UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 09-10996

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellant,

v.

MARK CUBAN,
Defendant-Appellee.

On Appeal from the United States District Court
for the Northern District of Texas

BRIEF OF MARK CUBAN, DEFENDANT-APPELLEE

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March 26, 2010

CERTIFICATE OF INTERESTED PARTIES
SEC v. Cuban (09-10996)

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

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STATEMENT REGARDING ORAL ARGUMENT

The Securities and Exchange Commission has requested oral argument. Mark Cuban agrees that oral argument may assist the Court in its consideration of the issues arising from the district court's order granting Mr. Cuban's motion to dismiss.

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STATEMENT OF ISSUES

The Securities and Exchange Commission ("SEC" or "Commission") is appealing the district court's dismissal of the SEC's civil enforcement action claiming that Mark Cuban engaged in insider trading violations of the antifraud provisions of the federal securities laws. The district court held that the SEC failed to adequately allege that Mr. Cuban's trading was deceptive and, therefore, actionable under Section 10(b) of the Securities Exchange Act. The district court also held that SEC Rule 10b5-2(b)(1), as applied in this case, exceeds the SEC's rulemaking authority and could not be relied on. The issues presented are:

(1) Whether a mere agreement to keep information confidential fails to give rise to a duty of disclosure and, therefore, cannot form the basis for insider trading liability under the misappropriation theory established by the Supreme Court in *United States v. O'Hagan*, 521 U.S. 642 (1997).

(2) Whether – even assuming *arguendo* that a mere agreement to keep information confidential gives rise to a duty of disclosure – trading securities breaches that agreement, acts as a deception upon the source of the information, and thereby forms the basis for insider trading liability under the misappropriation theory.

(3) Whether SEC Rule 10b5-2(b)(1), as applied in this case, is entitled to deference even though it goes beyond the scope of the SEC's rulemaking

authority as described by the Supreme Court, and the Supreme Court has held the plain meaning of Section 10(b) precludes liability for non-fraudulent conduct.

(4) Whether Rule 10b5-2(b)(1) applies in this case even though the SEC's own interpretive material demonstrates the Rule only applies to family or other personal relationships and the SEC does not allege such a relationship.

STATEMENT OF THE CASE

A. Nature of the Case

The SEC's Complaint alleges that Mr. Cuban engaged in insider trading when he sold his shares of Mamma.com Inc. securities in violation of Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, thereunder.[1] The district court granted Mr. Cuban's motion to dismiss the Complaint based on the SEC's failure to adequately allege that Mr. Cuban deceived Mamma.com and thereby committed securities fraud. The district court also found that SEC Rule 10b5-2(b)(1), 17 C.F.R. § 240.10b5-2 (the "Rule") as

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[1] As the district court noted, the parties agreed that, in this case, liability under Section 17(a) would be examined according to the same standards as under Section 10(b) and Rule 10b-5. *SEC v. Cuban*, 634 F. Supp. 2d 713, 717 n.2 (N.D. Tex. 2009).

applied in this case, exceeds the SEC's rulemaking authority under Section 10(b) and could not be relied on.

B. Statement of Facts

Mr. Cuban vigorously disputes the SEC's version of the facts – including the assertion that Mr. Cuban entered into a confidentiality agreement with Mamma.com – but for purposes of this appeal assumes the truth of the allegations in the Complaint as required by law.

Mamma.com was a Canadian company that operated an Internet search engine. *See* Mamma.com Inc., Annual Report (Form 20-F) (May 14, 2004).[2] (USCA5 82.) In March 2004, Mr. Cuban purchased 600,000 shares, or 6.3%, of Mamma.com's outstanding common stock. (Compl. ¶ 10, USCA5 11.) In compliance with SEC regulations, Mr. Cuban timely filed a Schedule 13G with the Commission disclosing his share purchase. *See* Mamma.com Inc., Schedule 13G (Mar. 15, 2004). (USCA5 84-88.) The SEC does not allege that Mr. Cuban had any relationship with Mamma.com other than as a minority shareholder.

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[2] In a motion to dismiss a securities fraud action, a court can consider "public disclosure documents required by law to be, and that have been, filed with the SEC, and documents that the plaintiffs either possessed or knew about and upon which they relied in bringing the suit, without, pursuant to Rule 12(b), converting the motion into one for summary judgment." *Fin. Acquisition Partners LP v. Blackwell*, 440 F.3d 278, 286 (5th Cir. 2006) (internal quotations and citation omitted).

During the spring of 2004, Mamma.com decided to engage in a private investment in public equity ("PIPE") offering and retained Merriman Curhan Ford & Co. ("Merriman") to serve as the placement agent. (Compl. ¶ 11, USCA5 11.) Although Mamma.com "anticipated" that Mr. Cuban would be upset about the forthcoming PIPE offering and would want to sell his shares, it nevertheless decided to tell him about the offering in advance of the public announcement. (*Id.* ¶¶ 12, 15, USCA5 11, USCA5 12.) The SEC alleges Mamma.com wanted to invite Mr. Cuban to participate in the PIPE offering. (*Id*. ¶ 15, USCA5 12.)

On June 28, 2004, just one day prior to the closing and announcement of the PIPE offering, the Chief Executive Officer ("CEO") of Mamma.com spoke with Mr. Cuban about the transaction for the first time. (Compl. ¶ 13, USCA5 11-12.) In that phone conversation, which lasted approximately eight minutes, the CEO allegedly "prefaced the call by informing Cuban that he had confidential information to convey to him, and Cuban agreed that he would keep whatever information the CEO intended to share with him confidential." (*Id.* ¶¶ 13, 14, USCA5 11-12.) The CEO then "proceeded to tell Cuban about the PIPE offering." (*Id.* ¶ 14, USCA5 12.) As anticipated by Mamma.com, Mr. Cuban reacted angrily to the information and indicated that he would sell his Mamma.com shares. (*Id.* ¶¶ 14, 15, USCA5 12.) According to company personnel, however, Mr. Cuban

also was concerned that he would be unable to sell his shares until after the PIPE offering was announced. (*Id.*)

Later that same day, the CEO of Mamma.com e-mailed Mr. Cuban with contact information for the Merriman sales representative. (*Id.* ¶ 16, USCA5 12-13.) Mr. Cuban spoke with the sales representative and reiterated his displeasure with the PIPE offering. (*Id.* ¶ 17, USCA5 13.) Mr. Cuban subsequently directed his broker to sell all of his Mamma.com shares. (*Id.* ¶ 18, USCA5 13.) Mr. Cuban's broker sold a small amount of the shares in after-hours trading on June 28, 2004, and sold the rest during regular trading hours on June 29, 2004. (*Id.* ¶¶ 19, 21, USCA5 13.) Mamma.com issued a press release about the PIPE offering on June 29, 2004 after the markets had closed. (*Id.* ¶ 22, USCA5 13.)

Mr. Cuban openly disclosed both his sale of Mamma.com shares and his reasons for selling. Mr. Cuban filed an amended Schedule 13G with the SEC stating that, *as of June 29, 2004*, he no longer held any shares of Mamma.com. *See* Mamma.com Inc., Schedule 13G (July 1, 2004). (USCA5 95-99.) In other words, Mr. Cuban immediately alerted the SEC and the public that he had sold his shares just prior to the announcement of the PIPE offering. According to the Complaint, Mr. Cuban also "publicly stated that he had sold his Mamma.com shares because the company was conducting a PIPE." (Compl. ¶ 25, USCA5 14.)

C. Proceedings in the District Court

On November 17, 2008, the SEC filed a Complaint against Mr. Cuban in the United States District Court for the Northern District of Texas, alleging that he engaged in insider trading in violation of Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, thereunder. (Compl. ¶¶ 28-33, USCA5 15-16.) On January 14, 2009, Mr. Cuban filed a motion to dismiss the Complaint under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief can be granted, and pursuant to Federal Rule of Civil Procedure 9(b) for failure to plead with particularity all of the circumstances constituting fraud. (USCA5 43-99.) *Amici curiae*, a group of five securities law professors, filed a brief in support of the motion to dismiss on February 5, 2009. (USCA5 200-203.) The SEC filed its opposition to the motion on February 27, 2009 (USCA5 217-247), and Mr. Cuban filed his reply on March 20, 2009. (USCA5 248-295.)

The district court granted the motion on July 17, 2009, based on the SEC's failure to adequately allege that Mr. Cuban deceived Mamma.com and thereby committed securities fraud. (USCA5 301-337.) *Cuban*, 634 F. Supp. 2d at 731. The district court also found that SEC Rule 10b5-2(b)(1), as applied in this case, exceeds the SEC's rulemaking authority under Section 10(b) and could not be

relied on. *Id.* The district court granted the SEC thirty (30) days to file an amended complaint. *Id*. On August 12, 2009, the SEC filed a notice stating that it did not intend to file an amended complaint. (USCA5 338-339.) *Cuban*, 634 F. Supp. 2d at 732. The district court subsequently dismissed the case with prejudice. *Id.* (USCA5 340-341.)

Mr. Cuban moved for sanctions on August 28, 2009, requesting that the SEC pay his attorneys' fees and litigation expenses. (USCA5 350-596.) Mr. Cuban contended in his sanctions motion that the SEC had insufficient evidence to support its claims, made factual misstatements in its Complaint, and had engaged in investigative misconduct. *Id.* The SEC filed its opposition to the motion on September 30, 2009 (USCA5 603-747), and Mr. Cuban filed his reply on October 28, 2009. (USCA5 750-764.) On December 4, 2009, the district court issued an order permitting discovery in connection with the motion and directing the parties to provide supplemental briefing following the discovery period.

SUMMARY OF THE ARGUMENT

The SEC has sued Mr. Cuban for insider trading based on a single, unsolicited phone conversation that Mr. Cuban had with the CEO of Mamma.com, a Canadian company in which Mr. Cuban was an investor. The call concerned a PIPE offering that Mamma.com was about to announce to the public. In its Complaint, the SEC alleges Mr. Cuban engaged in insider trading pursuant to

Section 10(b) of the Securities Exchange Act when he supposedly agreed to keep confidential the information about the offering he was about to receive, but then violated that alleged agreement by selling his Mamma.com stock based on the information.

