UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION Plaintiff, v. GALLEON MANAGEMENT, LP, et al. Defendants.	§ § § § § § § § § § §	No. 09-CV-8811-JSR ECF CASE

OPPOSITION TO PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT ON BEHALF OF RAJ RAJARATNAM

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Defendant Raj Rajaratnam respectfully submits this brief in opposition to the Plaintiff's motion for partial summary judgment.

I. INTRODUCTION

Mr. Rajaratnam was sentenced on October 13, 2011 to a term of incarceration of 11 years – the longest sentence of imprisonment ever imposed on a defendant for insider trading. He was also ordered to forfeit $53.8 million and fined an additional $10 million, which will be paid shortly. Mr. Rajaratnam is scheduled to surrender to the Bureau of Prisons on November 28, 2011. Suffice it to say, Mr. Rajaratnam's life and that of his family and loved ones have been indelibly altered by this sentence and they will all suffer immensely.[1]

In light of his conviction, Mr. Rajaratnam understands that collateral estoppel applies to him with respect to the insider trading claim for the stocks alleged in the instant motion.[2] Therefore, he does not oppose a finding of liability against him for the violations alleged by the SEC concerning the Collateral Estoppel Stocks. Mr. Rajaratnam also does not oppose the entry of an injunction against him based on his liability from the Collateral Estoppel Stocks.

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[1] While a term of imprisonment is undoubtedly difficult for any defendant and his or her family, the consequences of Mr. Rajaratnam's are significant. Mr. Rajaratnam will be separated from his wife and three school-aged children for approximately a decade, even if he receives credit for good conduct while incarcerated. He also may well never again see his elderly parents, who live with him and for whom he has cared for years in their poor health.

[2] The stocks included in the instant motion for partial summary judgment by the SEC are: Clearwire; Akamai; PeopleSupport; ATI; and Intel (the "Collateral Estoppel Stocks"). Mr. Rajaratnam was convicted of insider trading in connection with trading in the Collateral Estoppel Stocks. The instant motion does not include the Commission's allegations related to: EBay Polycom; Hilton; Google; and AMD. Those stocks were not part of substantive securities fraud counts in the criminal case. The SEC has not indicated whether it will proceed to trial on these other stocks or will dismiss them.

Since his criminal conviction, Mr. Rajaratnam has tried to resolve this case. But the parties have been unable to reach a settlement agreement principally because the SEC has persisted in seeking a still greater penalty against Mr. Rajaratnam despite the fact that he has been adequately punished. That punishment includes forfeiture and criminal penalties that are far in excess of the amount that he actually received from the trades at issue in this case.

As a result Mr. Rajaratnam appears before the Court on two issues: (1) whether disgorgement should be ordered in this case; (2) whether an additional civil penalty should be imposed.

With respect to disgorgement, the SEC has asserted that amounts calculated by Special Agent James Barnacle of the Federal Bureau of Investigation in the criminal action are the appropriate amount of disgorgement in this case. The agent calculated that the amount of profit and losses avoided realized by Galleon for the Collateral Estoppel Stocks is $31,563,661 and the SEC seeks that amount in this motion.

Through the forfeiture ordered in the criminal case, Mr. Rajaratnam has already been ordered to pay back profits and losses avoided related to the Collateral Estoppel Stocks. In the criminal case, Judge Holwell ordered $53,816,434 forfeited. That amount was based on the FBI's calculations that the SEC uses here and includes profits and losses avoided from the Collateral Estoppel Stocks. It is axiomatic that disgorgement cannot be obtained from someone who has already forfeited the ill-gotten funds.

With respect to civil penalties, in a summary discussion in its brief, the SEC asks the court to award a three times penalty against Mr. Rajaratnam. Using the SEC's disgorgement calculation, this would amount to an extraordinary $94.6 million penalty. In light of the severe

criminal sentence imposed by Judge Holwell, which will include the payment of the full amount of the disgorgement sought by the SEC, Mr. Rajaratnam respectfully submits that any further penalty is unnecessary, excessive, and unfair.

