UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
	:	No. 09 Civ. 8811 (JSR)
Plaintiff,	:	
	:	ECF CASE
- against -	:	
	:	
RAJ RAJARATNAM, and	:	
GALLEON MANAGEMENT, L.P.,	:	
	:	
Defendants.	:	

MEMORANDUM OF LAW OF DEFENDANT GALLEON MANAGEMENT, L.P. IN OPPOSITION TO PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT

Adam S. Hakki
John A. Nathanson
Terence P. Gilroy

SHEARMAN & STERLING LLP
599 Lexington Avenue
New York, NY 10022-6069
(212) 848-4000
(212) 848-7179 (facsimile)

Attorneys for Galleon Management, L.P.

Dated: October 17, 2011
New York, New York

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

CASES

STATUTES

Defendant Galleon Management, L.P. ("Galleon") respectfully submits this memorandum of law, together with its counterstatement of material facts, in opposition to the motion for partial summary judgment of plaintiff Securities and Exchange Commission (the "SEC").

PRELIMINARY STATEMENT

The SEC seeks partial summary judgment against Raj Rajaratnam and Galleon with respect to the alleged insider trades in this action that were also the subject of substantive counts in the criminal judgment against Mr. Rajaratnam. The SEC's motion would only partially dispose of this action.

The SEC's motion does not establish collateral estoppel as to Galleon. Galleon was not a party to the criminal case. As a result, it is subject to collateral estoppel only if the SEC can establish that Galleon was in privity with Mr. Rajaratnam at the time of his criminal trial. The SEC has not attempted this showing, let alone established privity as a matter of law. Instead, the SEC argues that because Galleon is (in the SEC's view) vicariously liable for Mr. Rajaratnam's conduct under the doctrine of respondeat superior, collateral estoppel necessarily has been established. That is incorrect as a matter of settled law. The doctrines of respondeat superior and collateral estoppel are distinct, and the presence of one does not establish the other. They focus on different time periods and are adjudged under different standards. Respondeat superior has relatively broad application. Privity, on the other hand, is more narrowly construed in keeping with the due process considerations associated with barring a party from defending itself based on a prior action in which it did not participate.

Because collateral estoppel is not established as to Galleon, the Court need not reach the SEC's request for partial summary judgment with respect to remedies. Moreover, even if consideration of remedies were appropriate, there would be no basis for summary judgment

against Galleon on those issues. First, the stipulated forfeiture order in the criminal case has effectively mooted the SEC's claim for disgorgement on summary judgment. The recovery the SEC seeks is "joint and several" as to Galleon and Mr. Rajaratnam, and the same allegedly ill-gotten gains cannot be disgorged twice. Second, injunctive relief is inappropriate on its face because Galleon is no longer a going concern, has de-registered as an investment advisor, and poses no risk of future violations of the securities laws. Third, the assessment of any penalty against Galleon would be inappropriate. The filing of this action and Mr. Rajaratnam's highly-publicized arrest put an end to Galleon (a once large and highly valuable business) as a going concern. That, coupled with the criminal sentence, fine and agreed forfeiture already imposed, is more than sufficient to satisfy the government's stated need to punish Mr. Rajaratnam and Galleon. Imposing additional penalties would be inequitable and serve no legitimate purpose.

The SEC's motion for partial summary judgment against Galleon should be denied.

RESPONSE TO LOCAL RULE 56.1 STATEMENT OF MATERIAL FACTS

Galleon's response to the SEC's Local Civil Rule 56.1 statement of undisputed material facts is set forth in Galleon's accompanying response to the SEC's 56.1 statement. The SEC's motion for partial summary judgment relies entirely on the judgment in the Government's criminal case against Mr. Rajaratnam. Galleon is not – and has never been – a party to the criminal case, and the SEC has failed to demonstrate privity between Mr. Rajaratnam and Galleon as required for the criminal judgment to establish facts in this action against Galleon.