Insider trading, however, is a securities fraud claim. The Supreme Court has held that under the misappropriation theory of insider trading – upon which the SEC exclusively relies – the relevant deception occurs when the recipient of material, nonpublic information, in violation of a *duty of disclosure* to the source of the information, trades securities. Accordingly, if an insider trading claim is based solely on the violation of an agreement, that agreement must create a duty of disclosure concerning the defendant's trading. The district court correctly dismissed the Complaint based on the SEC's failure to adequately allege that Mr. Cuban's supposed confidentiality agreement created *any* duty of disclosure concerning his securities trading. As a result, Mamma.com was not deceived when Mr. Cuban traded and there can be no basis for a securities fraud claim.

In this case, the SEC is improperly attempting to convert an alleged breach of contract into a federal securities fraud. The SEC's attempt fails for two reasons. First, courts have uniformly held that a confidentiality agreement does not create the type of relationship of trust and confidence that gives rise to a duty of disclosure. Without this duty of disclosure, Mr. Cuban had no obligation to inform

Mamma.com that he was going to breach his supposed confidentiality agreement and his failure to do so was not deceptive. Second, even assuming *arguendo* that the supposed confidentiality agreement created a duty of disclosure, it did not prevent Mr. Cuban from trading. The SEC's Complaint merely alleges that Mr. Cuban agreed to keep Mamma.com's information "confidential." There are no allegations establishing the existence of a no-trade provision. The district court therefore correctly held that Mr. Cuban's actions could not have deceived Mamma.com because his trading did not breach the alleged agreement.

The SEC's reliance on its own Rule 10b5-2(b)(1) – which the SEC argues creates insider trading liability based solely on the breach of a confidentiality agreement – is unavailing. As found by the district court, the Rule exceeds the SEC's rulemaking authority under Section 10(b), which is limited to proscribing securities fraud. Moreover, the Rule is not entitled to *Chevron*[3] deference because Section 10(b) unambiguously prohibits only fraud and the Rule's conversion of a breach of contract into a fraud is an unreasonable interpretation of Section 10(b). Finally, the Rule, as properly construed, only applies to family and other personal relationships and therefore has no applicability in this case.

The SEC's Complaint is a part of a transparent plan by the agency, through its enforcement program and its rulemaking, to expand the scope of insider trading

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[3] *See Chevron U.S.A. Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984).

liability. In a speech made shortly before the Complaint was filed, the SEC's director of enforcement made it clear that the Commission is bringing suits that "confront" the limits of insider trading law.[4] Attempting to stretch the anti-fraud provisions of the federal securities laws to cover non-fraudulent conduct, however, is simply going too far. The district court's dismissal of the SEC's Complaint against Mr. Cuban should be affirmed.

STANDARD OF REVIEW

The grant of a motion to dismiss for failure to state a claim is reviewed "*de novo*, 'accepting all well-pleaded facts as true and viewing those facts in the light most favorable to the plaintiffs.'" *Dorsey v. Portfolio Equities, Inc.*, 540 F.3d 333, 338 (5th Cir. 2008) (quoting *Stokes v. Gann*, 498 F.3d 483, 484 (5th Cir. 2007)). However, a plaintiff's pleading obligation "requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do, . . . [the] [f]actual allegations must be enough to raise a right to relief above the speculative level." *Bell Atl. Corp. v. Twombley*, 550 U.S. 544, 555 (2007). This Court "will not strain to find inferences favorable to the plaintiff." *Dorsey*, 540 F.3d at 338 (quoting *Southland Secs. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 361 (5th Cir. 2004)).

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[4] *See* Linda C. Thomsen, Director, Division of Enforcement, SEC, *Opening Remarks to the Securities Industry and Financial Markets Association Regulatory Symposium on Insider Trading* (May 19, 2008), *available at* http://www.sec.gov/news/speech/2008/spch051908lct.htm.

In addition, because the SEC asserts insider trading claims, which sound in fraud, the SEC must meet the heightened pleading requirements of Federal Rule of Civil Procedure 9(b). *Williams v. WMX Techs., Inc.*, 112 F.3d 175, 178 (5th Cir. 1997) (Rule 9(b) should be applied "with force, without apology."). Under Rule 9(b), plaintiffs must "plead[] fraud with particularity" using enough facts to illustrate "the 'who, what, when, where, and how' of the alleged fraud." *Carroll v. Fort James Corp.*, 470 F.3d 1171, 1174 (5th Cir. 2006) (quoting *Williams v. Bell Helicopter Textron, Inc.*, 417 F.3d 450, 453 (5th Cir. 2005)). In cases involving fraudulent omission of facts, "Rule 9(b) typically requires the claimant to plead the type of facts omitted, the place in which the omissions should have appeared, and the way in which the omitted facts made the representations misleading." *Id.* (quoting *United States ex rel. Riley v. St. Luke's Episcopal Hosp.*, 355 F.3d 370, 381 (5th Cir. 2004)). The SEC therefore must plead with particularity all of the circumstances constituting fraud under the misappropriation theory, including that Mr. Cuban breached a duty of disclosure to the source of the information. *See, e.g.*, *O'Hagan*, 521 U.S. at 652, 666.

ARGUMENT

THE DISTRICT COURT CORRECTLY DISMISSED THE COMPLAINT BASED ON THE SEC'S FAILURE TO ADEQUATELY ALLEGE FRAUD AS REQUIRED UNDER SECTION 10(b)

A. Mr. Cuban's Supposed Confidentiality Agreement Did Not Give Rise to a Duty of Disclosure and, Therefore, a Breach of the Agreement Could Not Form the Basis for Fraud Liability

The district court correctly dismissed the Complaint on the basis that the SEC has failed to adequately allege that Mr. Cuban's breach of a confidentiality agreement constituted a fraud. A bare confidentiality agreement does not create a relationship of trust and confidence and an accompanying duty of disclosure. In the absence of this duty, Mr. Cuban cannot be liable for insider trading under the misappropriation theory based on his failure to disclose to Mamma.com that he planned to sell his shares in the company.

1. The misappropriation theory of insider trading prohibits trading on the basis of material, nonpublic information in breach of a duty of disclosure to the source of the information

No federal statute expressly prohibits insider trading. Therefore, the SEC primarily has used Section 10(b) of the Securities Exchange Act, and its rules promulgated under that provision, to cover this conduct. As the Supreme Court has described the statute's scope: "Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud." *Chiarella v. United States*, 445 U.S. 222, 234-35 (1980); *see also United States v. Finnerty*, 533 F.3d 143, 150 (2d Cir.

2008) (same); *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 963 (5th Cir. 1981) (same). Manipulation and deception are the touchstones of Section 10(b) liability. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473 (1977) ("The language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception."). Section 10(b) thus makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any *manipulative* or *deceptive* device or contrivance." 15 U.S.C. § 78j(b) (emphasis added).

The only statutory term at issue in this case is "deceptive." In *O'Hagan*, the Supreme Court adopted the misappropriation theory of insider trading, pursuant to which the SEC has brought its case against Mr. Cuban. Under the misappropriation theory, Section 10(b)'s prohibition against the use of a "deceptive device or contrivance" is violated when a person "misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information." 521 U.S. at 652. The duty that must be owed to the source of the information is a duty of disclosure. *Id*. at 654 ("Deception through nondisclosure is central to the [misappropriation] theory . . . ."). Indeed, "[b]ecause the deception essential to the misappropriation theory involves feigning fidelity to the source of 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 § 10(b) violation . . . ." *Id.* at 655. Accordingly, this Court has held that the existence of the duty is an absolute prerequisite to Section 10(b) liability based on a "deception." *Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 389 (5th Cir. 2007).

In *Regents*, this Court specifically rejected a lower court's attempt to use a dictionary definition of "deceptive" to expand the scope of Section 10(b) liability. Instead, it found that the Supreme Court "has pointedly refused to define 'deceptive' in any way except through caselaw." 482 F.3d at 389. Based on the holdings in *Chiarella* and *O'Hagan*, this Court found that "a device . . . is not 'deceptive' unless it involves breach of some duty of candid disclosure." *Id.* As a result, "'deception' occurs where the misappropriator breaches his duty to his source, the act/scheme/omission (collectively 'device') is the trading of the security without disclosure." *Id.* at n.30.

2. A duty of disclosure arises from the existence of a "relationship of trust and confidence"

A duty of disclosure arises from the existence of a "relationship of trust and confidence" between the trader and the source of the information. *O'Hagan*, 521 U.S. at 652 (quoting *Chiarella*, 445 U.S. at 228). The Supreme Court has consistently found that this relationship is "akin to fiduciary duty" (*Chiarella*, 445 U.S. at 246 (Blackmun, J., Marshall, J., dissenting)) and has focused on fiduciary relationships in applying Section 10(b) to alleged frauds based on nondisclosure.

In *O'Hagan*, for example, the Court found that the trader, a partner in a law firm, engaged in insider trading under the misappropriation theory by violating a duty of disclosure that arose from his fiduciary relationship with his law firm's client, which was the source of the information. The Court cited the Restatement (Second) of Agency §§ 390, 395 (1958) for the proposition that an agent (such as an attorney) has a disclosure obligation if he uses the principal's information for his own benefit. 521 U.S. at 654-55.

Similarly, in its subsequent decision in *SEC v. Zandford*, the Court examined whether a securities broker who traded under a client's account and transferred the proceeds to his own account had Section 10(b) liability. 535 U.S. 813 (2002). The broker, who exercised discretionary authority over his client's account, had a fiduciary relationship with the client. *Id.* at 823. The Court found that the broker's actions were part of a single plan to deceive his client in connection with the purchase and sale of securities, but observed that "if the broker told his client he was stealing the client's assets, that breach of fiduciary duty might be in connection with a sale of securities, but it would not involve a deceptive device or fraud." *Id*. at 825 n.4.

