2009, the United States District Court in Dallas, Texas (the "Court") presiding over the SEC's civil action against Mark Cuban ("MC") dismissed insider trading charges relating to MC's sale of shares of Mamma.com Inc. (the "Company"). The dismissal is worth noting due to the profile of the case and, more importantly, the court's analysis regarding the "misappropriation theory" of insider trading liability.

The relevant allegations from the SEC's complaint can be summarized as follows:

- In March 2004, MC purchased 600,000 shares in the Company.
- In the spring of 2004, the Company's CEO told MC about a proposed PIPEs offering and prefaced the conversation with disclosure regarding the confidential nature of the information he intended to share with MC. MC agreed to keep the information he received confidential.
- Following his call with the Company's CEO, MC sold all of his shares. Based on the opening trading price of the Company's shares following the announcement of the PIPEs offering, MC avoided losses in excess of $750,000 by selling prior to the announcement of the PIPEs offering.
- MC did not inform the Company of his intention to trade on the information that he had been given in confidence and that he had agreed to keep confidential.

The SEC's claims against MC were based on the misappropriation theory of insider trading liability recognized by the Supreme Court in *United States v. O'Hagan*. Put simply, the theory holds that when a person other than a corporate insider misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information, that person commits a fraud in connection with a securities transaction and thereby violates Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 and possibly other antifraud provisions of the federal securities laws. The Court easily rejected most of the grounds upon which MC moved to dismiss the SEC's complaint, but then focused on the nature of the duty required to support misappropriation theory liability.

Citing *O'Hagan*, the Court explained that the key to the misappropriation theory is "deception through nondisclosure." Reasoning that since the *O'Hagan* Court made clear that a person can avoid misappropriation theory liability by disclosing to the source of the confidential information an intention to trade on the basis of such information, the Court stated that "nonpublic information cannot be deceptive unless the trader is under a legal duty to refrain from trading on or otherwise using it for personal benefit." The Court made clear that while the requisite "legal duty" can arise by agreement, the agreement alleged between MC and the Company's CEO did not contain such an agreement. As such, MC's sale of Company shares did not violate any duty running to the source of the confidential information, and MC did not commit a fraud as required under the misappropriation theory. It is worth noting that had MC and the Company's CEO had a fiduciary or fiduciary-like relationship, the Court probably would have come to a different conclusion since the Court explains that "both nondisclosure and non-use comprise part of the duty that arises by operation of law when a fiduciary relationship is created."

The Court next considered the alternative SEC position that Rule 10b5-2(b)(1) provided the requisite "legal duty" for purposes of the misappropriation theory of liability. Rule 10b5-2 provides a non-exclusive definition of circumstances in which a person has a duty of trust or confidence for purposes of the misappropriation theory of insider trading. Rule 10b5-2(b)(1) provides that a duty of trust or confidence exists whenever a person agrees to maintain information in confidence. Drawing on its reasoning as summarized above, the Court determined that since nothing in Rule 10b5-2(b)(1) requires that the confidentiality agreement encompass an obligation not to trade on or otherwise use the information, the SEC could not rely on it to establish MC's liability under the misappropriation theory. To do so would, in the words of the Court, "exceed the SEC's Section 10(b) authority to proscribe conduct that is deceptive."

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Because of the nature of the issues addressed in this case and the Court's somewhat novel theory of the "duty" required to support an insider trading claim under the misappropriation theory, it is unclear whether the SEC can or will take advantage of the opportunity the Court has provided to amend its complaint to include allegations that MC's agreement included, at least implicitly, an agreement not to trade or otherwise benefit personally from the information on the PIPEs transaction. The SEC may also determine that the issues are so important to an essential aspect of its enforcement program that it may elect to move directly to an appeal. In either case, we fully expect that the issues will ultimately reach the Fifth Circuit Court of Appeals.

Please do not hesitate to call us to discuss the Court's decision in this matter or any of the issues raised by this memorandum generally.

Paul R. Berger
+1 202 383 8090
prberger@debevoise.com

Matthew E. Kaplan
+1 212 909 7334
mekaplan@debevoise.com

Jonathan R. Tuttle
+1 202 383 8124
jrtuttle@debevoise.com