UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SIDNEY GORDON,

Plaintiff,

v. 11 CV 9665 (JSR)

SONAR CAPITAL MANAGEMENT,

Defendant.

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June 19, 2012
5:30 p.m.

Before:

HON. JED S. RAKOFF,

District Judge

APPEARANCES

SHAPIRO HABER & URMY LLP
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(Case called)

MR. HABER: Good afternoon, your Honor, Edward Haber of Shapiro Haber & Urmy for the co-lead plaintiff for the -- co-lead counsel for the co-lead plaintiffs. With me, your Honor, is my associate Patrick Vallely. I realized that he had -- my partner and I were admitted pro hac vice. I've not gotten him admitted pro hac vice. With your permission, could be at counsel table?

THE COURT: Yes.

MR. HABER: Thank you.

MR. HOFFNER: Good afternoon, your Honor, Brian Kerr from Brower Piven, also co-lead counsel for plaintiff.

THE COURT: Good afternoon.

MR. HYLAND: Good afternoon, your Honor, Mark Hyland of Seward & Kissel for defendant Sonar Capital Management LLC and Neil Druker. And with me is my associate Julia Spivack.

MS. SPIVACK: Good afternoon.

MR. HOFFNER: Good afternoon, your Honor, David Hoffner and Jason Billy of Dechert LLP for defendant Noah Freeman.

THE COURT: Good afternoon.

All right, so as I was looking through the papers in this case I thought, it just doesn't make sense to have oral argument on each and every one of the numerous issues raised. And so I thought maybe the best thing to do is to have counsel

for each of the parties address either issues that they think were not fully dealt with in the papers. For example, the plaintiff's counsel, this is their first opportunity to respond to reply papers so they might have some things they wanted to bring to my attention that are not yet before me, or issues where counsel thinks that it's really a matter that it's unusual or doesn't -- has some wrinkle that you really want to make sure the Court is cognizant of.

So you're free to address anything you want. I'm not saying you're limited to this, but I don't think it would be a prudent use of your time to go through each and every issue.

So on the defense side, who wants to go first?

MR. HYLAND: I think I will, your Honor, Mark Hyland for Sonar Capital and Neil Druker.

THE COURT: Very good.

MR. HYLAND: Good afternoon, your Honor.

At the outset, let me apologize for our noncompliance with your Honor's rules regarding the font size of footnotes in our opening brief. I didn't notice it until after the brief was filed. It wasn't in the 12 point, it was something less than that.

THE COURT: That's all right. My opthalmologist would be proud of me.

MR. HYLAND: Your Honor, just as an overview, I'm going to raise what I think is a bit of an unusual wrinkle that

this putative class action presents.

The plaintiffs allege that Sonar Capital, an investment advisor, caused funds that it managed to purchase Sigma stock while having material non-public information that was allegedly obtained by defendant Noah Freeman, an employee of Sonar Capital, who allegedly got that information from some unidentified source at PGR, called the PGR agent, who in turn allegedly got the information from some unidentified person working within Sigma.

The plaintiffs purport to represent a class consisting of sellers during a four month period. And their claim is that they sold Sigma shares at an artificially deflated price, and thus were harmed.

Now, here's the unusual wrinkle I think about this factual matrix. The usual case, of course, presents an issuer who is accused of misrepresenting or concealing facts that caused the market to be artificially inflated. So you typically have a class of buyers, almost always a class of buyers who buy stock and they say, well, the company misrepresented or withheld, and, therefore, I purchased at an artificially high price, and thus the entire market was deceived. The whole market would be deceived in that case.

Here the plaintiffs are purporting to represent a class of sellers. And the plaintiff's position is, well, there is a third party out there that had information that it

shouldn't have had. And if we had it and if everybody else had it, then the price of the stock would be higher than what it was. But in a case like that, the market wasn't exactly where it was supposed to be, according to their theory; that is, the information shouldn't have been in anyone else's possession and certainly shouldn't have been traded on. That's the theory. So the market was trading exactly where it should have been, unlike the buyer class where it's not trading where it should have been, but it's trading too high.

So if, in this instance, if Sonar had never purchased a share at all during the class period, the market would be exactly where it was and the plaintiffs would be exactly where they are. And so I think that's a very different perspective. And I think that the theory advanced by the plaintiffs here in the pleading filed have some very significant, and, I think, uncorrectable flaws.

One of the things I think, your Honor, that's glaring -- and I'm not going to get too deeply into this, but I think it's really critical -- is the failure to comply with Rule 9 or the PSLRA, in that conspicuously absent from this entire complaint are allegations that defendant Freeman told Druker anything about Sigma, let alone what he was told, how it was communicated, where it came from, when it was communicated, and how Druker supposedly knew what he was told, if anything, somehow constituted a breach of fiduciary duty by someone.

The complaint is 123 paragraphs. And the question that shouts out from the complaint is, where is Druker in all of this? He's dealt with in most summary fashion in paragraphs one through five under the section introduction, where that says that Freeman obtained material non-public information from a Primary Global research agent -- there's no detail about the information -- and provided it to Druker.

That said, the rest of the complaint, until you get up to paragraph 55, is what I would call just chafe. Because it just talks about trading in securities that have nothing to do with this complaint; namely, Marvel and Lavidia, they're not at issue or at play at all in this complaint, and it talks about alleged trading in 2006, way before the class action, and, indeed, concerning a timeframe that everybody would agree would be time barred if there were any complaints about it.

So the guts of the complaint go from paragraph 55 to 63. And in those nine paragraphs you really see Druker being connected to none of this.