The Supreme Court's jurisprudence has led the Second Circuit to conclude recently that there is a fiduciary relationship requirement for *any* alleged Section 10(b) violation that is *based on silence or nondisclosure* (e.g., insider trading under

the misappropriation theory). *SEC v. Dorozhko*, 574 F.3d 42, 48-49 (2d Cir. 2009).[5] Although the district court did not rely on this requirement in making its ruling (*see Cuban*, 634 F. Supp. 2d at 724 n.5), this Court does not have to address the issue to resolve the SEC's appeal. Whatever the source of the relationship of trust and confidence that gives rise to a duty of disclosure, the SEC has failed to adequately allege that Mr. Cuban owed any such duty to Mamma.com.

3. Mr. Cuban's supposed confidentiality agreement did not create a relationship of trust and confidence and an accompanying duty of disclosure

According to the SEC's Complaint, Mamma.com's "CEO prefaced the call by informing Cuban that he had confidential information to convey to him, and Cuban agreed that he would keep whatever information the CEO intended to share with him confidential." (Compl. ¶ 14, USCA5 12.) On the basis of this alleged confidentiality agreement, entered into at arms-length and containing no additional terms, the SEC asserts Mr. Cuban consented to the "functional equivalent of a traditional fiduciary relationship" and owed a duty of disclosure to Mamma.com

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[5] The SEC's citation to *Dorozhko* for the concept that a fiduciary relationship is not required for an "actionable claim under Section 10(b)" is disingenuous. (SEC Br. at 21.) The Second Circuit held that a fiduciary relationship *is* required for a claim based on *silence or non-disclosure* but *is not* required for a claim based on an *affirmative misstatement*. The SEC's action against Mr. Cuban is based on his alleged failure to disclose to Mamma.com that he was going to sell his shares (i.e., applying the misappropriation theory). (*See* Compl. ¶ 25, USCA5 14 (Cuban failed to disclose).) The SEC does not allege, and has never argued, that Mr. Cuban made any affirmative misstatement to Mamma.com.

that he violated when he sold his shares in the company. (SEC Br. at 23.) As a matter of basic contract and tort law, the SEC is wrong.

The SEC argues that the requisite duty "may arise by agreement, such that trading on the confidential information, while pretending to faithfully safeguard it, deceives the source of the information and therefore satisfies the 'deception' requirement of Section 10(b)." (SEC Br. at 18.) There is nothing controversial about this point, which was embraced by the district court. *Cuban*, 634 F. Supp. 2d at 724 ("there is no apparent reason why that duty cannot arise by agreement").[6] What the SEC completely fails to address is how a *confidentiality agreement* (without more) could create a "duty of candid disclosure" to the source of the information. The SEC ignores this issue because it presumably understands that its position is both unsupported and unsupportable.

As Mr. Cuban argued before the district court, the legal basis for determining what facts and circumstances give rise to the requisite duty of disclosure must come from state law. *See O'Melveny & Myers v. FDIC*, 512 U.S. 79, 87 (1994) (creation of federal common law discouraged); *Santa Fe*, 430 U.S. at

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[6] For example, a person could assume a fiduciary duty via an agreement, which would include a duty of disclosure if the person decided to use information he obtained as a result of the agreement for his own benefit. *See* Rafael Chodos, *The Law of Fiduciary Duties* § 1.1 (Blackthorne Legal Press 2001) ("A person may undertake a fiduciary duty by contract, and this contract may include an explicit agreement regarding fiduciary duty. We call the agreement 'explicit' when it includes, as one of its terms, an agreement by one party to hold something *in trust* for the other, or to act as *fiduciary* for another.").

479-80 (rejecting creation of "federal fiduciary principle" for purposes of Section 10(b) liability); *Croy v. Campbell*, 624 F.2d 709, 716 n.7 (5th Cir. 1980) (Congress did not intend in Section 10(b) to "'federalize' state rules of law dealing with fiduciary relationships"). Indeed, in a recent decision, the Delaware Chancery Court analyzed the question closely and found that "the federal insider trading regime as currently structured rests on a foundation of state law fiduciary duties." *Pfeiffer v. Toll*, C.A. No. 4140-VCL, 2010 WL 745001, at *20 (Del. Ch. Mar. 3, 2010). Given that all of Mr. Cuban's alleged actions took place in Texas, Texas state law should apply. *Benchmark Elecs., Inc. v. J.M. Huber Corp.*, 343 F.3d 719, 727 (5th Cir. 2003) (Texas courts decide choice of law issues using "most significant relationship" test). The SEC disagrees with this conclusion. (SEC Br. at 33-34.)[7]

The Court does not need, however, to address this choice of law question. The SEC fails to cite – and exhaustive research by counsel for Mr. Cuban did not reveal – *any* judicial decision holding that a person who enters into a bare confidentiality agreement has an affirmative obligation to inform the source of the

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[7] In the SEC's view, "the question of whether the defendant has breached a duty is federal." (SEC Br. at 33.) The SEC does not address why this approach is permissible under the *O'Melveny* and *Santa Fe* decisions. Indeed, the SEC's only substantive argument against the "state-law-only approach" is that it "would result in an undesirable lack of uniformity." (SEC Br. at 34 n.8.) The Supreme Court and this Court, however, have already rejected that argument. *O'Melveny*, 512 U.S. at 88 (desire for uniformity insufficient basis for creation of federal common law); *see also Leach v. FDIC*, 860 F.2d 1266, 1274 n.14 (5th Cir. 1988) (same).

information if he plans to breach the agreement (i.e., a duty of disclosure). To the contrary, courts are uniform in their rejection of the idea that these agreements create a "confidential relationship" that can lead to tort liability based on a breach. *See, e.g.*, *Nolan Bros. of Tex., Inc. v. Whiteraven, L.L.C.*, No. 99 Civ. 10256, 2004 WL 376265, at *1 (S.D.N.Y. Feb. 27, 2004) (confidentiality agreement does not create fiduciary relationship); *City Solutions, Inc. v. Clear Channel Commc'ns, Inc.*, 201 F. Supp. 2d 1048, 1049 (N.D. Cal. 2002) (same); *Anglo-Dutch Petroleum Int'l, Inc. v. Smith*, 243 S.W.3d 776, 782 (Tex. App. – Houston [14th Dist.] 2007, pet. denied) (same); *Ramco Oil & Gas Ltd. v. Anglo-Dutch (Tenge) L.L.C.*, 207 S.W.3d 801, 827 (Tex. App. – Houston [14th Dist.] 2006, pet. denied) (same).

It is for good reason that courts have been reluctant to find the existence of a fiduciary-like relationship based on a bare confidentiality agreement – it is impossible to reconcile that position with either the common law or common sense. There is nothing about agreeing to keep information confidential that would alert the recipient of the information to the existence of some broader relationship of trust and confidence that goes beyond the contract's terms. Indeed, as several federal courts have noted, the need to enter into a confidentiality agreement suggests "arm's length dealings between co-equals" and the *absence* of any relationship of trust and confidence. *See City Solutions*, 201 F. Supp. 2d at 1049; *Nolan Bros.*, 2004 WL 376265 at *1 (same).

4. In the absence of a duty of disclosure, Mr. Cuban's alleged breach of his supposed confidentiality agreement was not fraudulent

Because confidentiality agreements do not create a relationship of trust and confidence (or accompanying duty of disclosure), courts treat confidentiality agreements as standard contracts subject to contract law. *See, e.g.*, *CQ Inc. v. Txu Mining Co.*, 565 F.3d 268, 278-79 (5th Cir. 2009) (applying contract damages analysis to confidentiality agreement). Under well-established contract law, a contract serves only to establish a legal relationship between two parties; "it gives each party nothing more than a legal expectancy in having the other party *either* perform *or* (generally) respond in damages." *United States v. Blankenship*, 382 F.3d 1110, 1133 (11th Cir. 2004) (emphasis added). A "promise" contained in a contract is not a guarantee that the promisor will actually perform the specified acts, but is instead a grant of a legal right to the other party to either receive performance or recover damages. *Id.* Indeed, the concept of "efficient breach" is that a party *should* abrogate its contractual responsibilities if a more profitable opportunity comes along. *See Thyssen, Inc. v. S.S. Fortune Star*, 777 F.2d 57, 63 (2d Cir. 1985) ("[B]reaches of contract that are in fact efficient and wealth-enhancing should be encouraged, and . . . such 'efficient breaches' occur when the breaching party will still profit after compensating the other party for its 'expectation interest.'"). Accordingly, it should be no surprise to a contracting party that the contract may be breached.

As it turns out, Mr. Cuban fully performed under the supposed confidentiality agreement when he did not disseminate the information about Mamma.com's upcoming PIPE transaction to others. In other words, the Complaint fails to allege that Mr. Cuban even breached the agreement (*see* Section B below). Although the SEC now claims, in reaction to the district court's dismissal of its Complaint, that a confidentiality agreement must incorporate a no-trade provision, the SEC's new theory does not change the legal analysis.

Even if this Court were to find the SEC had adequately alleged that Mr. Cuban breached his supposed confidentiality agreement by trading, it is black-letter law that a failure to perform a contractual promise, even without excuse, is not evidence of fraud. *See Valdes v. Leisure Res. Group, Inc.*, 810 F.2d 1345, 1350 n.4 (5th Cir. 1987). If it were, "*every breach of contract would amount to fraud*." *Id.* (quoting *William B. Roberts, Inc. v. McDrilling Co.*, 579 S.W.2d 335, 340 (Tex. Civ. App. – Corpus Christi 1979, no writ)). Instead, a party to a contract "is free to pursue its own interests, even if it results in a breach of that contract, without incurring tort liability." *Crim Truck & Tractor Co. v. Navistar Int'l Transp. Corp.*, 823 S.W.2d 591, 594 (Tex. 1992).[8]

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[8] The only exception to this general rule is where the plaintiff alleges that "the promise was made with no intention of performing at the time it was made." *Herman Holdings Ltd. v. Lucent Techs., Inc.*, 302 F.3d 552, 564 (5th Cir. 2002) (quoting *Formasa Plastics Corp. USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 48 (Tex. 1998)). Because the SEC fails to allege that Mr. Cuban did

In sum, in the absence of a duty of disclosure that could form the basis of a "deception" under Section 10(b), there can be no securities fraud action (including no action for insider trading liability pursuant to the misappropriation theory) against Mr. Cuban for using the information he received to trade securities.

