Securities and Exchange Commission v. Galleon Management, LP et al Doc. 248

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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

DEFENDANT'S RAJARATNAM'S POST-ARGUMENT SUPPLEMENTAL MEMORANDUM IN OPPOSITION TO PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT

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Defendant Raj Rajaratnam, through counsel, hereby submits this Supplemental Memorandum addressing the issues raised at oral argument on October 28, 2011 regarding disgorgement and civil penalties, if any.

I. **Methodology**

In response to questions from the Court, the SEC proffered that the total profit on the five stocks at issue (Clearwire, Akamai, PeopleSupport, ATI and Intel) would increase from $31,563,661 to approximately $33 million if profit were calculated based on a hypothetical sale at the closing price on the first trading day after the public announcement of the information at issue. The SEC obtained these figures from information that the government submitted to Judge Holwell in the criminal case in response to questions that Judge Holwell raised at a pre-sentence hearing on the calculation of gain for Sentencing Guideline purposes. At that hearing, the different methodologies for calculating profit or gain were discussed. The government argued that its method of matching all purchases of the stocks at issue made after the alleged tip with the corresponding sale after the public announcement was the appropriate calculation. The defense pointed out that this method improperly inflated the gain because it swept into the calculation all stock price movement from date of purchase to date of sale regardless of whether the price moved as a result of the alleged inside information at issue. For some stocks, there were significant time periods between the public announcement and the date by which all shares were sold, *e.g.*, for Clearwire – 18 trading days; for Intel – 12 trading days. The defense argued that during this time period other market factors affected the share price and that it was inappropriate to treat all price movement as gain "resulting from" the alleged inside information. Instead, the defense presented expert testimony by Professor Gregg Jarrell who performed event studies that isolated the gain attributable to the public announcement of the alleged inside information.

As a result of this dispute over the proper methodology for calculating gain for Sentencing Guidelines purposes, Judge Holwell asked the government to submit their calculations of what the gain would be if all the shares were sold at the first closing price following the public announcement. The government submitted these calculations and claimed, as the SEC now does in this case, that the gain was higher if that "one day after" price was used. The defense objected to the government's calculations on several grounds, which are explained below. At Mr. Rajaratnam's sentencing, Judge Holwell did not specifically rule on these objections, nor did he find a specific dollar figure for the gain amount. Rather, Judge Holwell found that for all the stocks at issue (a total of twelve, including the five that are the basis for the pending motion), the gain exceeded $50 million, which was all that was necessary for purposes of determining the Sentencing Guidelines level. Therefore, the profit amounts that the SEC proffers here for the five stocks at issue, based on the government's calculations from the criminal case, were not specifically accepted by the Court in the criminal sentencing proceeding.

The defense objections to these calculations that are relevant to the five stocks at issue are set forth below:

1. ATI – Mr. Rajaratnam purchased ATI stock over a five-month period prior to the public announcement on July 24, 2006 that ATI was being acquired by AMD. Mr. Rajaratnam sold all these ATI shares on that date following the public announcement. Instead of using the actual sale price that day, the government's "one day after" methodology uses the closing price of the shares that day – a price higher than the actual sale price that occurred earlier in the day. As a result, the government's calculation increases the gain amount by approximately $2 million, *e.g.*, from $22.9 million to $24.9 million. *See* Declaration of James L. Canessa, filed in criminal case in opposition to government's "one day after" calculations, at 4 (attached as Ex. 1).

2. The government's "one day after" calculation was based on the inclusion of an additional 50,000 ATI shares that were not included in the original ATI profit calculation that was presented by the government at trial. Canessa Declaration, Ex. 1, at 2

3. ATI accounts for approximately 75% of the profit that the SEC seeks as the disgorgement figure. As noted, Mr. Rajaratnam purchased ATI stock over a five-month period preceding the acquisition announcement on July 24, 2006. The methodology used by the prosecutors in the criminal case, and by the SEC here, sweeps in all share price increase during this period and treats it as profit, or gain, resulting from the inside information. On the other hand, the event study method excludes price increases due to other market factors and calculates the gain resulting from the nonpublic information regarding the acquisition. That gain totals $15,423,132. *See* Defendant Rajaratnam's Opposition to Motion for Partial Summary Judgment at Ex. B (Jarrell Declaration) and supporting Ex. 2. The likelihood that external market factors other than material, nonpublic information influence the increase in stock price increases substantially where there is a longer period of time between the alleged tip and purchase and the subsequent announcement and sale. Professor Jarrell's event study applies a rigorous and routinely accepted methodology to maximize the accuracy of calculating the profit or gain taking account of external market factors.