What do those nine paragraphs say? Here's the guts of their case; that in early July, they allege the PGR agent informed, quote, Freeman and Sonar -- not Druker -- that Sigma had entered into a contract to purchase a computer chip for use by an American company that was going to result in second quarter sales exceeding expectations. It alleges two calls, July 9th and 12th, a purchase on July 13th, and it alleges then

a July 16th call and a July 17th purchase. No allegations are made about the substance of the July 16th or 17th calls. Here is where we get to something that's very substantive. The complaint alleges that on August 29th, maybe six weeks after those calls, Sigma issued a press release announcing second quarter results, and the price rose 14 percent the next day. This is all taking -- their whole complaint is based on an SEC complaint against 11 defendants that it mentions, 11 stocks, but doesn't mention Sigma -- 11 stocks, not Sigma. No mention of Druker in the SEC complaint, no mention of Sonar. And, in fact, your Honor, the SEC hasn't done anything to Sonar or Druker; no complaints and no action taken by anybody, private or public. Now, this has been going on for 20 months, almost 20 months, November of 2010. So this seems to be getting a little bit stale at this point.

Okay. So on August 29th, the press release comes out, the next day the price rose, rises by 14 percent. And those allegations, they connect Druker to none of this. And Sonar is only connected to any of it by reason of the fact that it made the purchase. The amended complaint -- here's the gaping hole. The amended complaint does not allege that Freeman told Druker, even in the guts of this complaint, that the information that was received was somehow dirty. There's not one word alleged about what Druker knew. Plaintiffs don't allege that Druker knew of a crooked Sigma employee who allegedly gave the

information to somebody at PGR, who, in turn, themselves was crooked, who gave it to Freeman. There is not even an allegation of what duty was breached or how Sonar or Druker supposedly were aware of anything illegal or improper.

Now, so just on a pleading, just on the basis of pleading, it falls woefully short of what they're required to do. And I'm not going to go through the cases, your Honor, because your Honor has a number of these that you've published fairly recently and knows this area of the law backwards and forward, but I would like to focus then on the two plaintiffs from a substantive point of view.

The plaintiff, Gordon, his claim rests on one transaction, the sale of 500 shares of Sigma stock on September 28th, 2007. This is four weeks after the allegedly material non-public information reached the public, and the price went up by 14 percent on August 30th.

So when Gordon sold on September 28th, he enjoyed the bump up in stock. He didn't sell before. He sold four weeks later. And, of course, it's well settled that, you know, when information that is non-public is made public, the public is restored to its position of equal access by circulation of the material information, and the duty to abstain or disclose is abrogated. The breach which occurred with the first disobedience sale likewise terminates. And I'm citing the Shapiro case. And tipee's liability begins at the time

10(b)(5) is violated, and continues until the non-public information is effectively publicly disseminated. That's the Elkin case.

Now, what do plaintiffs do to get around, try to get around this flaw? They say that Freeman spoke or exchanged voice mails with the PGR agent some 20 times during the November, October -- excuse me -- the September, October, November timeframe. And they surmise that Gordon, when he sold his shares -- the only transaction that he made -- he surmises that there must have been shenanigans going on between Freeman and the PGR agent. The complaint alleges two telephone calls on September 18th between Freeman and the unidentified agent, but that's all that's identified. Again, nowhere do plaintiffs allege what was said, whether it violated a duty, whether it was either positive or negative, or whether Druker even knew about it. The fact is that Gordon made a single sale on September 28th, four weeks --

THE COURT: So let me ask you this. Some of the flaws that you have identified, if I agree with them, knock out the complaint with finality. But on the stuff like what we're discussing here, where what you're saying is it doesn't meet the pleadings requirements of the PSLRA and Rule 9(b) and so forth, on those I would have to give them leave to amend, unless they were unable to represent to me that it would be a futility.

So you agree with me; yes?

MR. HYLAND: Partially. I would not agree with that -- I would not agree with that with respect to plaintiff Tauber. I'll get to that in a minute.

THE COURT: Right. All right.

MR. HYLAND: With plaintiff Gordon, I --

THE COURT: They may be able to do that, because you would think if they had something more particular, they would stick it in a complaint because it's such an obvious --

MR. HYLAND: Right.

THE COURT: -- gap, so to speak.

MR. HYLAND: Right.

THE COURT: So we'll have to ask them about that when they stand up in a minute.

All right, go ahead.

MR. HYLAND: So let me -- I think your Honor's got it with respect to plaintiff Gordon.

Let me turn my attention to plaintiff Tauber. And here's where I don't think anything can save plaintiff Tauber. In contrast to the plaintiff Gordon, Tauber was a prolific trader in Sigma shares, buying and selling -- buying and selling tens of thousands of shares 114 times during the class period, sometimes the same day, and all the time, except once, all the time way outside the market. It's striking to take a look at how far his transactions are outside the market price

for the day. When you take a look at the low and the high -- and it's in my affidavit, we've got the supporting -- it's not in dispute, the documents -- it's striking. And we brought that to the Court's attention in our opening brief, and it was ignored in the opposition, other than to say that they didn't dispute it and that this was really an issue for damages. But it's not an issue for damages. Aside from the fact that the prices that he purchased and sold at were way outside the market, that would, under Basic v. Levinson, sever the tie and not allow him to the presumption of reliance. I think that the language in Basic is quite clear on that; when you can sever the tie about reliance on market price, then there goes the presumption of reliance.

But perhaps more significantly, your Honor, during the class period Tauber was a net purchaser and he exited the class period with 15,790 more shares than he sold. So he's a net buyer, just like he alleges Sonar to be. He and Sonar are in the same position. They're net buyers. And he got the big bounce when the information became public.

