UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v. 12 Civ. 5027 (PAC)

PHILIP A. FALCONE, HARBINGER CAPITAL PARTNERS, LLC and HARBINGER CAPITAL PARTNERS SPECIAL SITUATIONS GP, LLC,

Defendants.

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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v. 12 Civ. 5028 (PAC)

HARBINGER CAPITAL PARTNERS, LLC, PHILIP A. FALCONE and PETER A. JENSON,

Defendants.

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February 28, 2013
2:45 p.m.

Before:

HON. PAUL A. CROTTY,

District Judge

APPEARANCES

SECURITIES AND EXCHANGE COMMISSION (12 Civ. 5027)
BY: DAVID STOELTING
KEVIN P. MCGRATH
MARK D. SALZBERG

SECURITIES AND EXCHANGE COMMISSION (12 Civ. 5028)
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THE DONTZIN LAW FIRM
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DAVID A. FLEISSIG
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Attorneys for Defendant Harbinger Capital Partners, LLC and Harbinger Capital Partners Special Situations GP, LLC
BY: ERIC S. GOLDSTEIN
WALTER RIEMAN

(Case called)

THE DEPUTY CLERK: Counsel for the SEC, please state your appearances for the record.

MR. GOTTESMAN: David Gottesman and Bridget Fitzpatrick on behalf of the plaintiff SEC for case 5027.

THE COURT: Okay.

MR. GOTTESMAN: Good afternoon.

THE COURT: Mr. Gottesman and Ms. Fitzpatrick.

M.S FITZPATRICK: Good afternoon.

MR. STOELTING: Good afternoon. For the 5028 case on behalf of plaintiff SEC, David Stoelting, Kevin McGrath and Mark Salzberg.

THE DEPUTY CLERK: Counsel for defendants?

MR. DONTZIN: Yes, your Honor. The Dontzin Law firm on 5028 and 5027 for Philip Falcone. I am here with David Fleissig and Tibor Nagy from my firm.

THE COURT: Mr. Dontzin, how are you.

MR. GOLDSTEIN: Good afternoon, your Honor. Eric Goldstein from Paul Weiss for Harbinger defendants on 5027 and 5028, and with me is Mr. Walter Rieman.

MR. SIEVE: Good afternoon, your Honor. Brian Sieve along with Robert Pommer on behalf of Peter Jenson.

THE COURT: Okay, gentlemen.

Do you want to take up the letters of February 20 and 25 dealing with the confidentiality of the documents to be produced?

MR. McGRATH: That's fine, your Honor.

THE COURT: I don't need an awful lot of argument on this. Do you want to argue? Do you want to say anything?

MR. McGRATH: No, your Honor. We are content to rest on the letters.

MR. NAGY: Your Honor, as are we, only to the extent someone wants to see examples of the personal documents we brought a couple with us just as examples, your Honor. But, beyond that, we are happy to rest.

THE COURT: I take it there is no doubt that the defendants are going to produce the personally sensitive communications and personal financial information, correct?

MR. NAGY: That's correct, your Honor.

THE COURT: The question is how it will be handled from a procedural standpoint.

MR. NAGY: Exactly, Judge.

THE COURT: I think -- I don't think, I'm going to rule in favor of the defendants. I think the SEC procedure is not warranted and so I'm going to deny the SEC's application. And I gather that means the defendants' version of paragraph 1B will be in the protective order. Is that correct?

MR. NAGY: Yes, your Honor.

THE COURT: All right.

Now, how do you want to proceed -- let's go and do

5027 First. So, who wants to be heard on that?

MR. NAGY: Your Honor, Tibor Nagy for Falcone and the Harbinger defendants.

As we indicated, your Honor, in our letter, we have a few slides that I would like to refer to during the argument. May I approach to hand you a copy?

THE COURT: Yes, please.

MR. NAGY: Your Honor, I will call out numbers, they're numbered on the bottom right.

Judge, I would like to focus on three issues and those are the complaint's failure to allege a manipulative act, its failure to allege facts that establish the plausibility of the scheme that's alleged in this case, and finally, your Honor, the complaint's failure to allege omissions of fact as to which there was a duty to state. I will start, your Honor, with what the parties agree on in this case.

The parties agree that there is a well-established body of law governing market manipulation claims and both sides, your Honor, cite cases to you that are largely the same and say largely the same things. There are many of the same things in passages and one of the those passages bears repeating here. In ATSI the Second Circuit stated: Manipulation is virtually a term of art when used in connection with securities markets. The term refers, generally, to practices such as wash sales, manufactured orders or rigged prices that are intended to mislead investors by artificially affecting market activity. What we have here, your Honor, is nothing of the sort. There are no washed sales, no rig prices. What we have here, your Honor, is something that is not at issue in any other case in which no Court has ever held to be manipulative. The plaintiff calls it a short squeeze and the plaintiff defines it as a form of market manipulation that occurs when a trader constricts the available supply of a security with the intention of forcing settlement from short sellers at the trader's arbitrary and inflated prices. And so, on its face, your Honor, this scheme does not involve deception, it involves forcing parties who already committed to deliver securities who are already betting against a company to pay what the complaint calls arbitrary prices.

Now, what the plaintiff claims is deceptive here is principally the fact that the defendants acquired more than 100 percent of the float and didn't tell anyone that they did. They made that allegation repeatedly in the complaint, they refer to it repeatedly in their briefs.

Your Honor, I won't repeat what we have briefed already. We have discussed the issue, there is something worth citing today, Judge, and that is what does the law say on that issue? The plaintiff doesn't point you to any case that says buying or selling more than a hundred percent of the float in a security is somehow deceptive and, Judge, there actually is a case which we believe addresses exactly that point, that's the Sullivan & Long case from the Second Circuit which both sides point you to. That case, your Honor, is the mirror image of what is alleged to have happened here.

Here the defendants, of course, are alleged to have purchased more than a hundred percent of the float. In the Sullivan & Long case, which is a market manipulation case, the plaintiff complained -- the plaintiff was a long investor, the plaintiff there complained that a short seller sold short more than the entire supply of a security. There that short seller was alleged to have sold 170 million shares when a float only had 122 million shares all together. And what Judge Posner said, writing for a unanimous Seventh Circuit panel: So what? That's not deceptive. In his own words, your Honor, this is slide 2, the first slide after the cover, Judge Posner wrote, "Defendant was not required to disclose the number and the plaintiffs were not entitled to assume that defendant would not sell more shares than were outstanding."

And that, your Honor, is precisely what the plaintiff here is complaining about.

There is another passage from the ATSI case that bears repeating here, the Second Circuit said -- this is on the same page I quoted last time, "In essence, taking a short position is no different than taking a long position. To be actionable as a manipulative act short selling must be willfully combined with something more to create the false impression of how market participants value a security."

And here, your Honor, the only something more that this plaintiff complains about is this idea that the defendants also didn't lend their bonds out to short sellers, and they say in their brief the combination of those two things, that's what makes this especially deceptive. But again, your Honor, where is the law here to back that up? If you can't assume -- if you are not entitled to assume that an investor like the defendants here are not going to buy more than 100 percent of the float, you absolutely are not entitled to assume that a long investor with a large position might not lend its bonds to you. It is a perfectly reasonable thing for it to do. There is no obligation to lend to short sellers and there is no authority, your Honor, that even remotely says otherwise.

For that reason, your Honor, the failure to allege a manipulative act, you can and should dismiss this complaint.

THE COURT: So, your position is there is nothing in the law that requires you can't take a short position. You can take a short position, it is perfectly legal.

MR. NAGY: Yes, your Honor.

THE COURT: You can take a short position and not lend out the stock to enable others and then you can charge whatever price that you want.

MR. NAGY: Yes, Your Honor.

THE COURT: If they come to you.

So, you say that this is a perfectly normal transaction.

MR. NAGY: Absolutely, your Honor. It is a perfectly lawful transaction. Whether it happens every day, your Honor --

THE COURT: Well, I should have said lawful, not normal.

MR. NAGY: Yes, your Honor, it is absolutely lawful. In fact, Sullivan & Long says precisely that you cannot only go short but go short more than a hundred percent in that investors are not entitled to assume you won't do that.

Second, your Honor, this complaint doesn't have any facts, doesn't allege anything that would allow you to conclude that this scheme is plausible. Every single market manipulation claim that has survived a motion to dismiss, Judge, has one thing in common: They all have allegations that made their schemes plausible. You look at cases about painting the tape like the Crane case, you can read in that complaint how that works, what it is the defendant hoped to do, how painting the tape drives up prices and the defendant cashes in on profits. You read cases like Martino or any other cases of wash sales and matched orders. You can read in the compliant how the end game is how the prices go up and defendant makes a profit. They all have those allegations. This complaint absolutely does not. And this is an issue, your Honor, that these parties have been discussing for years. It is nothing new. It is just not there.

In their pre-motion conference letter to you, your Honor, the plaintiff took a very unique position. They said we don't have to give you a plausible scheme and they've since backed off of that a little bit. They now acknowledge that they are obligated to satisfy Twombly's plausibility requirement and yet they don't, your Honor. In their brief what they do, again, it is something unique, they don't say well, here is the answer. What they say instead, Judge, this is page 22 of their brief: One need not speculate about whether defendant's scheme could be economically rational because in fact defendants did sell mass zips at exorbitant prices resulting from their squeeze.

THE COURT: Where is that reference?

MR. NAGY: Your Honor, it is the bottom of page 22 and goes on to page 23.

THE COURT: All right.