At oral argument on October 28, 2011, the Court focused on the statutory language in the Exchange Act defining "profit gained" or "loss avoided" as "the difference between the purchase or sale price of the security and the value of that security as measured by the trading price of the security a reasonable period after public dissemination of the nonpublic information." 15 U.S.C. § 78u-1(f). The event study method is consistent with this definition, as it focuses on the trading price for the security on the day of, or day following, the public announcement (depending on

whether the announcement is made during trading hours), which is "a reasonable period after public dissemination." The event study method looks at the "trading price" during that period and determines what component of the trading price is attributable to the nonpublic information that is now being disseminated – again consistent with § 78u-1(f).

The definition of "profit gained" or "loss avoided" is § 78u-1(f) must be read consistently with the other statutory provision that precedes it, *i.e.*, the penalty provision which provides for a maximum penalty of three times the profit gained or loss avoided "as a result of such unlawful purchase, sale or communication." § 78u-1(a)(2). Thus, reading the two provisions together, the profit must be the "result of" the unlawful activity, and must be calculated within "a reasonable period after public dissemination of the nonpublic information." The event study method accomplishes these statutory directives by calculating the profit resulting from the unlawful insider trading (and excluding profit caused by other factors) within one day of the dissemination of the nonpublic information. The SEC, in its response to Mr. Rajaratnam's Statement of Undisputed Material Facts, does not dispute that "[e]vent studies use market modeling to determine what portion of a stock's price change on a particular day was the result of material information and what portion was the result of normal market factors." Plaintiff's Response to Defendant Raj Rajaratnam's Counterstatement of Undisputed Material Facts at 2 (Para. 6). The SEC also concedes that "[m]arket modeling allows changes due to normal market factors to be removed, leaving only changes attributable to the release of material information," (*Id.,* Para. 7) and concedes that the event studies performed in this case yield a disgorgement of $22,300,551 for the collateral estoppel stocks. (*Id.,* Para. 8).

The significance of the event study method is best illustrated by the profit calculations for ATI, for which there is a $7 million difference between the parties' respective calculations. It is

undisputed that Mr. Rajaratnam's purchases of ATI occurred over an extended period from March-July 2006. The SEC calculated the profit by including all the price gain during this period through the date of the public announcement, which it claims totals $22,938,866. As noted above, the SEC now seeks to increase that amount by approximately $2 million by using the closing price on July 24, 2006, instead of the price at which the shares were actually sold during that day. The event study method calculated how much the share price increased net of normal market movement, following the public dissemination of the takeover announcement, and applied that price increase to the number of shares held at that time. The profit calculated is $15,423,132. This significant difference shows that not all price movement occurring a reasonable period after dissemination of the nonpublic information is profit "as a result of" the unlawful activity. The portion that is - $15,423,132 – should be utilized in making any necessary calculations in this case under 15 U.S.C. § 78u-1(f).[1]

4. The profit amounts that the SEC proffered at the October 28, 2011 argument include stock trades that were not proven at the criminal trial and therefore are not the subject of collateral estoppel. The evidence at the criminal trial established that Mt. Rajaratnam's stock trades were entered into Galleon's order management system under certain 3-letter fund manager codes, *e.g.*, TAM, TMT, and TMP. The government did not attempt to prove that trades entered under code CRS (for the Crossover Fund) were made by Mr. Rajaratnam. As part of the sentencing proceeding, the government attempted for the first time to inject the CRS codes as trades made by Mr. Rajaratnam and, accordingly, increase the gain calculation. The defense objected and at sentencing the Court sustained the objection and excluded the CRS trades,

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[1] Similar arguments would support the use of the event study method for Clearwire, Akamai, People Support and Intel.

finding that there was insufficient evidence that these trades originated with Mr. Rajaratnam. 10/13/11 Sentencing Tr. at 26. Nevertheless, the profit figures that the SEC proffered at oral argument included profit that was calculated for trades made under the CRS code for Akamai and Clearwire. For this additional reason, the Court should not consider the SEC's newly proffered profit amounts.