In the event the Court determines that an additional civil penalty should be imposed, the SEC's disgorgement amount should not be used as the basis for calculating the penalty, for two reasons. First, Agent Barnacle's disgorgement calculations fail to take into consideration market factors unrelated to the alleged inside information received by Mr. Rajaratnam that affect the share price at which the profit is calculated on the Collateral Estoppel Stocks. As we discuss below, disgorgement is limited to the amount of the ill-gotten gain (and only that amount). Events that move the price of securities unrelated to the alleged inside information received by a defendant should not be included in a disgorgement calculation. Attached to this Opposition is expert testimony based on event studies that establishes that the profit directly related to the purported inside information is $22,300,551, not the higher number asserted by the SEC. Declaration of Gregg A. Jarrell, Ph.D. at ¶ 24, attached hereto as Ex. B.

Second, the SEC's proposed calculation ignores the fact that Mr. Rajaratnam did not receive $31 million or even $21 million related to the Collateral Estoppel Stocks. Mr. Rajaratnam actually realized $4,725,150 in proceeds from the Collateral Estoppel Stocks. Mr. Rajaratnam should only be required to disgorge what he received.

II. INSIDER TRADING LIABILITY AND PERMANENT INJUNCTION

The SEC has moved for partial summary judgment on the issue of Mr. Rajaratnam's liability for insider trading in the securities of Akamai, ATI, Clearwire, Intel (Q1 2007), and PeopleSupport. Br. at 2. The SEC's sole basis for moving as to liability on those stocks is that

Mr. Rajaratnam is collaterally estopped from defending against the SEC's allegations due to his conviction for similar conduct in the parallel criminal case. Br. at 4-16. Mr. Rajaratnam agrees that he is collaterally estopped as to those five stocks only and does not oppose liability as to them.

The SEC has also requested that the Court permanently enjoin Mr. Rajaratnam from future violations of the securities laws. Br. at 20. Mr. Rajaratnam does not oppose the entry of a permanent injunction (of the same type that have been entered against other defendants in this case) against him based on liability that flows from the Collateral Estoppel Stocks.

III. NO DISGORGEMENT IS OWED IN THIS CASE

A. The SEC's Disgorgement Claim

The SEC claims that Mr. Rajaratnam should be ordered to disgorge $31,563,661. Br. at 18. The SEC's disgorgement amount is based on calculations performed by FBI Special Agent Barnacle, who also performed certain profit calculations that he presented at the criminal trial. Br. at 18. Agent Barnacle calculated what the SEC claims are Mr. Rajaratnam's insider trading profits using the FIFO ("first in, first out") method, which calculates the difference between the amount paid for shares and the price at which they were sold (or, in the case of a short, the amount at which the short was covered). Br. at 18. As discussed in Section V, the SEC's calculation method is flawed, and its resulting disgorgement amount is improperly inflated.

B. Mr. Rajaratnam Has Already Paid the Disgorgement Via His Criminal Forfeiture

On October 13, 2011, Judge Holwell ordered Mr. Rajaratnam to forfeit $53,816,434 in profits in connection with insider trading in a number of stocks, including those at issue in the instant motion. Ex. 1 to Declaration of W. White, attached hereto as Ex. A, at 29. Because the

criminal forfeiture amount is greater than even the SEC's inflated $31.5 million disgorgement amount, Mr. Rajaratnam's payment of the criminal forfeiture will also satisfy any disgorgement in this case.

Both criminal forfeiture and civil disgorgement seek to remedy unjust enrichment; neither are meant to punish. *SEC v. AbsoluteFuture.com*, 393 F.3d 94, 96 (2d Cir. 2004) ("the primary purpose of disgorgement is to correct unjust enrichment"); *United States v. Bajakajian*, 524 U.S. 321, 349 (1998) ("forfeitures of criminal proceeds serve the nonpunitive ends of making restitution"). As a result, Mr. Rajaratnam is entitled to offset his civil disgorgement amount by the criminal forfeiture amount he has been ordered to pay. *SEC v. Palmisano*, 135 F.3d 860, 864 (2d Cir. 1998) (finding that defendant was entitled to offset disgorgement amount by amount he paid or would pay as restitution in the parallel criminal proceeding); *SEC v. Credit Bancorp, Ltd.*, 738 F. Supp. 2d 376, 391 (S.D.N.Y. 2010) (same). Here, Mr. Rajaratnam's criminal forfeiture amount completely offsets even the SEC's inflated disgorgement number and as a result, he should not be ordered to pay any disgorgement in this action.