MR. NAGY: And it continues on, your Honor, on page 23 on the top to say that establishes the plausibility of the SEC's charge. And there is a reference you will see, your Honor, in the brief there, to certain paragraphs in the complaint. Those are paragraphs referring to four sales. And so, the plaintiff relies on the fact of these four sales which they say establishes the plausibility of their complaint. That is a critical admission, your Honor, that answer in that brief, and the reason it is so critical is because it is absolutely clear those four sales cannot and do not establish the plausibility of this alleged scheme. Instead, your Honor, it is a dodge and the reason it is a dodge is if you look at slide 3, your Honor, there is a 500-pound gorilla in the room which the plaintiff does not want to confront and cannot confront. And let me start by telling your Honor what this is.

Slide 3 is a visual graph showing the allegations in the complaint plotted along time and by amount invested by the defendants. And it shows you, the complaint here alleges that the defendants start to invest in these bonds for perfectly legitimate reasons. Their analyst thinks this is a real upside to the bonds. They begin investing in April 2006, they make an initial investment of $2.25 million. They then put in a total of about $5.5 million of their investors' money in these bonds and these are not any bonds, your Honor, they are bonds that this complaint calls volatile and distressed so they had better have done their homework. And then, your Honor, the complaint alleges something really curious. On a dime in September 2006 all of a sudden there is no longer real belief in these bonds being a good investment. Instead, there is what the plaintiffs brief calls a darker purpose and that darker purpose, your Honor, is to manipulate the market and to make money by squeezing some unspecified number of shorts for some unspecified potential benefit. And then, your Honor, we simply plot the numbers from the complaint and you can see that whole big red block, that is for over a year a $90 million risk that these defendants are taking for some unspecified potential upside. I'm not talking about an attempt to manipulate a market and a failure, I'm talking about what could have happened on their best day.

THE COURT: Well, according to the allegations in the complaint when, in January of 2007, am I correct, that that's when you had an investment of $90 million and you had all the zips then?

MR. NAGY: Yes, your Honor.

THE COURT: Okay.

MR. NAGY: Yes. And so, from that time period forward, January 2008, and as you move forward, your Honor, you have a $90 million risk that entire time and there is a little white line you see beginning in July 2007 and what that is is the four sales that the plaintiff is relying on as establishing the plausibility of its scheme here, that tiny little white line, and then there is an additional three sales in January of '08, that white line doesn't even reflect profits, it just reflects the amounts sold. And the next slide, your Honor, is slide 4, you will see the four sales that the plaintiff here tells you establish the plausibility of its scheme. And what is really notable about them, your Honor, is (A) there is four of them; but (B) is the prices. The prices at which these happen, three of them occur in January 2008, they're all at about $60. This complaint tells you in order to get up to the $90 million total investment to buy more than a hundred percent of the float, the defendants here paid prices as high as $86. So, selling at $60 doesn't establish plausibility.

And again, your Honor, what we thought might be helpful to you was to find a case that addresses a similar scenario because we were surprised when we saw the answer in the plaintiff's brief and so we looked and we found something that we believe says something similar and that's slide 5, this is the *Feely* case, it is one of three similar cases in which a plaintiff says something quite similar to what the plaintiff here is saying.

The plaintiff in that case says: The plaintiffs there, they were property owners whose properties had been foreclosed upon, they said that the banks who made them the loans purposefully made undercollateralized loans because they were engaged in a scheme to drum up some unspecified amount of loan origination fees.

All three cases, your Honor, came out the same way and in the interest of disclosure, Judge, two of them were by the same Judge. There is two judges, three cases; but they all came out the same way. They all come out and say this is completely implausible under Twombly because, and I will quote the Feely case: The motion is granted in light of the complaint's utter failure to allege how the banks entering into a scheme to make undercollateralized loans would be in their self-interest.

The explanation that was missing, your Honor, is how do you address the huge risk of the principal.

THE COURT: I think I can answer the question that you say is unresolved, but.

MR. NAGY: Please, your Honor.

THE COURT: I'm not going to, but go ahead.

MR. NAGY: Well, Judge, here you have a risk that is just like the risk in Feely. You have this large $90 million risk just like the banks there had the risk of their principal and there is nothing factual that's alleged in this complaint that would make this scheme plausible and for that reason, your Honor, that second reason, you can and should dismiss the complaint.

Finally, your Honor, we have been talking about the scheme liability largely. I would like to talk for a moment about the omission liability, the allegations that there were omissions or misleading; they're interrelated but they bear mentioning here separately.

The plaintiff claims in addition to having a manipulative act there were omissions made by the defendants.

On page 12 of their brief they say: Defendants, at a minimum, omitted to state material facts necessary to make their statements non-misleading, and the question that arises is, your Honor, well, what are the statements that were misleading around what are the omitted facts? And so, what we have done, your Honor, is we tried to summarize them for you, the statements we put on slide 6, and there are essentially four statements, these are all from the complaint, and the first thing that strikes me about them, your Honor, is they're all statements made to Goldman Sachs.

THE COURT: Do you find any irony in the fact that the SEC is trying to help out Goldman Sachs?

MR. NAGY: Excuse me, your Honor?

THE COURT: Do you find any irony in the fact that the SEC is trying to help out Goldman Sachs?

MR. NAGY: Just a little, your Honor.

THE COURT: Just a little. Okay.

MR. NAGY: The first statement is made in the winter and spring of 2007. The defendants here say, they're alleged to have said: Defendants press Goldman for delivery of the bonds it had failed to deliver at settlement. That's the deceptive statement. Goldman had been paid for bonds it had been contractually committed to deliver them; it didn't; the defendant said please deliver the bonds.

Statement 2, May 2007, in response to Goldman asking whether it had any bonds to sell the defendants say: They will sell at 100.

3. September 2007 the defendants: Insisted that Goldman buy in the bonds. They still hadn't been given the bonds they paid for and they said they would: Be willing to settle with the shorts now at 105 and said that they had acquired approximately 190 million bonds. They just tell Goldman we own more than the entire float.

And finally, your Honor, the last misleading statement alleged is that the defendants told Goldman that they had sold a block of bonds and no longer owned the entire issue and still would like delivery of the bonds they paid for a year ago.

On the next slide, Judge, what we did is we tried to summarize what are the facts the plaintiff claims should have been disclosed to Goldman.

THE COURT: Let me ask you a question about paragraph 101 of the complaint.

In the winter and early spring of 2008 Harbinger and the Wall Street firm -- we now know what it is -- resolved their differences in a negotiated resolution.

MR. NAGY: Yes, your Honor.

THE COURT: What was the resolution?

MR. NAGY: They entered into a deal, your Honor, by which most of the sales were cancelled.

THE COURT: Okay.

MR. NAGY: And so, Judge, what we have done is we've summarized the omitted facts; they're here on slide 7. The first is the plaintiff claims the defendant should have disclosed the fact that they held more than a hundred percent of the float. We believe the Sullivan & Long case touched on that directly, there is no such duty. Second, the defendants should disclose their decision not to lend to short sellers. Third, they should have disclosed their internal analysis about what the bonds were really worth. And finally, your Honor, the plaintiff claims that they should -- the defendants should have disclosed certain facts about what the complaint calls the Christmas Eve transaction.

There is one key step, your Honor, that the plaintiff simply fails to do, it is an essential step, and that step is to ask and to look at whether there is a duty to disclose these facts and we believe, your Honor, they just didn't do that, they didn't confront, for example, the holding in the Sullivan & Long case that there is no duty to disclose whether you own more than a hundred percent.

Similarly, your Honor, there is no authority that says a hedge fund that's got its own duty to its investors has to disclose to someone on the other side of the table what they think is security they're trying to sell is really worth. No court has ever said there is such a duty and it would be strikingly counterintuitive to settled expectations, your

Honor, in this industry.

Similarly, your Honor, there is no authority anywhere that says you have a duty to tell a short seller that you are not going to lend your bonds. No Court has ever said that. In fact, there is a statute that says it is perfectly proper not only to not lend to short seller but that brokers and dealers are required to tell you you are not required to lend to short sellers.

Finally, Judge, this Christmas Eve transaction, we think this is simply a distraction, your Honor, and the reason it is a distraction is a follows:

The plaintiff here claims that what is deceptive about the Christmas Eve transaction which is the sale at the end of 2007 of several of the bonds for a penny, what was deceptive about it, according to the plaintiff, is that the defendants purportedly didn't tell them -- didn't tell Goldman that the broker didn't report the trade on trace and that the broker then didn't make the bonds available in the market.

Now, what is -- why this is a distraction, the reason this is not relevant is the plaintiff didn't allege and couldn't, your Honor, in good faith allege, that the defendants were even aware of those facts. The plaintiff could have came in and alleged that the defendants told the broker don't report this. They could have alleged that the defendants told the broker don't make the bonds available. They could have done that, your Honor, but they didn't because they could not, in good faith, make those allegations because they don't have a factual basis for them.

THE COURT: Okay. So I have your point here, Mr. Nagy. You say the scheme here is not manipulative because there is no deception.

MR. NAGY: Yes, your Honor.

THE COURT: The alligations are not plausible.

MR. NAGY: Yes, your Honor.

THE COURT: And there is no duty to disclose the omitted facts.

MR. NAGY: Yes, your Honor.

THE COURT: Let me hear from Mr. Gottesman.

Thank you very much.

MR. NAGY: Thank you, your Honor.

MR. GOTTESMAN: Good afternoon, your Honor.

THE COURT: Mr. Gottesman.

MR. GOTTESMAN: The SEC is bringing this case not to protect the interests of any particular investor, but to protect the integrity of the capital markets of this country.

The defendant's first point about there not being deception is mistaken. Manipulation can include any number of tactics to interfere with the natural forces of supply and demand in the marketplace, that's what we're really talking about here. A manipulation and interference with natural forces of supply and demand that cause prices to be rigged so we do have rigged prices here, the prices that defendant was demanding, prices that defendant received when it was selling the bonds after its manipulation began.

