SECURITIES AND EXCHANGE COMMISSION
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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.	:	

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF'S MOTION FOR DEFAULT JUDGMENT AS TO DEFENDANT DEEP SHAH

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INTRODUCTION

Plaintiff Securities and Exchange Commission (the "Commission") respectfully submits this Memorandum of Law in support of its motion for default judgment against Deep Shah ("Shah"), pursuant to Federal Rule of Civil Procedure 55(b)(2) and Local Civil Rule 55.2(b). A judgment by default is appropriate against Shah because Shah was properly served with the Second Amended Summons ("Summons") and Second Amended Complaint ("Complaint"), but he has failed to answer, plead or otherwise defend this action, as required by the Federal Rules and the Local Civil Rules of this Court. Additionally, no attorney has entered an appearance on his behalf. Accordingly, the Commission seeks the entry of judgment by default against Shah.

The Complaint adequately alleges that Shah violated the federal securities laws by, among other things, tipping Defendant Roomy Khan ("Khan") to material, nonpublic information about: (a) The impending acquisition of Hilton Hotels Corp. ("Hilton") by the Blackstone Group ("Blackstone"); and (b) The impending acquisition of Kronos Inc. ("Kronos") by Hellman & Friedman. Accordingly, the Commission requests that the Court enter a judgment by default against Shah that: (1) permanently enjoins Shah from future violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78j(b)] and Exchange Act Rule 10b-5 [17 C.F.R. 240.10b-5]; (2) orders Shah to disgorge ill-gotten gains; (3) orders Shah to pay prejudgment interest; and (4) orders Shah to pay a civil monetary penalty.

STATEMENT OF FACTS

I. Shah Has Failed to Respond to the Complaint

The Commission commenced this action on October 16, 2009, with the filing of its Complaint and the issuance of summonses. Statement of Damages Declaration ("Casey Decl.") ¶5. The Commission filed an Amended Complaint on November 5, 2009. Id. The Commission

filed a Second Amended Complaint on January 29, 2010. Id. On March 22, 2010, copies of a Summons issued to Shah and the Complaint in this action were served on Shah by the Department of Legal Affairs of the Ministry of Law and Justice of India at the request of the Commission pursuant to Federal Rule of Civil Procedure 4 and the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents. Proof of such service was filed with the Court on March 4, 2011. Shah's answer was due no later than May 21, 2010. Id. ¶8.

As of May 23, 2011, Shah had not filed an answer or responsive pleading to the Commission's Complaint. The May 21, 2010 deadline to answer or otherwise respond to the Commission's Complaint has lapsed. Accordingly, on May 23, 2011, the Clerk of the Court issued a Clerk's Certificate noting Shah's default. Ex. 1.[1]

II. The Complaint's Uncontested Allegations and Facts

Shah is in default; therefore, the allegations in the Complaint as to Shah should be deemed uncontested. As specified in the Complaint, Shah resided in Jersey City, New Jersey during the relevant time period and, in 2007, was employed at Moody's, a rating agency, as a lodging industry analyst. Shah left Moody's in late 2007 or early 2008, and he is believed to currently reside in India. Ex. 2 ¶15.

A. The Hilton Announcement

On July 3, 2007, Hilton announced that a private equity group, Blackstone, would be buying the company for $47.50, a premium of $11.45 per share over the stock's July 3rd closing price (the "Hilton Announcement"). Id. ¶56. In advance of the Hilton Announcement, Shah was employed by Moody's, the rating agency that was evaluating Hilton's debt securities in connection with the takeover. Due to his position at Moody's, Shah had access to material

[1] "Ex." refers to the Casey Decl. Exhibits.

nonpublic information regarding Hilton. Id. On or about July 2, 2007, Shah informed Defendant Khan that Hilton was going to be taken private in a deal to be announced the following day, at a price around the mid-$40s per share. Id. ¶57. Shah cited as his source for this information a communication that representatives of Moody's had received from Hilton management. Khan paid Shah $10,000 as compensation for this tip. Id. ¶¶57, 62.

Just after receiving information regarding the takeover from Shah, Khan purchased 550 August $35 Hilton call option contracts at $1.07 per contract. The following morning, Khan purchased 100 July $35 Hilton call option contracts at $.90 per contract. Ex. 7. Khan also relayed the information she had received from Shah to Defendant Raj Rajaratnam ("Rajaratnam") on July 2, 2007. Ex. 2 ¶58. The next day, Rajaratnam and Defendant Galleon Management, LP ("Galleon") purchased 400,000 shares of Hilton for the Galleon Tech Funds. Ex. 8. Rajaratnam, or someone acting on his behalf, also purchased 7,500 shares of Hilton on behalf of Defendant Rajiv Goel ("Goel"). Ex. 9. Khan profited on her options purchases by more than $630,000. Ex. 4(a). The Galleon Tech funds sold their Hilton shares for a profit of over $4 million. Ex. 4(b). The shares purchased on behalf of Goel were sold at a profit of over $78,000. Ex. 4(c).