5. The Court should reject the SEC's attempt to create a new type of fraud

The SEC apparently believes that Mr. Cuban unfairly avoided losing money on his Mamma.com shares. (*See, e.g.*, SEC Br. at 31 ("Cuban's informational advantage over other investors was not based on research or skill.").) Financial unfairness, however, is not actionable under Section 10(b). In a recent decision – *United States v. Finnerty*, 533 F.3d 143 – the Second Circuit addressed a similar effort by the Department of Justice to expand the scope of Section 10(b). The Department of Justice brought a securities fraud case against a New York Stock Exchange specialist that executed trades for market participants. The court found that while the specialist may have "unfairly profited from superior information . . .

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not intend to perform under the supposed confidentiality agreement when it was entered into, this type of fraud claim is not sustainable here. *See, e.g.*, *id.* Indeed, the SEC's Complaint disproves any such fraud claim. The Complaint concedes that at the outset of the call, when Mr. Cuban allegedly agreed to keep the information confidential, he did not know the nature of the information Mamma.com's CEO was about to provide him. (Compl. ¶¶ 12-14, USCA5 11-12.) Under these circumstances, Mr. Cuban could not have already formed an intention to breach the agreement by disseminating the unknown information or, under the SEC's erroneous theory of the scope of the agreement (*see* below), by trading his shares. This is presumably why the SEC did not attempt to invoke this type of fraud claim when the district court granted it leave to amend its Complaint.

'not every instance of financial unfairness constitutes fraudulent activity under § 10(b).'" *Id.* at 150 (quoting *Chiarella*, 445 U.S. at 232)). The government's attempt to characterize the specialist's conduct as "self-evidently deceptive" was insufficient – in the absence of "manipulation or a false statement, breach of a duty to disclose, or deceptive communicative conduct," there could be no Section 10(b) liability. *Id.*

The Court should reject the SEC's attempt to convert Mr. Cuban's alleged breach of a confidentiality agreement, which did not create any duty of disclosure, into a federal securities fraud. While the SEC may have broad powers to enforce Section 10(b), these powers emphatically do not include expanding the scope of the statute by labeling every supposed act of financial unfairness a fraud and thereby creating civil and criminal liability (*see also* Section C below).

B. Mr. Cuban's Trading Was Not a Breach of His Supposed Confidentiality Agreement and, As a Result, There Is No Basis for Fraud Liability

As shown above, a bare confidentiality agreement cannot form the basis for insider trading liability under the misappropriation theory because such an agreement does not give rise to the requisite duty of disclosure. The dismissal of the SEC's Complaint can be affirmed on that basis alone. The district court's decision, however, also provides a separate, threshold basis for finding that the Complaint is fatally deficient.

As set forth in the Complaint, Mr. Cuban allegedly agreed to keep the information he received confidential. He did not agree to refrain from securities trading or otherwise using the information for his own benefit. Even assuming, *arguendo*, that the recipient of information pursuant to a confidentiality agreement has a duty to disclose to the source of the information his intention to breach the agreement, this duty only would have required Mr. Cuban to inform Mamma.com if he was going to disseminate the information about the PIPE transaction to others, not if he was going to trade securities. In the absence of any alleged breach of the bare confidentiality agreement, there can be no deception that would lead to insider trading liability.

1. The Complaint only alleges that Mr. Cuban agreed to keep the information confidential and, as a result, Mr. Cuban's trading could not have deceived Mamma.com

According to the SEC's Complaint, Mamma.com's CEO "prefaced the call by informing Cuban that he had confidential information to convey to him, and Mr. Cuban agreed that he would keep whatever information the CEO intended to share with him confidential." (Compl. ¶ 14, USCA5 12.) The Complaint contains no other allegations about the terms of this oral agreement. In other words, Mr. Cuban is only alleged to have agreed not to disclose the information to others (i.e., keep the information confidential). There is no allegation that Mr. Cuban agreed

not to trade securities based on the information or otherwise use the information for his own benefit.

As the district court correctly held: "With respect to confidential information, nondisclosure and non-use are logically distinct." *Cuban*, 634 F. Supp. 2d at 725 (footnote omitted). A person can preserve the confidentiality of the information "while simultaneously using it for his own gain." *Id.* Indeed, "the nature of insider trading is such that one who trades on material, nonpublic information refrains from disclosing that information to the other party to the securities transaction." *Id.* Disseminating the information would actually eliminate the person's trading advantage. *Id.* Nor does the act of trading itself reveal the information.[9]

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[9] In a footnote, the SEC asserts that "it is a reasonable inference from the complaint that Cuban, by trading a large block of stock . . . communicated information about Mamma.com, in breach of his agreement to keep the information about the company confidential. Trading communicates information to the market." (SEC Br. at 40 n.10.) In support of this assertion, the SEC cites two academic papers for the proposition that insider trading impacts stock prices. The SEC's argument has no merit. First, for Mr. Cuban to have violated the confidentiality agreement, he would have had to disclose the information that was *the subject of the agreement* (i.e., regarding the PIPE transaction), not just any information about Mamma.com's securities. The SEC does not, because it cannot, make this allegation. Second, the SEC is surprisingly limited in its survey of the academic literature. Numerous other academics have concluded, based on empirical research, that trading by insiders does *not* communicate meaningful additional information to the market. *See, e.g.*, William J. Carney, *Signaling and Causation in Insider Trading*, 36 Cath. U.L. Rev. 863, 887 (1987) ("[T]here is evidence that insider trading generally provides only weak signals to traders. . . . In stocks with considerable liquidity, even institutions are able to buy or sell large

Although the district court appears to be the only court that has examined the scope of a confidentiality agreement in the context of an insider trading case, other judicial decisions support the district court's determination that "nondisclosure and non-use are logically distinct." *Cuban*, 634 F. Supp. 2d at 725 (footnote omitted). Notably, in *Wichita Clinic, P.A. v. Columbia/HCA Healthcare Corp.*, 45 F. Supp. 2d 1164 (D. Kan. 1999), the court evaluated the scope of a "letter of intent" pursuant to which the parties to a business transaction agreed to keep the information they received from each other confidential. *Id.* at 1205. The court found that because the confidentiality provision did "not prohibit either party from 'using' the confidential information," a breach could only occur "if one party is improperly 'disclosing' confidential information 'to any third party.'" *Id.*; *cf. Devon Robotics v. Deviedma*, No. 09-cv-3552, 2010 U.S. Dist. LEXIS 6219, at *3-6 (E.D. Pa. Jan. 26, 2010) (allowing breach of confidentiality agreement claim to proceed where defendant was alleged to have improperly used information and agreement specifically prohibited defendant "from *divulging or using* any confidential information for any purpose other than analyzing [the] deal") (emphasis added).

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blocks without changing the price from the previous trade."); Stephen M. Bainbridge, *The Insider Trading Prohibition: A Legal and Economic Enigma*, 38 U. Fla. L. Rev. 35, 44-45 (1986) (based on empirical studies "insider trading simply is not communicating inside information to the market").

Moreover, the district court's holding is in conformity with the Supreme Court's general admonition, in *O'Hagan*, that the securities transaction and the breach of duty must "coincide." 521 U.S. at 656; *see also Zandford*, 535 U.S. at 824-25 (same). It is not enough for there to be a breach of *any* duty followed by the purchase or sale of a security. As in *O'Hagan*, the misappropriation of the information for purposes of securities trading must be, without question, a breach of the duty at issue. The SEC's allegation that Mr. Cuban entered into a confidentiality agreement is insufficient because a contractual *promise to keep information confidential* does not give rise to *any* promises with respect to *trading* on the information. In other words, when a person merely agrees not to disclose information, a subsequent decision to trade on the information does not breach the confidentiality agreement or otherwise violate any duties accompanying that agreement.

As a result, even under the SEC's erroneous theory that Mr. Cuban's confidentiality agreement created a duty of disclosure if he intended to breach the agreement, there can be no fraud liability under Section 10(b). "Absent a duty not to use the information for personal benefit, there is no deception in doing so." *Cuban*, 634 F. Supp. 2d at 725.

2. The Court should reject the SEC's self-serving attempts to transform a bare confidentiality agreement into a no-trade agreement

Recognizing that it has not actually alleged a breach of the supposed confidentiality agreement that could give rise to some duty of disclosure, the SEC argues that an "agreement to maintain information in confidence includes an agreement not to trade." (SEC Br. at 21-33.) Accordingly, the SEC goes on to assert that Mr. Cuban breached the alleged confidentiality agreement when he sold his Mamma.com shares. (*Id.*) The SEC's arguments are entirely unpersuasive.

a. The alleged confidentiality agreement involved nothing more than a promise to keep the information about the PIPE transaction secret

As a threshold matter, the SEC does not explain why this Court should go beyond the four corners of the alleged contract in determining its meaning. *Matthews v. Wozencraft*, 15 F.3d 432, 441 (5th Cir. 1994) ("In construing a contract, we ascertain and give effect to the real intentions of the parties, as that intention is revealed by the language used in the agreement. . . . This is the 'four corners' rule: The entire instrument, taken by its four corners, must be read and considered to determine the true intentions of the parties."). Mr. Cuban supposedly agreed to the keep the information about Mamma.com's pending PIPE transaction "confidential." (Compl. ¶ 14, USCA5 12.) In determining the scope of the agreement, the SEC's reliance on the dictionary definitions of "confidence" and

"trust" is wildly misplaced. (SEC Br. at 22 n.5.) The relevant definition, if one is even required, is the legal dictionary definition of "confidential" – i.e., "known or conveyed to only a limited number of people." Merriam-Webster's Dictionary of Law (1996); *see also* Black's Law Dictionary 339 (9th ed. 2009) ("meant to be kept secret"). Therefore, Mr. Cuban promised – at most – not to disseminate the information to others. *See Wichita Clinic*, 45 F. Supp. 2d at 1205 (bare confidentiality agreement does not incorporate non-use provision).

b. Mamma.com's supposed "understanding" that the alleged confidentiality agreement contained a no-trade agreement is factually unsupported and legally irrelevant

The SEC suggests that Mr. Cuban's supposed confidentiality agreement must have incorporated a no-trade provision because it was "important to Mamma.com that Cuban . . . refrain from trading on the information." (SEC Br. at 24.) There are several reasons why this argument fails.