The defendants rely upon the Sullivan case, it's totally unlike this case. Sullivan involved a short seller who was purporting to sell more than the entire issue. We are not talking about a short seller selling more than the entire issue in this case, that's not the issue. This case involves somebody in the long position who is actually holding the bonds acquiring more than a hundred percent, making them unavailable for anybody --

THE COURT: Wait a minute. Wait a minute. Wait a minute.

MR. GOTTESMAN: Yes.

THE COURT: What is wrong with being long?

MR. GOTTESMAN: There is nothing wrong with being long. Nothing wrong with buying all the bonds you can find if that's all --

THE COURT: Given the way the market operates there is nothing wrong with buying more than the market has, right?

MR. GOTTESMAN: In this particular situation with corporate bonds where there is no recover requirement, right, that can happen.

THE COURT: So, that step is all right. You can go long and you can go long more than the market has.

MR. GOTTESMAN: Yes. I believe so.

THE COURT: Okay.

MR. GOTTESMAN: Right. What is important in this case --

THE COURT: Where do we get off the tracks now?

MR. GOTTESMAN: It is the combination of events and the non-disclosure of what was going on. You have to look at the combination of events; acquiring more than a hundred percent.

THE COURT: Okay. You can do that, right?

MR. GOTTESMAN: You can do that.

Making them unavailable by locking them up in a bank and then also --

THE COURT: Making them unavailable. You mean you can be long and you have to sell because you're long?

MR. GOTTESMAN: No. No, you don't have to sell because you're long.

THE COURT: Where is the requirement that you have to sell?

MR. GOTTESMAN: You don't have to sell.

THE COURT: Okay.

MR. GOTTESMAN: Again, it is the combination of these things combined with the non-disclosure of them -- let me finish.

So, it is getting more in addition a hundred percent, making them unavailable by refusing to let them be lent out for shorts to cover.

THE COURT: I thought you said you didn't have to let them out.

You keep on saying this. You can go long and you don't have to tell.

MR. GOTTESMAN: Right.

THE COURT: So what is the combination?

MR. GOTTESMAN: The continuing on, they continue to make them unavailable they went out and purposefully exercised reverse repo transactions to take any other bonds that were in the marketplace out of circulation so short holders also could not get those, again to make it impossible for shorts to cover their positions. Then, again, it is a combination of these events --

THE COURT: Well, what is wrong with the shorts going out in the same market that Harbinger was participating in to buy the max zips?

MR. GOTTESMAN: The shorts could do that.

I'm saying the defendants went out, they took any bonds that were out there possibly available for borrowing, used reverse repo transactions to take those out of the market so the shorts had no way to get the bonds except buying them from defendants. Then the defendants pressured the shorts to cover their positions. The defendants demanded exorbitant prices.

THE COURT: Shouldn't somebody in a short position cover their position? Isn't that what the law requires?

MR. GOTTESMAN: Normally they should cover their positions. They shouldn't have to pay rigged prices that exist only because somebody has manipulated.

THE COURT: What is the rigged price here?

MR. GOTTESMAN: The rigged price is a price that the defendants unilaterally set at exorbitantly high levels.

THE COURT: Those are conclusory terms.

MR. GOTTESMAN: Yes. It is our conclusion of what they were. They were prices that bore no relation to what these bonds would be worth in the marketplace.

If you look at the --

THE COURT: We don't deal in conclusory allegations. I mean, you have to be plausible, right? You have to show facts that support the claim.

MR. GOTTESMAN: Well, we do. In a complaint, for example, we allege that there was a class of senior bonds to the bonds that we are talking about in this case --

THE COURT: Right.

MR. GOTTESMAN: -- which are called the zips. There was a senior class of bonds that because of the structure of the bonds and the structure of the company the senior bonds would be worth more and would command a higher price than the zips.

THE COURT: Yes; and they flip.

MR. GOTTESMAN: Here they flipped and they flipped only because of the manipulation; the only reason anybody was paying more for these junior bonds which were not backed by any assets unlike the senior bonds which were backed by assets. There is no democratic, financial reason why these junior zips would trade for more money than the senior bonds. It makes no economic sense. The only reason it would happen is because somebody was manipulating the market and causing it and that's what we allege in the complaint. It is a specific fact.

THE COURT: Tell me, Mr. Gottesman, what is the danger to the capital markets from this conduct that Harbinger engaged in?

MR. GOTTESMAN: The danger is that you don't have natural force of supply and demand dictating the price. You have somebody who went out and cornered the market.

THE COURT: What do you mean you don't have supply and demand? You have restricted supply and unlimited demand. I mean, I'm having difficulty seeing exactly where the wrong occurred here.

MR. GOTTESMAN: Because the normal functioning of the market doesn't involve one person acquiring all of the supply of something, locking it up so it can't be used, going out and demanding excess prices when he doesn't tell anybody that that's going on and that's the key here. It was the deception of what he did -- what the defendants did. Acquiring the bonds, making them unavailable, demanding exorbitant prices and then not disclosing that's what they were doing at the same time that they were going out and affirmatively pressuring the shorts to cover the positions.

When the defendants went out and spoke to the shorts and said you must cover this position, I demand that you cover this position and didn't at the same time disclose the manipulation that they had caused, that's where the deception was.

THE COURT: The deception it may have caused is buying up all the zips.

MR. GOTTESMAN: Buying up all the zips, making them unavailable and causing exorbitant prices.

THE COURT: These are the component parts. I mean, I have been asking you about the component parts and you say each one by itself is all right, it is only when you get them all together.

MR. GOTTESMAN: When you get them all together and don't disclose them at the same time you go out and make a demand.

THE COURT: How should disclosure have taken place? Announce to the world we have all the zips now?

MR. GOTTESMAN: At a minimum, when they went to any short holder and made a demand of cover or made a demand for price, they should have disclosed. When they went to a short holder --

THE COURT: What use is that information?

MR. GOTTESMAN: Because then the short holder would know, wait a minute, they have all of the bonds and they're demanding a price that's above the seniors. They're manipulating the market and dictating a rigged price. That's what's going on. That's what the short would have known. Because it didn't disclose that to the shorts the shorts had no way to know that the only reason that these prices were so high was because of the defendants' manipulation. That's why, for example, when Goldman, the largest short holder, saw reports that some people had purchased these bonds at 60 in January 2008 but didn't know that the defendants were the seller, Goldman was willing to go out and buy them also at about 60 because they didn't know.

The defendants never told them the defendants had been pressuring them to cover but the defendants didn't say: But, by the way, in fairness you should know, we're the only people who are selling these. We're dictating the price. Nobody can buy them except from us and we're going to say what the price is.

THE COURT: Armed with this information what would they have done then?

MR. GOTTESMAN: They would have refused to cover as they had done previously because until they saw some trades in the marketplace there is a public report called Trace that shows trades in the market. Until they saw trades actually happening at 60, Goldman was not willing to pay that price because they had learned by then that the defendants had more than a hundred percent.

And so, once they learned that they said, well, we can't participate in the market manipulation so we are not going to cover this, we're not going to buy. Then the defendant claimed that he had released some into the market. He didn't tell them it was to a long-time associate for a penny at the same time that the defendant was demanding a price that was 600,000 percent higher. The defendants disclosed that and then Goldman said, well, if you hold more than a hundred percent of this you control the market, you're manipulating this, we're not participating, we're not buying.

A few weeks later Goldman saw that a couple of trades took place in the market at $60 and in light of all that information it appeared that the market had freed up, the defendant was no longer the sole seller and in fact somebody from the defendant told Goldman they were not the seller of those bonds at 60 so Goldman went out and itself bought. So, there is an instance where because they did not have full disclosure of what the defendants had done --

THE COURT: You say Goldman itself went out and bought. Where did they buy?

MR. GOTTESMAN: They bought through an intermediate broker and they came from the defendants -- the bonds themselves came from the defendants, were sold to Goldman through the intermediate broker. So, they didn't know the identity of the seller and that's the way bond transactions often take place over the counter. It is done through intermediate brokers and you don't have visibility into who the seller is. That's just the way the market works with these.

Anyway, so it is the combination of events together with their non-disclosure that led to a manipulation and a manipulation of the market causing short sellers to in fact go out and actually buy bonds and at prices that had no economic justification based on the financials of the company. But, because defendants hadn't disclosed their role in manipulating the market, the market reflected some transactions that caused people to not understand the extent of the defendant's manipulation.

Now let me talk about the plausibility issues.

We only have to allege a scheme that's plausible on its face and what is important in an SEC enforcement action such as this is that a manipulation doesn't have to be financially profitable for it to be actionable. If somebody wanted to manipulate the market not to make a profit but because they hated capitalism, they hated the free market, they wanted to mess it up, would anybody seriously contend that the SEC doesn't have the ability to bring an enforcement action against that person?

If somebody went in and manipulated the market just out of pure spite to get even with market participants, would anybody seriously contend that the SEC could bring an action against them regardless of whether they could make money?

THE COURT: So, it doesn't have to be profitable to be --

MR. GOTTESMAN: It doesn't have to be profitable to be plausible.

THE COURT: Why is it plausible here?

