



SEC v. Galleon Management, 09-CV-8811 (S.D.N.Y. 2009)
Hedge Funds Are No Longer Immune to Insider Trading Enforcement
Actions

Presented by:

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Galleon: Key SEC Allegations

- Several hedge funds (including Galleon – founded and controlled by Rajaratnam) along with sources at major companies engaged in widespread and repeated insider trading
- Scheme generated over \$33 million in illicit profits or losses avoided
- Unlawful trading involved at least 12 companies, i.e. Google, Hilton, Intel

The Parties

- Plaintiff
 - Securities and Exchange Commission
- Defendants (as of 1/11/10)
 - See chart

Parties: Defendants

Defendant	Role in Insider Trading Scheme	SEC Case	Criminal Charges
Galleon Management multi-billion dollar NY hedge fund complex founded and controlled by Rajaratnam	Rajaratnam's unlawful trading imputed to Galleon	Yes	
Raj Rajaratnam founder and managing general partner of Galleon	Received tips and traded on AKAM, AMD, CLWR, GOOG, HLT, INTC, PLCM, PSPT	Yes	Yes
Rajiv Goel managing director at Intel Capital, an Intel subsidiary; good friend of Rajaratnam's	Intel and Clearwire Source; Rajaratnam traded in Goel's personal account on material nonpublic information regarding PeopleSupport and HLT	Yes	Yes
Anil Kumar director at McKinsey & Co; investor in Galleon funds.	AMD Source	Yes	Pled guilty
Danielle Chiesi portfolio manager at New Castle	Tipped and traded in AKAM and AMD based on material nonpublic information; traded in IBM and SUN based on material nonpublic information	Yes	Yes
Mark Kurland senior managing director and general partner at New Castle.	Tipped and traded in AKAM and AMD based on material nonpublic information; traded in IBM and SUN based on material nonpublic information	Yes	Yes
Robert Moffatt IBM executive	IBM, SUN, AMD Source	Yes	Yes

Parties: Defendants

Defendant	Role in Insider Trading Scheme	SEC Case	Criminal Charges
New Castle Fund LLC hedge fund with assets under management over \$971 million (formerly part of Bear Sterns Asset Management)	Chiesi and Kurland's unlawful trading imputed to New Castle	Yes	
Roomy Khan Galleon employee; former Intel employee	Tipped and traded in GOOG, HLT, KRON, PLCM based on material nonpublic information	Yes	Pled guilty
Deep Shah Moody's employee	HLT Source; Tipped and traded in Kronos	Yes	Pled guilty
Ali T. Far managing partner, portfolio manager, and co-founder of Spherix Capital, an unregistered hedge fund investment advisor. Far is a managing partner of Far & Lee. Far was previously a managing director, portfolio manager, and analyst at Galleon.	Traded in GOOG and Atheros based on material nonpublic information	Yes	Pled guilty
Choo-Beng Lee managing partner, portfolio manager, and co-founder of Spherix Capital, an unregistered hedge fund investment advisor. Lee is also a managing partner of Far & Lee.	Traded in GOOG and Atheros based on material nonpublic information	Yes	Pled guilty
Ali Hariri VP of broadband carrier networking at Atheros since March 2008.	Atheros source	Yes	Yes

Parties: Defendants con't

Defendant	Role in Insider Trading Scheme	SEC Case	Criminal Charges
<p>Zvi Goffer trader at Schottenfeld during the relevant time period; former Galleon trader</p> <p><small>*Goffer implicated in another insider trading scheme with Ropes & Gray attorneys. SEC v. Cutillo and SEC v. Santarlas</small></p>	Received information and traded in GOOG, HLT, KRON	Yes	Yes
<p>David Plate trader at Schottenfeld during the relevant time period. Plate is currently a registered representative at G-2 Trading, LLC</p> <p><small>*Plate implicated in another insider trading scheme with Ropes & Gray attorneys SEC v. Cutillo and SEC v. Santarlas</small></p>	Received information and traded in GOOG, HLT, KRON	Yes	Yes
<p>Gautham Shankar trader at Schottenfeld during the relevant time period, and is currently unemployed</p> <p><small>*Shankar implicated in another insider trading scheme with Ropes & Gray attorneys SEC v. Cutillo and SEC v. Santarlas</small></p>	Tipped and traded in GOOG, HLT, KRON	Yes	Pled guilty
<p>Schottenfeld Group LLC registered broker-dealer based in New York, NY.</p> <p><small>*Schottenfeld implicated in another insider trading scheme with Ropes & Gray attorneys SEC v. Cutillo and SEC v. Santarlas</small></p>	Goffer, Plate and Shankar's unlawful trading imputed to Schottenfeld	Yes	
<p>Steven Fortuna co-founder and principal of S2 Capital, an</p>	Received information and traded in AKAM and AMD	Yes	Pled guilty
<p>S2 Capital Management LP unregistered hedge fund investment adviser</p>	Fortuna's unlawful trading imputed to S2	Yes	