II. Other Considerations

In calculating the profit gained or losses avoided, it is relevant that most of the gain was not realized by Mr. Rajaratnam but by the investors in the Galleon funds where the stock trades were made, *i.e.*, the pension funds, university endowments, individual investors and others who invested in Galleon. The total that would have been realized by Mr. Rajaratnam from the five stocks at issue here is $4,725,150, which the SEC acknowledges is undisputed. *See* Plaintiff's Response to Defendant Raj Rajaratnam's Counterstatement of Undisputed Material Facts at 3.[2]

Given the dispute between the parties on the accurate calculation of disgorgement and, indeed, the SEC's acknowledgement that its calculation does not factor out external market factors, the undisputed amount realized by Mr. Rajaratnam -- $4,725,150 – could be utilized as the base amount upon which any penalty is predicated. There is no authority of which we are aware requiring the Court to adopt the disgorgement figure as a base on which to apply a penalty. Indeed, the financial penalty already imposed by Judge Holwell with the $10 million fine is over two times the amount Mr. Rajaratnam would have earned from these trades, and even a one-time

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[2] In reality, Mr. Rajaratnam received far less compensation from trading in the collaterally estopped stocks. Galleon's funds had negative returns during 2008 and as a result Galleon Management, L.P. received no annual performance fees in connection with its trading that year. This means that the trades in Clearwire, Akamai and PeopleSupport, which occurred in 2008 and account for over $6 million of the SEC's $33 million profit figure, actually generated no performance fees. Accordingly, Mr. Rajaratnam received no compensation from these contractual performance fees either.

penalty based on a disgorgement figure of $33 million under the SEC's calculations would constitute almost eight times Mr. Rajaratnam's actual potential gain.

Alternatively, the Court could utilize the criminal fine of $10 million imposed by Judge Holwell as a touchstone for determining the appropriate fine in this matter. The criminal statutes permitted Judge Holwell to impose a fine far in excess of that amount. Judge Holwell observed the trial on all of the stocks, including the five at issue here, and all of the evidence presented before electing to penalize Mr. Rajaratnam with a $10 million fine. It bears note that this $10 million fine imposed in the criminal case dwarfs any of the penalties imposed in total against any of the Galleon defendants to date.

Finally, at oral argument, the Court indicated its view that Mr. Rajaratnam is a "bad guy" (Tr. 22) and "someone who committed his wrongdoing to make a lot of money." (Tr. 27). The Court has not had the benefit of the Presentence Report (PSR) in the criminal case. While we recognize the serious nature of the offenses for which he was convicted, which are discussed in the Report, the Report also discussed at length many of the good things that Mr. Rajaratnam has done in his life. Defense counsel quoted from the PSR at the sentencing hearing, as follows:

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          The information that we provided the court and is now
 7    contained in the presentence report provide a great deal of
 8    insight into the history and characteristics of Raj Rajaratnam.
 9    The letters that were submitted to the court by hundreds of
10    people all over the world describe the real Raj Rajaratnam.  He
11    is the person whom I have come to know over the past two years,
12    a very kind, considerate, polite, generous and caring person, a
13    man genuinely concerned about helping others.  I would like to
14    quote from a few of the provisions that the probation office
15    put in the presentence report about Mr. Rajaratnam.
16              The report says:  "Mr. Rajaratnam cares deeply about
17    leaving behind a better world than the one to which he was
18    born."  The report says that his charitable efforts go far
19    beyond his ability to write a check.  The report said:  "He
20    truly cares about the causes he champions, wants to see
21    children receive good educations, wants to help those struck by
22    natural disasters, and wants to help provide others with the
23    advantages that he was able to enjoy in his own life."  Those
24    are not my words; those are the words that the Probation
25    Department put in the presentence report.
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1 As the court has learned, his compassion and
2 generosity have manifest themselves in many ways, from serving
3 on the board of the Harlem Children's Zone here in New York
4 City, a very worthwhile organization, to providing millions of
5 dollars to worthwhile organizations and individuals around the
6 world, from supporting global efforts like fighting AIDS and
7 poverty and natural disasters to helping needy individuals pay
8 for their cancer treatment or their children's education.
9 Raj Rajaratnam has attempted to make the world a
10 better place. If there is a ledger of one's life, he should
11 have some credit in that ledger to draw upon now that things
12 have gone bad.