MR. GOTTESMAN: It is plausible here because the law says that we can show a plausible scheme through a number of means. You know, this gets into the scienter element where we show the motive and opportunity that we have, we have facts showing that. We show that what the defendants were trying to do here, in part, was to get even, to act out on their anger against Goldman for having short positions that they were not covering. We allege facts in the complaint establishing that. We allege facts in the complaint establishing that defendants decided they wanted to control the market in these bonds and manipulate the market in these bonds and we allege specific facts showing their knowledge of that. And, in fact, this doesn't need to be but it could have been economically profitable if defendants had been able to sell enough bonds at a high enough price. We see allegations in the complaint that the defendants were out there demanding extraordinarily high prices and at the same time that the defendants were demanding prices of not only 60 but a hundred and over a hundred, at that same time the defendants, within a very short period thereafter, were selling to a long-time associate for a penny.

THE COURT: Do you allege, Mr. Gottesman, that Mr. Falcone and Harbinger in fact did make money on this?

MR. GOTTESMAN: Ultimately they had a net loss on this.

THE COURT: So, they had a net loss because Goldman Sachs refused to do the deal and they cancelled the transaction?

MR. GOTTESMAN: Well, not enough short holders or others actually went in and succumbed to the manipulation. If more had -- if enough had maybe they could have made money. If enough short holders had gone into the market and bought these bonds at a high enough price -- and defense were trying to get people to buy at a hundred, even 105 as we allege in the complaint, if they had sold enough bonds at that price --

THE COURT: Did they sell any at that price?

MR. GOTTESMAN: I don't think they sold any at that price. At that price they sold some as high as $95 on July 30, 2007. As we allege in paragraph 76 they sold some bonds at $95. At the same time they were marking them down on their books as low as $40.

So, yes, they he were able to sell a number of the bonds at a high price, not enough to make a net profit but they didn't need to. And we allege in our complaint, or at least we cite some cases to the effect that --

THE COURT: You mean they didn't need to as a matter of law.

MR. GOTTESMAN: As a matter of law.

One of the cases we cited essentially stated that a defendant is not relieved of liability simply because he is unable to unload all of the securities at a high enough price. And that is certainly true here.

So, certainly it was plausible, both in terms of a scheme just to go out there and control and manipulate out of anger, spite, whatever, which is certainly something the SEC is entitled to enforce; and secondly, it was a potentially financially profitable deal. Ultimately they didn't succeed enough at their fraud so they didn't make the profit, but that doesn't excuse them and doesn't get them off the hook.

THE COURT: Do you want to say a few more words about the duty to disclose?

MR. GOTTESMAN: Sure.

There were two failures to disclose here. One, the failure to disclose the overall scheme. We cited a number of cases in our brief establishing that somebody who engages in market manipulation has a legal duty to disclose the fact that he is doing that. And the failure to disclose it itself triggers liability, we cited the Crane case which was a Second Circuit case from 1969 establishing that fact. We cited several other cases.

The defendants argue --

THE COURT: So in your view, Mr. Gottesman, what should they have disclosed?

MR. GOTTESMAN: They should have disclosed all the facts surrounding their manipulation.

THE COURT: Don't use the word manipulation.

MR. GOTTESMAN: Okay. Factually.

THE COURT: What are the facts that should have been disclosed?

MR. GOTTESMAN: They should have disclosed we hold more than a hundred percent of these. We are not allowing them to be borrowed by anybody, the only way to get these is by buying them directly from us. The prices we're demanding have no relationship to the economics at all, we're just setting as high a price as we can possibly set, and --

THE COURT: And each one of those steps, now, we have agreed, are lawful in themselves? A holder of a product of a stock can say I want a hundred for it. You can say it is not worth a hundred. That's my price; if you want it, you have to give me a hundred.

MR. GOTTESMAN: Yes. I would say that's correct, each of those things standing in isolation, but the law has a lot of things in which isolated acts, standing by themselves maybe are okay, but when you put them together, maybe they're not, because all together they form a scheme and a plan and something that is deceptive and that's what we have here.

So, all of those acts together, the failure to disclose those, that's one type of deception that the law recognizes. The second are the specific misleading omissions. Again, even if it had been all right -- even if it had been all right, just for the sake of argument, to not disclose what they were doing overall when they affirmatively went out and made statements to the short sellers, that triggered an obligation to tell the full and complete truth of the facts surrounding the events and not leave anything out and we cite the case law to that effect. When you choose to speak you have to speak truthfully about the material issues. Your speech must be both accurate and complete and we cited the Caiola v. Citibank case, Second Circuit 2002 for that principle.

So, when the defendant went out and made demands upon the shorts that they covered their short positions, they should have disclosed, to be honest with the shorts, that the defendants held all the bonds and the shorts wouldn't be able to cover them to cover the short positions without buying at the defendant's high prices.

When the defendants went out and demanded prices that bore no relation to the economic realities, the defendants had an obligation to tell the full truth about the prices they were demanding, that these bore no relation to the finances of the company --

THE COURT: They had an obligation to say I'm sticking you?

MR. GOTTESMAN: Pretty much. They had an obligation to say these prices are things we're unilaterally setting because we can. You can't get these anywhere else, we have made sure of that, and we're going to stick it to you and we're going to demand these prices.

THE COURT: Thank you, Mr. Gottesman.

Mr. Nagy, do you want to take two minutes to reply?

MR. NAGY: Yes, your Honor. Thank you.

THE COURT: Thank you, Mr. Gottesman.

MR. NAGY: Your Honor, very briefly on the sales because these four sales are the thing the plaintiff is relying on to establish plausibility. I want to clarify something Mr. Gottesman said. He mentioned at one point defendants were out there trying to get higher prices. I want to clarify here the defendants never went out and solicited prices from anybody. The sale at 95 in July 2007, that was an open market transaction. The defendants here don't even know who that purchaser was. They certainly didn't go out and say: Hey, buy at 95. It just didn't happen.

THE COURT: What paragraph is that again?

MR. NAGY: Paragraph 76, your Honor.

THE COURT: So that is an open market transaction?

MR. NAGY: Absolutely, your Honor.

THE COURT: It is alleged to be an open market transaction.

MR. NAGY: That's correct. There is no solicitation by defendant at that price.

The other three sales, of course, all happen after the defendants told Goldman that they own a hundred percent of the float. We contend Goldman has no entitlement to assume that is never going to happen but even if they did those three sales all happen after that fact and those three sales, your Honor, all happen at 60, prices lower than these defendants paid to acquire the bonds here.

Mr. Gottesman mentioned that there is a duty to disclose and he kept saying that, your Honor, but he couldn't point you to any cases. No Court has ever held there is a duty to disclose something like your price analysis internally. They just don't have the authority for that, your Honor. You would be the first Judge ever to hold --

THE COURT: What is the value in being first?

MR. NAGY: Very little in this case, Mr. Nagy.

THE COURT: All right.

MR. NAGY: Only if you're right, your Honor. Only if you're right.

Finally, your Honor, only as to plausibility I didn't understand the answer you got other than to say if the motive here was to get even with Goldman, then that's perfectly okay, they can still come after the defendants. But, your Honor, they can't have it both ways, it is one way or the other. Was that the motive or was it the motive to make a profit? Their complaint seems to say there was a motive to do both but now I think what we hear Mr. Gottesman saying is there wasn't a profit motive, this was purely in spite of Goldman because Goldman had been acting contrary to the defendants' interests and the defendants, of course, were Goldman's client.

THE COURT: Thank you very much, Mr. Nagy.

MR. NAGY: Thank you, Judge.

THE COURT: Mr. Dontzin, do you want to be heard on the loan in the preferential treatment?

MR. DONTZIN: Yes, your Honor; if we haven't completely worn out our welcome already.

Your Honor, with the Court's permission, I would like to hand up a couple of slides.

Your Honor, I am here on behalf of Mr. Falcone and the

Harbinger Funds, collectively the Harbinger defendants. This case, 5028, is unique in that it alleges two entirely distinct sets of facts. Actually, sort of two cases within one.

THE COURT: You have your own statement of facts here.

MR. DONTZIN: And I'm not going to go through any of the facts.

THE COURT: Because we can take the facts as alleged in the complaint as true, correct?

MR. DONTZIN: We have to, your Honor. Absolutely.

THE COURT: And all the inferences that can be favorably drawn from that as well.

MR. DONTZIN: All those that are plausible, yes, your Honor.

THE COURT: Why don't you tell me why a loan, made without disclosure to when there is a lockup going on, is not the kind of thing -- it is a kind of self-dealing that at a bare minimum has to be disclosed.

MR. DONTZIN: Sure, your Honor.

My only argument today, and it will address that precisely, is the question of whether the plaintiffs have satisfied the in-connection-with requirement that is required for both 17a and 10b and 10b-5.

With respect to the loan, they cannot make out the in-connection-with requirement for either --

THE COURT: So it is okay for somebody like

Mr. Falcone to borrow a hundred million dollars from Harbinger?

MR. DONTZIN: Yes, your Honor.

THE COURT: Really? It is not a sale within the meaning of?

MR. DONTZIN: No, your Honor.

THE COURT: The pledge isn't?

MR. DONTZIN: The fund itself was a lockup so there was no sale of securities with respect to the fund itself. The only --

THE COURT: You keep on saying that in the papers, about the value of the lockup, but the fact of the matter is the lockup makes it worse because Mr. Harbinger got and Mr. Falcone got his money out and nobody else could.

MR. DONTZIN: No, your Honor, he didn't get it out; he borrowed it and then he paid it back with interest.

THE COURT: Was that available to anybody else?

MR. DONTZIN: Was it available to other investors in the fund? No, your Honor.

THE COURT: Okay.

MR. DONTZIN: It was not.

THE COURT: Isn't there something wrong with that?

MR. DONTZIN: No, your Honor. There isn't.

THE COURT: Why not?

MR. DONTZIN: Because there has to be an in-connection-with requirement. You have to have a fraud, you have to have a sale in the security which they've argued, principally, is the pledge or the loan.