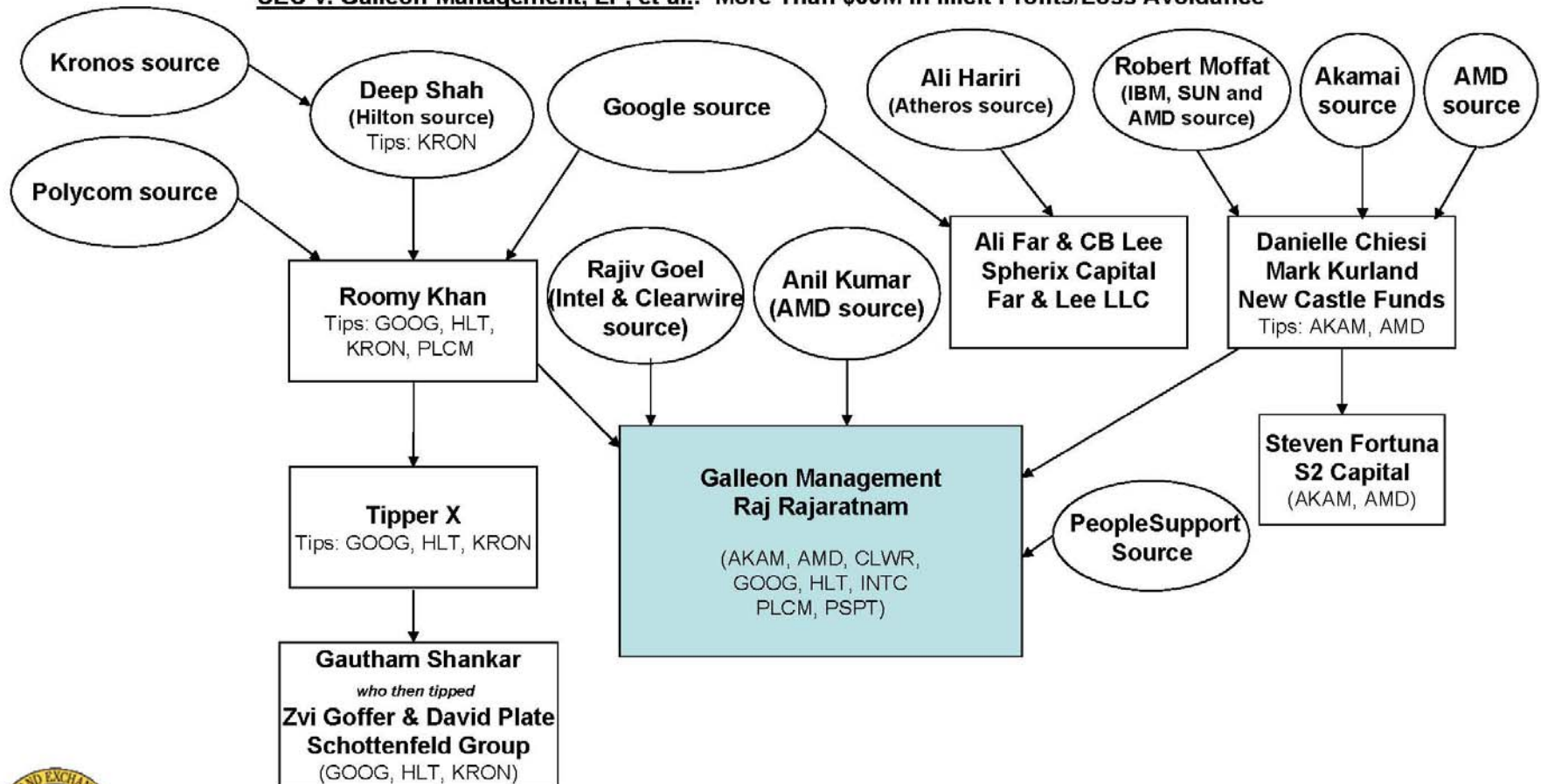
Parties: Defendants con't

Defendant	Role in Insider Trading Scheme	SEC Case	Criminal Charges
<i>Far & Lee*</i> Delaware LLC formed in July 2007 to operate as a trading entity used by Lee and Far prior to their establishing Spherix Capital.	Unlawful trading of Far and Lee imputed to Far & Lee	Dismissed	
<i>Spherix Capital*</i> Spherix Capital LLC, a Delaware LLC, was an unregistered hedge fund investment adviser based in San Jose, CA. Spherix Capital was co-founded in January 2008 by Lee and Far, who are both managing partners and portfolio managers at the company. Spherix Capital served as the investment adviser to the Elliptical family of hedge funds and is in the process of winding down its operations.	Unlawful trading of Far and Lee imputed to Spherix	Dismissed	

