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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JAMES MERCER, Plaintiff,	:	11-cv-3828 (JSR)
v.	:	
RAJAT K. GUPTA, Defendant.	:	

REPLY MEMORANDUM OF LAW OF DEFENDANT RAJAT K. GUPTA IN SUPPORT OF HIS MOTION, PURSUANT TO FED. R. CIV. P. 12(b)(6), TO DISMISS THE COMPLAINT

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Rajat K. Gupta respectfully submits this reply memorandum of law in support of his motion, pursuant to Fed. R. Civ. P. 12(b)(6), to dismiss the Complaint.

ARGUMENT

A. The Opposition Fails To Meet The Central Points Of The Motion

We begin with the arguments that plaintiff is unable to answer. First, the opposition cannot dispute that Congress—in enacting § 16(b)—excluded liability for tipping inside information to others, leaving redress for such conduct to different provisions of the Exchange Act. Put another way, the opposition concedes that tipping information—which is the core allegation of the Complaint—does not, per force, create liability under § 16(b).

Second, the opposition cannot dispute that § 16(b) plays a different role than the anti-fraud provisions of the Exchange Act. Section 16(b) is a remedial and not a punitive provision. *See, e.g., SEC v. Bear, Stearns & Co., Inc.* 626 F. Supp. 2d 402, 406 (S.D.N.Y. 2009). A defendant who has already disgorged the alleged profits of insider trading cannot be subject to double payment via a § 16(b) action. *See Litton Indus., Inc. v. Lehman Bros. Kuhn Loeb Inc.*, 734 F. Supp. 1071, 1076-77 (S.D.N.Y. 1990). The "Section 16(b) Basics" that plaintiff offers the Court confirm that § 16(b) "imposes a strict prophylactic rule with respect to [statutory] insider, short-swing trading." (Opp. Mem. 2, quoting *Foremost-McKesson, Inc. v. Provident Secs. Co.*, 423 U.S. 232, 251 (1976)). While the opposition argues that § 16(b) should be interpreted broadly in some situations, *Foremost-McKesson* said that "[i]t is inappropriate to reach the harsh result of imposing [Section] 16(b)'s liability without fault on the basis of unclear language. If Congress wishes to impose such liability, we must assume it will do so expressly or by unmistakable inference." 423 U.S. at 252. And *Feder v. Frost*, 220 F.3d 29, 34 (2d Cir. 2000), does not hold that issues of beneficial ownership "are interpreted broadly." (Opp. Mem. 3).

Third, the opposition cannot dispute—and actually confirms— that the Complaint is prompted by, and largely tracks, the OIP's tipping allegations. (Opp. Mem. 7). Yet missing from the 24-page opposition is even one case holding that the act of tipping by a director makes the director subject to disgorgement of short-swing profits realized by the tippee under § 16(b)—a glaring omission given the number of tipper-tippee cases in the federal reporters finding liability under other provisions of the Exchange Act and given that, absent the allegations of tipping, the Complaint lacks **any** asserted basis for liability under § 16(b). The opposition quotes from a 1987 law review article (Opp. Mem. 8, 10) without mentioning that the article flat out states that "Section 16(b) does not attempt to govern tipping by insiders." Arnold S. Jacobs, *An Analysis of Section 16 of the Securities Exchange Act of 1934*, 32 N.Y.L. Sch. L. Rev. 209, 348 (1987). Plaintiff's reliance on *Dirks v. SEC,* 463 U.S. 646 (1983), is way off-target considering that § 16(b) is not mentioned in the case and that *Dirks* is known for holding that the alleged tippee was not liable under the Exchange Act's anti-fraud provisions because his tipper had not benefitted from passing on inside information. And the opposition has no case holding that receipt of quid pro quo payments establishes "beneficial ownership" or "pecuniary interest" for purposes of § 16(b), or that attempting to ingratiate oneself with a trader in the issuer's stock satisfies § 16(b)'s elements.

B. The Complaint Offers Labels And Conclusions Rather Than Plausible Factual Allegations

The opposition unsuccessfully tries to argue that the allegations of the Complaint meet the elements of § 16(b) by repeatedly invoking the terms "beneficial ownership" and "pecuniary interest" in close proximity to the insider trading allegations of the Complaint—as if mere repetition of regulatory words together with select allegations of insider trading will morph into plausible allegations that Mr. Gupta engaged in short-swing trading covered by § 16(b). But

"'naked assertions'" and "'labels and conclusions'" are insufficient to survive a motion to dismiss. *Ashcroft v. Iqbal,* 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 555, 557 (2007)).