THE COURT: Yes.

MR. DONTZIN: Beyond you have to have in-connection-with the two, and they don't make that out. There are cases with respect to a loan, your Honor, are governed by the United States Supreme Court case in Reeves. There are four factors that would determine whether or not the loan qualifies as a security. We have gone through the four factors in our papers, I'm happy to tick them off now, your Honor, they're at slide 3 of your packet and the plaintiffs don't make out any of the four requirements.

THE COURT: That's for the loan.

MR. DONTZIN: That's correct.

THE COURT: What about the pledge?

MR. DONTZIN: I think the road is much tougher with respect to the pledge.

THE COURT: Really?

MR. DONTZIN: It is some dense reading, your Honor, to fully understand why that's the case, but it certainly is the case that the pledge does not qualify. And I'm happy to take your Honor through that argument.

THE COURT: Take me through it, please.

MR. DONTZIN: Thank you, your Honor.

First, your Honor, you have to ask whether the pledge is in fact a security. That's one of the requirements. So our position, your Honor, is that while the pledge is indeed a security under the Ruben case -- and we have no quarrel with that -- Ruben only gets them halfway. So, now we have an alleged fraud, we have got a security, but the plaintiff still needs to demonstrate that the security and the fraud were in connection with one another and they can't make that showing and they rely on Zandford to get them across the line. That doesn't do it. The case here is Chemical Bank, Second Circuit --

THE COURT: And not Zandford?

MR. DONTZIN: Not Zandford, your Honor.

THE COURT: Why not Zandford? It is certainly more recent than Chemical Bank. It is in the Supreme Court but not in the Second Circuit.

MR. DONTZIN: I certainly understand.

THE COURT: Yes.

MR. DONTZIN: Zandford doesn't get them there. I'm happy to address Zandford. Zandford was a scum ball broker who --

THE COURT: Who robbed --

MR. DONTZIN: Who robbed an elderly man who had a mentally disabled daughter, took $412,000 --

THE COURT: Right.

MR. DONTZIN: -- entered into -- had a power of attorney, full discretion over the account --

THE COURT: Yes.

MR. DONTZIN: -- bought securities. Immediately upon selling the securities what does Zandford do? He pocketed all the proceeds.

THE COURT: That's right.

MR. DONTZIN: After four years, no money left. But, the Court in Zandford which I think, your Honor, frankly helps us here, said specifically, and I will quote, your Honor, in that case the court held the scheme satisfied the in-connection-with requirement because the security sales and respondent's fraudulent practices were not independent events. Rather, respondent's fraud coincided with the sales themselves at 820, your Honor.

Here, in sharp contrast, the alleged fraud, the misrepresentations and omissions about the loan, they're not about the pledge, your Honor. There is no allegation that there was misrepresentations and omissions about the pledge, it is about the loan. Those don't coincide with the sale. That's what makes it fatal. In fact, the complaint does not allege that anyone was defrauded in connection with the pledge. All of the misrepresentations and omissions to investors alleged in the complaint occurred -- very importantly, your Honor -- after the pledge was made. So, how could the pledge have induced the fraud or vice versa? How can the fraud --

THE COURT: Under Zandford they coincided.

MR. DONTZIN: That's right, but here they didn't, your Honor. No temporal relationship. And the pledge had nothing to do with what the misrepresentations were made with respect to the loan. These are completely distinct and that's why, your Honor, we think that Chemical Bank does in fact control.

THE COURT: This is what I'm really having trouble with, Mr. Dontzin.

MR. DONTZIN: Yes, sir.

THE COURT: Tell me why, during the period of lockup, Mr. Falcone can get a loan from Harbinger when nobody else can and he doesn't disclose it.

MR. DONTZIN: Your Honor, he does disclose it.

THE COURT: No. No. No. No. He doesn't disclose it at the time.

MR. DONTZIN: He doesn't disclose it at that time.

THE COURT: He disclosed it after it is done.

MR. DONTZIN: That is certainly true, your Honor.

THE COURT: After he has been told you shouldn't do this by his outside counsel and he gets another law firm in to give the blessing.

MR. DONTZIN: Your Honor, I know I'm bound by the facts alleged in the complaint --

THE COURT: Yes.

MR. DONTZIN: -- obviously, and if we have to have a day in court, that would be hotly disputed, but I understand your Honor's position, you have to accept the facts as alleged.

THE COURT: I should be very clear about this. I'm accepting the facts as alleged in the complaint as true.

MR. DONTZIN: I understand that.

THE COURT: I don't know whether they're true or not. You say they're not but that's not what we are here for today.

MR. DONTZIN: I totally understand, your Honor.

THE COURT: You have to accept them as true.

MR. DONTZIN: Yes, your Honor. I understand.

Our position is that the loan was absolutely lawful. The question is whether or not the failure to disclose for five months was in connection with the pledge because the loan won't qualify as a security for the in-connection-with requirement under either Ruben or Zandford or Chemical Bank and Chemical Bank is good law. They say it isn't. They say it is not after Zandford but that case has been cited after -- Zandford was decided in 2004 by this Second Circuit and 2010 by the Ninth Circuit so that's still good law and Chemical, your Honor --

THE COURT: Are you familiar with the Latin maxim of *nemo iudex sui causia*?

MR. DONTZIN: I don't, your Honor.

THE COURT: Did you go to Harvard? I will translate for the Harvard guys here.

MR. DONTZIN: Thank you.

THE COURT: It says no man can sit in judgment of himself. So, I am having very grave difficulty saying how could Mr. Falcone make a loan to himself at what the SEC alleged to be preferential rates without disclosing it.

MR. DONTZIN: Your Honor, again, there were lawyers all over this. This was disclosed five months later in the year end audited financial state.

THE COURT: In a footnote.

MR. DONTZIN: It was absolutely lawful. The taking of the loan was lawful. There is no an allegation in the complaint that says the loan itself was unlawful.

THE COURT: No, the pledge.

MR. DONTZIN: Yes. The allegation is that they're not saying that the pledge was unlawful. They're not saying that the loan was unlawful. They're saying that the conduct, the disclosure in connection with the pledge and the loan were unlawful and the difficulty, your Honor, and I know they can't get around it, there may be a cause of action by investors that want to complain who were here with the SEC, for a 10b or a 17a, they've got to allege that the fraud and the sale were in connection with one another. They can't make it out on the loan based on Reeves and, respectfully, they can't make it out on the pledge based on Zandford, Ruben and Chemical Bank. The pledge was but the part of a larger transaction says Chemical Bank, and under those circumstances it is not a qualifying security for in-connection-with. That's the law, your Honor. And it is the law after Zandford in a case in the Second Circuit in 2004 and in the Ninth Circuit in 2010.

THE COURT: After the loan was disclosed on March 10th of 2010 there were representations made as to which the SEC says were inaccurate and misleading.

MR. DONTZIN: I understand that.

THE COURT: What about those?

MR. DONTZIN: Respectfully, your Honor, same procedural difficulty. We're not sitting here arguing whether there was a fraud, your Honor. We're arguing whether there is a violation of a securities laws under 10b, 10b-5 and 17a. And all those representations dealt with the loan, they didn't deal with the pledge and, again, they're stuck under Reeves because the loan was not a security no matter how much they hope it to be. That's exactly the teaching of Reeves, your Honor. They can't make those tests. The best they do is hang their hat on the fourth prong of the Reeves test saying, well, there is no other regulatory regime that would regulate this particular loan.

THE COURT: I view them as saying they satisfy 1 and 3.

MR. DONTZIN: Your Honor, again, I'm happy, very quickly, to take your Honor through the Reeves factors.

Let's take 1, for example, the motivations that would prompt a reasonable seller and buyer to enter into the transaction.

THE COURT: Slide 3.

MR. DONTZIN: Thank you, your Honor. Yes.

So, the Supreme Court gives guidance itself in Reeves on that factor. It says, and I'm quoting, your Honor: If the note is exchanged to correct for the seller's cash flow difficulties, the note is less sensibly described as a security.

That's this case, your Honor. There can be no dispute that the purpose of the loan was to address Falcone's cash flow difficulties and the plaintiff says so in paragraph 2 of the complaint.

THE COURT: So, a man who has an obligation to look out for the interest of Harbinger and put those interests first, because he is having cash flow difficulties can take the money?

MR. DONTZIN: Absolutely, your Honor.

You know, your Honor, I understand we have to accept the complaint as pleaded and we can, but what do we know about this? We know that nobody got hurt on this loan, the investors got paid back.

THE COURT: Well, listen. You can't take money from your escrow account. I couldn't when I was in private practice, even if we paid it back. And the defense is not that nobody got hurt because I paid it back before I got caught. You can't do it.

MR. DONTZIN: Well, respectfully, your Honor, nobody got caught (A) and (B) an escrow account isn't the Harbinger fund where it was carefully documented by a world-class law firm.

THE COURT: It was an analogy.

MR. DONTZIN: That part I understand, your Honor.

THE COURT: All right.

MR. DONTZIN: I'm happy to deal with the second prong of the case, the preferential.

THE COURT: Sure. Go ahead.

MR. DONTZIN: Thank you.

THE COURT: Plan of distribution of the incident.

MR. DONTZIN: Yes, your Honor.

The third factor, that is the reasonable expectations of the investing public, that's the third factor, your Honor, right? And here we submit that no member of the investing public would expect the loan to be considered a security because it is not something they can invest it and it is not transferable. Compared to the notes at issue in Reeves which the Supreme Court held were securities, in that case the notes were offered and sold to a broad segment of the public. In fact, your Honor, quoting in Reeves they were distributed to more than 1600 people and they were held by them. The contrast to this case couldn't be any more stark. No notes were even issued in connection with the loan and no member of the public was solicited to invest in connection with the loan. So, that knocks out factor three.