Because Tauber purchased shares at an artificially deflated price, as he admits, and then sold them also at an artificially deflated price, he can not show that he suffered any losses. I think Dura is very clear on that, on that point. The plaintiff suffers no loss due to an alleged misrepresentation or omission either at the instant the

transaction takes place or if he sells shares quickly before the relevant truth begins to leak out. Under Dura, it follows that when a seller buys and sells the same number of shares the same time within a short period of time, there cannot be any loss. Because even if the price of the security is artificially deflated, because he's selling and buying the same thing -- and in this case again it's different from Dura -- and that's a buyer class, this is a seller class, where the market is exactly where it's supposed to be. It is. The market's trading exactly where it's supposed to be. He's not complaining about that. He's just saying there's a third party that just sort of got the jump on somebody, taking that true, which we have to do at this stage of the proceedings, but we vigorously dispute. So he actually ends up having a net benefit. And he was even a net buyer -- and you can see this from the affidavit and the chart, your Honor -- Tauber was a net buyer even before the August 29th disclosure. That's the disclosure where they came out with the second quarter results. So he's a net buyer then, and that he's a huge net buyer at the end of the class period. So if you buy and you sell before the leakage, you get equivalent value.

And here I don't think that -- I think all they can say about that is, well -- their retort to that is, well, that's probably something that we ought to take up on class certification and not now. That's not so. If that's who he

is, he can't stick around. He doesn't have a claim. You don't have a claim. If he's a net buyer during this period, he doesn't have a claim. I think that that is necessarily so under Dura. I think it's necessarily so under Flag Telecom Holdings, Second Circuit case. There I'll concede it was done in the context of a class certification motion. But the Court kicked those people out. The Second Circuit kicked those people out, said they had no claim. If they have no claim then, they've got no claim now; might as well deal with it. There's no reason why we can't deal with it at this point. It's not in dispute. And Corner Stone, which is a Northern District of California case -- and your Honor certainly doesn't have to follow that -- but that's stated under Dura, there could be no loss causation for plaintiffs who purchased and sold stock at the inflated share price prior to the corrected disclosure, and thus these plaintiffs may not recover at all, again, kicking them out of the class.

Again, on getting back to the basic point on the transactions that were uniformly outside the market price. Any showing that severs the link between the alleged misrepresentation and either the price received or paid by the plaintiff or his decision to trade at a fair market price will be sufficient to rebut the presumption of reliance.

He has not pleaded adequately reliance here, and cannot, given what he's done. So I think, your Honor, right

there we've got an uncorrectable flaw and the complaint needs to be dismissed with respect to Tauber with prejudice.

We also have the argument of contemporaneous trades. I don't think we need to even reach that necessarily. I know Mr. Hoffner has briefed that extensively. But we don't have contemporaneous trades under Second Circuit law in this case sufficient to bring a 10(b)(5) case. Because there is a contemporaneous requirement under 10(b)(5), just as there is a under Section 20(A). There are only three dates alleged where there were purchases by Sonar, July 13th, 17th and September 18th, and we don't have any trades contemporaneous with those. The closest one was Gordon's on September 28th, but that's ten days or eight trading -- I believe it was eight trading days, and that's not contemporaneous. And Tauber doesn't come close, his transactions don't come close to any of that. He's trading -- he sold on July 30th, August 16th and October 25th, so he doesn't have any trades that are even close to the trades alleged by Sonar.

So for all those reasons, your Honor -- and I have condensed a lot of this under your Honor's instructions -- the amended complaint -- this is an amended complaint, this is their second shot -- does not comply with Federal Rule of Civil Procedure 9(b), does not comply with the PSLRA, and for substantive reasons they can't state a claim.

THE COURT: All right. Thank you very much.

MR. HYLAND: Thank you.

THE COURT: I think before we hear from co-defendant, I want to hear from plaintiff's counsel in response to the arguments just made, and I'll come back to the defense counsel.

MR. HABER: Your Honor, is it all right with you if I argue from here?

THE COURT: Sure.

MR. HABER: Thank you.

Let me begin, please, by addressing the arguments that Sonar and Mr. Druker's counsel made regarding the inadequate factual allegations in the complaint. Those --

THE COURT: Well, let me start with this one. Where do you allege, with any particularity, that Mr. Freeman received material non-public information after August?

MR. HABER: I'm sorry?

THE COURT: After August 29th, 2007?

MR. HABER: What we allege, your Honor, and you'll find those allegations starting on paragraph 64 of the complaint -- and I will agree, to some degree, we allege by inference that this was inside information. We allege numerous conversations between September -- this is starting with 64 -- between September 2007 and on November 2007, the Primary Global agent repeatedly and consistently communicated with Freeman and Sonar and provided them with material non-public information --

THE COURT: Okay, so --

MR. HABER: -- about Sonar.

THE COURT: -- let me just stop there. You would agree, would you not, that that sentence is a classic conclusory allegation that's not entitled to any weight if you can't spell out what the material non-public information was when it was provided, et cetera?

MR. HABER: I only partially agree, your Honor. I think --

THE COURT: What do you disagree?

MR. HABER: I think that that allegation needs to be evaluated by your Honor, along with all of the other allegations that follow it in the complaint down through paragraph 69 of the complaint.

THE COURT: Well, in 65 you say, Freeman and Sonar had two telephone calls, and Sonar then caused the John Doe hedge funds to purchase more than 205,000 shares of Sigma stock. And in the next paragraph you say that, during the period, all the way from September to November, Sonar caused John Doe hedge to purchase a total of 617,000 shares of Sigma while in possession of material positive non-public information. And in 67 you say that on November 28 Sigma issued a press release announcing better than expected third quarter financial results, and those results were exceeding market expectations and that, therefore, Sonar and John Doe realized profits.

