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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	
Plaintiff,	
-against-	
GALLEON MANAGEMENT, LP,	
RAJ RAJARATNAM,	
RAJIV GOEL,	
ANIL KUMAR,	
DANIELLE CHIESI,	**09 Civ. 8811(JSR)**
MARK KURLAND,	
ROBERT MOFFAT,	**ECF CASE**
NEW CASTLE FUNDS LLC,	
ROOMY KHAN,	
DEEP SHAH,	
ALI HARIRI,	
ZVI GOFFER,	
DAVID PLATE,	
GAUTHAM SHANKAR,	
SCHOTTENFELD GROUP LLC,	
STEVEN FORTUNA,	
and	
S2 CAPITAL MANAGEMENT, LP,	
Defendants.	

PLAINTIFF'S REPLY TO DEFENDANTS' OPPOSITION TO PLAINTIFF'S MOTION IN LIMINE TO PRECLUDE DEFENDANTS' EXPERT'S TESTIMONY AND OTHER DISCLOSURES

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I. INTRODUCTION

According to Defendants, Jarrell's testimony relates to: (1) event studies; (2) whether certain information was public; (3) whether it would have been reasonable for a well-informed, professional investor to trade the relevant securities in a particular manner; and (4) "background" as to the practices of Galleon, Rajaratnam and the hedge fund industry. Opp. at 2.[1] The Commission does not object to Jarrell's event studies, insofar as they relate to stocks that are *not* the subject of the substantive counts of Rajaratnam's criminal conviction. However, whether certain information was public is not an appropriate subject of expert testimony because it is a topic a fact-finder can easily comprehend. Jarrell's opinion as to whether it would have been reasonable for a well-informed, professional investor to trade the relevant securities in a particular manner is completely irrelevant. Finally, Jarrell is unqualified to opine on Defendants' and hedge funds' investment practices and trading. Though Defendants suggest that this testimony is merely to "provide brief and helpful background or to summarize voluminous records," *id.*, Jarrell's testimony in this regard is exactly what *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993), and its progeny prohibit.

The overwhelming majority of Defendants' proposed expert testimony is not the appropriate subject of expert testimony because it is irrelevant, unreliable and unhelpful. With the exception of the event studies, Jarrell's testimony, and the manner in which it is presented, is prejudicial and confusing. It is inadmissible under Fed. R. Civ. P. 401-403 and 702, and under the important strictures established by *Daubert* and its progeny.

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[1] "Opp." refers to Defendant's Opposition to Plaintiff's Motion in Limine to Preclude Expert Testimony," filed by Raj Rajaratnam and adopted by Galleon Management LP. See Opp. at n.1. "Jarrell Rep., ¶ __" refers to the Expert Report of Gregg A. Jarrell.

II. ARGUMENT

Expert Testimony Concerning Stocks that are the Subject of the Substantive Counts of the Parallel Criminal Case Is Irrelevant

As detailed in the Commission's moving papers, Rajaratnam will be estopped from litigating Claims I and II of the Second Amended Complaint based on his conviction on Counts 6-14 of his criminal indictment. Rajaratnam's conviction on those counts will estop him from re-litigating that he traded the securities of Clearwire Corp., Akamai Technologies, Inc., PeopleSupport, Inc., ATI Technologies Inc. and Intel Corp. (in Q12007), while in possession of material, non-public information. Defendants do not argue that estoppel will not apply if Mr. Rajaratnam's motion for judgment of acquittal is denied; they argue only that a sentence must be imposed before estoppel can be applied. Opp. at 3. Rajaratnam's sentencing is set to occur prior to the trial date in the Commission's action. Thus, there is no reason not to order the preclusion of any expert testimony on any stocks that are the subject of the substantive counts upon the entry of the judgment of conviction.[2]

Jarrell Should Be Precluded From Providing "Summary" Testimony

Defendants propound Jarrell's testimony concerning such topics as Galleon's and Rajaratnam's research, trading and business practices – not because they cannot find a prescient witness to do so, but apparently because they prefer to present this type of testimony through an "expert." What Defendants seem to ignore is that the law requires