First, the SEC's claim that a no-trade provision was "important to Mamma.com" is belied by the SEC's own Complaint. According to the Complaint, Mamma.com's CEO "was instructed to contact Cuban and to preface the conversation by informing Cuban that he had confidential information to convey to him in order to make sure that Cuban understood – before the information was conveyed to him – that he would have to keep the information confidential." (Compl. ¶ 12, USCA5 11.) Nowhere does the Complaint allege that

Mamma.com sought to obtain anything more than an agreement from Mr. Cuban to keep the information confidential. *See Ware v. Associated Milk Producers, Inc.*, 614 F.2d 413, 414 (5th Cir. 1980) ("we must evaluate the correctness of the dismissal solely on the basis of the allegations in the complaint").

Second, whether it was "important to Mamma.com that Cuban . . . refrain from trading on the information" about the PIPE transaction is legally irrelevant. The SEC cannot rely on the ostensible understanding of Mamma.com to determine the scope of the alleged confidentiality agreement. As a matter of black letter contract law, a "determination of whether a meeting of the minds has occurred is based on an objective standard; thus, evidence of [one party's] subjective belief about what the contract says . . . is not relevant to whether there was a meeting of the minds." *Paciwest, Inc. v. Warner Alan Props., LLC*, 266 S.W.3d 559, 568 (Tex. App. – Fort Worth 2008, pet. denied). The alleged facts are that Mr. Cuban only agreed to keep the information confidential. He did not agree to refrain from using it for his own benefit.

Finally, the SEC's blanket assertion that all companies, including Mamma.com, enter into bare confidentiality agreements with the understanding that the agreements will also prevent trading is simply incorrect (as the SEC well knows). (SEC Br. at 23.) The chapter on "Traditional PIPE Transactions" in the Practicing Law Institute's treatise on Exempt and Hybrid Securities Offerings

provides some corrective counterbalance. Anna T. Pinedo and James R. Tanenbaum, *Exempt and Hybrid Securities Offerings* Vol. 1 § 13:3.3 (PLI 2009). In discussing best practices for a PIPE transaction, the treatise states that the issuer and placement agent should obtain "written confidentiality agreements with all potential investors" and refers readers to a form confidentiality agreement. *Id.* at 13-28 & n.50. The form confidentiality agreement, in turn, has the potential investor promise to (a) not disclose the information about the PIPE transaction to others, (b) maintain the information about the PIPE transaction in "trust and confidence," (c) not use the information for any "unauthorized purpose," and (d) specifically agree not to trade for a certain period. *Id.* at Vol. III, Form 15.[10] In other words, companies (and their counsel) understand that there is a distinction between an agreement to keep information confidential and an agreement not to trade. Moreover, the standard form confidentiality agreement for PIPE transactions creates a fiduciary-like relationship that clearly would give rise to

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[10] The securities market also understood back in 2004 that there was a difference between a confidentiality clause and a non-use clause, and often required recipients of information to agree to each covenant separately. *See, e.g.*, Axesstel, Inc., Current Report (Form 8-K), at Ex. 99.1 (Securities Purchase Agreement dated as of August 18, 2004 between the Registrant and Laurus Master Fund, Ltd., § 7.1 (confidentiality) and § 7.2 (non-use) (Aug. 18, 2004)), *available at* http://www.sec.gov/Archives/edgar/data/1092492/000119312504144433/dex991.htm; Kintera, Inc., Current Report (Form 8-K), at Ex. 10.9 (Form of Securities Purchase Agreement among the Company and the investors identified on the signature pages thereto, dated as of July 12, 2004, § 3.2(f)), *available at* http://www.sec.gov/Archives/edgar/data/1117119/000110465904019475/a04-7729_3ex10d9.htm.

insider trading liability if the potential investor traded the company's securities (*see* Section A above). All of this is a far cry from the bare confidentiality agreement alleged in the SEC's Complaint.

c. The insider trading cases cited by the SEC do *not* support its position that a bare confidentiality agreement incorporates a no-trade provision

The SEC then resorts to quoting snippets from various insider trading cases and arguing that these decisions "support the view that an agreement to maintain information in confidence necessarily includes an agreement not to trade." (SEC Br. at 25-29.) As the district court found, however, none of these cases actually "analyzes the nature of the agreement that is required for misappropriation theory liability." *Cuban*, 634 F. Supp. 2d at 726 n.7. The courts forego this analysis because they do not rely exclusively on the existence of a confidentiality agreement to find that the defendant had a duty of disclosure. In every decision cited by the SEC, the court also discusses the existence of a pre-existing confidential relationship. *See SEC v. Yun*, 327 F.3d 1263, 1273-74 (11th Cir. 2003) (evidence of husband-and-wife relationship involving "a history or pattern of sharing and keeping business confidences" and wife "explicitly accepted the duty to keep in confidence the business information she received"); *SEC v. Nothern*, 598 F. Supp. 2d 167, 173-76 (D. Mass. 2009) (evidence of longstanding, pre-existing confidential relationship between source of defendant's information

and the Treasury Department and they had express confidentiality agreement); *SEC v. Kornman*, 391 F. Supp. 2d 477, 488-89 (N.D. Tex. 2005) (course of communications between advisor and executives, as well as advisor's superior knowledge, led to development of confidential relationship and advisor provided materials indicating information would be kept confidential); *SEC v. Kirch*, 263 F. Supp. 2d 1144, 1150-51 (N.D. Ill. 2003) (parties had pre-existing membership in CEO Roundtable that had "express" confidentiality agreement and confidentiality agreement was reiterated directly before information was provided).[11] The courts' discussion of these pre-existing confidential relationships belies any contention that the decisions "support" the SEC's position. *Cf. United States v. Kim*, 184 F. Supp. 2d 1006, 1015 (N.D. Cal. 2002) ("an express [confidentiality] agreement can provide the basis for misappropriation liability only if the express agreement sets forth a relationship with the hallmarks of a fiduciary relationship").

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[11] Two other decisions cited by the SEC – *United States v. Falcone*, 257 F.3d 226, 234 (2d Cir. 2001) and *Compudyne Corp. v. Shane*, 453 F. Supp. 2d 807 (S.D.N.Y. 2006) – are inapposite. (SEC Br. at 26-29.) *Falcone* merely states that a fiduciary relationship or its functional equivalent exists only where there is either "explicit acceptance" of the requisite duty or where it may be implied from a "similar relationship of trust and confidence between the parties." 257 F.3d at 234. As discussed *supra*, Mr. Cuban does not dispute that a relationship of trust and confidence can be formed through the explicit acceptance of a fiduciary-like duty. *See* Section A above. *Compudyne* is not an insider trading case, but rather a claim for securities fraud based on an alleged misrepresentation. 453 F. Supp. 2d at 819.

d. The "various common law doctrines" cited by the SEC are inapposite

The SEC's assertion that "[v]arious common law doctrines also support the view that agreeing to maintain information in confidence includes agreeing not to trade" is similarly flawed. (SEC Br. at 29-30.) The SEC cites a contract law treatise for the notion that one who acquires knowledge of a trade secret has a duty not to disclose or use it for his own advantage even in the absence of a contract to that effect. Yet, as the title of the treatise section makes clear, it is the "permanence of the relationship" that is the key basis for finding the existence of this duty. 6 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 13:14 (4th ed. 2009) (citing Restatement (Third) of Agency § 8.05 (2006)). Mr. Cuban is not alleged to have any such permanent relationship with Mamma.com.

As for the SEC's reliance on *Dearborn Indus. Mfg. Co. v. Soudronic Finanz AG*, No. 95-cv-4414, 1997 WL 156589 (N.D. Ill. Apr. 1, 1997) and *North Atlantic Instruments, Inc. v. Haber*, 188 F.3d 38 (2d Cir. 1999), the SEC's carefully-selected quotations hide a multitude of sins. In *Dearborn*, the defendant was alleged to have fraudulently induced the plaintiff to enter into a confidentiality agreement so as to misappropriate the information he received. *Dearborn*, 1997 WL 156589 at *3. Not surprisingly, the court found the defendant had violated his covenant of good faith and fair dealing when he used the information for his own

benefit. *Id.* at *5. Mr. Cuban is not alleged to have engaged in a fraud-in-the-inducement.

In *North Atlantic*, the court held that an employee's duty not to use confidential information given to him by his employer was imposed by New York law and reinforced by an express confidentiality agreement. *North Atlantic*, 199 F.3d at 47. There is nothing novel about a case holding that an employee has a fiduciary relationship with his employer. *See United States v. Chestman*, 947 F.2d 551, 566 (2d Cir. 1991) (employee-employer relationship can form basis of insider trading liability). Mr. Cuban, of course, was not a Mamma.com employee.

e. The SEC fails to establish any public policy rationale for its position

In a last gasp effort to support its position, the SEC falls back on "public policy." (SEC Br. at 30-31.) It is certainly true, as recognized by the Supreme Court in *O'Hagan*, that investors would be reluctant to "venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law." 521 U.S. at 658. The key limitation, however, is that the information be "misappropriated." If the information is obtained by non-fraudulent means, the recipient can trade on the information. Indeed, the existence of "informational disparity is inevitable in the securities markets." *Id.*

The SEC suggests that the district court's decision "would cause anomalies" in the federal securities laws, including causing "the prohibitions on tipping and

trading" to become "disjointed" and creating a conflict with Regulation FD. (SEC Br. at 32.) These arguments are curious, to say the least. First, it is far from clear why the district court's decision would have any effect on insider trading liability based on "tipping" another person. Both the recipient of information obtained under a bare confidentiality agreement and anyone to whom he gave the information would be free to trade. The recipient of the information, however, might be subject to a breach of contract action for providing the information to a third party. Second, as the SEC concedes, Regulation FD was adopted simultaneously with Rule 10b5-2(b)(1). (*Id.*) To the extent that Rule 10b5-2(b)(1) is invalid as applied in this case (*see* Section D), it is hardly surprising that the SEC may need to revisit its rulemaking and make conforming changes to Regulation FD as well.