Now, I don't see anywhere -- and I've now covered the

paragraphs you mentioned -- I don't see anywhere the allegation that on day X, Mr., the Primary Global agent told Mr. Freeman Y, and that as a result of that, the following trades were executed and the following profits resulted.

What you're saying, as near as I can tell, is because there were some telephone calls between people who had previously exchanged inside information, and because after those telephone calls there was some trading, there is a basis as a matter of pleading, consistent with the PSLRA and the case law and Rule 9(b), to infer that some specific piece of inside information about what would happen to a particular stock was given. I don't see anything in the case law that supports that.

MR. HABER: Well, respectfully, your Honor, I think that there's even a little more to add to the description that you just gave. The complaint, in describing the earlier transmittal of inside information and describing the relationship between Primary Global and the defendant -- and the other defendants, are Primary Global was specifically paid to convey inside information. That's expressed and pleaded in the complaint.

The reasons for the communications between -- there was no social relationship here. They weren't talking about sports. They had a relationship to convey inside information for money, and that's alleged. And then we have a period of

time when they have 20 such conversations, all right. Yes, we do ask you to draw that inference at the pleading stage, that -- and one of the allegations is that they have two telephone calls on September 18th, and on that very same day they buy 205,000 shares of Sigma.

THE COURT: So let me go back. Let's take -- you say in paragraph 67, on November 28, 2007, after the close of the market, Sigma issued a press release announcing better than expected 2007 third quarter financial results.

MR. HABER: Yes.

THE COURT: When do you say that information was conveyed as illegal inside information?

MR. HABER: What I say, your Honor, is that there is a reasonable --

THE COURT: No, no, no.

MR. HABER: I --

THE COURT: Are you saying it was the day before or are you saying the hour before, the week before?

MR. HABER: Your Honor, clearly what we -- the best inference of that is that it would have been on September 18th when there were two telephone conversations with --

THE COURT: 10 days before.

MR. HABER: I'm sorry? Yes, the 10 days before.

THE COURT: I'm sorry. No, I'm sorry. No. A lot more.

MR. HABER: I'm sorry, I'm sorry.

THE COURT: I'm talking about November 28.

MR. HABER: I misspoke. I misspoke.

Your Honor, if I can step back a minute.

THE COURT: No, no, no. Just answer my question, if you can. If you can't, that's fine. But because you just said to me that with respect to the September calls, I should assume, or there's a strong inference because they had two telephone calls, and then there was an immediate purchase, that there was information conveyed.

MR. HABER: Yes, sir.

THE COURT: Now, it follows from that that if, before the November 28 disclosure, there were no immediate phone calls or there was no immediate purchase, then there's nothing to suggest that that information was conveyed.

MR. HABER: And what we know and what we allege is that during the September to November 2007 timeframe, as alleged in paragraph 64, there were voice mails and conversations on at least 20 occasions.

THE COURT: Yes. When was the one closest to November 28th?

MR. HABER: We don't know, your Honor.

THE COURT: So for all you know, it could have been a week before.

MR. HABER: Yes, your Honor, that's true.

THE COURT: Or a month before.

MR. HABER: Correct. This is pleading, your Honor. All right.

THE COURT: I know it's pleading. And, unfortunately for you, under the PSLRA it's a very high standard of pleading. In the old days -- and I'm old enough to remember -- you --

MR. HABER: So am I.

THE COURT: This undoubtedly would have given rise to a plaintiff -- a complaint that would have survived because -- I'm not totally sure of that because of 9(b) -- but at least prior to the PSLRA, there was much less demanding. The result of the PSLRA is that many suits that are meritorious get knocked out, because Congress has decided that in order to prevent un-meritorious suits from somebody, we're going to place on plaintiffs a very substantial burden, and you're going to have to somehow or another discover X, Y, Z, Q and R, and if you can't do it, too bad for you. That may be lousy policy, but that's the law.

MR. HABER: Your Honor, I think that we're -- to just go back to the beginning here.

THE COURT: Yes.

MR. HABER: I think given as I indicated, as alleged in the complaint, the history and relationship between Primary Global and then Freeman on the one hand, and then Druker and Sonar on the other, that the reasons for -- it is a more than

reasonable inference under the PSLRA that the reasons these entities communicated with Primary Global was to receive inside, confidential inside information from Primary Global for which they paid and for which they then used to trade. And the allegation -- and the inferences that, those -- drawing those inferences with respect to the September 18th telephone conversations --

THE COURT: Well, I'm going to accept that for the moment, although in fact from my own knowledge of the criminal cases involving Primary Global, it simply is not true that every conversation was about inside information. But I'm going to accept -- because I can't go and bring that knowledge to bear -- I'm going to accept that your suggestion, which itself doesn't seem to me to be particularized, but I'll accept for the purpose of this moment in this argument that all the conversations were about inside information. It doesn't -- you know, if I have 15 conversations with you about inside information on day one, and on day 61 you make some purchases, it's hardly obvious that that is based on the inside information that you got on day one, because you would have thought you would have made those purchases on day two.

MR. HABER: But, your Honor, I'm talking about the same day here. If you look --

THE COURT: That's why I focused not on your September, but on your November. Because in November that's

where you give some of the specificity as to what it is that someone might want to know beforehand.

On November 28th Sigma publicly discloses X, Y and Z. So, okay. So if, therefore, on November 27th they learn that inside information, and then -- and trade on it on November 27th, there's a reasonable inference, I suppose, that they were getting the information that the public got on November 28th.

MR. HABER: So this goes to another issue that is raised in the papers in the context of contemporaneousness. This goes to the issue of, that as we stand here today, all right, plaintiffs and through the pleadings, the Court knows three of the days that Sonar traded, specific days, specific amounts of trading of either numbers of shares or dollar volume of shares.