[2] Defendants make the conclusory statement that because the Commission will seek disgorgement of gains associated with transactions that are the subject of the criminal conviction, expert testimony about those transactions is relevant to the Court's analysis of potential disgorgement amounts. Opp. at 3. Defendants do not explain, however, how the proposed testimony would be relevant in any way to a disgorgement analysis, which merely calculates the trading profits and/or trading losses avoided by Rajaratnam's unlawful trading. None of the Jarrell's proposed testimony appears to relate to that calculus.

their expert to be qualified about the topics on which he intends to testify. *See, e.g., Nimely v. City of New York*, 414 F.3d 381, 396 & n.11 (2d Cir. 2005) (whether a purported expert witness is qualified as such by his or her "knowledge, skill, experience, training or education," is a "threshold question" to be resolved prior to other inquiries). There is no basis to conclude that Jarrell meets this threshold test. Nor do the cases relied upon by Defendants help them.

Defendants cite *United States v. Daly*, 842 F.2d 1380, 1388 (2d Cir. 1988), for the proposition that "background evidence" may be admitted as expert testimony. Opp. at 4. However, the *Daly* court held that to be true only when "the background evidence is testimony of the witness based on his own knowledge, or is expert testimony as to opinions or inferences arrived at in reliance on the type of evidence normally relied on by experts in the field." 842 F.2d at 1388. Thus, in *Daly*, an FBI agent -- whose qualifications to testify as an expert on the nature and structure of organized crime families were *unchallenged* -- was permitted to testify as to background on, for example, codes of conduct and silence and the meaning of certain jargon within crime families, since law enforcement agents routinely and reasonably rely upon such information. *Id.* at 1387-88. Here, Jarrell is not qualified as an expert in Defendants' trading or in hedge fund trading more broadly. The proffered testimony is not the type of evidence someone in Jarrell's field of economics normally relies upon. If, alternatively, Jarrell's testimony as to Defendants' practices is not offered as "expert testimony," but only as "background," as Defendants suggest, then it is inadmissible under *Daly* because it is not based on Jarrell's own knowledge.[3]

[3] Defendants cite cases that find no error in permitting a witness to testify as both an expert and a fact witness, but those cases have no application here. *See, e.g., United*

United States v. Mulder, 273 F.3d 91, 101 (2d Cir. 2001), relied upon by Defendants, similarly is unavailing. In *Mulder*, as in *Daly*, the Court held that the experts had specialized or expert knowledge in the area of their respective testimony and, thus, that they could testify as to evidence that were "normal source[s] of information" for someone of their respective expertise. 273 F.3d at 102. What Defendants fail to mention about *Mulder* is that it cuts against them. *Mulder* makes clear that the Defendants cannot ask the jury to find that the Defendants acted in conformity with the behavior about which they seek to have Jarrell testify, *see id.*, but that is exactly what Defendants are attempting to do here.

Moreover, Defendants' arguments as to the relevance of such evidence are unpersuasive. Defendants have not explained how evidence of Rajaratnam's trading that is not at issue would inform the fact-finder as to the legality of the trading at issue. Defendants' claim, for example, that the expert testimony will assist the fact-finder to "evaluate the trading patterns surrounding the trades at issue." Opp. at 6. First, it is entirely unclear which portion of the proposed testimony, if any, sheds any light on Rajaratnam's "trading patterns."[4] Second, though Defendants promise Jarrell "will not opine about the motivation behind particular trades," that is exactly what his Report does: *See, e.g.*, Jarrell Rep., ¶273 & n.261 ("I would expect individuals trading on inside information to trade in much closer proximity to the announcement date .... Mr.

States v. Feliciano, 223 F.3d 102, 121 (2d Cir. 2000); *United States v. Faison*, 393 Fed. Appx. 754, 758-59 (2d Cir. 2010). Those cases deal with law enforcement officers who are permitted to testify as experts to convey background information concerning the crime at issue, as well as to testify as fact witnesses about the steps they personally took investigating that crime. Jarrell is not a fact witness because, unlike the law enforcement agents in *Feliciano* and *Faison*, none of his knowledge is first-hand.