Khan relayed the information she received from Shah to Khan's friend, Thomas Hardin.[2] Hardin traded profitably on this information. Hardin also relayed the information regarding Hilton to Defendant Gautham Shankar ("Shankar"), a proprietary trader at Defendant Schottenfeld Group, LLC ("Schottenfeld Group"). Ex. 2 ¶65. Shankar purchased

[2] Thomas Hardin is identified in the Complaint as "Tipper X." The Commission sued Hardin in separate district court actions, SEC v. Hardin, 10 Civ. 8600 (JSR), and SEC v. Lanexa Mgmt., LLC, et al., 10 Civ. 8599 (RJS).

approximately 25,000 Hilton shares, spread out over several accounts, including a Schottenfeld Group account he managed. Ex. 2 ¶4, Ex. 11. Shankar sold these shares for a profit of over $156,000. Ex. 4(d). Shankar relayed this information regarding Hilton to associates at Schottenfeld Group, including Defendant Zvi Goffer ("Goffer"). Ex. 2 ¶66. On July 3, 2007, Goffer purchased 5,000 Hilton shares and 510 call option contracts in a Schottenfeld Group account that he managed. Ex. 12. Goffer's purchases generated profits of approximately $329,000. Ex. 4(e). On July 3, 2007, a total of 81,000 Hilton shares and 773 Hilton call options were purchased in various Schottenfeld Group accounts generating total cumulative profits from Shankar's tip of over $1.2 million. Exs. 4(g), 13.

B. The Kronos Announcement

On March 23, 2007, Kronos announced that it would be acquired by private equity firm Hellman & Friedman for $55 per share (the "Kronos Announcement"). Ex. 2 ¶¶80, 84. Earlier that month, Shah learned from a friend (the "Kronos Source") that Kronos was about to be acquired. The Kronos source and Shah communicated several times on March 14, 2007, and the Kronos source relayed specific information concerning a bid to acquire the company. Shah and Khan also communicated several times on March 14, 2007 when Shah provided Khan with material nonpublic information concerning the Kronos acquisition. Khan subsequently tipped Hardin to this information. Ex. 2 ¶82. On March 16, 2007, Khan purchased 35 April $40 Kronos call options at $3.00 per contract based on the information she had received from Shah. Ex. 14. After the Kronos Announcement, Khan sold the options she had purchased on March 16, 2007 for a profit of approximately $37,000. Ex. 4(h). In exchange for this information, Khan paid Shah $10,000 through Hardin. Ex. 2 ¶85.

On or about March 15, 2007, Khan shared with Hardin the information she received from Shah regarding the Kronos Announcement. Hardin traded profitably based on this information and also personally paid Shah $10,000 for the information. Ex. 2 ¶86; Ex. 4(k). Hardin also passed this tip, including information about its source, on to Shankar. Shankar then tipped Goffer to the Kronos Announcement. Ex. 2 ¶¶87-88. Shankar purchased 7,500 Kronos shares on March 19 and 20, 2007 in a Schottenfeld Group account Shankar managed and sold those shares after the announcement for a profit of more than $78,000. Exs. 4(i), 15. Goffer also purchased and sold Kronos shares in a Schottenfeld Group account Goffer managed. Ex. 16. Goffer sold these shares for a profit of approximately $200,000. Ex. 4(j). David Plate ("Plate"), another Schottenfeld Group colleague, began purchasing Kronos shares on March 20, 2007 and sold them after the announcement for a profit of approximately $90,000. Exs. 4(l), 17. Shankar, Goffer and/or Plate passed along the material nonpublic information regarding the Kronos announcement that originated with Shah to other colleagues at Schottenfeld Group. Ex. 2 ¶92. Fourteen Schottenfeld Group accounts purchased Kronos shares ahead of the Kronos announcement, realizing total profits of more than $800,000. Exs. 4(m), 18.

ARGUMENT

The Court should enter a default judgment against Shah due to his failure to answer or otherwise respond to the Commission's Complaint. The Complaint charges Shah with violations of the antifraud provisions of the federal securities laws, Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Exchange Act Rule 10b-5 [17 C.F.R. 240.10b-5]. The Complaint, which must be deemed conceded, sets forth sufficient factual allegations to support the Commission's charges against Shah and the Commission's request for a permanent injunction, disgorgement plus prejudgment interest, and civil money penalties.