We also in the complaint explicitly allege -- we don't just say and they traded more -- we explicitly -- they're the two trading periods as Sonar's counsel indicated -- and we specifically allege that in the first trading period there were additional $3.5 million worth of Sonar shares that were purchased. But we don't know when. And we specifically allege in the complaint that there were over 400,000 additional shares of Sigma purchased in the second trading period. And the courts in this Circuit consistently do not dismiss complaints when the dates of trading under circumstances like this, when

the plaintiff and the Court don't have that information, the information that is exclusively in the possession of the defendants, that's the kind of information that the courts do not dismiss on the basis of and allow --

THE COURT: What case are you -- give me your best case for that proposition.

MR. HABER: Yes, your Honor. Give me one second.

THE COURT: Yes.

MR. HABER: We discuss this on pages 15 and 16 of what I call our Freeman memo, our memo opposing the defendant Freeman's motion to dismiss. And in particular I would point the Court to HAB Associates versus Heinz, where the Court denied the motion to dismiss where the trades occurred in the same month but did not -- but the complaint did not specify the particular dates of the parties' trades within the month. And --

THE COURT: So I'd have to take a look at that. I mean, looking at it on its face, first of all it's 1990, which is rather early in the development of this area of the pleadings.

MR. HABER: I'll do better. I'll do 2008 then, your Honor.

THE COURT: And also, of course, I have to see what was said in that opinion.

MR. HABER: I appreciate that, your Honor. I'm at

page 16. We point the Court to In Re: Connetics Corp. Securities Litigation. It's from August of 2008. And there the Court denied a motion to dismiss where the plaintiffs allege that the defendant sold 68,000 shares of stock during -- and this is the Court's term -- a relatively short window, close quote, which was about two months, your Honor, but were, quote, unable to pin down the precise dates of defendant's trades without discovery. And --

THE COURT: See, it's funny because -- and your footnote there is relevant as well. It certainly was the law at one time that the only reason you were unable to fill in the blanks was because you hadn't yet received discovery about the things that were exclusively within the perview of the defense, that was excused at the pleading stage. I think the cases are legion that says that is no longer the case.

MR. HABER: I think your Honor --

THE COURT: Because it's really the same policy point I made before, one which reasonable people can disagree. But the point is that Congress determined, in effect, or so the argument goes, we're only going to let plaintiffs bring securities class actions where they have done a lot of homework in advance so we know in advance it's a viable lawsuit. And every plaintiff's lawyer from time to memorial faced with that kind of situation says you're asking the impossible; how can I possibly find out something that's exclusively within my

adversary's knowledge without discovery? And the answer that Congress gave, which may or may not be satisfactory in a broader sense, but they're the boss so to speak, is that this is the price that has to be paid to prevent what they perceive was a lot of frivolous lawsuits that were extortionate because once you get to discovery, it's so expensive, blah blah blah, that you have to settle. So and the history of the PSLRA is filled with that kind of stuff.

MR. HABER: I understand, your Honor. Your Honor, I think -- I don't disagree with the description you give of the public policy behind the PSLRA.

We're dealing here -- but let's remember that what the PSLRA was addressing was that there were complaints about the illegal conduct that were thin in the complaints. And I'm not standing here saying this complaint should be sustained and we should be able to then get discovery so we can prove the illegal conduct. We allege the illegal conduct. We allege it quite explicitly. Mr. Freeman has pled guilty to that illegal conduct.

THE COURT: Yes, although not involving this particular stock, right?

MR. HABER: I understand that, your Honor. But when he testified just in -- and this changes the subject slightly, but I think --

THE COURT: Go ahead.

MR. HABER: -- it's perfectly relevant.

THE COURT: Go ahead.

MR. HABER: Sonar's counsel said that we make no allegations in the complaint about Mr. Druker knew anything about the inside information. Of course in paragraph 44 of the complaint, we expressly allege that Freeman told him about the inside information and he relied on it in making the trades. And we -- and even though we didn't have to, as a pleading matter, explain in the complaint where we got that factual allegation from, we say in the complaint that we got it from Mr. Freeman's testimony before your Honor in this Court in the U.S. v. Winfred Deall case.

And just to -- this was a year ago, your Honor. But just to give you a flavor, because it goes to the question of we're not seeking discovery to sustain the complaint that the securities laws were violated. And that's really what Congress was talking about, don't bring a case, don't conclusorily allege the securities laws were violated, and then get discovery to see whether they were.

This is what Mr. Freeman testified in front of your Honor with respect to the criminal -- criminal conduct, but certainly the conduct that would be actionable in this case. He's asked by the Prosecutor. Now, if you can describe for the jury, first of all, when you're involved in putting in a trade, you and Neil Druker, for example, how does that trade get

affected? Can you walk the jury through the process from when you get insider information to the trade getting affected? And his answer, sworn before you; "So the first step is we would get the inside information. Then we would have to -- we being my team and I, would have to determine how this data compared to what Wall Street was expecting. Then the next thing we had to do was evaluate this data versus that source historically to see if the source was accurate. And if the data passed both of those two tests, which is this data from a source that's historically proven, and is this data different from what Wall Street is expecting, I would bring the package to Neil Druker and I would explain to him who the source was, how proven the source was, what the source was saying, and what data the source -- what the source told us and how that differed from what Wall Street was expecting. Then Neil Druker and I would discuss it together, and it would be Neil's decision to put the trade on. He would then call our trader who actually performed the trade."

We know --

THE COURT: I mean, I actually recall that testimony while you're reading it to me.

MR. HABER: Okay.

THE COURT: It's in the context of explaining, basically, how the scheme worked.

MR. HABER: Yes, sir, exactly.

THE COURT: But it doesn't relate to any given stock.