[4] The Report simply states the total of Rajaratnam's trading in a given security in a given time period.

Rajaratnam's purchases ... suggest to me that he was not in possession of material nonpublic information."). Thus, Defendants seek to have Jarrell present trading data, not to merely summarize that data, but to tell the fact-finder what inferences to draw from the data. This is impermissible. *See, e.g., Master-Halco, Inc. v. Scillia, Dowling & Natarelli, LLC,* 2010 U.S. Dist. LEXIS 38113, *12 (D. Conn. Apr. 19, 2010) (parties can use argumentative charts and summaries in their closing arguments; it would be improper to introduce them through experts).

Jarrell Should Be Precluded From Offering "Custom and Practice" Testimony

Defendants seek to introduce evidence of the custom and practice of the hedge fund and/or investment professional industries. Opp. at 7, 12. Such testimony has no relevance to the issues in this action. The cases Defendants cite illuminate this point. In *Marx & Co. v. Diners' Club, Inc.*, 550 F.2d 505, 508-09 (2d Cir. 1977), the Court upheld the admission of custom and practice testimony because, at issue there, was a claim that defendants had not used their best efforts to make effective a registration of plaintiff's stock. 550 F.2d at 506. Thus, in *Marx*, custom and practice testimony was relevant because the jury had to evaluate the conduct of the parties against the standards of ordinary practice in the industry. *Id.* at 509; *see also Highland Capital Mgmt., L.P. v. Schneider*, 551 F. Supp. 2d 173, 180 (S.D.N.Y. 2008) (custom and practice testimony permitted in a case for breach of duty to negotiate and sell promissory notes); *SEC v. Zwick*, 317 Fed. Appx. 34, 35-36 (2d Cir. 2008) (expert testimony permitted on whether broker markups were excessive because among the factors relevant to that determination was comparison to other markups for the securities at issue). As is explained in *Marx*, "expert testimony concerning the practices of a particular trade or business is not

admissible if, as a matter of substantive law, only the jury's common understanding and not the customary practices or usages are relevant." *Id.* at 509 n.11. Such is the case here. Defendants' conduct is not being held to the standards of those in the hedge-fund industry. The fact-finder here will be required to look at Defendants' conduct alone and not to compare it to others in the industry.[5]

Also unpersuasive are Defendants' arguments that Jarrell is qualified to provide expert testimony about the customs and practices of hedge funds and investment professionals. Defendants admit that Jarrell is not a professional trader or hedge fund manager, Opp. at 7, nor has he ever been, Jarrel Rep. Ex. 1. Defendants claim Jarrell is qualified "through his work at the SEC and his decades-long study of the securities industry" to provide testimony about the customary practices of hedge-funds. Opp. at 8. It is unclear what insights Jarrell had into the hedge-fund industry as the SEC's Chief Economist in April 1984 through January 1987 and to what extent, if any, those insights have any application whatsoever to the hedge-fund industry of 2006-2008. Jarrell's publications from this time period certainly do not appear to focus on hedge fund practices. *See* Jarrell Rep. Ex. 1 at 6-13. For that matter, none of Jarrell's studies appear to relate specifically to hedge fund practices. *Id.* Indeed, Jarrell does not count hedge funds among his areas of specialization. *Id.* at 3.