I. The Court Should Order a Default Judgment Against Shah

A. Default Judgment Standard

A judgment by default may be entered where a party fails to plead or otherwise respond or defend. Fed. R. Civ. P. 55; Local Civil Rule 55.2(b). The entry of a default judgment is within the sound discretion of the district court. Shah v. New York State Dept. of Civ. Serv., 168 F.3d 610, 615 (2d Cir. 1999). "[W]here a party fails to respond, after notice the court is ordinarily justified in entering a judgment against the defaulting party ... ." Bermudez v. Reid, 733 F.2d 18, 21 (2d Cir. 1984) (citing Fed. R. Civ. P. 55(b)(2)). A party's default is deemed to constitute a concession of all the factual allegations of the complaint concerning liability. Cotton v. Slone, 4 F.3d 176, 181 (2d Cir. 1993); Au Bon Pain Corp. v. Artect, Inc., 653 F.2d 61, 65 (2d Cir. 1981).

B. Shah Was Properly Served with the Summons and the Complaint and Failed to Appear, Answer or Otherwise Respond

Service of the Complaint and a Summons to Shah was affected on March 22, 2010, by the Department of Legal Affairs of the Ministry of Law and Justice of India pursuant to Federal Rule of Civil Procedure 4 and the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents. Despite proper service, Shah has nonetheless failed to plead, respond or otherwise defend this action as required by the Federal Rules and Local Rules of this Court. Shah should not be permitted to evade the consequences of his unlawful conduct by ignoring this lawsuit. Accordingly, a judgment by default is appropriate. See Bermudez, 733 F.2d at 21 ("where a party fails to respond, after notice the court is ordinarily justified in entering a judgment against the defaulting party....").

II. The Complaint Establishes Shah's Liability For Violations of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5

The legal effect of a default judgment is to establish conclusively that the violations alleged in the Complaint did indeed occur; thus, because Shah is in default, the Court should accept as true all the factual allegations of the Complaint, except those relating to damages. See Cotton, 4 F.3d at 181; Au Bon Pain, 653 F.2d at 65. The detailed allegations in the Complaint, deemed true, establish Shah's liability for violating the federal securities laws and establish the appropriateness of the remedies sought against Shah by the Commission. See Au Bon Pain, 653 F.2d at 65.

Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5 prohibit fraud in connection with the purchase or sale of securities. United States v. Naftalin, 441 U.S. 768, 777, 778 (1979); SEC v. Nat'l Sec., Inc., 393 U.S. 453, 466 (1969). According to the misappropriation theory of insider trading, a violation of the securities laws occurs once a person "misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information." United States v. O'Hagan, 521 U.S. 642, 652 (1997). The misappropriation theory thereby targets "a duty owed not to a trading party, but to the source of the information" and applies even when the source for the tip is not an insider at the company. Id. at 653. The "insider" and the "misappropriater" are prohibited from trading on the basis of the confidential information they receive. They are also prohibited from "tipping" such information to another person – a "tippee" – who engages in the trading, knowing that the information is confidential. See SEC v. Yun, 327 F.3d 1263, 1269 (11th Cir. 2003). To establish the tipper's liability, the Commission must show that the tipper conveyed material, nonpublic information in breach of a fiduciary or similar relationship of trust and confidence and the tipper received a "benefit," directly or indirectly, from the disclosure. Dirks v. SEC, 463

U.S. 646, 659-62 (1983). Section 10(b) of the Exchange Act and Rule 10b-5 also require proof of scienter, or "a mental state embracing intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). Proof of scienter can be inferred from circumstantial evidence. Herman & MacLean v. Huddleston, 459 U.S. 375, 390-91 n.30 (1983).

The allegations in the Complaint, deemed true upon default, adequately allege that Shah conveyed material nonpublic information to Khan regarding the Hilton Announcement and regarding the Kronos Announcement, that Shah did so in breach of a fiduciary duty, and that he received a benefit as a result of these disclosures. Ex. 2 ¶¶56-67, 80-92. The information Shah conveyed was unquestionably material as it related to significant events for the relevant companies. Shah therefore violated the anti-fraud provisions of the federal securities laws.

