INITIAL DECISION RELEASE NO. 415
ADMINISTRATIVE PROCEEDING
FILE NO. 3-13913

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of	:	
	:	INITIAL DECISION
DAVID E. ZILKHA	:	April 13, 2011

APPEARANCES: Luke T. Cadigan, James S. Goldman, and Michael D. Foster for the Division of Enforcement, Securities and Exchange Commission

Henry Putzel, III, of the Law Office of Henry Putzel, III, for Respondent David E. Zilkha

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision (ID) concludes that David E. Zilkha (Zilkha), while associated with an investment adviser for an investment company (commonly known as a "hedge fund"), violated the antifraud provisions of the Securities Exchange Act of 1934 (Exchange Act) by providing material non-public information concerning Microsoft Corporation (Microsoft) to an affiliate of the adviser, who traded profitably on the information. The ID orders Zilkha to cease and desist from violations of the antifraud provisions and to disgorge ill-gotten gains of $250,000.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission (Commission) issued its Order Instituting Proceedings (OIP) on May 27, 2010, pursuant to Section 21C of the Exchange Act, Section 203(f) of the Investment Advisers Act of 1940 (Advisers Act), and Section 9(b) of the Investment Company Act of 1940 (Investment Company Act). The undersigned held a four-day

hearing on November 1-4, 2010, in New York City. Six witnesses testified, including Zilkha, and numerous exhibits were admitted into evidence.[1]

The findings and conclusions in this ID are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the parties' December 14, 2010, Proposed Findings of Fact and Conclusions of Law and Post-Hearing Briefs and January 18, 2011, replies were considered. All arguments and proposed findings and conclusions that are inconsistent with this ID were considered and rejected.

B. Allegations and Arguments of the Parties

This proceeding concerns alleged insider trading in the securities of Microsoft in April 2001. The OIP alleges that Zilkha, a Microsoft insider, provided material non-public information to the chairman and chief executive officer of Pequot Capital Management, Inc. (Pequot), Arthur J. Samberg (Samberg), who traded profitably on the information. Thus, the OIP alleges, Zilkha willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Additionally, the Division of Enforcement (Division) argues that Zilkha engaged in acts of fraudulent concealment such that any applicable statute of limitations is tolled.

The Division of Enforcement (Division) is seeking a cease-and-desist order; disgorgement; a third-tier civil money penalty of $120,000; and investment adviser and investment company bars. Zilkha argues that the charges are unproven and no sanctions should be imposed.

II. FINDINGS OF FACT

A. Respondent and Other Relevant Individuals and Entities

During the time at issue, Zilkha left the employment of Microsoft and became employed by Pequot, a registered investment adviser.

1. David E. Zilkha

Zilkha desired ultimately to work in the financial industry after earning an MBA in 1998. Tr. 41, 47, 470-72. As the first step in his career plan, he worked at Microsoft from 1998 to 2001. Tr. 41-44, 461-63. His last day at Microsoft was May 7, 2001.[2] Div. Ex. 93. During 2000 and early 2001, Zilkha began to seek employment in the investment advisory field. Tr. 47-48; Div. Ex. 10. He interviewed at several firms, including Pequot, where he became employed on April 23,

[1] Citations to the transcript will be noted as "Tr. __." Citations to exhibits offered by the Division of Enforcement and by Zilkha will be noted as "Div. Ex. __" and "Resp. Ex. __," respectively.

[2] Some Microsoft documents note May 8 as his termination date. Tr. 252-53; Div. Exs. 92, 128.

2001. Tr. 49-50, 57-58, 75, 500-01; Div. Exs. 11, 13, 18, 57. He worked there until November 2001, having been let go by Samberg.[3] Tr. 271-72; Div. Exs. 112, 117.

2. Pequot

Pequot is a Commission-registered investment adviser, incorporated in Connecticut. Div. Ex. 160 at 1. It has been, and still is, a registered investment adviser since 1998, according to the Commission's public official records, of which official notice is taken pursuant to 17 C.F.R. § 201.323. Div. Ex. 160 at 1.

3. Microsoft

Microsoft is a public company incorporated and headquartered in Redmond, Washington. Div. Ex. 160 at 1. Its securities trade on the NASDAQ under the symbol "MSFT" and are registered under Section 12(g) of the Exchange Act. Id. Microsoft's fiscal year ends on June 30. Id.