IV. IN LIGHT OF THE PENALTY IMPOSED IN THE CRIMINAL CASE, NO ADDITIONAL PENALTY IS WARRANTED IN THIS CASE

The SEC is seeking an extraordinary penalty of three times its overstated disgorgement amount - $94.6 million. Br. at 21-22. As the SEC correctly points out in its brief, "civil penalties are designed to punish the individual violator and deter future violations of the securities laws." Br. at 21. The Court must determine the penalty amount "in light of the facts and circumstances" of the case. 15 U.S.C. § 78u-1(a)(2).

When deciding whether to impose a civil penalty in a situation where there is a parallel criminal case, courts consider whether the defendant was subject to a burdensome criminal trial

and appeal, whether the defendant will be permanently enjoined from working in the securities industry, and whether imposition of a penalty will have any punitive and deterrent effects. *See SEC v. Shah*, No. 92 Civ. 1952, 1993 WL 288285, at *6 (S.D.N.Y. July 28, 1993) (declining to impose a civil penalty in light of "extensive criminal and regulatory penalties and discipline" the defendant had already suffered, and finding that the goal of deterrence was already achieved); *SEC v. Smath*, 277 F. Supp. 2d 186, 188 (E.D.N.Y. 2003) (declining to impose any civil penalty in light of punishment imposed in a parallel criminal case and stating that "any substantial recovery…would further penalize a defendant who has already been severely punished"); *SEC v. Mellert*, No. C03-0619, 2006 WL 927743 (N.D. Cal. Mar. 29, 2006) (no penalty where defendant had already been criminally convicted and paid a fine).

Just as the Government did in the criminal case, the SEC here attempts to paint Mr. Rajaratnam in the worst possible light. But in reaching his decision on the appropriate sentence, Judge Holwell had the benefit of the pre-sentence report, as well as the hundreds of letters of support that were submitted to the Court by people who know Mr. Rajaratnam.[3] The report and the letters described another side of Mr. Rajaratnam, including his extraordinary generosity in terms of both financial support and his time for worthy causes in this country and around the world. White Decl., Ex. 1 at 32. Nonetheless, Judge Holwell still imposed the longest sentence ever for an insider trading case, a substantial criminal fine of $10 million, and a forfeiture of $53.8 million – numbers far in excess of what Mr. Rajaratnam received in purported ill-gotten gains and far in excess of the disgorgement claim of the SEC. Moreover, Judge Holwell found

[3] Mr. Rajaratnam has no objection to this Court also reviewing the pre-sentence report if the Court felt that such a review would be helpful to a determination of penalties in this case. Additionally, the letters mentioned above are described in detail in Mr. Rajaratnam's Sentencing Memorandum. White Decl. at Ex. 2.

that Mr. Rajaratnam has serious health issues and nevertheless imposed a significant sentence while recognizing that incarceration imposes an even greater penalty on defendants who have serious medical conditions. *Id.* at 32-33. In light of all the factors Judge Holwell carefully considered, and the substantial penalty he imposed, Mr. Rajaratnam submits that no further punishment or penalty is warranted.

The public interest is not served by the excessive and exorbitant penalty the SEC seeks in this case because the goals of such a penalty have already been achieved.[4] The investing public has been amply protected by the significant sentence ordered in the criminal case. Mr. Rajaratnam will also be subject to a permanent injunction and a lifetime bar from the securities industry. The imposition of an additional civil penalty will not add to the deterrent effect of the substantial criminal sentence.

Moreover, a significant penalty is at odds with how other defendants in this case have been treated. The only defendant to have received a triple penalty in this case, to date, is Deep Shah, who is a fugitive and who has had a default judgment entered against him. White Decl. at Ex. 4. Unlike Mr. Shah, Mr. Rajaratnam has faced the charges and allegations against him. In both the criminal case and this case, he has met all deadlines, complied with all court orders, and has appeared at every court proceeding where his presence was required.