III. The Court Should Order the Commission's Requested Relief Against Shah

A. The Court Should Permanently Enjoin Shah From Future Violations of the Federal Securities Laws

The Complaint's allegations amply support the Commission's request for an order permanently enjoining Shah from future violations of the federal securities laws. The authority of a federal district court to order permanent injunctive relief in a Commission enforcement action is well established, see, e.g., SEC v. Commonwealth Chem. Secs., Inc., 574 F.2d 90, 99-100 (2d Cir. 1978), and permanent injunctions may be ordered as part of a judgment by default upon a finding by the Court that a factual basis for such relief exists, see, e.g., SEC v. McNulty, 137 F.3d 732, 736-37, 741 (2d Cir. 1998); SEC v. Management Dynamics, Inc., 515 F.2d 801, 814 (2d Cir. 1975). In the context of a default judgment, the "factual allegations of the complaint are taken as true" and, thus, "it is appropriate that the Court . . . enter findings of fact and conclusions of law." See, e.g., Chen v. Jenna Lane, Inc., 30 F. Supp. 2d 622, 624 (S.D.N.Y.

1998); SEC v. Interlink Data Network, 1993 U.S. Dist. LEXIS 20163, at *29 (C.D. Cal. Nov. 15, 1993).

Section 20(b) of the Securities Act [15 U.S.C. § 77t(b)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)] authorize permanent injunctive relief upon a showing that (1) violations of the securities laws have occurred, and (2) a reasonable likelihood exists that violations will occur in the future. SEC v. Benson, 657 F. Supp. 1122, 1132-33 (S.D.N.Y. 1987); Commonwealth, 574 F.2d at 99-100; SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1100-01 (2d Cir. 1972). To determine whether a reasonable likelihood of future violations exists, courts generally consider: (i) the egregiousness of the conduct; (ii) the isolated or recurrent nature of the infraction; (iii) the degree of scienter involved; (iv) the sincerity of the defendant's assurances (if any) against future violations; (v) the defendant's recognition (if any) of the wrongful nature of his conduct; and (vi) the defendant's position in an occupation where future violations would be likely to occur. SEC v. Power, 525 F. Supp. 2d 415, 427 (S.D.N.Y. 2007); SEC v. Cavanaugh, 155 F.3d 129, 135 (2d Cir. 1998); SEC v. Univ. Major Indus. Corp., 546 F.2d 1044, 1048 (2d Cir. 1976).

Defendant Shah conveyed sensitive confidential information that he obtained as a result of his employment at Moody's. He knowingly shared this information and received payment for doing so. He thereby breached his duty to his employer to maintain such information in confidence and not sell it to third parties for his own personal gain. This Court should permanently enjoin Shah from any such future violations of the federal securities laws. See SEC v. Colonial Inv. Mgmt. LLC, 2008 U.S. Dist. LEXIS 41442, *7-8 (S.D.N.Y. May 22, 2008) (collecting Second Circuit cases granting injunctive relief based on allegations of past violations).

B. The Court Should Order Shah To Disgorge the Ill-Gotten Gains and Those of His Downstream Tippees

It is well settled that the Commission may seek, and courts may order, disgorgement of ill-gotten gains in Commission injunctive actions. Manor Nursing, 458 F.2d at 1104 ("The deterrent effect of an SEC enforcement action would be greatly undermined if securities law violators were not required to disgorge illicit profits."). A district court has broad discretion in determining whether to order disgorgement and in calculating the amount of disgorgement. SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1475 (2d Cir. 1996). Furthermore, "[a] tippee's gains are attributable to the tipper, regardless whether benefit accrues to the tipper." SEC v. Warde, 151 F.3d 42, 49 (2d Cir. 1998); SEC v. Hirshberg, 1999 U.S. App. LEXIS 4764, *9 (2d Cir. Mar. 18, 1999).[2]

The Commission is not required to establish with certainty the amount to be disgorged; rather the Commission's burden is to come forward with a "reasonable approximation of profits causally connected to the violation." First Jersey, 101 F.3d at 1475; SEC v. First City Fin. Corp., 890 F.2d 1215, 1231 (D.C. Cir. 1989). Once the Commission has done so, the burden shifts to the defendant to come forward with evidence that the requested disgorgement is not a "reasonable approximation" of unjust enrichment. First City, 890 F.2d at 1232. If the measure of disgorgement is reasonable, the wrongdoer bears the risk of any uncertainty in this disgorgement calculation. Warde, 151 F.3d at 50; SEC v. Patel, 61 F.3d 137, 140 (2d Cir. 1995); First City, 890 F.2d at 1232. In the context of a motion for default judgment, the Court may award disgorgement and prejudgment interest without an evidentiary hearing where, as here, the

[2] To date, the Commission has obtained judgments for disgorgement of certain Hilton and Kronos trading profits against Defendants Khan, Shankar, Hardin and Schottenfeld Group. To the extent these judgments have been paid, the Commission is not seeking them from Shah. To the extent judgments for disgorgement have been ordered, but not yet paid, the Commission seeks liability against Shah on a joint and several basis.

record is sufficient to establish the disgorgement amount. See Fustok v. ContiCommodity Servs., Inc., 873 F.2d 38, 39-40 (2d Cir. 1989) (detailed affidavits, documentary evidence and the court's knowledge formed sufficient basis for damages awarded in default judgment). The Commission has demonstrated that the amount of Shah's disgorgement is $8,201,464.96. Ex. 5.