Jarrell's expertise as to hedge funds is analogous to expertise questioned by the Court in *Zaremba v. GMC*, 360 F.3d 355 (2d Cir. 2004). In *Zaremba*, the Court rejected

[5] Defendants also seek to present expert testimony that the so-called "mosaic theory" is a "well-recognized method for collecting and analyzing information to inform trading decisions." Opp. at 13. The "mosaic theory" is not an economic theory or legal defense. The Commission has not claimed that it is illegal to collect information from multiple sources. What is illegal is trading on material, non-public information one has collected. The mosaic theory is not a defense to that claim and expert testimony concerning it is irrelevant.

a witness' expertise to testify on the subject of automobile design when that witness had a bachelor's degree in engineering and his only practical experience was in designing parts for automobile air bags. 360 F.3d at 359. The Court noted: "Other than that, his employment has consisted entirely of consulting for purposes of litigation .... Rule 702 requires that expert testimony come from someone who is 'qualified as an expert by knowledge, skill, experience, training or education[.]'" Jarrel's resume indicates his employment after the SEC has been in academia and consulting. Jarrell Rep. Ex. 1 at 1-2. What is clear from Jarrell's resume is that he has never worked in the hedge fund industry. *Id.* Thus, Jarrell's experience stands in stark contrast to that of the expert permitted to testify concerning industry custom and practice in *Highland Capital*, the case relied upon by Defendants. In *Highland*, the expert had over forty years of experience in the securities industry and was, therefore, qualified as an expert as to industry custom and practice. 551 F. Supp. 2d at 182.

Jarrell Cannot Testify as to Whether Certain Information Was "Public"

Defendants claim that because the SEC has argued that the public nature of certain information is an inappropriate topic for expert testimony, the SEC does not understand the function of public information in an event study analysis. Opp. at 8. They state: "An event study, by its very nature, takes into account information already in the market about a relevant event and the market's view of it, making testimony about public information concerning that event both relevant and necessary." *Id.* The problem with Defendants' argument is that it directly contradicts their own expert's view of what an event study is. At the Rajaratnam criminal trial, Jarrell testified on cross-examination:

> Q. ... An event study is a statistical analysis of what the impact of an announcement was on the price of the stock, correct?

A. Yes, sir.
Q. And you can do that analysis without relying on newspaper articles and Web postings prior to that, correct?
A. You can do that without looking at any other news stories other than the announcement on that day. You can do that particular task that you are discussing, yes. ... To do the mathematical calculation of what is the excess return and to say whether or not the excess return is or is not statistically significant at the 95 percent confidence level does not require you to go examine newspaper articles or publicly released information related to the tip in the prior period; not to do that particular task.

Ex. 1 to Pl's Reply; *see also* Jarrell Rep., ¶¶ 21-22. Jarrell admits that an event study looks only at the announcement at issue and, thus, the selected articles that Defendants propose Jarrell will present to the jury "in connection with his event study," are irrelevant.

What Defendants hope to do with Jarrell's testimony concerning whether certain information was "public" is to present their factual and legal arguments to the fact-finder under the guise of summaries and charts ordained by an expert, thus substituting the aura and authority of an "expert" for their own factual and legal arguments. This approach has been rejected by courts, and for good reason. For example, in *Ram v. New Mexico Dep't of Env't*, 2006 U.S. Dist. LEXIS 95369 (D.N.M. Dec. 15, 2006), the court found that a statistician "began to function as a paralegal, preparing descriptions or summaries of what is in the documents." 2006 U.S. Dist. LEXIS 95369, * 51. The court held that that type of testimony was inadmissible:

> If she is testifying as an expert, her expertise in this case was only marginally employed, and her methodology and opinions are neither reliable nor helpful. If she is merely describing the contents of documents, her description has limited usefulness, and brings a substantial risk of prejudice, confusion, and the possibility of misleading the jury.

Id. at *55. The court was not persuaded by the argument that "it may make it easier to have one witness summarize the contents of a large number of documents" and held that

someone else would have to serve the role of summary witness. *Id.* Likewise here, a fact-finder, instructed by a judge as to the law, is fully capable of comprehending whether something was public without the help of Jarrell and, if the summaries and charts are otherwise admissible under Rule 1006, they should be presented by a summary witness – not an expert.