[4] Interestingly, at the same time the SEC is seeking the maximum civil penalty against Mr. Rajaratnam in this case, it was simultaneously trying to increase Mr. Rajaratnam's punishment in the criminal case. *See* White Decl. at Ex. 3 (Ltr. from R. Khuzami, SEC Director of Enforcement, to J. Holwell urging Judge Holwell, when determining Mr. Rajaratnam's sentence, to consider the SEC's position that "insider trading victimizes the national markets"). By advocating its position in the criminal case, the SEC has clearly confirmed that criminal punishment can be used to satisfy its own remedial needs. Thus, Mr. Rajaratnam's sentence should be considered in this case in assessing whether any additional penalties are warranted.

Mr. Rajaratnam received a substantially more severe sentence than all the other defendants who were prosecuted criminally and/or sued civilly by the SEC in what have been loosely described as the "Galleon cases." No other defendant in these cases brought by the SEC has received even a two times penalty. Brian Santarlas, Richard Yokuty, and Shammara Hussain each received a penalty that was one times their relative disgorgement amount. White Decl. at Exs. 5-7. Penalty determinations have been made against only six other defendants. Robert Moffat received no monetary penalty. White Decl. at Ex. 8. Michael Cardillo, Ali Far, Steven Fortuna, and Choo Beng Lee all received a penalty that was one half times their relative disgorgement amounts. White Decl. at Exs. 9-11. Sunil Bhalla received an $85,000 civil penalty and no disgorgement. White Decl. at Ex. 12.

V. IN THE ALTERNATIVE, IF THE COURT IS INCLINED TO IMPOSE AN ADDITIONAL CIVIL PENALTY, ANY SUCH PENALTY SHOULD NOT BE CALCULATED USING THE SEC'S IMPROPERLY INFLATED DISGORGEMENT AMOUNT.

For the reasons stated above, we respectfully submit that no additional penalty is warranted in this case. We include the following discussion in the event that the Court is inclined to consider an additional civil penalty based on a determination of the disgorgement amount for the stocks at issue in the current motion.

A. Unrelated Market Factors Must Be Removed from the Disgorgement Calculation

The SEC's disgorgement calculation of approximately $31 million does not take other, unrelated market factors into account, and thereby fails to exclude profits with no causal link to Mr. Rajaratnam's alleged receipt of inside information. The SEC's proposed disgorgement is improperly based on the FIFO (first in, first out) method that indiscriminately includes all movements in share price, and all resulting profits, between the date of the original purchase of

the shares and the date of their final sale (or cover, as the case may be) no matter how long that time period may be.[5] Because that method broadly sweeps in all stock price movements regardless of cause, it is not the appropriate method to calculate the profit, and the resulting disgorgement amount should be rejected.

As previously noted, disgorgement is not punitive and only the money directly related to the illicit profits is subject to disgorgement. *See SEC. v. First Jersey Sec., Inc*., 101 F.3d 1450, 1476 (2d Cir. 1996) ("No more than the total amount of First Jersey's unlawful profits, plus interest on those amounts, is to be disgorged"); *SEC v. First City Fin. Corp., Ltd*., 890 F.2d 1215, 1231 (D.C. Cir. 1989) ("[D]isgorgement may not be used punitively."); *SEC v. Commonwealth Chem. Sec., Inc.*, 574 F.2d 90, 102 (2d Cir. 1978) ("[T]he primary purpose of disgorgement is not to compensate investors. Unlike damages, it is a method of forcing a defendant to give up the amount by which he was unjustly enriched.").

Disgorgement therefore should only include those amounts that are attributable to the wrongdoing, not amounts that are attributable to other events or to general market movement. *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 346 (2005) (the law requires, and the plaintiff must prove, a proximate causal link between the fraud and the economic consequence); *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC*, 595 F.3d 86, 95 (2d Cir. 2010) (same); *accord United States v. Rutkoske*, 506 F.3d 170 (2d Cir. 2007) (excluding market movements and other events from loss calculation for purposes of sentencing guidelines); *United States v. Olis*, 429 F.3d 540 (5th Cir. 2005) (same); *see also* Mark L. Mitchell & Jeffry M.

