

# Securities Law Alert: SEC v. Cuban: What the Decision Means For Insider Trading Liability and Confidentiality Agreements

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On July 17, 2009, a federal judge in the United States District Court for the Northern District of Texas dismissed the Securities and Exchange Commission's (SEC) insider-trading case against Dallas Mavericks owner Mark Cuban for failure to state a claim on which relief could be granted. The SEC's claim was based on the misappropriation theory of insider trading, which provides that a person commits fraud in connection with a securities transaction, and thereby violates Section 10(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 10b-5 issued thereunder, when he misappropriates confidential information for securities trading purposes in breach of a duty owed to the source of the information.<sup>1</sup>

The court in this case found that since Mr. Cuban had not agreed both (1) to keep information that he had received from an issuer confidential *and* (2) not to trade on the basis of such information, he had not violated a duty to the issuer under the misappropriation theory. As described further below, in response to this case, we recommend that confidentiality agreements include express provisions binding information recipients both to maintain the confidentiality of material, non-public information, and not to trade on such information until the information is no longer material and non-public.

## Background

The SEC's complaint against Mr. Cuban centered on his sale of stock of Mamma.com, an Internet search company of which Mr. Cuban owned a 6% stake. In 2004, the CEO of Mamma.com informed Mr. Cuban, its then largest-known stockholder, that the Company planned to raise money through a private investment in public equity (PIPE) transaction and invited him to participate. The CEO prefaced the call by informing Mr. Cuban that he had confidential information to convey to him, and Mr. Cuban orally agreed that he would keep whatever information the CEO intended to share with him confidential. According to the complaint, Mr. Cuban reacted angrily to the news, stating "[w]ell, now I'm screwed. I can't sell." Later that night and the next morning, Mr. Cuban's broker sold his full stake, sparing him a \$750,000 loss. Mr. Cuban, his lawyers, and a group of law professors as *amici curiae* moved to dismiss the complaint for failure to state a claim, arguing that Rule 10b-5 insider trading liability requires a fiduciary or fiduciary-like relationship with the provider of the information, and a mere agreement cannot be the basis for liability.

## What Did the Court Say?

The court disagreed with this claim, instead finding that a duty sufficient to support liability under the misappropriation theory can arise by agreement, absent a preexisting fiduciary or fiduciary-like relationship. However, the court explained that the agreement must consist of more than a mere express or implied promise to keep information confidential, as Mr. Cuban had done when he told the CEO he would keep the information about the PIPE confidential. Rather, for misappropriation theory liability to be predicated on an agreement, the agreement must impose on the party who receives the information the legal duty to refrain from trading on or otherwise using the information for personal gain. Therefore, a person must agree both (1) to maintain the confidentiality of the information, *and* (2) not to trade on the information or otherwise use it for personal benefit, in order for a duty to be created under this theory.

The court noted that absent a duty not to use the information for personal benefit, there is no deception, and therefore no liability, under Rule 10b–5. The deception that is necessary to state a claim under this rule can, however, occur when a person secretly trades on confidential information in violation of the source’s legitimate and justifiable expectation that the recipient will not do so. Such an expectation can be created when the source entrusts a person with confidential information, in reliance on an agreement not to disclose the information and not to use it for personal gain. Ultimately, the court dismissed the case, stating that the SEC failed to allege that Mr. Cuban was liable under the misappropriation theory since, under the facts stated, he did not have a fiduciary relationship with the Company and one was not created when he orally agreed to keep the information about the PIPE confidential. The court did allow the SEC 30 days to file an amended complaint.

## **What Does This Mean for Holders of Material, Non–Public Information?**

While the SEC will most likely replead its complaint against Mr. Cuban, regardless of the final outcome, the decision is a wake–up call for companies and their advisors about to share material, non–public information with potential investors, business partners or acquirors. We advise companies and their advisors to review their written confidentiality and non–disclosure agreements to ensure that they expressly require recipients of the information to agree to keep the information confidential *and* not to trade on the information in the marketplace, or otherwise use the information for their benefit. Absent both of these undertakings, this case at least suggests that misappropriation liability will not be found if someone trades on information, even after agreeing to keep that information confidential, if they have not also agreed not to trade on the information.

This case will likely be reheard and is not binding on other courts. Accordingly, we urge any recipients of non–public information not to rely on the decision to justify trading, and to keep any material, non–public information confidential and refrain from using it as a basis for trading.

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Please contact Mintz Levin if you have any questions or concerns regarding this decision, or if you would like us to review your confidentiality and non-disclosure agreements in light of this decision.

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## **Endnotes**

<sup>1</sup> United States v. O'Hagan, 521 U.S. 642 (1997).

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*For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.*

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