Tipped Information

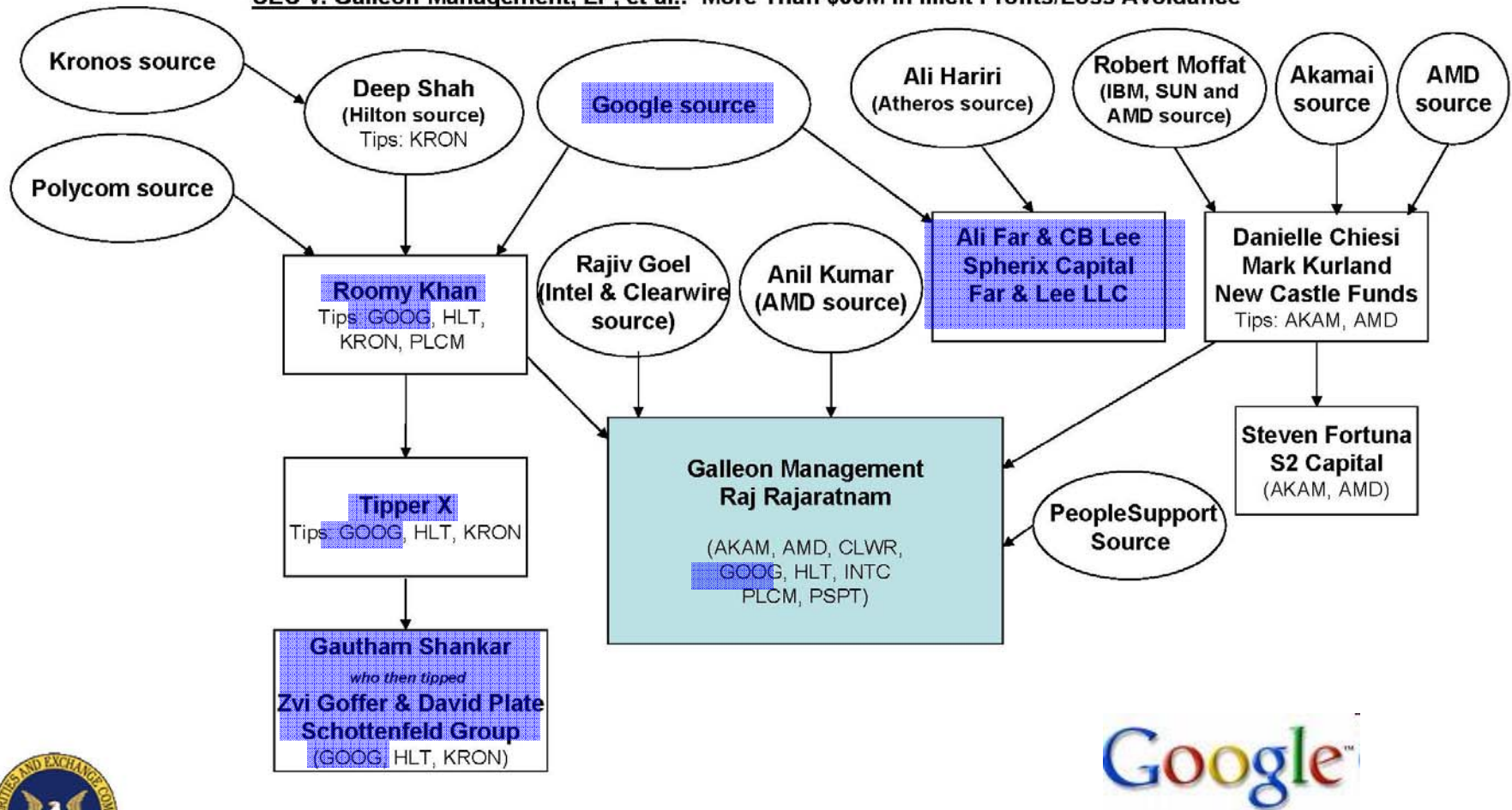
- **Polycom:** A senior executive at Polycom provided information on Polycom's Q4 2005 and Q1 2006 earnings.
- **Hilton:** A Moody's rating agency analyst provided information about the imminent takeover of Hilton by the Blackstone Group. Moody's was evaluating Hilton's debt in connection with the takeover.
- **Google:** An employee at Market Street Partners, a consulting firm, provided information about Google's Q2 2007 earnings. Market Street did public relations work for Google and had access to non-public information concerning Google's earnings announcements.
- **Intel:** A managing director employed by Intel Capital, a subsidiary of Intel, provided information about Intel's Q4 2006, Q1 2007, and Q3 2007 earnings.
- **PeopleSupport:** Galleon had regular access to inside information about PeopleSupport because Galleon owned 25 percent of the company, and because a managing director at Galleon served on PeopleSupport's board.
- **Advanced Micro Devices (AMD):** A director at global consulting firm McKinsey provided information about AMD's pending transactions with two Abu Dhabi sovereign entities. McKinsey and this director, Anil Kumar, were then advising AMD in connection with its negotiations with the two Abu Dhabi sovereign entities.
- **Akamai Technologies:** An Akamai executive provided information about Akamai's Q2 2008 earnings.
- Impending acquisition of **Kronos** by private equity firm
- **Sun Microsystems** Q2 2009 earnings
- **IBM** fiscal quarter ending December 2008
- **Atheros** Q4 2008 earnings