Plaintiff's inability to state a viable claim under § 16(b) premised on insider trading is exposed by the inconsistency infecting the opposition's opening paragraph. Plaintiff states as his first argument that "the **only** reasonable inference to be drawn . . . is that Mr. Gupta got paid for providing information to Mr. Rajaratnam." (Opp. Mem. 1) (emphasis added). Just six lines later, the opposition states that "Mr. Gupta also used the confidential insider information to ingratiate himself with Mr. Rajaratnam for the prospect of lucrative business opportunities." (*Id.*). If Mr. Gupta sought to "ingratiate himself with Mr. Rajaratnam," can the "**only** reasonable inference to be drawn" be that he "got paid for providing the information"? And, if Mr. Rajaratnam had to pay for the information, would he be "ingratiate[d]" by Mr. Gupta? It is noteworthy—when assessing "reasonable inferences"—that neither the SEC nor the Government has drawn the inference that "Mr. Gupta got paid," each alleging that Mr. Gupta merely had a variety of business dealings, and stood to benefit from his relationship, with Mr. Rajaratnam. (*See* OIP ¶ 4; Compl. ¶¶ 4, 10, 48, *SEC v. Gupta,* No. 11 Civ. 7556 (Oct. 26, 2011); Ind. ¶¶ 8, 25, *United States v. Gupta,* No. 11 Cr. 907 (Oct. 25, 2011)). These pleadings are known to plaintiff: the opposition (at 15 n.5) refers to the indictment and SEC complaint (without mentioning that neither alleges that Mr. Gupta "got paid"). Because the opposition asserts (at 1) that the allegation that "Mr. Gupta got paid" "unquestionably establishes Mr. Gupta's beneficial ownership of the Goldman Sachs shares Mr. Rajaratnam profitably traded on the short-swing," exposing the deficiency of that allegation necessarily exposes the Complaint's failure to plead "beneficial ownership."

Roth v. Jennings, 489 F.3d 499 (2d Cir. 2007), discussed at length is our moving memorandum (at 9-10) yet largely ignored by the opposition (Opp. Mem. 14), offers the best guidance. The Second Circuit held that a § 16(b) claim could not survive a motion to dismiss, despite the fact that EMR had financed Jennings' purchase with a $10 million loan and "may well [have] improved its prospects for an eventual merger" by doing so. *Id.* at 516-17. Critically, the court found that "what is required for the imposition of strict liability on EMR is that EMR itself have realized profits from short-swing transactions." *Id.* at 517.

That precise type of allegation is missing here, because the Complaint does not plead any purchase and sale, or sale and purchase, made by Mr. Gupta in Goldman stock within a six-month period resulting in a profit realized by him. In lieu of plausible allegations showing that Mr. Gupta realized short-swing profits, the opposition makes an argument similar to one by the unsuccessful plaintiff in *Roth*—"'Is it not *possible, maybe* even probable, that there was *some understanding* between Jennings and EMR?'" *Id. Roth* held that this was an insufficient basis on which to proceed to discovery. *Id.* The same result should be reached in our case.[1]

Analytical Surveys, Inc. v. Tonga Partners, L.P., No. 06 Civ. 2692, 2008 WL 4443828 (S.D.N.Y. Sept. 29, 2008), relied on by the opposition, illustrates beneficial ownership. The court was called upon to determine if three co-defendants were all beneficial owners of the stock of the plaintiff Analytical Surveys under Rule 16a-1(a)(1), 17 C.F.R. § 240.16a-1(a)(1). Judge Wood began with the basic precepts that we set out in the moving memorandum: that § 16(b) imposes strict liability without a showing of actual misuse of inside information or of unlawful intent. The court recounted that defendant Tonga was a limited partnership formed to

[1] The opposition (at 4) highlights the Complaint's allegation that the trades made on Mr. Gupta's information resulted in "millions of dollars in loss avoidance," but § 16(b) does **not** cover "loss avoidance." *See* Peter J. Romeo and Alan L. Dye, *The Section 16 Deskbook*, § III.G at 507 (2011). A plaintiff must allege actual profits from short-swing trading.

trade stocks for the benefit of its partners; defendant Cannell Capital was the general partner of Tonga; and J. Carlo Cannell was the managing director and sole controlling member of Cannell Capital. Tonga made a loan to Analytical Surveys, convertible into shares of common stock. The "purchases" in the action involved conversions of the debt held by Tonga and the "sale" was made by Tonga. This structure gave each entity a pecuniary interest in the profits of Tonga from short-swing trades. *See* § 240.16a-l(a)(2)(i). The court found:

> It is undisputed that (1) Tonga purchased and sold shares of ASI common stock; (2) Cannell Capital served as the general partner of Tonga, a limited partnership entity; (3) Cannell Capital thus exercised sole voting and investment power for Tonga . . . ; (4) Cannell served as the sole managing member of Cannell Capital, a limited liability company; and (5) Cannell, acting through Cannell Capital, thus exercised sole voting and investment power for Tonga . . ..
>
> However, Tonga's delegation of voting and investment power to Cannell Capital does not divest Tonga of such power. Likewise, Cannell Capital's exercise of this voting and investment power through Cannell does not divest Cannell Capital of such power. . . .
>
> Accordingly, the Court finds that Tonga, Cannell Capital, and Cannell all satisfy the Rule 16a–1(a)(1) definition of beneficial ownership. To hold otherwise would create a strong incentive for short-swing profiteers to establish limited partnerships and other entities to evade being deemed beneficial owners as defined by Rule 16a–1(a)(1).