ARGUMENT

I. Galleon Is Not Subject to Collateral Estoppel

As noted, the SEC's motion for partial summary judgment against Galleon is based entirely on the purported collateral estoppel effect of the judgment in the criminal case against Mr. Rajaratnam. The SEC concedes, as it must, that Galleon was not a party to the criminal case. Nevertheless, the SEC argues that Galleon is collaterally estopped solely because – in the SEC's view – Galleon is vicariously liable under the doctrine of respondeat superior for the conduct upon which Mr. Rajaratnam was convicted and sentenced. Plaintiff Securities and Exchange Commission's Memorandum in Law in Support of its Motion for Partial Summary Judgment Against Defendants Raj Rajaratnam and Galleon Management, L.P. 2, 6, 16-17 ("SEC Br."). The Second Circuit has squarely rejected this argument, holding that respondeat superior and collateral estoppel are "distinct" doctrines, and that one does not establish the other. Stichting v. Schreiber, 327 F.3d 173, 186 (2d. Cir. 2003).

"Collateral estoppel applies only against a party to a previous adjudication and that party's 'privies.'" Id. at 184 (quoting N.L.R.B. v. Thalbo Corp., 171 F.3d 102, 109 (2d Cir. 1999)). Because Galleon undisputedly was not a party to Mr. Rajaratnam's criminal case, collateral estoppel only can be established as to Galleon if it "was in privity with [Mr. Rajaratnam] at the relevant time, i.e., during [Mr. Rajaratnam's] trial." Id. The "relevant time" is what distinguishes the privity analysis that governs collateral estoppel from the respondeat superior analysis that governs vicarious liability. As the Second Circuit has explained:

> Because the doctrine of respondeat superior asks whether an agent's action, and his or her state of mind when he or she undertook the action, are imputable to the principal, a relevant inquiry is the closeness of the relationship at the time of the act in question. In contrast, because the doctrine of collateral estoppel asks whether a party is bound by the result of a prior judicial proceeding, and thus implicates the due process rights to notice and an opportunity to be heard, the

> relevant inquiry is the closeness of the relationship at the time of the prior proceeding.

Id. at 186.

The SEC's motion for partial summary judgment erroneously "conflates" respondeat superior and collateral estoppel and fails entirely to address the governing question: whether Galleon was in privity with Mr. Rajaratnam with respect to his criminal trial. Id. ("[W]e must be careful not to conflate the doctrines of collateral estoppel and respondeat superior.") Instead of addressing privity at the time of trial, the SEC argues only that "Galleon is liable for the acts committed by Rajaratnam" because "[t]he misconduct of an agent" is – under the doctrine of "respondeat superior" – "imputed to the corporation if committed within the scope of the agents' employment." (emphasis added) (SEC Br. 16.) The SEC then cites a series of cases concerning vicarious or imputed liability that do not address collateral estoppel, let alone privity at the time of trial. (Id. 16-17.)

The party invoking collateral estoppel must "establish[] as a matter of law" that privity existed at the time of the prior proceeding, with the facts construed "in the light most favorable," to the non-moving party. Stichting, 327 F.3d at 186. The SEC has not even attempted to establish privity at the time of Mr. Rajaratnam's trial and has presented no facts that would support summary judgment on the issue. Its brief does not even utter the word "privity." Accordingly, as a matter of law, the SEC's motion for partial summary judgment should be denied as to Galleon.

In view of the SEC's failure to offer evidence (undisputed or otherwise) – or even argument – on the question of privity at the time of trial, Galleon bears no burden of raising issues of fact to defeat summary judgment. See Adickes v. S. H. Kress & Co., 398 U.S. 144, 160 (1970) ("[W]here the evidentiary matter in support of the motion does not establish the

absence of a genuine issue, summary judgment must be denied even if no opposing evidentiary matter is presented."). That said, there is nothing to indicate that the SEC could establish privity if it tried.