SEC v. Galleon Management, LP, et al.: More Than \$33M in Illicit Profits/Loss Avoidance



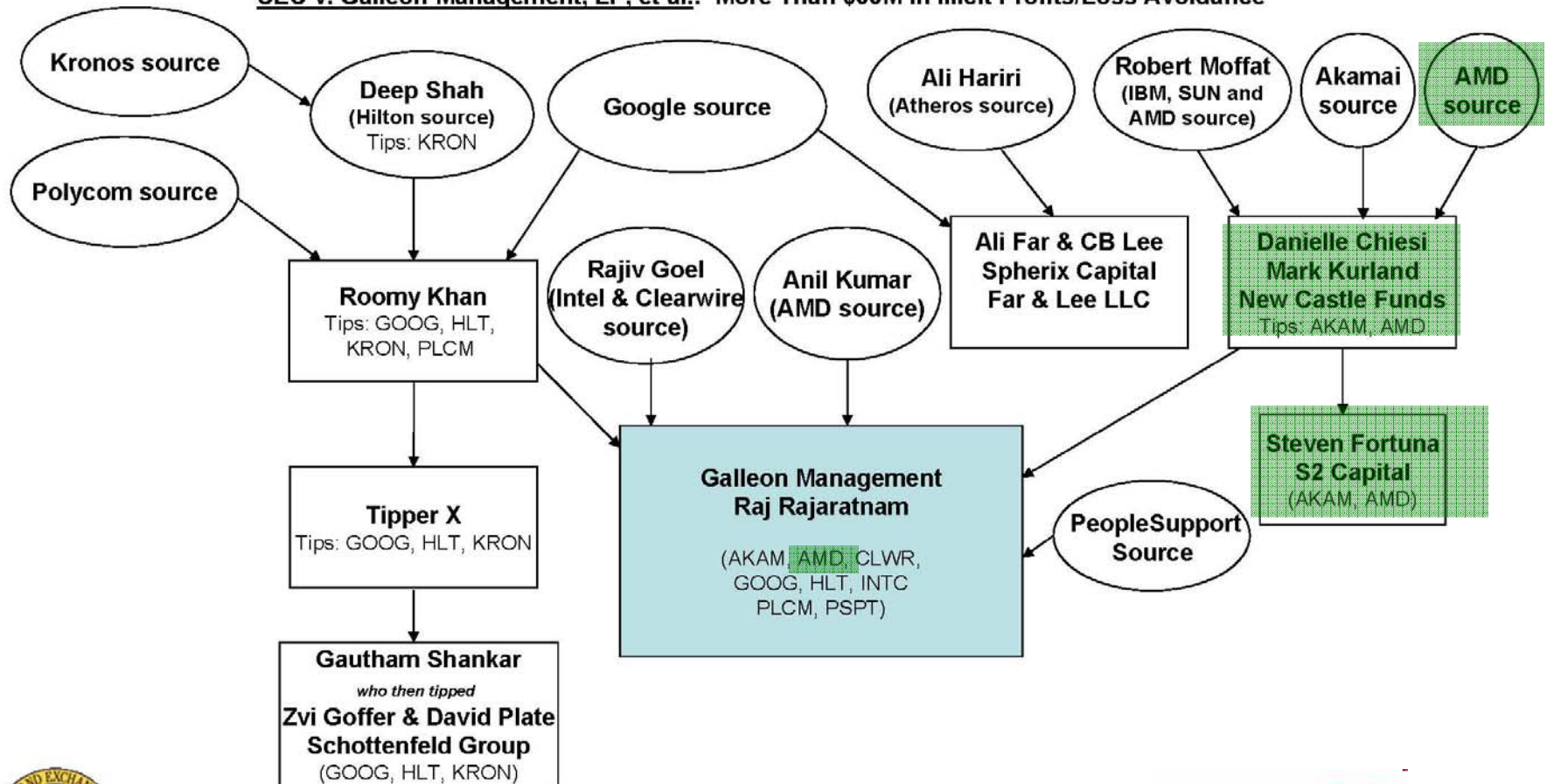
Source: U.S. Securities and Exchange Commission

SEC v. Galleon Management, LP, et al.: More Than \$33M in Illicit Profits/Loss Avoidance



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SEC v. Galleon Management, LP, et al.: More Than \$33M in Illicit Profits/Loss Avoidance



Source: U.S. Securities and Exchange Commission



SEC Alleges Violation of Securities Laws

- Section 17(a) of the Securities Act of 1933 (“Securities Act”), Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 10b-5 under the Exchange Act.

Theories of Insider Trading

- No federal statute expressly prohibits Insider Trading – SEC relies on Section 10(b)'s prohibition of “deceptive” conduct and Rule 10b-5's antifraud provisions.
- Two theories of insider trading
 - Classical Theory
 - Misappropriation Theory

Classical Theory of Insider Trading

- Corporate insider trades on nonpublic, material information in breach of duty to shareholders. This relationship gives rise to a “duty to disclose” confidential information prior to trading. *Chiarella v. United States*, 445 U.S. 222, 227-228 (1980).

Misappropriation Theory of Insider Trading

Corporate outsider commits fraud if trades on nonpublic, material information in breach of duty owed to the source of the information. *United States v. O'Hagan*, 521 U.S. 642 (1997).