MR. HABER: Well, but, your Honor, there is -- but again we're talking about pleading, and we're talking about what inferences are reasonable even under the PSLRA for us to ask your Honor to draw that we have adequately alleged the securities law violations. I think we've done that.

THE COURT: All right.

MR. HABER: We have done that in detail.

THE COURT: Let's -- anyway, I understand your point. And by cutting you off, I'm not suggesting I don't think --

MR. HABER: That's fine.

THE COURT: I have not made a determination on any of the issues in this case.

MR. HABER: Fine.

THE COURT: But let's turn, though -- I guess I'm conscious of the time -- let's turn to Mr. Tauber and the point that was being made about his net benefit and all like that.

MR. HABER: Yes, your Honor. I think that -- there's two things I want to say about that. First of all, we have, of course, after we, you know, received the motions to dismiss and the discussion in them of the fact that so many of Mr. Tauber's trades seem to be at either higher or lower prices than the high low for that day as reported, I think it was Bloomberg which was attached to defendant's declaration, and we made inquiry about that, all right. And Mr. Tauber trades through a

Fidelity account, just on the computer through a Fidelity account. Just like, you know, millions of people in this country. He lives in California. He is often doing that after the markets would be closed in the east. So maybe those -- and this is just true surmise, all right -- maybe those trades were being executed on after hours trading; that then the high and lows for Bloomberg don't reflect what, you know, highs and lows for the after hours trading. We honestly don't know. But there was certainly nothing in his -- in the way in which he went about buying and selling Sigma stock, other than relying on the integrity of the market by placing orders through his Fidelity account. And certainly if there is anything that should -- that would flow from defendant's honest investigation about that, that is obviously a factual matter that would have to be explored by both sides to learn what was going on, and then people can make legal arguments based on it.

As far as the fact that Mr. Tauber purchased more shares during the period than he sold. I would say, your Honor, that at least to my knowledge, all right, there is no jurisprudence -- I could be wrong, Westlaw can always prove you wrong when you make a comment like this, all right -- there is no judicial decision, to my knowledge, that addresses the question of whether or not the entitlement to disgorgement of profits or losses avoided from an insider trader under 20(a), is affected by the question of whether or not the person who is

seeking that disgorgement in this case bought more shares than he sold, all right.

We would argue and we would articulate reasons why the public policy behind section 20(a), which is of course to deter inside trading, to deter the very kind of conduct that happened here, all right. And one of the ways Congress chose to affect that deterrence is to say if you insider trade, you are liable to disgorge your profits. And here we, of course, specify what those profits are in the $13 million range for the class period at issue here. And what I would say standing here as an officer of the Court is I'm aware of no case law that talks about whether or not that right to disgorgement from the bad guy, so to speak, is affected by the fact that you traded more in the other direction during that same period.

THE COURT: All right.

MR. HABER: I do recognize that it could affect 10(b)(5) damages, all right. But all of that, everything I just talked about is a damages question, all right. And depending ultimately how your Honor came out on that issue, it might mean that Mr. Tauber isn't entitled to any recovery. But it's a damages question. It's not --

THE COURT: Well, no. If, on a motion to dismiss as a matter of law on his allegations he could not establish damages, then he would be and your adversary would be entitled to dismissal. The fact that it relates to the damages doesn't

make it not a ground for dismissal if the damages, as a matter of law, are zero.

MR. HABER: I agree with your Honor. But I guess what I was saying is is that since -- but since it does relate to damages and it is an issue that is not -- it's not even settled, it's -- there's no speaking about it under 20(a), to my knowledge -- I respectfully suggest that that is not the kind of issue that should be decided on the pleadings on the papers.

THE COURT: Well, I mean, it's interesting. If an issue is presented to me, I got to deal with it if it's ripe for decision.

MR. HABER: Well, and appropriate for decision, sir. That's your decision.

THE COURT: The fact, the mere fact that no one's decided it, other than getting me salivating, is not a reason per se for not reaching it, but I understand what you're saying.

Let me take the liberty of interrupting you at this point, and let's hear from counsel for Mr. Freeman and then we'll come back.

MR. HABER: Thank you, sir.

THE COURT: Thank you.

MR. HOFFNER: Your Honor, Mr. Hyland identified a number of fatal infirmities in the complaint, and I'll rest on

his explanation for those.

I want to address two legal points that I think also, if your Honor gets to them, would also mandate dismissal of the complaint.

First, the 10(b)(5), Section 10(b) and Rule 10(b)(5) claim is not properly brought. As an initial matter, the allegations here are that Mr -- with respect to Mr. Freeman, is that he was a non-trading tipper. And what is not alleged is that he conducted any personal trading in Sigma design stock. It's not alleged that he had any interest in, financial interest in those trades, direct interest in those trades. It's not alleged that he had any trading authority. And it's not alleged that he had any management control over Sonar.

What is alleged is that Mr. Druker was -- excuse me -- what is alleged is that he was an employee of Sonar; that Mr. Druker had complete management control of Sonar and the Sonar funds, and that Mr. Druker had sole trading authority. And given these allegations, or lack thereof, plaintiffs cannot meet the test for primary liability recently enunciated by the Supreme Court in the Janus case. And in Janus -- I recognize it's a misrepresentation case -- but in Janus the Court said that only those who have ultimate authority, quote unquote, or control are the primary violators. And if it were otherwise, then you would have so many -- you would have so many primary violators. And anyone who does not have ultimate control or

authority is not a primary violator of Section 10(b). And under Central Bank and its progeny therefore, since there is no private right of action for an aiding and abetting violation of Section 10(b), there is no Section 10(b) claim against Mr. Freeman.