[5] The SEC adopts calculations performed by Agent Barnacle, who admitted during the criminal trial that he "didn't do an event study" and "didn't perform any analysis" to exclude price movements not attributable to the inside information. White Decl., Ex. 13 at 3551-2. Instead, Agent Barnacle improperly treated "the entire increase in the stock price, upon the announcement of the news, as insider trading gain." *Id.*

Netter, *The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission*, 49 BUS. LAW. 545, 549, 565 (1994) (SEC staff members discussed that "the SEC recently began to use stock price evidence to show materiality in securities fraud cases, especially insider trading cases. . . . Statistical tests of significance are useful both in establishing materiality and in calculating disgorgement").

The SEC has presented no evidence that its disgorgement calculation excludes profits that relate to market movements that were unrelated to the inside information. As a result, the Court should instead determine the proper disgorgement amount based on event studies submitted through expert testimony that remove those market factors affecting the stock price that are unrelated to the release of the alleged inside information. Indeed, reliance on such event studies to determine a causal relationship between the release of information and changes in stock price is a crucial component in securities cases in this Circuit and elsewhere. *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier Capital Mortg. Securitization Corp.*, 546 F.3d 196, 207-208 (2d Cir. 2008) ("An event study that correlates the disclosures of unanticipated, material information about a security with corresponding fluctuations in price has been considered prima facie evidence of the existence of such a causal relationship."); *In re Vivendi Univ. S.A. Sec. Litig.*, 634 F. Supp. 2d 352, 364 (S.D.N.Y. 2009) (describing expert event studies as "almost obligatory" in determining causation in securities cases); *In re Credit Suisse First Boston Corp. (Lantronix, Inc.) Analyst Sec. Litig.*, 250 F.R.D. 137, 143 n. 14 (S.D.N.Y. 2008) (an event study is the "generally accepted" approach for proving that a stock was responding to a specific piece of information on a specific day); *In re N. Telecom Ltd. Sec. Litig.*, 116 F. Supp. 2d 446, 460-61 (S.D.N.Y. 2000) (finding that plaintiff's expert testimony was "fatally deficient" in a securities fraud case because the expert did not perform an event study to "remove the effects on stock

price of market and industry information"); *In re Exec. Telecard Ltd. Sec. Litig.*, 979 F. Supp. 1021, 1025-27 (S.D.N.Y. 1997) (precluding expert testimony on damages because of failure to conduct an event study); *In re Imperial Credit Indus., Inc. Sec. Litig.*, 252 F. Supp. 2d 1005, 1014-15 (C.D. Cal. 2003) (requiring an event study or similar analysis).[6]

Event studies result in a more reasonable disgorgement amount that properly removes unrelated market factors, leaving only price changes related to the release of the material information. The event study methodology, which is widely accepted, is described in detail in the Declaration of Gregg A. Jarrell, attached hereto as Exhibit B. Professor Jarrell is a Professor of Finance at the University of Rochester and the former Chief Economist at the SEC. He was accepted as an expert witness in the criminal case. He performed event studies for all the stock transactions implicated in the SEC's Motion. Jarrell Decl. at ¶¶ 1, 4, 23. In summary, event studies use market modeling to determine what portion of a stock's price change on a particular day was the result of the release of material information and what portion was the result of normal market factors. Jarrell Decl. at ¶¶ 17-22. This modeling allows changes due to normal market factors to be removed, leaving only changes attributable to the release of the material information. Jarrell Decl. at ¶ 19. Event studies performed in this case result in a total disgorgement figure for Akamai, ATI, Clearwire, Intel, and PeopleSupport of $22,300,551, which is approximately $9 million lower than the SEC's improperly calculated disgorgement figure. Jarrell Decl. at ¶ 24.

[6] The SEC apparently agrees that there must be a causal relationship between the conduct and the economic consequence because the SEC, itself, has used expert event studies to show just that. *See, e.g.*, *SEC v. Razmilovic*, No. CV-04-2276, 2011 WL 4629022, at *10 (E.D.N.Y. Sept. 30, 2011) (SEC expert assessed impact of financial misrepresentations on stock prices using an event study methodology substantially the same as the one used by Professor Jarrell in this case).