C. The Court Should Order Shah to Pay Prejudgment Interest

The Court should require Shah to pay prejudgment interest on the disgorgement amount. The decision whether to grant prejudgment interest and the rate to use of such interest are matters within a district court's broad discretion. First Jersey, 101 F.3d at 1476. The Second Circuit stated:

> In deciding whether an award of prejudgment interest is warranted, a court should consider (i) the need to fully compensate the wronged party for actual damages suffered, (ii) considerations of fairness and the relative equities of the award, (iii) the remedial purpose of the statute involved, and/or (iv) such other general principles as are deemed relevant by the court. In an enforcement action brought by a regulatory agency, the remedial purpose of the statute takes on special importance. When the SEC itself orders disgorgement, which ... is designed to strip a wrongdoer of its unlawful gains, the interest rate it imposes is generally the IRS underpayment rate . . . . That rate reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from its fraud.

Id., 101 F.3d at 1476 (citations and internal quotations omitted). The Commission respectfully requests that the Court employ the same prejudgment interest formula in this case and award the Commission prejudgment interest on its disgorgement remedy against Shah at the IRS underpayment rate. The Commission has demonstrated that the appropriate prejudgment interest amounts to $1,755,865.09. Exs. 5, 6.

D. The Court Should Order Civil Penalties Against Shah

"Civil penalties are designed to punish the individual violator and deter future violations of the securities laws." SEC v. Haligiannis, 470 F. Supp. 2d 373, 386 (S.D.N.Y. 2007); see also

SEC v. Moran, 944 F. Supp. 286, 296 (S.D.N.Y. 1996). "Disgorgement alone is an insufficient remedy, since there is little deterrent in a rule that allows a violator to keep the profits if [he] is not detected, and requires only a return of ill-gotten gains if [he] is caught." SEC v. Inorganic Recycling Corp., 2002 U.S. Dist. LEXIS 15817, at *11-12 (S.D.N.Y. Aug. 22, 2002).

Subsection (a)(1) of Section 21A of the Exchange Act authorizes the Commission to seek, and the district court to impose, a civil penalty for insider trading — i.e., for "purchasing or selling a security . . . while in possession of material, nonpublic information in, or . . . communicating such information in connection with, a transaction . . . ." 15 U.S.C. §78u-1(a)(1); SEC v. Rosenthal, 2011 U.S. App. LEXIS 11684. *7 (2d Cir. June 9, 2011). In a separate subsection, Section 21A provides that the amount of such a penalty "shall be determined by the court in light of the facts and circumstances," and "shall not exceed three times the profit gained or loss avoided as a result of such unlawful purchase, sale, or communication." 15 U.S.C. §78u-1(a)(2); Rosenthal, 2011 U.S. App. LEXIS 11684, at *7. To determine what civil penalties should be imposed, courts have looked to a number of factors, including: "(1) the egregiousness of the defendant's conduct; (2) the degree of the defendant's scienter; (3) whether the defendant's conduct created substantial losses or the risk of substantial losses to other persons; (4) whether the defendant's conduct was isolated or recurrent; and (5) whether the penalty should be reduced due to the defendant's demonstrated current and future financial condition." SEC v. Opulentica, 479 F. Supp. 2d 319, 331; see also SEC v. Rosenthal, 2011 U.S. App. LEXIS 11732, *7 (2d Cir. June 9, 2011) (affirming district court's consideration of same factors).

Shah's conduct here was egregious. As an employee of Moody's, he was entrusted by Moody's clients – Hilton and Kronos -- with the very information he chose to share with Khan for securities trading purposes. Shah is a fugitive and has chosen not to appear, answer or

otherwise defend this action. Under these circumstances, a maximum penalty of three times the trading profits is justified.

CONCLUSION

For the foregoing reasons, the Commission respectfully requests that this Court enter a default judgment against Shah for the relief requested in the Complaint, including: (1) a permanent injunction against future violations of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5; (2) disgorgement of ill-gotten gains; (3) prejudgment interest; and (4) civil penalties. A proposed form of judgment is filed herewith. Ex. 3.

Dated: New York, New York
June 23, 2011

Respectfully submitted,

By: _____

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