More importantly, the SEC fails to point to any disruption in the securities markets that has occurred, or will occur, because of the district court's ruling. If anything, the district court's decision reflects the existing common practice. As discussed above, participants in securities transactions already routinely insist that recipients of material, nonpublic information expressly agree to *both* keep the information confidential *and* not use it for their own benefit. *See* Section B(2)(b).

C. Mr. Cuban's Alleged Statement Concerning His Inability to Trade Was Neither a Confirmation of an Earlier Agreement Not to Trade Nor a Separate Agreement Not to Trade

After he had received the information about the PIPE transaction, Mr. Cuban allegedly said to Mamma.com's CEO: "Well, now I'm screwed. I can't sell." (Compl. ¶ 14, USCA5 12.) The SEC argues that this statement demonstrates Mr. Cuban's "understanding that he had agreed at the beginning of the call to abstain from trading on the basis of the confidential information." (SEC Br. at 35.) Moreover, the SEC declares, the district court committed "reversible error" when it failed to accept this "inference." (*Id.* at 36-37.) As it turns out, the problem lies not with the district court, but with the allegations in the SEC's Complaint. *See Dorsey*, 540 F.3d at 338 (court "will not strain to find inferences favorable to the plaintiff").

According to the Complaint, the only thing that Mr. Cuban agreed to do regarding the PIPE information was keep it "confidential." (Compl. ¶ 14, USCA5 12.) There are no allegations that Mamma.com's CEO sought an agreement not to trade or that Mr. Cuban entered into such an agreement. The SEC's requested inference is simply a rehash of its failed argument (*see* Section B) that a confidentiality agreement also incorporates a no-trade provision. Without this erroneous assumption, there can be no reasonable inference that Mr. Cuban acknowledged an agreement not to trade that *the Complaint does not even allege*

existed. The district court therefore correctly found that the statement merely "appears to express [Mr. Cuban's] belief, at least at that time, that it would be illegal for him to sell his Mamma.com shares based on the information the CEO had provided." *Cuban*, 634 F. Supp. 2d at 728. The fact that Mr. Cuban may have had this belief, of course, does nothing to establish the existence of a Section 10(b) violation. *See, e.g.*, *Finnerty*, 533 F.3d at 150-51 (evidence of "consciousness of guilt" does not demonstrate fraudulent conduct where government fails to establish elements of Section 10(b) violation).[12]

The SEC also asserts that Mamma.com confirmed the existence of Mr. Cuban's supposed agreement not to trade in internal e-mail correspondence. (SEC Br. at 38.) The two e-mails in question say nothing of the sort. Instead, they merely report that Cuban "said he would sell his shares (recognizing that he was not able to do anything until we announce the equity)" and "he will sell his shares, which he can not do until after we announce." (SEC Br. at 38-39 (emphasis omitted).) The e-mails do not report that Mr. Cuban even entered into a confidentiality agreement, never mind a confidentiality agreement that incorporated a no-trade provision. The district court correctly found that these e-

[12] The SEC goes on to claim that the district court's conclusion is "implausible" because it assumes that Mr. Cuban later concluded "it would actually be lawful for him to sell and proceeds to sell." (SEC Br. at 37.) Why it would be implausible for someone to conclude, upon reflection, that an agreement to merely keep information confidential would not actually prevent him from trading, the SEC does not say.

mails, at best, indicate that Mamma.com had a unilateral expectation that Mr. Cuban would not sell his shares until after the PIPE transaction was announced. *Cuban*, 634 F. Supp. 2d at 728. Mamma.com's expectation, however, did not create any obligation on the part of Mr. Cuban to abstain from trading. *See Walton v. Morgan Stanley & Co.*, 623 F.2d 796, 799 (2d Cir. 1980) (expectation of source that party receiving nonpublic information will not trade cannot create insider trading liability); *SEC v. Maydew*, 916 F. Supp. 123, 129-30 (D. Conn. 1995) (same); *see also Official Airlines Schedule Info. Serv., Inc. v. E. Air Lines, Inc.*, 333 F.2d 672, 674 (5th Cir. 1964) (person may not unilaterally impose upon another a relationship of trust and confidence).

Finally, the SEC cryptically suggests – without any legal or factual citations – that Mr. Cuban's alleged "now I'm screwed" statement might have constituted its own agreement not to trade. (SEC Br. at 36 ("even if Cuban were not viewed as having agreed not to trade at the beginning of the call . . . he had an understanding by the end of the call").) As the district court held, however, this argument has no merit. *Cuban*, 634 F. Supp. 2d at 728 ("This statement, however, cannot reasonably be understood as an agreement not to sell based on the information.").

First, the Complaint expressly states that this statement was an "acknowledgment that [Mr. Cuban] could not sell until after the public announcement." (Compl. ¶ 16, USCA5 12.) A mere acknowledgment does *not*

constitute an acceptance of a contractual obligation. *Transperfect Translations Int'l, Inc. v. Merrill Corp.*, 159 Fed. Appx. 313, 314 (2d Cir. 2005) (a "promise is a quite different thing from an acknowledgment").

Second, the statement cannot have acted as an acceptance of some earlier offer by Mamma.com to enter into a no-trade agreement because, as the SEC describes the chain of events, it came *after* Mamma.com's CEO provided the PIPE information to Mr. Cuban. The law is clear that an agreement cannot be formed by a gratuitous promise made after the consideration has been provided. *See, e.g.*, *TMC Worldwide, L.P. v. Gray*, 178 S.W.3d 29, 37-38 (Tex. App. – Houston [1st Dist.] 2005, no pet.) ("If anything in the classical law of contracts is clear, it is that past [or future] consideration is not good consideration." (citations omitted; bracketed text in original)); *see also* 4 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 8:11 (4th ed. 2008) ("something that has been given before the promise was made and, therefore, was neither induced by the promise nor paid in exchange for it, cannot, properly speaking, be sufficient, valid, legal consideration").

Third, any suggestion by the SEC that this statement was an acceptance of a new offer by Mamma.com to enter into a no-trade agreement in consideration for additional information about the PIPE transaction from Mamma.com's private placement agent is something that the SEC has made up out of whole cloth. The

Complaint is bereft of *any* allegations that such an offer was ever made or accepted. *See Ware*, 614 F.2d at 414 ("we must evaluate the correctness of the dismissal solely on the basis of the allegations in the complaint").

D. The SEC's Reliance On Rule 10b5-2(b)(1) Is Unavailing

1. Rule 10b5-2(b)(1), as applied by the SEC, is invalid

The SEC's argument that Rule 10b5-2(b)(1) creates insider trading liability based solely on the breach of a confidentiality agreement cannot salvage the SEC's claim against Mr. Cuban. The SEC argues that the Rule "provides that an agreement to maintain information in confidence gives rise to a duty that makes trading on the confidential information without disclosure deceptive." (SEC Br. at 10.) For all of the reasons shown above, however, under *Chiarella*, *O'Hagan*, and *Regents*, the mere breach of a confidentiality agreement does *not* fall within the scope of Section 10(b). A confidentiality agreement does not give rise to any duty of disclosure (much less a disclosure duty that would be violated by merely *trading* on the confidential information), and a breach of the agreement does *not* amount to fraud and deception under Section 10(b). (*See supra* at Section A(3).) That the SEC chose to codify in Rule 10b5-2(b)(1) its improper construction of Section 10(b) does not render the SEC's construction any more valid.

The district court therefore correctly held that Rule 10b5-2(b)(1) – at least as construed by the SEC in this case – exceeds the SEC's rulemaking authority under

Section 10(b). *Cuban*, 634 F. Supp. 2d at 730-31; *see also, e.g.*, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976) (under Section 10(b), the SEC may not make new law, but rather is limited to "adopt[ing] regulations to carry into effect the will of the Congress as expressed by the statute." (internal citations omitted)); *O'Hagan*, 521 U.S. at 671 (Section 10(b) "simply authorizes the SEC to proscribe 'manipulative or deceptive devices or contrivances'").

The SEC counters that even if Rule 10b5-2(b)(1) reflects a construction of Section 10(b) that differs from the Supreme Court's, the Rule nevertheless is valid because it is entitled to *Chevron* deference. (SEC Br. at 16-18.) This argument is unavailing for multiple reasons.

a. Rule 10b5-2(b)(1) is not entitled to *Chevron* deference because Section 10(b) is unambiguous

The SEC promulgated Rule 10b5-2(b)(1) several years *after* the Supreme Court held in *Chiarella* and *O'Hagan* that Section 10(b) reaches only fraud and that the misappropriation theory is based upon deception through the breach of a duty of disclosure. (*See supra* at Section A(1).) Where a court interprets a statute and an agency later interprets it *differently*, the agency's interpretation is *not* entitled to *Chevron* deference if the court held its construction of the statute "unambiguously forecloses" the agency's interpretation. *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982 (2005).

There is no doubt that the SEC has interpreted Section 10(b) "differently." In the proposing release for Rule 10b5-2(b), the SEC itself states that courts "previously interpreted" Section 10(b) for purposes of the misappropriation theory "differently from" the SEC. *See Brand X*, 545 U.S. at 982-83. The release candidly states that Rule 10b5-2(b), which was promulgated more than three years after *O'Hagan*, "does not enumerate relationships that existing case law already recognizes as providing a clear basis for misappropriation liability." Selective Disclosure and Insider Trading, 64 Fed. Reg. 72590, 72603 n.109 (proposed rule, Dec. 28, 1999).

There likewise is no doubt that the Supreme Court has held its construction of Section 10(b) unambiguously forecloses the SEC's interpretation with respect to the misappropriation theory. The Supreme Court's construction of Section 10(b) in *Chiarella* and *O'Hagan* simply left no room for the SEC to construe the statute in the manner it does in Rule 10b5-2(b)(1). The Supreme Court established in *Chiarella* and *O'Hagan* that the text of Section 10(b) is *not* ambiguous and is susceptible *only* to the Supreme Court's stated interpretation. *Cf. Brand X*, 545 U.S. at 982. The Supreme Court could not have been any clearer about the unambiguous scope of Section 10(b) when it held that what Section 10(b) "catches *must* be fraud" (*Chiarella*, 445 U.S. at 234-35 (emphasis added)), and that the

plain text of Section 10(b) *requires* a breach of a duty of disclosure for there to be fraud under the misappropriation theory. *Id*. (emphasis added).