Analytical Surveys, 2008 WL 4443828, at *11 (citations and footnotes omitted).

The facts of *Analytical Surveys* reveal how much the opposition is stretching to contrive a § 16(b) claim. Mr. Gupta's role vis-à-vis the Goldman Sachs stock held by the Galleon Tech funds is in no way analogous to Tonga's ownership of the stock being traded, Cannell Capital's role as Tonga's general partner, and Mr. Cannell's role as the individual acting on behalf of the entities.

C. **The Complaint Fails To Plead Facts Showing That Mr. Gupta Realized Short-Swing Profits Or That Mr. Gupta Had Beneficial Ownership In The Galleon Tech Funds' Goldman Sachs Stock**

The opposition argues that the "Complaint sets out factual allegations supporting 'indirect pecuniary interest' in three respects." (Opp. Mem. 12). First, the opposition alleges that Mr. Gupta received a "quid pro quo" payment, but it fails, as the Complaint failed, to flesh out a plausible theory that Mr. Gupta beneficially owned the Galleon Tech funds' Goldman Sachs shares based on the alleged quid pro quo payment. *See Iqbal,* 129 S. Ct. at 1949 ("Where a complaint pleads facts that are 'merely consistent with' a defendant's liability, it 'stops short of the line between possibility and plausibility of 'entitlement to relief.'") (quoting *Twombly,* 550 U.S. at 557). Speculation is built upon speculation from the allegation that Anil Kumar was paid for inside information; the Complaint premises Mr. Gupta's liability on another person's relationship with Mr. Rajaratnam. This falls short of plausible allegations. Read in context, Judge Howell's opinion in *United States v. Rajaratnam,* No. 09 Cr. 1184, 2011 WL 3585075, at *18 (S.D.N.Y. Aug. 11, 2011) (citing *Dirks,* 463 U.S. at 664), quoted by the opposition (at 16), does not support the inference that Mr. Gupta received quid pro quo payments. Both *Rajaratnam* and *Dirks* make clear that the "benefit" received by a tipper for purposes of securities fraud analysis need not consist of payment or any other pecuniary interest that would make a tipper the beneficial owner of the tippee's securities for purposes of § 16(b). *See Rajaratnam,* 2011 WL 3585075, at *18; *Dirks,* 463 U.S. at 663-64.

Second, the opposition tries to base beneficial ownership on allegations of a business relationship between Mr. Gupta and Mr. Rajaratnam. The Complaint alleges that Mr. Gupta "stood to benefit from his relationship with Rajaratnam" (Opp. Mem. 15), but *Roth* makes this allegation inadequate. Just as the opposition fails to recognize the implications of *Roth,* the opposition misses the significance of Mr. Gupta's point that § 16(b)'s concern is with profits

realized by the insider. To be the "beneficial owner" of equity securities, the insider must have or share a direct or indirect "pecuniary interest" in the equity securities. 17 C.F.R. § 240.16a-1(a)(2). To have a "pecuniary interest," the insider must have the opportunity "to profit or share in any profit derived from a transaction in the subject securities." § 240.16a-1(a)(2)(i). As a matter of statutory construction, the opposition concedes that "profit" must be "reducible to monetary value," but the opposition leaves unclear how the alleged intangible benefits through enhanced business dealings with Mr. Rajaratnam "are one form of Mr. Gupta's pecuniary interest." (Opp. Mem. 18).

SEC v. Blackwell, 477 F. Supp. 2d 891 (S.D. Ohio 2007), cited by the opposition, is instructive. In *Blackwell,* the defendant provided inside information on a merger to, among others, a 30-year business associate with whom Blackwell was a partner in a business venture. The associate traded on the information, both for his personal account and for the partnership. *Id.* at 897. The SEC claimed that Blackwell violated § 16(a)'s requirement to make certain filings in relation to securities of which he was the beneficial owner. If Mr. Mercer's theory of beneficial ownership were correct, Blackwell's violation should have extended to the securities his associate traded both for his personal account and on behalf of the partnership. But the SEC alleged only a violation as to securities held by the partnership and it did not argue that Blackwell was the beneficial owner of shares held personally by his business associate, despite the fact that Blackwell stood to benefit from an enhanced business relationship with his associate. *Id.* at 905. Blackwell was also not alleged to be the beneficial owner of securities traded by an employee to whom he tipped inside information in relation to her year-end performance review. Ultimately, the SEC alleged only that Blackwell had a pecuniary interest in, and beneficial ownership over, the securities traded by two entities: a partnership in which he

had a 50% ownership interest, and a trust of which he was the trustee and his wife was a beneficiary. The Complaint tries to stretch the concept of beneficial ownership far past this.