Jarrell's Testimony that A Reasonable, Well-Informed Investor Would Trade as Rajaratnam Traded is Impermissible

Expert testimony cannot be used as a proxy for explaining or arguing to the fact-finder what the Defendants' intentions were. *See United States v. Dupre*, 462 F.3d 131, 138 (2d Cir. 2006) (affirming exclusion of expert testimony that would "permit the defendant to put an impermissible theory of justification before the jury."); *United States v. Rahman*, 189 F.3d 88, 136 (2d Cir. 1999) (affirming exclusion of expert testimony that "constituted an effort to tell the jury the defendant's intentions through the mouths of witnesses other than [the defendant.]"). Despite Defendants' assurances that in testifying as to how a "reasonable, well-informed investor would trade," Jarrell "will not attribute the behavior of other investors to Mr. Rajaratnam," nor will his testimony "concern Mr. Rajaratnam's motivation for making particular trades," that is exactly what Jarrell's testimony will do. Throughout his Report, Jarrell states: "It would be reasonable for a well-informed, professional investor (such as a hedge fund manager) to trade, *as Rajaratnam did,* in the securities of each of the companies. *See, e.g.,* Jarrell Rep., ¶¶ 2, 74-78, 120-123, 149-152, 183-186, 215-218, 244-247, 267-270, 336-339, 380-383, 408-411, 441-444, 494-497, 527-530. And, Jarrell certainly does speculates about the basis upon which Rajaratnam's trading decisions were made. *See, e.g., id.* at ¶273 & n.261 ("There are several reasons to doubt that an allegedly credible tip was provided to Mr.

Rajaratnam... ."); ¶ 375 ("I draw no negative inference regarding the alleged insider trading by the fact that Mr. Rajaratnam purchased shares of Hilton (a non-tech company) within Galleon's tech funds.").

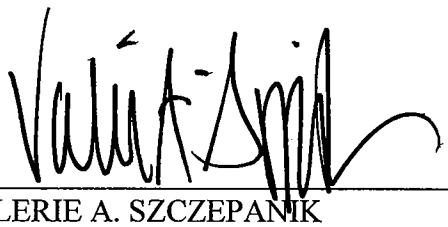
Jarrell's Testimony Concerning His Event Studies Should Not Be Permitted to Conflate a Finding of "Statistical Significance" with "Materiality"

A finding of statistical significance is not synonymous with "materiality" under the securities laws. *See, e.g., Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1318-19 (2011) (allegation of statistical significance not required to establish materiality); *SEC v. Penthouse Int'l, Inc.*, 390 F. Supp. 2d 344, 353 (S.D.N.Y. 2005) ("there is no requirement that stock prices fluctuate as a result of a defendant's misstatements or omissions in order for them to be material") (citing cases). Rather, information is "material" if there is a "substantial likelihood that a reasonable [investor] would consider it important in [making their investment decision]." *Basic Inc. v. Levinson,* 485 U.S. 224, 231-32 (1988). None of the cases cited by Defendants in their opposition hold that an event study is either necessary or determinative to a finding of materiality, and Jarrell should not be permitted to testify to the contrary.

III. CONCLUSION

For the reasons discussed herein and in its moving papers, the Commission respectfully requests that the Court preclude Jarrell's expert testimony and other disclosures, other than his event studies. As for his event studies, Jarrell should be limited to testifying whether an event is "statistically significant" and not be permitted to equate that to materiality. Finally, Defendants should not be permitted to "back-door" their factual and legal arguments to the fact-finder in the form of summaries and charts of an expert.

June 10, 2011



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CERTIFICATE OF SERVICE

The undersigned hereby certifies that, on the 10th day of June 2011, copies of the Plaintiff's Reply to Defendant's Opposition to Plaintiff's Motion in Limine to Preclude Defendants' Expert Testimony and Other Disclosures was served on Defendants by ECF filing and by sending a copy by email and UPS Overnight delivery to:

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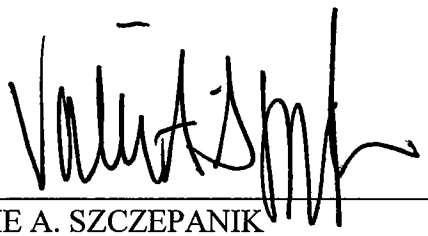

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EXHIBIT 1

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------x

UNITED STATES OF AMERICA,

v. 09 CR 1184 (RJH)

RAJ RAJARATNAM,

Defendant.

