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Securities Litigation E-Alert: The SEC, Insider Trading, and Dallas Sports

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As a Dallas-based securities litigator and basketball fan, I have taken a keen interest in the SEC's insider trading case against Mark Cuban. Obviously, I am not alone. Over the last couple of weeks, I have read and heard a great deal of commentary on Mr. Cuban's troubles with the SEC. Two thoughts keep coming to mind: Much of this commentary is wrong. And why aren't we talking about Barry Switzer?

The SEC's Allegations

The SEC filed suit against Cuban on November 17th, alleging that he engaged in illegal insider trading in the securities of internet search engine Mamma.com. According to the complaint, Cuban sold his entire 600,000 share position in Mamma.com on the basis of material, non-public information concerning an impending PIPE (private investment in public equity) offering by the company.

The complaint alleges that Cuban was approached by the CEO of Mamma.com with information about the PIPE transaction, and he agreed in advance to keep the information confidential. Cuban allegedly became angry during the conversation because the PIPE would dilute existing shareholders, and he told the CEO, "Well, now I am screwed. I can't sell." Nevertheless, a few hours later, Cuban sold his entire position in the company. The complaint alleges that Cuban avoided losses in excess of \$750,000 by selling his stock prior to the public announcement of the PIPE offering.

This Is Not a Criminal Case

The case was just filed, and we certainly don't know all the facts. But that hasn't stopped commentators, including those who should know better, from convicting Mr. Cuban in the court of public opinion and speculating on the length of his future jail term. This is nonsense.

First of all, this isn't a criminal case, and Cuban won't be going to jail. The SEC hasn't charged Cuban with a crime; it has filed a lawsuit against him. In fact, the SEC doesn't even have the power to bring criminal charges. People do go to jail for insider trading, but those cases are brought by the Department of Justice, not the SEC. It's possible that the Justice Department may seek to indict Mr. Cuban in the future, but that hasn't happened and may never happen.

But what about Martha Stewart? Yes, she went to jail, but not for insider trading. Ms. Stewart was neither charged with nor found guilty of insider trading, and she appeared to have good defenses to such a claim. Instead, Ms. Stewart was charged with obstruction of justice for lying to federal investigators. As is so often the case, her problem was the cover-up. The moral to the Martha Stewart story? Never lie to the federal government. But her story tells us nothing about the insider trading laws.

I will concede there is one striking similarity between the Mark Cuban and Martha Stewart cases. Both were filed with much public fanfare, and both came on the heels of massive financial scandals that Ms. Stewart and Mr. Cuban had nothing to do with. Make of that what you will.

The SEC and Barry Switzer

Enough about Martha. Let's talk about Barry Switzer. Interestingly, Mark Cuban is not the first Dallas sports celebrity to have attracted the attention of the SEC. Switzer, the former Dallas Cowboys coach, was also accused of insider trading.

In 1981, Switzer allegedly received an inside tip concerning the sale of Phoenix Resources Company. Switzer bought a substantial number of Phoenix shares in advance of the transaction, and he also tipped off a number of his friends. He and his friends made a handsome profit.

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At the time, Switzer was the head football coach at the University of Oklahoma and Phoenix was the sponsor of Switzer's television show. Its CEO, George Platt, was a prominent Oklahoma booster, a season ticket holder, and a personal acquaintance of Switzer. He also was the source of Switzer's inside information. Sounds like a classic case of tipping. But Switzer won.

What was his defense? Switzer testified that he ran into Mr. Platt at an Oklahoma track meet. They spoke to one another, and then Switzer laid down on a row of bleachers behind Platt in order to sunbathe. While sunbathing, Switzer overheard Platt talking to his wife about Phoenix's pending transaction. Shortly thereafter, Switzer bought Phoenix stock based on what he had overheard. Nobody contradicted this story, and the court dismissed the SEC's complaint.

Most people would be surprised to learn that Switzer's sunbathing story would constitute a defense to insider trading. It's true, though. Not everyone who has inside information is prohibited from making trades. Corporate insiders can't trade, and neither can outside professionals who have a fiduciary duty to the company. Likewise, if a corporate insider gives a friend an illicit tip, both of them can be held liable. But if you overhear a private conversation in an elevator, on an airplane, or even sunbathing, you are free to trade away.

And that brings us to Mr. Cuban.

Mr. Cuban's Defense

Switzer won his battle with the SEC. Will Mr. Cuban? Despite what you may have read, the SEC does not have a slam dunk case.

Mr. Cuban may have been provided with material, nonpublic information about the pending PIPE transaction. But it's not enough for Mr. Cuban to possess inside information. The Switzer case proves that much. The SEC also must prove that Cuban had a duty not to trade.

This may not be easy. The SEC alleges that Mamma.com's CEO began his conversation with Cuban by telling him that he had nonpublic information to disclose, and Cuban agreed in advance that he would keep their conversation confidential. Cuban disputes this. He contends that he made no promises or agreements, and he supports this argument with excerpts from an interview of Mamma.com's CEO, in which the CEO could not remember what Cuban said during their conversation.

In short, the SEC's case hinges on an agreement that may not have existed. The publicly-disclosed facts are sure to change, and things could get complicated fast. So far, though, Cuban has done a nice job of poking holes in the SEC's theories. Right now, it looks like Cuban has a viable defense, and he easily could win the case. One thing is certain - it will be interesting.

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