10/13/11 Sentencing Tr. at 4-5.

The vast majority of the profit made by Galleon has never been questioned by the government. Indeed, the stock trades at issue in the criminal and civil cases amounted to only a fraction of 1% of the overall trades that Mr. Rajaratnam authorized during the years in question. Mr. Rajaratnam traded over $100 million of stock every trading day – including during the nine-month period when the wiretap was in place. Less than 1% of these trades have been alleged to be based on inside information.

Mr. Rajaratnam has already suffered enormous financial consequences for his conduct. Galleon, the company that he built, has gone out of business. Upon his arrest, Mr. Rajaratnam was committed to making his investors whole and therefore responsibly and carefully wound down Galleon, returning funds to each and every investor with a sizable return. What Mr. Rajaratnam did not do is equally telling. He did not "gate" or restrict fund redemptions upon his arrest, a lawful option that other hedge funds and hedge fund managers have invoked during times of crisis. Had he done so, Mr. Rajaratnam would have reaped millions of dollars in management fees during the early stages of these litigations. Instead, he moved swiftly to return all funds to his investors to protect their interest, at great expense and loss of revenue to himself.

These actions, and others that Mr. Rajaratnam has taken during his life, show that he was not motivated by greed or by the desire to make a lot of money. The overwhelming majority of

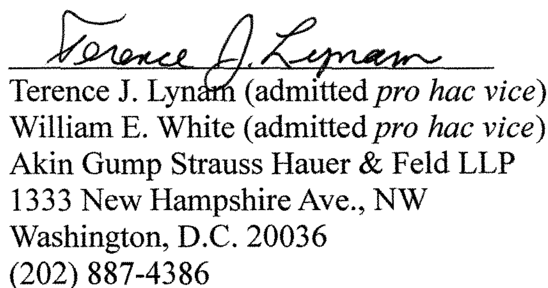
the money that he made was the result of building a legitimate and successful business. The Probation Office, after interviewing Mr. Rajaratnam and other people and conducting a careful and rigorous analysis of Mr. Rajaratnam as a person and his conduct, included in its PSR a discussion of its view of Mr. Rajaratnam's conduct – one that explicitly called into question whether he was in fact motivated by greed given the fullness of his life and generosity. The PSR discussed these factors and motivations in the Sentencing Recommendation Section in which the Probation Office recommended a below-Guidelines sentence. We ask the Court to review the independent assessment of the Probation Office contained in the Recommendation Section of the PSR, which we attach hereto as Exhibit 2.[3] We believe it may assist the Court in understanding Mr. Rajaratnam and the conduct at issue.

III. Conclusion

For the reasons stated herein, and those provided in Mr. Rajaratnam's earlier brief and at oral argument, we respectfully submit that the penalty already imposed on Mr. Rajaratnam from the criminal case, combined with the civil injunction and lifetime bar, are sufficient to satisfy the purposes of the civil penalty statute and that no additional civil penalty should be imposed.

Dated: November 1, 2011
New York, NY

Respectfully submitted,



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[3] Defense counsel checked with the Probation Office and they advised that we are free to submit this PSR material to the Court for Your Honor's consideration.

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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 1st day of November 2011 on:

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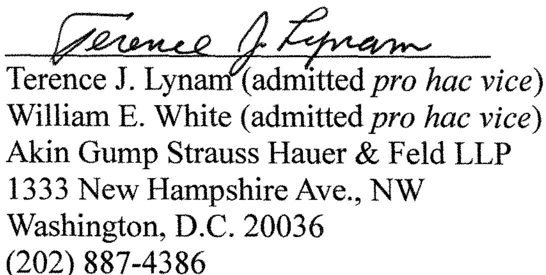

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