----------x

New York, N.Y.
April 8, 2011
9:40 a.m.

Before:

HON. RICHARD J. HOLWELL

District Judge

APPEARANCES

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TERENCE J. LYNAM

I prefer not to, obviously, and there are reasons probably the government would prefer not to. But you can make that judgment and we'll talk about it this afternoon.

MR. LYNAM: Your Honor, would you like a copy of what we give the government, would you like a copy as well another disk?

THE COURT: No, I don't think.

MR. LYNAM: There will be more spreadsheets.

THE COURT: I have the summary that was produced. I took a look at that.

MR. STREETER: Could I have ten or fifteen more minutes of cross-examination to address some of the other things that were raised this morning about newspaper articles and things of that sort, so that I can make arguments to you about what I think this expert should and should not be allowed to testify about.

THE COURT: All right. That's fine.

GREGG JARRELL, resumed

CROSS-EXAMINATION CONTINUED

BY MR. STREETER:

Q. Professor Jarrell, at the beginning of your testimony with Mr. Lynam you went through some newspaper articles and Web postings, correct?

A. Yes, sir.

Q. And you can certainly perform an event study around each of

the announcements that are at issue in this case without going back and presenting to the jury newspaper articles that preceded that, correct?
A. I'm sorry?
Q. You can certainly perform -- the event study is basically a statistical analysis of what was the impact of an announcement on a particular --
A. I'm sorry. I understand your question.
Q. Let me finish my question. I want to make sure it's clear for the record.
An event study is a statistical analysis of what the impact of an announcement was on the price of the stock, correct?
A. Yes, sir.
Q. And you can do that analysis without relying on newspaper articles and Web postings prior to that, correct?
A. You can do that without looking at any other news stories other than the announcement on that day. You can do that particular task that you are discussing, yes.
Q. And so you need to look at the fact that eBay announced a layoff on that particular day, right?
A. Right.
Q. But in order to perform the statistical analysis, you don't need to also analyze newspaper articles from a month before?
A. To do the mathematical calculation of what is the excess

return and to say whether or not the excess return is or is not statistically significant at the 95 percent confidence level does not require you to go examine newspaper articles or publicly released information related to the tip in the prior period; not to do that particular task.

To interpret that excess return and to discuss why it is what it is, why it might be significant, why it might not be significant does require you to do what we call -- there are two issues that come up. One is confounding information and that's information that's released simultaneously with the announcement. As we saw in eBay there were three other announcements that are included with the layoff announcement.

And then we have another term which is called truth on the market or market anticipation. The legal people call it truth on the market. The economists call it market anticipation or leakage. Obviously, to determine whether or not there's been leakage and to determine how much leakage, the market anticipation obviously requires you to go beyond what you're talking about and look at publicly released information in the period prior to the announcement.

Q. But none of that is necessary to perform the event study, correct?

A. None of that is necessary to compute the t statistic on the announcement day.

Q. And to --

A. But to interpret --
Q. Let me just -- and to tell the jury whether or not the particular event had a statistically significant impact on the stock price, you could perform the analysis. That you can do. It's the part about interpreting what that result means that you say you need to use newspaper articles for, correct?
A. I think that that's fair.
I mean -- you can't interpret -- you can't interpret and make a full explanation of why it did what it did without also examining market leakage and anticipation in the marketplace. And, obviously, in an insider trading case, you know, those are critical issues.
Q. Understood.
And you testified a little bit when Mr. Lynam was questioning you about your report about what a reasonable investor would do with particular information.
A. Yes.
Q. With respect to -- let me back up and ask you a couple of questions.
Most of the stocks traded in the U.S. securities markets are being traded by sophisticated investors, right?
A. At any point in time?
Q. Most of the -- if you took a snapshot of today and you said what percentage of the trades that were executed on any given day, the vast majority of them would be executed by