As the Supreme Court "emphasized," "the 1934 Act cannot be read more broadly that its language and the statutory scheme reasonably permit," (*id.* at 234) and, for purposes of Section 10(b), this means that "[w]hen an allegation of fraud is based upon nondisclosure [as the SEC concedes is true of a misappropriation claim (SEC Br. at 9, 14 and n.3)], there can be no fraud absent a duty to speak." *Id*. at 235 (internal quotations omitted); *see also O'Hagan*, 521 U.S. at 659 & n.9 (referring to the "textual *proscription*" of Section 10(b), and construing what the "text of [Section 10(b)] *requires*") (emphasis added).

In so holding, the Supreme Court plainly meant that the language of Section 10(b) unambiguously forecloses the possibility that fraud based on nondisclosure could be found in the absence of a "duty to speak." *See Brand X*, 545 U.S. at 982. Indeed, in *Chiarella*, the Supreme Court held that imposing fraud liability under Section 10(b) for insider trading where *no* duty to speak exists – as Rule 10b5-2(b)(1) seeks to do – is *not* consistent with the text of Section 10(b) because it "*read[s] [Section 10(b)] more broadly than its language . . . permit[s]*." *Chiarella*, 445 U.S. at 234 (internal quotations omitted) (emphasis added). This was but one of several occasions when the Supreme Court has warned against allowing SEC rules to be used to expand the concept of fraud in the securities

context beyond what the plain words of the Exchange Act permit. *See, e.g.*, *O'Hagan*, 521 U.S. at 651 ("Liability under Rule 10b-5, our precedent indicates, does not extend beyond conduct encompassed by § 10(b)'s prohibition."); *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994) ("With respect . . . to . . . the scope of conduct prohibited by § 10(b), the text of the statute controls our decision."); *Hochfelder*, 425 U.S. at 214 (scope of Rule 10b-5 cannot exceed power granted Commission under § 10(b)).

This Court has recognized that the Supreme Court's construction of Section 10(b) is exclusive and controlling. In *Regents*, the Court held that the Supreme Court has "authoritatively construed" deception under Section 10(b) as "requir[ing]" a breach of duty. 482 F.3d at 389. Citing both *Chiarella* and *O'Hagan*, the *Regents* Court held that under Section 10(b), a device, such as a scheme, is simply "not 'deceptive' *unless* it involves breach of some duty of candid disclosure." *Id*. (emphasis added). The Court took pains to note that none of its Section 10(b) decisions has ever "contradicted" the Supreme Court on this issue. *Id*.

This Court's "not deceptive unless . . ." formulation in *Regents* makes abundantly clear this Court's view – in accordance with *Chiarella* and *O'Hagan* – that for purposes of the misappropriation theory, Section 10(b) is not susceptible to being construed as requiring anything less than *fraud* perpetrated through the

breach of a duty of disclosure. *Chiarella*, *O'Hagan*, and *Regents* thus all squarely foreclose the possibility that under Section 10(b), insider trading liability can be based upon a mere confidentiality agreement, which does *not* give rise to a duty of disclosure, and whose breach does *not* constitute *fraud.* (*See supra* at Section A.) Under *Brand X*, therefore, the SEC's view of insider trading liability, as embodied in Rule 10b5-2(b)(1), is *not* entitled to *Chevron* deference and is invalid. *Brand X*, 545 U.S. at 982.

b. The SEC's construction of Section 10(b) is not entitled to *Chevron* deference because it is unreasonable

The SEC's reliance upon *Chevron* is unavailing for a further reason. Even assuming *arguendo* that Section 10(b) is ambiguous, the SEC's interpretation of it still must be rejected because even under *Chevron*, an agency's interpretation of a statute is entitled to deference only if that interpretation is reasonable. *Brand X*, 545 U.S. at 982. For all of the reasons discussed above, it is *not* reasonable – indeed, there is no basis whatsoever in law, fact, or logic – for the SEC to construe a mere breach of a confidentiality agreement as constituting fraud or deception. (*See supra* at Section A.) Moreover, it is patently unreasonable (as set forth in the district court's ruling, *see supra* at Section B) to find that someone who merely agrees to keep information confidential and then *trades* on such information has

breached the confidentiality agreement or perpetrated a fraud or deception on the source of the information.[13]

Indeed, the SEC's position that a confidentiality agreement alone gives rise to a disclosure duty, and breach of the agreement gives rise to fraud, is so out of step with traditional notions of contract law and fraud that the SEC's position cannot fairly be characterized as a mere "interpretation," or "construction" of Section 10(b)'s prohibition of fraud and deception. *See, e.g.*, *Brown Express, Inc. v. United States*, 607 F.2d 695, 700 (5th Cir. 1979) ("[T]he label that the particular agency puts upon its given exercise of administrative power is not, for our purposes, conclusive; rather it is what the agency does in fact.") (citations omitted). Rather, under the guise of "construing" Section 10(b) and "proscribing" fraudulent conduct, the SEC is actually making new federal contract and tort law for purposes of Section 10(b), which the SEC lacks authority to do. *(See supra* at Section D(1)(a).) For that reason too, the SEC's position is not entitled to *Chevron* deference. *See, e.g.*, *United States v. Mead Corp.*, 533 U.S. 218, 226-27 (2001) (for agency action to qualify for *Chevron* deference, it must be in the exercise of the agency's prescribed authority); *see also Hochfelder*, 425 U.S. at 214 (under

[13] To begin with, even assuming *arguendo* that under a confidentiality agreement the recipient of the information has a duty to disclose his intention to share the information with a third party, merely trading on the information does not breach such a duty because trading does not actually reveal the information to any third parties. (*See supra* at Section B.)

Section 10(b), the SEC may not make new law); *O'Hagan*, 521 U.S. at 671 (Section 10(b) "simply authorizes the SEC to proscribe 'manipulative or deceptive devices or contrivances'").[14]

2. Rule 10b5-2(b)(1), as properly construed, does not apply to business relationships

As shown above, Rule 10b5-2(b)(1) is invalid. Moreover, the SEC's construction – that a mere confidentiality agreement by itself can form the basis for insider trading liability – is inconsistent with the intent of the Rule. The Rule's actual intent is that a confidentiality agreement can form the basis for insider trading liability only when the parties to the agreement have an existing family or other personal relationship. Properly construed, therefore, the Rule cannot save the SEC's insider trading claim against Mr. Cuban because the SEC does not (and could not) allege in its Complaint that Mr. Cuban had a family or other personal relationship with Mamma.com or Mamma.com's CEO.[15]

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[14] *See also Nat'l Treasury Employees Union v. Chertoff*, 452 F.3d 839, 856 (D.C. Cir. 2006) ("The Court's decision in *Mead* reiterates the command in *Chevron* that deference to an agency's interpretation of a statute is due only when the agency acts pursuant to delegated authority."); *Arent v. Shalala*, 70 F.3d 610, 619 n.1 (D.C. Cir. 1995) (Wald, J., concurring) (*Chevron* "requires a reviewing court to ask . . . whether an agency's *specific course of action* is permitted by statute. It is possible that a statute might grant an agency authority to act in some fashion, but not in the particular manner it has chosen.").

[15] Likewise, the SEC never argued in the district court, nor does the SEC argue in its opening appeal brief, that Mr. Cuban had a *non*-business relationship with either Mamma.com or Mamma.com's CEO.

The Rule's intent is made clear in the SEC's proposing and adopting releases. Those releases plainly state that the SEC created the Rule to resolve "an unsettled issue in insider trading law" – specifically, "under what circumstances certain non-business relationships, such as family and personal relationships, may provide the duty of trust or confidence required under the misappropriation theory." Selective Disclosure and Insider Trading, 65 Fed. Reg. 51716, 51729 (final rule, Aug. 24, 2000); *see also* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72603 n.109.

The commentators on the proposed Rule provided their comments based on the accuracy of that statement. Indeed, commentators on the proposed Rule uniformly understood that it only applied to family and personal relationships. *See* Comment letters from the Corporation, Finance and Securities Law Section of the District of Columbia Bar (Apr. 28, 2000), Ad Hoc Task Force of the Sections of Business Law and Litigation of the American Bar Association (May 8, 2000), and Committee on Securities Regulation of the Association of the Bar of the City of New York (June 19, 2000).[16] The SEC's adopting release reiterated the limitation on the Rule's scope. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51729.

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[16] These comment letters are available at http://www.sec.gov/rules/proposed/s73199/dcbar1.htm, http://www.sec.gov/rules/proposed/s73199/keller1.htm, and http://www.sec.gov/rules/proposed/s73199/schulte2.htm, respectively.

With this background, it is obvious why the only two courts to have expressly considered the issue have found that Rule 10b5-2 does *not* apply to business relationships. In *United States v. Kim*, the court found that the "language of the release makes clear [Rule 10b5-2] applies to family 'or other non-business relationships.'" 184 F. Supp. 2d at 1015. Likewise, in *SEC v. Talbot*, the court specifically rejected the SEC's attempt to apply Rule 10b5-2 to the business relationships at issue in that case. 430 F. Supp. 2d 1029, 1061 n.91 (C.D. Cal. 2006), *reversed on other grounds*, 530 F.3d 1085 (9th Cir. 2008). *Cf. Kornman*, 391 F. Supp. 2d at 489-91 (court's determination that fiduciary-like relationship existed "bolstered" by Rule 10b5-2, but court did not address issue of Rule's scope).

In its briefs filed in the district court, Mr. Cuban raised *Kim* and *Talbot*, and although the SEC strained to distinguish them, nothing the SEC said altered the fact they are the only two cases to expressly consider whether the Rule applies to business relationships, and both cases – with good reason – conclude it does not. In its opening appeal brief, the SEC makes no mention of *Kim* and *Talbot*.