- The fraud is the “deception through nondisclosure” by failing to tell the source of the material, nonpublic information that he is going to use the information for his own benefit by trading in the securities. *Id.* at 654. The trader’s actions constitute deception if he had a duty to disclose. *Id.* at 652. The duty to disclose arises by the existence of a fiduciary or similar relationship of trust and confidence between the source and the trader. *Id.* at 652.
- Examples of “relationships of trust and confidence”
 - Attorney-Client
 - Employer-Employee

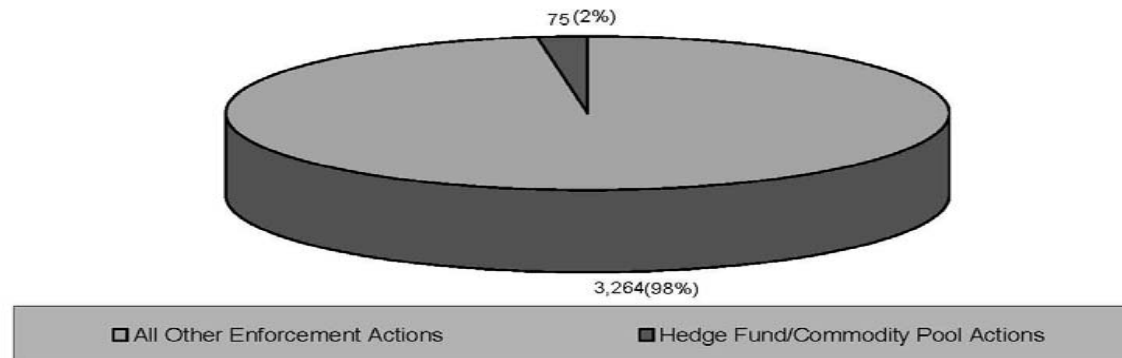
Pre-Galleon SEC Hedge Fund Enforcement/Regulation

- No federal statute defines “hedge fund”
- Investment Company Act of 1940
- Investment Advisors Act of 1940
- 1998: Long Term Capital Management
- December 2004: SEC issued *the Hedge Fund Rule* requiring hedge fund managers to register with the SEC as investment advisers under the Investment Advisers Act.
- June 2006: The U.S. Court of Appeals for the District of Columbia overturned the rule in *Goldstein v. SEC*
- 2006: SEC declares hedge fund insider trading “top priority”
- August 2007: In response to *Goldstein* SEC adopts Rule 206(4)-8, unlike the earlier challenged rule, "does not impose additional filing, reporting or disclosure obligations" but does potentially increase "the risk of enforcement action" for negligent or fraudulent activity.

- Hedge Fund Insider Trading Cases
 - *SEC v. Michael K.C. Tom*, No. 05 Civ. 1966 (D. Mass. June 19, 2008)
 - *SEC v. Guttenberg* No. 07 Civ. 1774 (S.D.N.Y. Mar. 1, 2007)
 - *SEC v. Aragon Capital Management*, No. 07 Civ. 00919 (S.D.N.Y. Feb. 8, 2007)

SEC and CFTC Hedge Fund/Commodity Pool Enforcement Actions

Total Combined Enforcement Actions 1997-2002: 3,339*



* SEC enforcement action during 1997-2002 totalled 3,076. CFTC enforcement actions during the same period totalled 263. See SEC and CFTC Annual Reports, 1997-2002.

Post-Galleon SEC Hedge Fund Enforcement/Regulation

- October 16, 2009 *With the announcement of Galleon, Enforcement Director Robert Khuzami gave a warning: “It would be wise for investment advisers and corporate executives to closely look at [Galleon], their own internal operations, and the increasing focus and scrutiny on hedge fund trading by the SEC and others.”*
- October 30, 2009 *SEC v. King Chuen Tang*

Parallel Criminal Charges Pending

- The U.S. has brought criminal charges against various defendants.
- **Judge Rakoff refused to stay the SEC trial pending the criminal trial.** This unusual ruling could force the Government to display evidence against defendants in advance of the criminal trial.
- Largest criminal insider trading hedge fund case ever charged
- First time government used **wiretaps** in insider trading case.
 - US Attorney for the Southern District warns that *Galleon* is a “wake up call.” “Today, tomorrow, next week, the week after, privileged Wall Street insiders who are considering breaking the law will have to ask themselves one important question: Is law enforcement listening?”

Lessons learned from *Galleon*

- **Hedge Funds are no longer immune to insider trading actions.**
- The Government will approach insider trading investigations using same methods used in mob and drug cartels.
- Hedge fund compliance programs will need to reevaluate how they operate and what, if anything, could be done to catch this type of illegal trading.
- All hedge funds should consider the following:
 - Written Insider Trading Policies
 - Application of policies
 - Third Party sources of information
 - IT
 - Top-down awareness

THE END

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