And the fourth factor, your, the lack of risk to the fund also weighs strongly in our favor. The last factor is whether some factor reduces the risk of the instrument thereby rendering application of the securities act unnecessary.

Here, the loan itself is designed to eliminate any risk to the fund since it was collateralized by Mr. Falcone's interest in the fund and backed by Mr. Falcone's own net worth when he signed the loan agreement in his personal capacity.

So, this collateral argues against the loan being considered a security and we rely on the Sixth Circuit case of Bass v. Montgomery for that proposition.

Your Honor, so again, they don't meet the in-connection-with requirement either for the pledge or for the loan. If you would like, your Honor, I will take you through the second sort of case within a case dealing with the preferential treatment claims.

THE COURT: Yes, please.

MR. DONTZIN: Thank you, your Honor.

As your Honor is now well aware, the plaintiff's claims relate to a March 2009 vote for change in the redemption provisions of a distinct Harbinger fund, it is Harbinger Fund

HCP fund 1 which is not implicated in the first aspect of the complaint dealing with the loan.

THE COURT: The loan was from SSF, correct?

MR. DONTZIN: Yes.

THE COURT: The Special Situation Fund.

MR. DONTZIN: That's correct, your Honor. Absolutely.

And the change that was being proposed with respect to the gating position --

THE COURT: From 20 percent to 25 percent.

MR. DONTZIN: The purpose of the change was to protect investors from losses as a result of the fund having to sell assets at a fire sale, at fire sale prices to meet high redemptions which arose after the collapse of the financial markets in 2008 when Lehman went under in September.

THE COURT: Right.

MR. DONTZIN: The purpose was not to provide any improper benefit to the Harbinger defendants and the complaint doesn't say otherwise. In fact, the proposal also included a provision giving investors the benefit of a 7 percent hurdle rate they hadn't enjoyed previously so there was a high water mark of 7 percent you would have to get to before the fund could actually take performance fees. So, that is the backdrop.

Now, plaintiffs claims relate to certain side letters and agreements defendants entered into with three large investors granting them preferential liquidity allegedly in exchange for their vote in favor of the gating proposal and the complaint does not allege that this conduct was unlawful. To be clear, the HCP Fund 1's governing documents permitted the fund to grant preferential redemption treatment to investors and the complaint itself concedes that at paragraph 85. Because the plaintiffs can't assert claims based on the terms of the side arrangements, they instead look to the Harbinger -- they look to the side letters and, again, it is a disclosure issue, the failure to disclose the side deals to other investors in the fund and to the board of directors, two guys sitting in the Cayman Islands. But, plaintiff's claims fail for lack of scienter and I just want to argue two minutes on scienter, your Honor and I will sit down.

THE COURT: Are you going to tell me why if I am not investor A, B and C who have these side agreements, I am investor D through Z, why I'm not interested in knowing that A, B and C have different terms that are being made available to them?

MR. DONTZIN: Your Honor, the fund documents -- and it is not contested -- the fund documents absolutely permit Harbinger to enter into side letters. That's not in dispute. It is what they're saying is somehow we had a duty to disclose that and we had sufficient scienter to meet the standards on the Second Circuit. I'm only arguing the scienter point.

THE COURT: Okay. Go ahead.

MR. DONTZIN: Okay. So, again, the standard set forth at slide 6, your Honor, in Shields which is the strong inference standard.

Now, as we know, your Honor, until just Monday of this week plaintiffs argued that the strong inference standard doesn't apply to enforcement actions brought by the SEC. That was their position until they sent a letter to the Court and we got a copy.

THE COURT: I got a copy of that.

MR. DONTZIN: Now, there is no doubt that the Second Circuit's strong inference standard plies. Here the preferential treatment claims fail to satisfy the standard in Shields and plaintiffs had two ways of going about this to try to meet the standard. One, they have to show motive and opportunity which they didn't do and they don't mention in their opposition brief but, regardless, dealing with the second prong, they both require a strong inference standard. Let me explain how the complaint fails to meet either prong of the Shields test.

In our opening brief, your Honor, we demonstrated that to satisfy the first prong, motive and opportunity, the plaintiffs had to allege facts showing that the Harbinger defendants benefitted in some concrete and personal way from the purported fraud. And here, of course, they can't meet that standard because there are no allegations in the complaint that the Harbinger defendants personally benefitted from the preferential treatment scheme. Plaintiffs have apparently conceded this point, doesn't address it in the opposition brief. Instead they're relying on the second prong of the test in Shields, your Honor, and that's that the complaint alleges facts that constitute -- quoting -- constitute circumstantial evidence --

THE COURT: Strong circumstantial evidence.

MR. DONTZIN: -- strong circumstantial evidence of conscious misbehavior or recklessness and that is a very high standard. The Court in ECA, the Second Circuit case observed: The absence of improper motive means that the strength of the circumstantial allegations must be correspondingly greater. At 199.

The Second Circuit's decision just last year in Gould v. Winstar, the most recent recitation of the elements to satisfy the conscious misbehavior test, and that's at slide 7, your Honor. As the Second Circuit held in Gould, to meet the conscious misbehavior test a plaintiff must allege deliberate illegal behavior or, said differently, a scheme that is necessarily going to injure -- injure is the key, your Honor. The standard for recklessness is equally high. A plaintiff must allege that the defendants have engaged in conduct that was highly unreasonable representing an extreme departure from the standards of ordinary care. And the facts of Gould are instructive because there I think that case was against Grant Thornton, an auditor, who consciously ignored and acquiesced in a fraudulent scheme by its own client and the complaints allegation relating to the preferential treatment scheme fail to satisfy the Gould standard.

If you can turn to slide 8, your Honor, I will sum up, but let's tick through the factors that were articulated by Gould.

Does the complaint allege deliberate illegal behavior? No. The complaint does not allege any facts even suggesting that the Harbinger defendants' actions were illegal let alone that the defendants knew that their actions were illegal.

Second of the three questions, your Honor: Does the complaint allege a scheme that is necessarily going to injure? And, again, the answer is, no, it doesn't allege that the scheme injured anyone. In short, there is no adequate pleading to demonstrate the conscious misbehavior.

And finally, your Honor, before I sit down, the final question is does the complaint allege conduct representing an extreme departure from the standards of ordinary care? And, again, the answer is no. Instead, the complaint alleges facts that we say are more akin to administrative failings than acts of fraud. The failure to seek the offshore board approval of two guys in Cayman. The failure to comply about the most favored nations provision of some investor agreement.

There is no allegation that Mr. Falcone played any role in connection with these administrative, virtually back office tasks. These administrative failures cannot, under the teachings of Gould, it is our position, your Honor, by any stretch of the imagination, be considered extreme departures from the standard of care and thus the plaintiffs have failed to meet their burden under scienter.

THE COURT: Thank you, Mr. Dontzin.

MR. DONTZIN: Thank you, your Honor.

THE COURT: Let me ask you one question about the loan.

MR. DONTZIN: Anything.

THE COURT: Did the SSF have independent counsel advising on the loan to Mr. Falcone?

MR. DONTZIN: No, your Honor.

THE COURT: Checking the time?

MR. DONTZIN: No, your Honor.

THE COURT: He did not?

MR. DONTZIN: He did not, your Honor.

THE COURT: The fund did not?

MR. DONTZIN: Correct, your Honor.

THE COURT: Mr. Stoelting.

MR. SIEVE: Your Honor, I don't know if you want me to go after Mr. Stoelting. I had a couple of points on Mr. Jenson

I would like to make.

THE COURT: I didn't mean to overlook you. Go ahead.

MR. SIEVE: Thank you, your Honor.

THE COURT: It is logical that you should come in now.

MR. SIEVE: Your Honor, Brian Sieve on behalf of Peter Jenson.

I would like to make three points if I could, your Honor. One, on the substantive allegations with respect to the primary violation, and that is whether the -- the SEC has adequately alleged materiality and that's a separate issue from the one Mr. Dontzin was arguing. Mr. Dontzin, I think, was addressing your Honor's questions dealing with whether there is a duty to disclose the loan and also whether or not the transactions satisfy the in-connection-with requirement of Section 10b. But, I think there is a separate argument, your Honor, somewhat related but separate, which is that the loan transaction itself, as a matter of law, would not be material to the investors because of the lockup provision. And that is a separate legal issue, your Honor.

And I understand, your Honor --

THE COURT: That's not really an argument that I'm very disposed to.

MR. SIEVE: Okay. I would like to point out just briefly, your Honor, that we think it is simple.

THE COURT: Nor am I well disposed to the argument that a hundred million is less than a material amount given the billions that are involved.

MR. SIEVE: I wasn't going to advance that argument, your Honor, but if you are not disposed to that let me turn to the two arguments that are specific to Mr. Jenson.

THE COURT: Yes.

MR. SIEVE: The first is the failure to plead specific facts that give rise to an inference of scienter and, of course, Mr. Jenson is in a different position than Harbinger and Mr. Falcone and, of course, as your Honor knows, needs to be evaluated separately.

THE COURT: Yes.

MR. SIEVE: And I don't want to repeat the standards that Mr. Dontzin covered because I think he did a very nice job of laying out what those are, but the question is whether or not the SEC has satisfied its burden of alleging facts that give rise to a strong inference of fraudulent intent on behalf of Mr. Jenson. And Mr. Jenson, of course, is in a different situation.

Now there are two ways, your Honor, as you know, that they can meet their burden. First, do they allege facts that Mr. Jenson had both a motive and an opportunity to commit the fraud. Motive and opportunity. We would submit the answer to that is no.