Privity in the context of collateral estoppel has narrow application because of the obvious "due process concerns" implicated by forbidding a party to litigate an issue based upon the outcome of a prior proceeding to which it was not a party. Stichting, 327 F.3d at 184. Because of these concerns, privity is recognized if the interests "of the person alleged to be in privity were 'represented [in the prior proceeding] by another vested with the authority of representation.'" Id. at 185 (quoting Monahan v. N.Y.C. Dep't of Corr., 214 F.3d 275, 285 (2d Cir. 2000)). Typically, privity based on representative capacity applies where the party to the prior proceeding was explicitly representing the interests of the party sought to be estopped in the subsequent proceeding, such as where a union president sues on behalf of the union in his official capacity. Id. at 185 (citing U.S. v. Int'l Bhd. of Teamsters, 931 F.2d 177, 185-86 (2d Cir. 1990); see, e.g., Taylor v. Sturgell, 553 U.S. 880, 894 (2008) (beneficiaries precluded by judgment in prior action litigated by trustee on their behalf).

The SEC does not – and could not – argue (let alone establish) that Mr. Rajaratnam litigated his criminal case in a representative capacity. It is Mr. Rajaratnam, not Galleon, that was indicted, tried, and sentenced, and that agreed to $53.8 million in criminal forfeiture. There was no (and constitutionally could be no) implication or suggestion in the criminal proceeding that the government was prosecuting anyone other than Mr. Rajaratnam and his co-defendants, or that a non-party to the proceeding could be punished based on its outcome. None of the hallmarks of a representative action were present.

The Second Circuit has recognized that privity can be applied to a party that was not represented in the prior proceeding if that party "nonetheless exercised some degree of actual control over the presentation of a party's case at the previous proceeding." Stichting, 327 F.3d at 185 (citing Cent. Hudson Gas & Elec. Corp. v. Empresa Naviera Santa S.A., 56 F.3d 359, 368-69 (2d Cir. 1995)). The SEC does not argue that Galleon exercised any control over Mr. Rajaratnam's defense of the criminal trial. Leaving aside whether a corporation ever lawfully could "control" a natural person's defense of himself in a criminal proceeding, there could be no suggestion that Galleon (which was wholly owned by Mr. Rajaratnam at the time of trial) could or did exercise control over his defense.[1] Furthermore, the fact that Mr. Rajaratnam and Galleon were separately represented at all relevant times would weigh against any finding of privity, even if the SEC had presented argument or evidence on these issues (which it has not). See Conte v. Justice, 996 F.2d 1398, 1403 (2d Cir. 1993) ("[J]ust as mutuality of attorneys bolsters a finding of control, the lack thereof dissuades us from such a finding.").[2]

Having offered no evidence or argument in support of a finding of privity, and construing all facts in Galleon's favor as the non-moving party, the SEC's motion for summary judgment as to Galleon based on collateral estoppel should be denied.

---

[1] Mere involvement in the preparation of the party's case in the prior proceeding is not enough for a finding of actual control. See Hallinan v. Republic Bank & Trust Co., No. 06-CV-185, 2007 WL 39302, at *9 (S.D.N.Y. Jan. 8, 2007) (declining to find control on summary judgment in the absence of a more developed record even where it was undisputed that non-party paid for most of the party's legal fees; received analyses of facts, legal arguments, and claims in the prior proceeding; and appeared as a witness at the prior proceeding).

[2] The fact that the individual charged in the prior proceeding (the company's CEO) was no longer an employee of the company sought to be estopped in the subsequent proceeding appears to have been a significant factor in the court's determination in Stichting that privity was absent. 327 F.3d at 186-87. This makes sense in that it would be difficult to find that the company continued to have authority to control the actions of the CEO or that the CEO continued to represent the company. But the mere fact that an individual who was party to the prior proceeding continues to maintain an affiliation with (or even owns the company) does not, in and of itself, establish that he was "representing" the company in his own criminal case, or that the company was controlling his case. The question whether parties are in privity "is a factual determination of substance, not mere form." Expert Elec., Inc. v. Levine, 554 F.2d 1227, 1233 (2d. Cir. 1977).

II. Summary Judgment on Remedies Would Be Premature and Inappropriate

The SEC seeks the following relief in its motion for partial summary judgment: injunctive relief against Mr. Rajaratnam and Galleon (in the form of an injunction against future violations of Section 10(b) of the Securities Exchange Act of 1934 and Section 17(a) of the Securities Act of 1933), as well as – jointly and severally from Mr. Rajaratnam and Galleon – disgorgement of $31,563,661, prejudgment interest of $9,703,724.96, and "the maximum three-time civil penalty against Rajaratnam and Galleon pursuant to Section 21A of the Exchange Act." (SEC Br. 3.)