B. The SEC's Disgorgement Amount is Inflated Because it is Not Limited to the Profits Mr. Rajaratnam Personally Received

The SEC's disgorgement number is also unreasonably inflated because it is not limited to the profits Mr. Rajaratnam personally received as a result of the conduct at issue in the SEC's Motion. Because disgorgement is a remedy for unjust enrichment, the disgorgement amount should reflect only profits Mr. Rajaratnam realized himself. *SEC v. Tome*, 833 F.2d 1086, 1096 (2d Cir. 1987) (requiring defendant to disgorge a sum of money equal only to the payments he received); *SEC v. Falbo*, 14 F. Supp. 2d 508, 528 (S.D.N.Y. 1998) (determining disgorgement amount based on profits realized by defendant); *SEC v. Downe*, 969 F. Supp. 149, 158 (S.D.N.Y. 1997) (declining to order first-level tippee to disgorge profits realized by second-level tippee when the SEC failed to show how first-level tippee was enriched by those trades).

Courts in other Circuits agree. For example, in *Hateley v. SEC*, the Ninth Circuit rejected the notion that disgorgement should include the total amount of ill-gotten gain rather than just the gain the defendant received. 8 F.3d 653, 655-56 (9th Cir. 1993). The court reasoned that, since disgorgement is the means by which unjust enrichment is remedied, the disgorgement amount must be "approximately equal to the unjust enrichment." *Id.* at 656. The court rejected the lower court's disgorgement order because it was ten times the amount the defendant actually retained from the illegal conduct. *Id.* The court emphasized the importance of an agreement between the parties that set the percentage of commissions the defendant would retain. *Id.* at 655-56. The agreement provided for division of profits, with the defendant retaining only 10%. *Id.* at 656. As a result, the court agreed with the defendant that the disgorgement amount should be approximately equal to what the defendant personally received. *Id.* at 655-56.

The reasoning in *Hateley* is directly applicable to this case. If disgorgement is meant to remedy unjust enrichment, the disgorgement amount should be approximately equal to what Mr. Rajaratnam actually received. Mr. Rajaratnam's personal gains came from two sources: his share of Galleon's management fees and returns on his personal investments in Galleon funds. *See* Declaration of former Galleon CFO George Lau at ¶ 6, attached hereto as Exhibit C. As a portfolio manager and partner in Galleon Management, L.P., Mr. Rajaratnam was entitled to a portion of the fees that Galleon charged the funds for fund management, as provided by contract. *Id*. Mr. Rajaratnam also had direct investments, as well as an indirect interest through his deferred compensation, in both the Diversified and Technology Funds. *Id*. Those interests entitled him to a pro rata portion of any profits those funds generated, again by contract. *Id*. As explained in further detail in Mr. Lau's Declaration, Mr. Rajaratnam's share of Galleon Management's management fees was 65% from 2005 to 2007, and 50% in 2008. Lau Decl. at ¶¶ 11-12. This translates to a personal pre-tax gain from management fees attributable to the five stocks at issue equal to $2,582,808. Lau Decl. at ¶ 13. The return on Mr. Rajaratnam's direct and indirect investments in the funds that are attributable to the same stocks during the relevant periods was $2,142,342. Lau Decl. at ¶ 17. The total realized from the trading in the five stocks at issue, therefore, was $4,725,150.[7] That is the amount upon which the Court should base its determination about a civil penalty, if any.

VI. CONCLUSION

For all of the foregoing reasons, Mr. Rajaratnam, through counsel, respectfully requests that the Court deny the SEC's request for disgorgement since it already has been paid in the

[7] None of the PeopleSupport trades at issue were made in Galleon accounts so there are no management fees or investment returns associated with PeopleSupport.

criminal case and deny the SEC's request for civil penalties in light of the substantial penalties already imposed on Mr. Rajaratnam.

Dated: October 17, 2011

Respectfully submitted by:

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing document was served by causing a copy to be filed with the Court via CM/ECF on this 17th day of October 2011 on:

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