If you look at the complaint, there are no allegations from which your Honor can plausibly glean that he had a motive to participate in what he understood to be a fraud. In fact, in their brief for the first time they raise two new theories: They said, well, Mr. Jenson had a motive to see Harbinger succeed. Well, that's not pled anywhere in the complaint, your Honor. You can look in the complaint, it is not in there.

Second, in their brief they said he had a motive to curry favor with his boss. That's not pled in the complaint, that is just new stuff they're adding in their brief, so we think that's obviously something you ought to be ignoring.

The third thing they allege is that, well, he had a motive to keep the loan secret and that's in paragraph 21 of their complaint. But, your Honor, that is not, as a matter of law, an adequate allegation to meet the motive prong of the test. There are a host of the cases that have addressed this including SEC v. Espuelas, and in that case what the Court said is it is not enough to make an allegation that an employee had a motive that was not common to every employee at the firm, rather they have to allege something that would show that he benefitted himself in a concrete and personal way. And there are absolutely no allegations in this complaint, nor is it logical, I would submit, that Mr. Jenson was benefiting in a concrete and personal way from participating in what is alleged to be an illegal transaction with respect to the loan. In fact, to the contrary --

THE COURT: His role in facilitating the transaction is not enough?

MR. SIEVE: It is not, your Honor.

THE COURT: There is a difference between the scienter prong and the substantial assistance prong. And, if you look in their brief, I think they conflate the two. The whole part of their brief deals with the substantial assistance prong, in other words what actions he took in order to meet the aiding and abetting test. We're not making that argument for purposes of the motion to dismiss. We certainly will later.

The question that faces your Honor now is are there allegations that he knowingly participated in what he understood to be an illegal transaction and there is no sufficient allegation in that.

Because they haven't met the motive prong then the cases say that they have to allege facts that constitute, and I'm quoting: Strong circumstantial evidence of conscious misbehavior or recklessness.

MR. SIEVE: Again, your Honor, there are no allegations of that.

THE COURT: Your point is with regard to what you might call the substantive offense as opposed to aiding and abetting, you are only moving against the substantive offense? Aiding and abetting you are not challenging?

MR. SIEVE: No, no. I am challenging that Mr. -- I am challenging that, your Honor. I am challenging the fact that Mr. -- that they have not alleged that Mr. Jenson had the requisite scienter for the aiding and abetting allegation. That's what I'm focused on. And the fact that Mr. Jenson is situated separately and differently, obviously, from Mr. Falcone and Harbinger, and they aren't alleging any facts from which you could conclude, plausibly, your Honor, that Mr. Jenson -- that there was strong circumstantial evidence that Mr. Jenson had engaged in conscious misbehavior.

And, your Honor, the only thing they really focus on, if you look at it -- and I'm going to admit that I don't find the complaint on this score to be a model clarity, it is a little confusing to me, but what they seem to be suggesting is that because he allegedly gave erroneous information to Sidley, you should infer that somehow he consciously was involved in illegal behavior. And, your Honor, we dispute that on a variety of levels. They don't allege that Mr. Jenson was --

THE COURT: We do have to take the allegations, though, in the complaint, as true.

MR. SIEVE: I do. And I do for purposes of this. But, even accepting the allegation as true, if you look at the totality of the complaint, all of the allegations, and you just parse out what is alleged with respect to Mr. Jenson, I don't think, your Honor, that they have met their burden of showing a strong circumstantial evidence of conscious misbehavior.

THE COURT: Thank you.

MR. SIEVE: Your Honor, the last argument that I just want to address briefly, and it is one that only we raise, and that is the failure to comply with 9b.

Your Honor pointed out earlier that there are some allegations with respect, I think, to Mr. Jenson, particularly in paragraphs 52 through 55, that somehow he gave erroneous information to the Harbinger Investor Relations folks.

THE COURT: Yes.

MR. SIEVE: And so that, somehow, was relayed to investors.

But, your Honor, importantly, if you look at those allegations closely, they do not satisfy 9b. There are no allegations of who the investors were, what was said, where it was said, when it was said, or why the statement was fraudulent. In fact, you can search the complaint and you won't find any allegation of any specific investor that they allege was misled. There is nothing in the complaint with respect to affirmative allegations that were made to specific investors. All they allege, generally, is that Mr. Jenson supposedly gave misleading information to the investor relations people but they don't go the next step to tie it to an investor.

So, your Honor, for that reason, we would urge that at a minimum, the claims dealing with the alleged misrepresentations have to be dismissed.

THE COURT: Thank you very much, Mr. Sieve.

MR. SIEVE: Thank you, your Honor.

THE COURT: Mr. Stoelting?

MR. STOELTING: Thank you, your Honor.

Your Honor, I will start with the in-connection-with issue which relates only to the 10b claims relating to the loan, and Zandford is the case that -- the Supreme Court case that governs here. And, in SEC enforcement actions, as Zandford held, the in-connection-with requirement should be construed not technically but flexibly to effectuate its remedial purposes. And, Zandford also says, which is the test here, that the securities transactions and the breaches of fiduciary duty coincide and the in-connection-with here that we are arguing is under the Supreme Court case in Ruben. Mr. Falcone pledged his interest in SSF fund as collateral for the loan. Nobody disputes that that pledge represents the purchase and sale of a security. The only dispute is whether that purchase and sale of that security was in connection with a breach of fiduciary duty.

THE COURT: Can you tell me, Mr. Stoelting, why you think Zandford should apply here? It is a materially different case, isn't it? I mean, it is a complete robber taking advantage of an elderly man and his disabled daughter and stealing everything. I mean that -- whatever you can say about this transaction, that did not happen here.

MR. STOELTING: Well, the legal principle is the same, the legal issue of what does in-connection-with mean, but there is similarities because the facts of Zandford found that when that broker went into Mr. Zandford's account and redeemed that money, that each time he did that it was a breach of fiduciary duty and that equates to when Mr. Falcone removed that $113 million from this SSF fund, that was a breach of fiduciary duty.

THE COURT: Well, the broker didn't have a legal opinion saying it was all right, did he?

MR. STOELTING: Well, we would argue that.

THE COURT: Mr. Falcone did.

MR. STOELTING: A legal opinion based on faulty facts and misleading evidence and completely false representations about what the fund was. That lawyer, when you read his legal opinion, he had -- he thought the fund was all cash. His legal opinion says this is based on my information from Mr. Jenson and Harbinger that this fund is all cash. It is based on the information given to me by Jenson and Harbinger that this was not a self-created problem, that it is something that he just found out about, that it is something that there was no other option, this is the only option in order to solve the tax problem. All of those bases of the draft memo provided by the Sidley firm were not true, as we allege in the complaint, and that memo was sent to Mr. Jenson, he received it, he knew that all of those were not false, he knew that it was not that -- that taking the loan was not --

THE COURT: You said were not false, were not true.

MR. STOELTING: Were not true, yes, your Honor. Thank you.

He knew this was not a loan of last resort. Jenson knew that because he had been to the bank in September and sat down with the bank and explained to them the assets that were available and the bank appeared ready to put a loan together for him but Mr. Falcone said no because he didn't want to curtail his lifestyle by impairing his house and impairing his other assets in order to cover this tax obligation. And this relates to the pledge also, and that's why the pledge is so central and integral to the complaint and that's why the Ruben case, under Ruben, the pledge, it is in connection with the breach of fiduciary duty here.

The way that Mr. Falcone could achieve his goal of not using his liquid assets and house and other assets to pay his taxes was by dipping into the fund and using those assets, and if he was going to do that he has to pledge his interest. And when you look at the legal memo, it is a draft memo that says: This is all based on what you told us. If there is anything wrong in this memo, you have to correct it. And there was never any corrections. That's what the draft memo and all there ever was.

But, when you read that draft memo you can see the importance of the pledge and how important it was to the way the loan was put together because it achieved Mr. Falcone's goals of not using any other assets. And the pledge was really critical to the loan at all stages of it. When you read the loan agreement the defense here has put the loan agreement and the audited financial statements that disclosed the loan in a footnote. You see the pledge, the importance of the pledge there. When they finally disclosed the loan in March 2010 in the footnote to the financial statements, just many mentions of the pledge as a critical aspect to it, that's how they justified it. That's how it was presented to investors. Well, it was no risk to you because I just pledged my interest in the fund and that was more than the amount I took out. I mean, when you read defendants' brief, even they, when they talk about the loan as a riskless transaction, what they talk about is the pledge.

On page 1 of the opening brief defendants say: The loan harmed no one. To the contrary, the loan was fully secured by Mr. Falcone's interest in the SSF.

And on page 6 of their brief defendants say: The loan had no downside because it was overcollateralized by Mr. Falcone's interest in the SSF.

So, when they want to present the loan as something that was benign, they rely on the pledge. But when it comes to the in-connection-with argument, the pledge and the loan are miles apart and have nothing to do with one another.

And just getting back to the legal test of what in-connection-with requires, the most recent teaching from the Second Circuit interpreting the coincide requirement in Zandford and what that means is in Romano v. Kazacos and in the Romano case from 2010, the Second Circuit said that the coincide requirement is broad in scope, plaintiff's claims must necessarily allege, necessarily involve or rest on the purchase or sale of a security.

So, the coincide requirement is not some very onerous requirement as defendants make it out to be.

And the Chemical Bank case that we've heard a lot about today and that is discussed extensively in their briefs, especially the reply briefs -- that of course was 30 years ago and we're not saying that it has been overruled because no court has formally overruled it, but certainly Zandford makes clear that in-connection-with does not require an allegation of the fraud in connection with the thing pledged. In Chemical Bank it was just a different set of facts. It was a lawsuit against an accounting firm over a blown audit by a group of banks and the loan that they were suing the auditing firm about was secured by a pledge made by a subsidiary and the accounting firm had never accounted -- examined the books of this subsidiary so the conclusion was, well, the losses in this case were caused by the accounting firm, not by the pledge, so therefore the pledge was not in-connection-with.