As a threshold matter, the SEC cannot obtain remedies as to Galleon on its motion for partial summary judgment because, as detailed above, it has not established collateral estoppel as to Galleon, which is the entire basis for the SEC's motion. It is axiomatic that a court can only impose remedies after liability has been established. See, e.g., S.E.C. v. First Jersey Sec., Inc., 101 F.3d 1450, 1474 (2d Cir. 1996) ("Once the district court has found federal securities laws violations" it can exercise its power to fashion appropriate remedies. (emphasis added)). Moreover, even if the SEC could establish collateral estoppel as to Galleon, its request for remedies on partial summary judgment would be inappropriate for multiple reasons.

After the SEC filed its motion for summary judgment, several events highly relevant to disgorgement and penalties occurred. Mr. Rajaratnam was sentenced to 132 months (11 years) in prison (reportedly the longest such sentence in the history of insider trading cases) and a fine of $10 million for alleged conduct that includes all of the alleged insider trading at issue in this action. In addition, Mr. Rajaratnam has agreed to criminal forfeiture in the amount of $53.8 million, covering the same trading and alleged gains for which the SEC seeks disgorgement on its motion, and in an amount that includes, and indeed far exceeds, the disgorgement and interest the SEC seeks by its motion. The SEC's motion could not have taken account of these

developments before they occurred, but does not appear to acknowledge their relevance to the appropriate remedies in this case.[3]

A. The SEC's Motion For Disgorgement on Summary Judgment is Moot

Forfeiture and disgorgement both serve the same purpose: to deprive a wrongdoer of illicit profits. S.E.C. v. Fischbach Corp., 133 F.3d 170, 175 (2d Cir. 1997) ("The primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains"); U.S. v. Emerson, 128 F.3d 557, 567 (7th Cir. 1997) ("Forfeiture . . . seeks to punish a defendant for his ill-gotten gains by transferring those gains from the defendant to the . . . Department of Justice . . ."). The SEC, therefore, cannot seek disgorgement of alleged ill-gotten gains already forfeited. See S.E.C. v. Palmisano, 135 F.3d 860, 866-67 (2d Cir. 1998) (holding that the civil disgorgement obligation of an attorney who had run a Ponzi-like scheme must be offset against his criminal obligation to pay restitution); S.E.C. v. Opulentica, LLC, 479 F. Supp. 2d 319, 331 (S.D.N.Y. 2007) (ordering disgorgement to be offset by the restitution in the criminal judgment); U.S. v. Elliott, 714 F. Supp. 380, 381-82 (N.D. Ill. 1989) (defendant who had already disgorged to the SEC the profits made in an illegal securities transaction could not also be subject to criminal forfeiture for the same ill-gotten gains).

As is self-evident from the fact that the SEC seeks partial summary judgment entirely based on the judgment in the criminal action, all of the conduct for which the SEC seeks disgorgement and interest in its motion is encompassed within the $53.8 million forfeiture amount in the criminal case. The SEC cannot argue otherwise. Because the forfeiture amount far exceeds the disgorgement and interest amount sought, the SEC's request for disgorgement

[3] Mr. Rajaratnam's brief in opposition to the SEC's motion ("Rajaratnam Br.") goes into greater detail on the facts and arguments as they relate to his sentencing, as well as the gain calculations done in connection with his criminal case. Rather than repeat those arguments in full here, Galleon joins in those arguments and any others in Mr. Rajaratnam's brief applicable to Galleon.

and interest is already satisfied and thus moot. The fact that Mr. Rajaratnam is paying the forfeiture amount does not affect the analysis as to Galleon because the entire premise of the SEC's motion is that Galleon's liability is vicarious, and the SEC is seeking to disgorge a unitary and undifferentiated gain from Mr. Rajaratnam and Galleon on a "joint[] and several[]" basis. (SEC Br. 17.)