The SEC does cite to *Kornman* (SEC Br. at 28-29), but that case is unavailing, because nowhere in the passage cited by the SEC, nor anywhere else in the case, does the *Kornman* court expressly consider whether the Rule applies to business relationships. *See generally Kornman*, 391 F. Supp. 2d 477. The

defendant in *Kornman* made only the narrow argument that a "prospective business relationship" cannot create a fiduciary or fiduciary-like duty, and the court's two-page analysis of that issue does not once mention Rule 10b5-2(b)(1). *Id*. at 490-92.

The SEC also does not reconcile its arguments with its own proposing release, which "makes clear" the Rule only applies to "family 'or other non-business relationships.'" *See Kim*, 184 F. Supp. 2d at 1015. Nor does the SEC adequately explain why the Rule should not be interpreted in light of the SEC's proposing and adopting releases, or identify any cases holding that the SEC's releases have no interpretative value.

In fact, courts have held that the "plain language of a regulation . . . will not control if 'clearly expressed [administrative] intent . . . to the contrary'" is found "in the published notices that accompanied the rulemaking processes." *Safe Air for Everyone v. EPA*, 488 F.3d 1088, 1097-98 (9th Cir. 2007) (citations omitted). Similarly, this Court has held that "[w]hen an agency has given its regulation a definitive interpretation, and later significantly revises that interpretation, the agency has in effect amended its rule, something it may not accomplish without notice and comment." *Shell Offshore Inc. v. Babbitt*, 238 F.3d 622, 629 (5th Cir. 2001) (citations omitted).

If an agency expresses one view of a rule in the promulgating documents, but then adopts a different view in the enforcement of the rule once enacted – as

the SEC did here – the agency effectively deprives the public of both fair notice of unlawful conduct and meaningful opportunity to comment on proposed regulations required by the Administrative Procedure Act, 5 U.S.C. §§ 552(a)(1), 553(b). *See Brown*, 607 F.2d at 702 ("(W)hen a proposed regulation of general applicability has a substantial impact on the regulated industry, . . . notice and opportunity for comment should first be provided") (citations omitted); *Chamber of Commerce v. SEC*, 443 F.3d 890, 908 (D.C. Cir. 2006) (vacating in part SEC rule based on procedural deficiencies in rulemaking); *Alaska Prof'l Hunters Ass'n, Inc. v. FAA*, 177 F.3d 1030, 1033-34 (D.C. Cir. 1991) ("Once an agency gives its regulation an interpretation, it can only change that interpretation as it would formally modify the regulation itself: through the process of notice and comment rulemaking.") (citation omitted).

In an effort to escape the application of the foregoing principles and case law, the SEC argues that "[a]lthough certain passages in the Commission's proposing and adopting releases for the Rule discuss the application of the Rule to personal and family relationships, those statements are best understood as indicating the Commission's focus on Rules 10b5-2(b)(2) and (3), which specifically address family and other personal relationships." (SEC Br. at 28, n.7.) This argument fails. The SEC's releases plainly indicate that the Rule's narrow focus on non-business relationships applies to the *entire* Rule (i.e., *all three*

subsections of the Rule, (b)(1), (b)(2) and (b)(3)). For example, the adopting release broadly explains the purpose of the *entire Rule* as follows:

> B. Rule 10b5-2: Duties of Trust or Confidence in Misappropriation Insider Trading Cases
>
> 1. Background
>
> As discussed more fully in the Proposing Release, an unsettled issue in insider trading law has been under what circumstances *certain non-business relationships, such as family and personal relationships*, may provide the duty of trust or confidence required under the misappropriation theory. Case law has produced the following anomalous result. A *family member* who receives a "tip" (within the meaning of *Dirks*) and then trades violates Rule 10b-5. A *family member* who trades in breach of an express promise of confidentiality also violates Rule 10b-5. A *family member* who trades in breach of a reasonable expectation of confidentiality, however, does not necessarily violate Rule 10b-5.
>
> As discussed more fully in the Proposing Release, we think that this anomalous result harms investor confidence in the integrity and fairness of the nation's securities markets. The *family member's* trading has the same impact on the market and investor confidence in the third example as it does in the first two examples . . . . Additionally, the need to distinguish among the three types of cases may require an unduly intrusive examination of the details of *particular family relationships*. Accordingly, we believe there is good reason for the broader approach we adopt today *for determining when family or personal relationships* create "duties of trust or confidence" under the misappropriation theory.

Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51729 (emphasis added).

There is nothing in the foregoing passage or anywhere else in the proposing and adopting releases that indicates the Rule applies to any relationships other than family and personal ones.[17] The statements in the releases regarding family and other personal relationships cannot be understood at all – much less "best understood," as the SEC maintains (SEC Br. at 28, n.7) – to apply to only certain parts of the rule (subsections (b)(2) and (3)) and not others (subsection (b)(1)).

In sum, Rule 10b5-2(b)(1) does not salvage the SEC's insider trading claim against Mr. Cuban because: (i) the Rule, as construed by the SEC in this case, exceeds the SEC's rule-making authority, and (ii) even assuming *arguendo* the Rule does *not* exceed the SEC's rule-making authority, the SEC's construction of the Rule is incorrect. With respect to the latter point, the Court should find that as properly construed, the Rule is not applicable to Mamma.com and Mr. Cuban and that the Rule therefore is irrelevant to this case. Alternatively, the Court should

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[17] The SEC's reliance upon *El Comite Para El Bienestar de Earlimart v. Warmerdam* is misplaced. 539 F.3d 1062 (9th Cir. 2008). (SEC Br. at 27, n.7.) There, in challenging a rule, the plaintiff relied on the rule's "preamble" and the proposed version of the rule. 539 F.3d at 1070-72. The court rejected plaintiff's challenge, *inter alia*, because the court found no relevant inconsistency between the preamble and the final rule. *Id.* at 1070. As such, *El Comite* is inapposite. As demonstrated above, there is clear inconsistency between, on the one hand, the SEC's clear intent expressed in the releases for 10b5-2(b), and on the other hand, Rule 10b5-2(b)(1), as least as the SEC seeks to apply it in this case. The *El Comite* court also found that the meaning of a preamble, or a proposed version of a rule, does not trump the rule itself, but these findings are not relevant here. *Id*. at 1071-72. *El Comite* is simply not on point, whereas *Kim*, *Talbot*, *Safe Air*, *Shell Offshore*, and *Brown* are.

find that the SEC's rulemaking was sufficiently flawed that the Rule is presumptively invalid. *See, e.g.*, *Chamber of Commerce*, 443 F.3d at 908 (vacating in part SEC rule based on procedural deficiencies in rulemaking).

CONCLUSION

For the foregoing reasons, the judgment of the district court should be affirmed.

Respectfully submitted,

s/

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March 26, 2010

STATUTORY ADDENDUM

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Section 17(a) of the Securities Act of 1933,
15 U.S.C. § 77q(a) SA1

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Section 17(a) of the Securities Act of 1933,
15 U.S.C. § 77q(a)

§ 77q. Fraudulent interstate transactions

(a) Anti-fraud and anti-manipulation enforcement authority. It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 USCS § 78c note]) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly--

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

. . . .

Section 10(b) of the Exchange Act of 1934,
15 U.S.C. § 78j(b)

§ 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act [15 USCS § 78c note]), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5
17 C.F.R. § 240.10b-5

§ 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Rule 10b5-2
17 C.F.R. § 240.10b5-2

§ 240.10b5-2 Duties of trust or confidence in misappropriation insider trading cases.

Preliminary Note to § 240.10b5-2: This section 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 under Section 10(b) of the Act and Rule 10b-5. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5, and Rule 10b5-2 does not modify the scope of insider trading law in any other respect.

(a) Scope of Rule. This section shall apply to any violation of Section 10(b) of the Act (15 U.S.C. 78j(b)) and § 240.10b-5 thereunder that is based on the purchase or sale of securities on the basis of, or the communication of, material nonpublic information misappropriated in breach of a duty of trust or confidence.

(b) Enumerated "duties of trust or confidence." For 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;

(2) Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality; or

(3) Whenever a person receives or obtains material nonpublic information from his or her spouse, parent, child, or sibling; provided, however, that the person receiving or obtaining the information may demonstrate that no duty of trust or confidence existed with respect to the information, by establishing that he or she neither knew nor reasonably should have known that the person who was the source of the information expected that the person would keep the information confidential, because of the parties' history, pattern, or practice of sharing and maintaining confidences, and because there was no agreement or understanding to maintain the confidentiality of the information.

CERTIFICATE OF SERVICE
SEC v. Cuban (09-10996)

I hereby certify that 1) the foregoing Brief of Mark Cuban, Defendant-Appellee complies with the required privacy redactions (5th Circuit Rule 25.2.13); 2) the electronic submission is an exact copy of the paper document (5th Circuit Rule 25.2.1); and 3) the document has been scanned for viruses with the most recent version of a commercial virus scanning program and is free from viruses.

I hereby certify that on the 26th day of March, 2010, the foregoing Brief of Mark Cuban, Defendant-Appellee, was electronically filed with the Clerk of the Court using the CM/ECF system, which will then send notification of such filing to the following ECF participants. The foregoing Brief was also emailed to Kevin P. O'Rourke on this 26th day of March, 2010.

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I hereby certify that the foregoing Brief of Mark Cuban, Defendant-Appellee complies with the type-volume limitation of FED. R. APP. P. 32(a)(7)(B) because this brief contains 13,636 words, excluding the parts of the brief exempted by FED. R. APP. P. 32(a)(7)(B)(iii).

I also certify that this Brief complies with the typeface requirements of FED. R. APP. P. 32(a)(5) and the type style requirements of FED. R. APP. P. 32(a)(6) because this Brief has been prepared in a proportionally spaced typeface using Word 2003 in 14 point, Times New Roman type.

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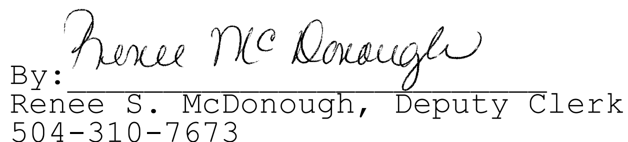

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