Third, the opposition tries to show that Mr. Gupta was a beneficial owner of Goldman Sachs shares owned and traded by the Galleon Tech Funds, but there are no plausible allegations that Mr. Gupta controlled the purchases and sales by the Galleon Tech funds. The opposition asserts in bold letters that Mr. Gupta was an investor and a director of the Voyager fund, "a master fund with assets that were invested in numerous Galleon hedge funds." (Opp. Mem. 21)(emphasis deleted). But it is a huge leap and unwarranted speculation to argue that Mr. Gupta's investment and role in Voyager gave him investment control over the billion-dollar Galleon Tech funds, where the Complaint has no allegations about the size and actual role of Voyager in relation to the Galleon Tech funds. And, in contrast to the Complaint's lack of specificity, the indictment against Mr. Gupta alleges in ¶ 8 that Mr. Gupta invested $10 million in Voyager.

We showed in the moving memorandum (at 12-14) that the allegations (and the facts not alleged) in the Complaint put Mr. Gupta within the terms of a safe harbor exemption created by the SEC in its regulations for § 16. *See* § 240. 16a-1(a)(2)(iii). The opposition recognizes the strength of our argument when it begins its discussion of this provision by saying: "[E]ven if the safe harbor were triggered, it would remove only one of several bases for beneficial ownership." (Opp. Mem. 19).

In the construct of the safe harbor provision, those Goldman Sachs shares held by the Galleon Tech funds are concededly "portfolio securities," (*see* Opp. Mem. 12), and those shares can be attributed to Mr. Gupta only if the Complaint plausibly alleges that Mr. Gupta was a controlling shareholder of the Galleon Tech funds or that he had or shared investment control

over the Galleon Tech funds' portfolio. § 240.16a-1(a)(2)(iii). The opposition concedes that Mr. Gupta was not a controlling shareholder in the Galleon Tech funds (Opp. Mem. 20), and the Complaint fails to allege plausibly that Mr. Gupta had investment control—such as control to determine the precise amount of shares that would be both purchased and sold by the Galleon Tech funds on specific dates (since both sides of a transaction are needed to achieve short-swing profits). *See Feder v. Frost,* 474 F. Supp. 2d 520, 523 (S.D.N.Y. 2007) (director of corporation did not have or share investment control because he was not officer or manager of corporation and did not control corporation's portfolio). In applying the exemption, the Court should be guided by the Second Circuit's explanation that the safe harbor was adopted because "attributing a corporation's transactions in portfolio securities to all shareholders would clearly cast the net too wide." *Feder*, 220 F.3d at 34.

The opposition fails to fit Mr. Gupta into the mold of the insider in *Strauss v. Am. Holdings, Inc.*, 902 F. Supp. 475 (S.D.N.Y. 1995)—a case decided before *Twombly* and *Iqbal*. In *Strauss*, an individual named Koether was the sole general partner of Shamrock and the president and chief executive officer of Amhold. Shamrock and Amhold, which together held more than ten percent of the securities in Servico, had engaged in transactions in the securities of Servico over a six month period. In contrast to Mr. Gupta, who allegedly had an interest in a Galleon fund that invested in other Galleon funds that traded Goldman Sachs stock, Koether had a direct pecuniary interest in the sales of Servico stock as sole general partner of Shamrock and President/CEO of Amhold. Based on these facts and Koether's admission that he controlled Amhold, the court held that the plaintiff had stated a claim sufficiently alleging that Koether had investment control over Amhold's trades. In contrast, the opposition at most alleges that Mr. Gupta tipped information to Mr. Rajaratnam who allegedly used the information to trade for

funds in which Mr. Gupta had no direct interest or role. That is not a plausible allegation of investment control.

CONCLUSION

For the foregoing reasons, as well as those in Mr. Gupta's moving memorandum, Mr. Gupta's motion to dismiss should be granted and the Complaint should be dismissed with prejudice.[2]

Dated: New York, New York
December 14, 2011

Respectfully submitted,

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[2] Mr. Gupta raised in his moving memorandum (at 2 n.1) the statute of limitations under § 16(b) as an alternative basis for dismissal. The pending Supreme Court case should be controlling on this issue. Mr. Gupta does not seek a ruling at this juncture; he simply wants to be able to invoke the limitations period if appropriate after the Supreme Court issues its opinion.