B. Material Issues Of Fact Exist With Respect To Disgorgement

Even if disgorgement were not mooted by the forfeiture order, the factual issues of the amount of gains in question, and the economically appropriate way to calculate gains, would be in dispute. The SEC does not contend that the judgment in the criminal case has any collateral estoppel effect as to the quantum of alleged ill-gotten gains or appropriate disgorgement.

The SEC's disgorgement calculation is based entirely on calculations made by FBI Special Agent James Barnacle, Jr., who testified at the criminal trial. Special Agent Barnacle, however, was offered as a summary witness, not an expert, and did not apply (or purport to apply) an econometric analysis (such as event studies, which the SEC itself has used in the past and which are a widely-accepted method for calculating gains or losses in securities cases[4]) appropriate for the calculation of actual disgorgement or damages in a securities case.[5] In any event, Special Agent Barnacle's calculations have been and continue to be disputed. Defendants have proffered the expert analysis of Professor Gregg Jarrell, that concludes that the gain figures calculated by Special Agent Barnacle significantly overstate the actual economic gain resulting

[4] See, e.g., S.E.C. v. Razmilovic, No. 04-CV-2276, 2011 WL 4629022, at *18 (E.D.N.Y. Sept. 30, 2011) ("It is undisputed that [event study] methodology is a generally accepted method of calculating the inflation in a stock's price in cases involving securities fraud"); S.E.C. v. Koenig, 557 F.3d 736 (7th Cir. 2009); S.E.C. v. Yuen, 272 Fed. App'x 615 (9th Cir. 2008); S.E.C. v. Leslie, No. 07-CV-3444, 2010 WL 2991038 (N.D. Cal. July 29, 2010); Wagner v. Barrick Gold Corp., 251 F.R.D. 112, 120 n.7 (S.D.N.Y. 2008) ("[N]umerous courts have held that an event study is a reliable method for determining market efficiency and the market's responsiveness to certain events or information.").

[5] Declaration of Terence Gilroy dated Oct. 17, 2011, Ex. A ("Gilroy Decl.").

from the alleged insider trading. (Rajaratnam Br. § V.A.) These genuine and material disputes should foreclose the SEC's request for disgorgement on summary judgment.

Defendants also dispute the SEC's assumption that the relevant measure of gain, however calculated, is all gains (or losses avoided) attributable to the allegedly illegal transactions, regardless of who, in fact, received the gains sought to be disgorged. (Rajaratnam Br. § V.B.) Disgorgement is an equitable remedy designed to "deprive violators of their ill-gotten gains," First Jersey Sec., Inc., 101 F.3d at 1474. Accordingly, Galleon should not be ordered to disgorge gains it did not receive. Hately v. S.E.C., 8 F.3d 653, 656 (9th Cir. 1993) (stating that the disgorgement of the gross amount of fees generated in violation of NASD rules is "unreasonable and excessive" where the disgorging broker-dealer received a mere ten percent of the ill-gotten gains"). Indeed, although the SEC has not attempted to calculate amounts actually received by Galleon, Galleon's former CFO has estimated that the notional gain (in the form of management and performance fees) to Galleon on the trading gains calculated by Professor Jarrell for the stocks at issue here totaled approximately $4.46 million (of which approximately $2.58 million would have been notionally allocable to Mr. Rajaratnam). (Declaration of George Lau dated Oct. 17, 2011 ¶ 13 n.4 (submitted by Mr. Rajaratnam in support of his brief).) In all events, the disputed and factual issues of the nature and amount of gains to the defendants are not appropriate for summary judgment. Fed. R. Civ. P. 56(c); see, e.g., Cambridge Realty Co., LLC v. St. Paul Fire & Marine Ins. Co., 421 Fed. App'x 52, 53 (2d Cir. 2011) ("Summary judgment is appropriate where 'the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law.'").

C. Penalties and Injunctive Relief Would Be Unnecessary and Inappropriate As To Galleon

Penalties and injunctive relief are not ripe for determination as to Galleon because the SEC has not established liability or the amount of alleged ill-gotten gains. Even apart from those threshold failures, penalties and injunctive relief plainly would be inappropriate as to Galleon at any juncture.