THE COURT: Mr. Stoelting, what is your best case or your best argument for the proposition that you have offered here that the loan and pledge, when made back in October of 2009, had to be disclosed?

MR. STOELTING: It had to be disclosed based on the Supreme Court's opinion in Capital Gains that imposed a fiduciary duty on him. And no one disputes that he was a fiduciary, Harbinger was a fiduciary -- I am just reading from Capital Gains here: An affirmative duty of utmost good faith and full and fair disclosure of all material facts as well as an affirmative obligation to employ reasonable care to avoid misleading his clients.

Now, of course it is material to the investors in the fund that the advisor to the fund is removing -- secretly removing $113 million from the fund when they can't take loans. And, remember, about 60 percent of the investors in the fund had pending redemption requests that had been backing up over the past year.

So, if there was money that could be freed up for some purpose, the investors would probably like to see that return to them to fill the pending redemption requests.

So, a secret removal of $113 million is a breach of

Mr. Falcone's fiduciary duty to the fund and to the investors and the LP agreement that Mr. Dontzin also put before the Court in his opening motion in Section 2.8 provides for approval by an investor committee that was never convened, never consulted, no investor knew about this loan at all until it was disclosed in a footnote in March, and then when it was disclosed the cover up and the lies and misrepresentations about the loan and the circumstances began. And we saw them in the e-mail that Mr. Jenson sent.

And, by the way, Mr. Jenson, sending an e-mail to people in the investor relations department whose job it is to communicate with investors about what is going on in the fund, certainly shows an intent for them to relay those falsehoods to investors.

THE COURT: Mr. Stoelting, can you say a word or two about preferential treatment, please?

MR. STOELTING: Yes, your Honor.

These allegations concern side deals and the similarity with the loan is that both were in breach of Harbinger and Mr. Falcone's fiduciary duty to the investors to affirmatively disclose all material facts and to employ reasonable care to avoid misleading clients. These allegations concern side deals that Mr. Falcone and Harbinger made with some of the largest investors to give them preferential liquidity in return for affirmative votes on a proposal that would lock up or tighten the redemption requirements.

Now, obviously there is not much more that's important to an investor in a hedge fund than when he can get his money out which is the redemption requirements. And so, when Mr. Falcone went to them and said we need to tighten up the redemption requirements, as the complaint alleges he was worried that that proposal might not pass.

So, what he did was secretly make deals with some investors, the biggest ones, to give them preferential returns in order to ensure that the vote passed.

THE COURT: There is nothing wrong with the deals made.

MR. STOELTING: Well, there is.

THE COURT: What is wrong?

MR. STOELTING: He was supposed to obtain approval by the board. This was an offshore fund, they had the articles of association that Mr. Dontzin has also put before the Court and are incorporated into this motion, and those articles of association say, in Section 27A, that only the directors in, quote, their absolute discretion, can waive or modify the conditions relating to redemptions for certain large and strategic investors.

And so, if he is going to do that, he can only do it with the board approval. And he not only did not get board approval, he did not even tell them or disclose the quid pro quo deals that he reached with sponsors A, B and C.

THE COURT: So, with respect to the arrangements that he had with A, B and C, you say they were deficient for failure to get board of director approval?

MR. STOELTING: Well, that was part of it.

THE COURT: What is the other part?

MR. STOELTING: Well, he didn't tell the other investors that he was -- you know, at the same time he has an obligation to treat all investors the same and not to give favored treatment to some. When he sent out the letter on March 9th to the investors it said: Dear investors, I'm asking you to vote on this proposal that will make it harder for you to redeem money. It will mean that when we calculate the redemption requirements and when there is a cap, we're going to do a fund level gate instead of the investor level gate. That's a significant measure that makes it harder.

And so, investors receiving that proposal would think, okay, well, this is fair? Because it is going to apply to everybody. But it doesn't. It doesn't apply to the big sponsors -- A, B, C -- because he cut side deals with them.

Now, this part of the -- you know, there is some other bad behavior here which is prior to the vote Harbinger had side letters with several investors. That was designed to sort of ferret out that kind of behavior. And what they say is if you reach a better redemption term with somebody else, then I have to get the opportunity to get the same provisions, that's called most favored nation MFN. So, because if he honored those MFN provisions it would -- everybody would then know about his scheme, he just ignored them and didn't follow them.

So, we cite in the complaint two side letters that require disclosure of the preferential redemption terms and it was concealed from those investors as it was concealed from the board.

THE COURT: What paragraphs are those in the complaint?

MR. STOELTING: 65.

And, further, there were questionnaires that investors submit to the advisor Harbinger that make the same kinds of questions about whether there are side deals or any other arrangements with other investors and he failed to answer those accurately in order to conceal the scheme.

THE COURT: Mr. Stoelting, can you say a few words about Mr. Jenson?

MR. STOELTING: I'm sorry, your Honor. My colleague is --

MR. McGRATH: Your Honor, also 65 and --

THE COURT: 65, 55 and 86. Thank you.

MR. STOELTING: Let me briefly address Mr. Jenson.

Mr. Jenson is, as alleged in the complaint, paragraphs 16 through 59 of the complaint, Jenson appears every step of the way along this loan. He receives the e-mail in April '09 from Mr. Falcone's accountant saying that Philip shows $70 million in taxes due. He met with the bank on September 1, 2000, about a loan to pay his tax obligations. He provided financial documents to the bank showing that Mr. Falcone had $55 million available to pay his loan.

THE COURT: So in terms, in your view under the allegations of the of the complaint, Mr. Jenson is an active participant in violation of 10b-5 and 17?

MR. STOELTING: He is only charged with aiding and abetting the fraud by Mr. Falcone and Harbinger so he is aiding and abetting the 10b violation, he is aiding and abetting the Advisors' Act violation.

THE COURT: All right.

MR. STOELTING: But I don't think I need to run through them because they're all there in paragraphs 16 to 59.

But, you know, Jenson's significant role at the time of the transaction in October is to sort of massage the legal cover because they knew at some point people were going to find out about it and they knew they needed some legal piece of paper to show people. So, you will notice the complaint says that David Sawyer, the lawyer, never spoke to Falcone, it was all through Jenson. And, you know, even when they had the big sitdown with Mr. Falcone on October 9 to review the PowerPoint, Sawyer wasn't there, he wasn't on the call. And everything, all the information to Sawyer came through Jenson as we allege in the complaint and, of course, that information is wildly inaccurate. The fund was all cash when it was a $2 billion fund that was invested in all sorts of securities and that Mr. Falcone had no other choice and so on.

THE COURT: Thank you very much.

MR. STOELTING: Your Honor, I just wanted to get on the record as well because we didn't say this in our complaint, but if there is any aspect of the motion to dismiss that is granted, we would ask the opportunity to replead.

THE COURT: Yes, sir.

Mr. Dontzin?

MR. DONTZIN: Yes, your Honor. Three very quick points.

First, your Honor, we haven't heard a word with respect to the preferential treatment claims about scienter. Not a word. Not today and not effectively in any of the briefs.

Second, your Honor, we have heard a lot about breach of fiduciary duty so in large respect, your Honor, I want you to consider that the question is not whether or not there is a breach of fiduciary duty and that's what we heard mostly from Mr. Stoelting. The question is whether there is a securities law violation whether this is the proper plaintiff in this action. There may well have been a breach of fiduciary duty but that's not for the SEC enforcement action.

And finally, your Honor, I had the benefit of the general counsels here today and I misspoke and I want to make sure I am clear on the record and obviously there is no enforcement proceeding with respect to the general counsel who was there at the time, but apparently I was not clear, your Honor, that Sidley in fact represented the funds, had no representation of Mr. Falcone -- represented the funds who, of course, had a fiduciary duty to their investors.

So, effectively, Sidley was representing the best interests of the investors, not Mr. Falcone at the time of the representation.

I have nothing further, your Honor.

THE COURT: Thank you very much.

Mr. Sieve?

MR. SIEVE: Two points briefly, your Honor.

On the request to replead I point out under the Court's local rules we did exchange letters and the rule states if the plaintiff chooses not to amend in response to the premotion letters that no further amendments would be allowed. So, we would oppose that.

And secondly --

THE COURT: I know that is what the letter says but that's not the rule of the Second Circuit.

MR. SIEVE: Thanks. Well, we think they've had plenty of opportunities. This investigation has been going on for two and a half years, your Honor.

The other thing I would point out, your Honor, is that again, the SEC continues to conflate, in our view, the substantial assistance prong and the scienter prong with respect to Mr. Jenson. Again, just to give you one example, there is no allegation in the complaint nor could they make one in good faith, that Mr. Jenson was aware of what they call law firm B's earlier advice about the loan because he wasn't there at the time and there is no allegation that he knew that. So, they suggest -- they try to suggest that somehow he was an active participant when in fact we would submit that there is nothing in the complaint that would, in any way, lead to the strong conclusion that he understood or believed there was anything unlawful about the loan. And, in fact, if you look at all the allegations in the complaint, we just do not believe that they've met their burden on that score.

THE COURT: Thank you very much.

Will somebody order a copy of the transcript so I have the benefit of the oral argument?

MR. DONTZIN: Yes, your Honor. We will get that done.

THE COURT: Thank you very much for the oral argument. I will get to this just as quickly as I can.

Thank you very much.

THE DEPUTY CLERK: This Court stands in recess.

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