And in response plaintiffs cite a number of cases that all predate Central Bank, in which -- and in that circumstance there would have been no reason for the Court to parse out what constitutes a primary violation versus an aiding and abetting of a Section 10(b) claim. And the only post Central Bank cases that they cite really are cases brought by the SEC, which post Central Bank Congress found fit to endow with explicit authority to bring such aiding and abetting claims. So they cited no cases subsequent to the recent jurisprudence of the Supreme Court making clear that there is no aiding and abetting liability, demonstrating that a non -- a non-trading tipper, such as Mr. Freeman, is primarily liable under Section 10(b). That's point one.

In addition, I want to talk about now Section 20(A) as opposed to Section 20(a). I'm not going to -- 20(a). I'm going --

THE COURT: Yes, I.

MR. HOFFNER: I'm not going to address the Section 20(a). I think our brief stands on its own. Basically, the complaint alleges that Mr. Druker had sole management

authority, sole trading authority and that Mr. Freeman was just an employee and the cat is out of the bag in that regard. They can not now take it back and say that he was a control -- that Freeman was a control person of Sonar, and that claim, therefore, should fail.

But what's interesting is that -- is how they plead 10(b) and 20(A) in the alternative. Now, in 1988, Congress enacted the insider trading and securities fraud enforcement act, SFEA, and in that Section 20(A).

In response to cases that had found that there was no implied right of action under Section 10(b) against insider traders, alleged insider traders such as the defendants here who had no connection to the issuer, and, therefore, had no fiduciary duty that was breached as a result of that trading. But they -- but Congress explicitly laid out requirement restrictions on liability within Section 20(A), capped the damages, capped the defendant's potential exposure at disgorgement, and, in addition, gave defendants an offset against monies that they had already paid to the Securities and Exchange Commission -- something that's already happened with respect to Mr. Freeman here. So it's a pertinent fact. And that by doing that, basically, Congress was saying, you have a cause of action, contemporaneous traders, but you're subject to these limitations and these offsets. But the plaintiffs here were not content with living with Section 20(A). They insist

on bringing a Section 10(b) claim on top of that and arguing that that claim is not bound by the same restrictions as the 20(A) claim and that they -- and, therefore, the class of persons who traded in the securities of Sigma designs can go after these defendants for the entirety of their losses and not solely for disgorgement. And that's just not what Congress intended and that's not supported by the cases.

Now, the case -- notedly, they just ignore the cases that go, that make this clear. Just six weeks ago Mr. Haber was representing plaintiffs in a case in the District of Connecticut in which he argued the same points about the interplay of Section 20(A) and 10(b) in his brief, and the Court rejected that argument and threw out the case because he had not alleged, specifically alleged that the trades were contemporaneous because they weren't within the five to seven day rule that Mr. Hyland spoke about. That's the weight of authority, according to the Take Two decision in this Court. And that case, as well as the Motel 6 case, Judge Keenan's decision, also basically says that if you're going to have a Section -- if you insist on pleading 10(b) and 20(A), you can -- you know, maybe you can plead them both, but no matter what, your Section 10(b) claim is going to be governed by the restrictions of Section 20(A).

Now they cite, in response to this argument -- let me go -- excuse me. And there is one case that really is on all

fours with this case and that's the T. Rowe Price, New Horizons v. Preletz case from the District of Maryland, goes through the analysis and says, if you were to find that the 10(b) claim is not governed by the limitations on liability of Section 20(A), it would undermine the whole Congressional scheme. And that court finds that whether you want to let that claim be asserted in the alternative, or you throw out the claim, bottom line is if you got a claim, it's going to be governed by the restrictions of Section 20(A).

Now, there's been some confusion I think in the cases. They cite a number of cases, one from the District of Nevada, one from the District of Colorado that go through this analysis and say -- and relying on some language in SFEA and Section 20(A), which says that nothing in this Section shall be construed to limit or condition the right of any person to bring an action to enforce a requirement of this chapter or the availability of any cause of action implied from a provision of this chapter. And they rely on some cases that say, that specifically says, well, just because Congress was enacting this 20(A), didn't change anything, and if you had a 10(b) claim, you still have a 10(b) claim. I will note, however, in this circuit this circuit did recognize, prior to the enactment of Section 20(a), this type of claim, but under the Elkin case specifically limited damages to disgorgement. So it's almost a moot point. I think the law in this circuit would in any event

be that they're subject to the disgorgement limitation. But that case wouldn't at least have the SEC setoff applicable.

What's different about those cases is that those cases, the defendants really were pushing too far. Those were cases brought against officers and directors of issuers where the officers and directors had made, allegedly made false and misleading statements or were -- or there were actionable omissions. So of course those plaintiffs had what I'll call standard Section 10(b) claims against those defendants. And just by serendipity, because those defendants had also traded in the stock and, therefore, were subject to Section 20(A) liability, it wouldn't diminish their right under their standard Section 10(b) claim to seek the entirety of the class damages.

But here, as in the Preletz case, the 10(b) claim and the Section 20(A) claim are predicated on the exact same trade, same factual allegations of insider trading. These are not -- the defendants here had no relationship to the issuer, they're not alleged to have made any false and misleading statements about Sigma designs that fraudulently induced these plaintiffs to purchase the stock or not -- or have been responsible for actionable omissions in that regard.

So in that circumstance it makes perfect sense when the 10(b) claim and the 20(A) claim are predicated on the exact same conduct, that if you're going to allow a Section 10(b)

claim to be asserted in the alternative, it at least has to be governed by the restrictions of 20(A).

THE COURT: All right, I'm going to take the liberty of, you know, cutting you off at this point.

MR. HOFFNER: That's fine.

THE COURT: I think I have your essential argument. Let's go back to plaintiff's counsel to respond --

MR. HOFFNER: Thank you.