As to injunctive relief, the SEC acknowledges that in order to obtain summary judgment, there must be no genuine and material dispute that "there is a reasonable likelihood that a defendant will commit future violations [of the securities laws]" (SEC Br. 20 (citing S.E.C. v. Commonwealth Chem. Sec., Inc., 574 F.2d 90, 99 (2d Cir. 1978)). The SEC makes no showing in this regard other than its statement that it has "no assurances that Galleon will not seek to do business in the future." (SEC Br. 21.) That is no basis for summary judgment, which would require this Court to conclude as a matter of law that there is a "reasonable likelihood" of future violations. Commonwealth, 574 F.2d at 99. It is also an unfounded concern. Other than to wind down its affairs and funds, Galleon ceased operations almost immediately after Mr. Rajaratnam was arrested. (Declaration of George Lau, dated Oct. 17, 2011 ¶ 7 (Gilroy Dec. Ex. B.).) As part of that wind-down, Galleon voluntarily de-registered as an investment advisor and terminated its investment management agreements with all of the funds it managed. Id. ¶ 5. With its principal, Mr. Rajaratnam, convicted and sentenced, its investment management contracts terminated, and its staff down to a small handful of employees and consultants necessary to complete its wind-down and assist in the response to subpoenas (see id. ¶ 9), Galleon has no ability or intention "to do business" (SEC Br. 21) in the future.

Accordingly, there is no basis for injunctive relief or reason to treat Galleon differently from other investment advisor defendants named in the SEC's Second Amended Complaint in

this action. S2 Capital Management, LP, whose principal pleaded guilty to criminal insider trading, was voluntarily dismissed from this case on September 28, 2011, apparently without injunction, penalty, or disgorgement. (See Gilroy Decl. Ex. C.) New Castle Funds LLC ("New Castle") was likewise dismissed from this case without any relief imposed against it. (See id. Ex. D.). Mark Kurland, the co-founder of New Castle, and Danielle Chiesi, a former New Castle employee, both pled guilty to criminal insider trading. (See id. Ex. E; Id. Ex. F.) The stipulation of dismissal states that New Castle "is withdrawing as an investment adviser" and that "it will not engage in further operations." (See id. Ex. D.) Galleon would be willing to enter into the same stipulation were the SEC to dismiss it from this case as has been the practice as to other investment advisors in this action. In all events, the SEC has offered no basis for summary judgment as to injunctive relief.

For largely the same reasons, imposing penalties on Galleon would be inappropriate and serve no legitimate remedial or punitive purpose. As noted, none of the other investment advisor entities in this action was subjected to penalties. Galleon has already experienced the de facto punishment of losing all of its value as a market-leading going concern and being put out of business. As evidenced by the SEC's approach to other defendants in this action and substantial additional precedent, punishing a defunct entity where the individual alleged wrongdoers have been punished serves no end and would be a redundant and unduly punitive exercise.[6]

[6]The SEC routinely declines to seek penalties from defunct or bankrupt entities after it settles with or obtains a judgment from the company's executives. See id. Ex. G.

CONCLUSION

For all of the foregoing reasons, the SEC's motion for partial summary judgment should be denied as to Galleon.

Dated: October 17, 2011
New York, New York

SHEARMAN & STERLING LLP

By: /s/ Adam S. Hakki
Adam S. Hakki
John A. Nathanson
Terence P. Gilroy

599 Lexington Avenue
New York, NY 10022-6069
(212) 848-4000
(212) 848-7179 (facsimile)
ahakki@shearman.com
john.nathanson@shearman.com
terence.gilroy@shearman.com

Attorneys for Galleon Management, L.P.

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:

VIA CM/ECF

Valeria A. Szczepanik
Securities and Exchange Commission
New York Regional Office
3 World Financial Center, Suite 400
New York, New York 10281
szczepanikv@sec.gov

Attorney for Plaintiff

SHEARMAN & STERLING LLP

/s/ Terence P. Gilroy
Adam S. Hakki
John A. Nathanson
Terence P. Gilroy

599 Lexington Avenue
New York, NY 10022-6069
(212) 848-4000
(212) 848-7179 (facsimile)
ahakki@shearman.com
john.nathanson@shearman.com
terence.gilroy@shearman.com

Attorneys for Galleon Management, L.P.