THE COURT: -- on the two points just made.

MR. HABER: Thank you, your Honor. I'd like to respond to Mr. Freeman, counsel for Mr. Freeman's argument that he was only a tipper and not a trader. And they would ask you to truncate liability for insider trading in a way that, to my knowledge, no court has ever done.

As your Honor has personal knowledge of the defendant before you, Mr. Gupta, last week, there was never a single allegation -- I only know what I read in the newspapers about the case -- there was never a single allegation that he traded on any inside information. He was alleged to be and convicted of being a classic tipper. And not only did that violate the civil securities laws, but it violated the criminal laws. And the simplest way to point out the fallacy in defendant's argument there -- give me one moment, please -- is that -- obviously, we all know that it was the Central Bank decision of the Supreme Court that held that -- bear with me one minute,

your Honor, I'm sorry -- that held that there is no cause of action for aiding and abetting under 10(b)(5).

The Court -- and it's interesting that the defendants don't cite the Central Bank in making this argument. They cite to two subsequent Supreme Court decisions. And I suggest that the reason they don't cite to Central Bank is because the language in Central Bank makes really quite clear that what the Supreme Court was talking about was not Mr. Freeman, all right. When it was talking about that an aider and abettor is not liable under 10(b)(5), they weren't talking about someone who participated in a scheme to defraud by inside -- by the purchase of inside information and use of it to trade like as alleged in the complaint and referenced through the testimony that I read you.

The Supreme Court drew a distinction between primary and aiding and abetting liability. And they said, aiding and abetting liability extends beyond persons who engage even indirectly in prescribed activity. Aiding and betting reaches persons who do not engage in the prescribed activities at all, but will give a degree of aid to those who do.

THE COURT: So, for example, Mr. Gupta was, in the substantive counts charging with securities fraud, was not charged as an aider and abettor.

MR. HABER: Yes.

THE COURT: He was charged as a principal.

One way, another way of looking at it -- forget about Mr. Gupta. The tipper is just as much a protagonist of the fraudulent scheme as the tipee, because under the law of the United States, they both have to receive benefits. And so the tipper, in many instances, will be the person who actually orchestrates the scheme. Sometimes it will be the tipee, but they are both essential to the scheme.

MR. HABER: Your Honor, I would observe --

THE COURT: So --

MR. HABER: I would just observe, your Honor, that on the facts of this case, one could really accurately describe Mr. Freeman as both a tipper and a tipee.

THE COURT: That's interesting, and perhaps correct.

But what about the second argument?

MR. HABER: Your Honor, the issue of the interrelationship between 10(b)(5) and 20(A) I think is -- fundamentally I would say is premature, all right. As counsel read, there is an explicit unambiguous statutory provision in Section 20(A) that says that -- in which Congress is saying by enacting this statute, we are not doing anything to 10(b)(5); we're not restricting it, we're not changing it, we're doing nothing to it. That statutory reference even says, any cause of action implied under 10(b)(5). So there is -- but I don't think there's any reasonable way to read that provision of 20(A), other than it doesn't affect 10(b)(5).

So then the question is, there different damages under 10(b)(5) under the facts of this case for the violation of 10(b)(5) if proven, and the violation of 20(A) if proven. We submit they may well be. Our claim would be the defendants -- it's undisputable under the law -- once they received inside information, they had a duty to abstain or disclose. If they wanted to trade legally, they first had to disclose. Had they disclosed, the market price would have changed, then they could've legally traded. But then the market would have corrected for the information they knew and the market didn't know, and our clients and the class would have sold, in this case at a higher price, because the disclosure would have caused the price to rise.

And one thing that Sonar's counsel and Mr. Druker's counsel mentioned earlier that I didn't want to very quickly respond to, where he was saying that in this case since the information wasn't supposed to yet be in the market place, the price of, the market price of Sigma stock was what it was supposed to be, that's an observation you can always make about insider trading. It proves nothing.

Your Honor, I think that there is -- I would just like to reiterate the fact that there is no question, as we stand here today, based on the allegations in this complaint, that we have more than adequately met our burden of alleging that the securities laws were violated. If there are any matters that

are lacking in this complaint, they aren't of the level that should cause this complaint to be dismissed. We should be entitled to proceed with this case. Thank you.

THE COURT: All right, thank you very much.

The Court will take the matter under advisement. I know there are many things that both sides did not have the opportunity to cover, but I think you have, all three of you, have very effectively framed many of the issues that were of most concern to the Court. And it's a very interesting case in terms of this motion, but I will try to get you a ruling promptly. So I thank all counsel, and the matter will be taken sub judice.

MR. HABER: Your Honor, I know it's late. I just want your Honor to advise as to when we should -- I'm going to be optimistic and assume the motion is denied. We obviously have a scheduling order that your Honor entered. We have now lost about two months of that without discovery. We served the discovery, as your Honor ordered, but it hasn't been responded to because of defendants' position that the automatic stay was in place. So I just want to alert the Court that this order, this schedule is no longer possible.

THE COURT: I understand that completely. We'll have to redo the schedule depending when I get my decision out, if the case goes forward.

MR. HABER: Thank you.

MR. HYLAND: Your Honor, it's not just our position that, you know, we're taking a position that discovery is stayed. It is said by statute.

THE COURT: No, no. What he's saying -- this is not worthy of any --

MR. HABER: I wasn't picking a fight.

THE COURT: Everyone understands that it's an automatic stay. What plaintiff's counsel was saying is that the schedule previously entered will have to be adjusted, of course.

MR. HYLAND: Okay.

MR. HABER: Thank you very much, your Honor.

MR. HYLAND: Thank you, your Honor.

(Adjourned)