4. Arthur J. Samberg

Samberg was, and is, the chairman and chief executive officer of Pequot. Pequot Capital Mgmt., Inc., Uniform Application for Investment Adviser Registration (Form ADV), at Sched. A (Mar. 31, 2011). Samberg and Pequot entered settlements, of charges arising out of the events at issue in this proceeding, in a civil action brought by the Commission and an administrative proceeding. SEC v. Pequot Capital Mgmt., Inc., No. 3:10-cv-00831-CFD (D. Conn. June 2, 2010); Pequot Capital Mgmt., Inc., Advisers Act Release No. 3035 (June 8, 2010). The court enjoined Pequot and Samberg against violating Exchange Act Section 10(b) and Rule 10b-5, ordered them to disgorge over $15 million plus prejudgment interest, and fined each $5 million. In the administrative proceeding, Pequot was censured and Samberg was barred from association with any investment adviser, with the proviso that he could participate in the wind down of Pequot. Pequot's current Form ADV, of which official notice is taken pursuant to 17 C.F.R. § 201.323, lists Samberg as Managing Director, Chief Executive Officer, Chairman, and 75% or more owner of Pequot.

At Pequot, according to Zilkha, Samberg eschewed research analysis in favor of pursuing the "hot tip"; for instance, he would return from lunch with a source and take huge positions in securities he knew nothing about. Tr. 568. Samberg was not called as a witness; he advised that he would assert his Fifth Amendment privilege against self-incrimination and decline to answer any questions, and the parties stipulated as to this. Tr. 321-28; Div. Ex. 160 at 5. Zilkha considers Samberg to be a crook and a manipulative, ruthless liar, as well as being nasty, malicious, and uncaring of injury caused to others. Tr. 567.

[3] After leaving Pequot, Zilkha was employed sporadically in the financial industry until March 2004. Tr. 304-05, 558-59; Div. Ex. 160 at 4. He has not had outside employment since then. Tr. 305-08.

5. Mark Spain

Mark Spain (Spain) was a regional technology specialist in Microsoft's U.S. Sales and Services division. Div. Ex. 160 at 2. Spain was Zilkha's neighbor. Tr. 113-14. Microsoft fired Spain when the events at issue came to light. Tr. 293. Spain was not called as a witness; he advised that he would assert his Fifth Amendment privilege against self-incrimination and decline to answer any questions, and the parties stipulated as to this. Tr. 321-28; Div. Ex. 160 at 5.

B. Employment at Pequot

During January 2001, Zilkha had employment interviews with Goldman Sachs, Fidelity Ventures, Alliance Capital, Galleon Group, Lazard Asset Management (Lazard), and Pequot. Tr. 500-01. On February 28, 2001, Samberg offered Zilkha a position at the vice president level at Pequot, at a salary of $250,000 plus minimum bonus for 2001 of $250,000 and various benefits and moving expenses. Tr. 57-58; Div. Ex. 13. At the same time, Zilkha was considering an offer from Lazard on similar terms and had an offer from Alliance Capital as well. Tr. 506-07, 513, 515-17; Div. Ex. 18 at 2-3. Zilkha accepted Samberg's offer on March 4, 2001. Tr. 75-76, 517; Div. Ex. 18 at 1. His start date was April 23, 2001. Div. Ex. 57, Div. Ex. 160 at 3.

1. Overlap in Employment and Access at Microsoft and Pequot

Zilkha's last day at Microsoft was May 7, 2001; he was on vacation from December 2000, followed by various forms of leave, ending May 7, 2001. Tr. 63-65, 473-76; Div. Exs. 93, 161. He had access to Microsoft premises and was on the Microsoft e-mail server during that time. Tr. 63-66; Div. Ex. 160 at 2. Until May 7, 2001, he had his Microsoft laptop and cell phone and was able to use his Microsoft e-mail account and access Microsoft's intranet. Tr. 66, 476-77; Div. Ex. 89, Div. Ex. 160 at 2. He was also receiving e-mails related to Microsoft business activities; for example, he was listed as a required attendee at a May 3 meeting to discuss revenue strategy in an e-mail sent on April 30. Tr. 254-55; Div. Ex. 87. In fact, there was an overlap in his employment at Pequot and Microsoft – he was an employee at both from April 23 through May 7. Tr. 67.

2. Samberg Solicits Information about Microsoft; Zilkha Provides It

When interviewing Zilkha for employment, Samberg asked for his views about Microsoft, but not about any other company, and asked whom he knew at Microsoft. Tr. 53-55, 503-04. On February 28, the same day he extended the offer of employment, Samberg e-mailed Zilkha, expressing the view that the momentum in technology stocks had gone "too far on the downside," indicating that he was considering buying Microsoft, and asking "do you have any current views [on Microsoft] that could be helpful? might as well pick your brain before you go on the payroll!!" Div. Ex. 15.

Microsoft's third quarter ended on March 31, and Zilkha knew that Microsoft would announce its third quarter earnings in the middle of April. Tr. 76. Zilkha gave notice to his manager at Microsoft on Friday, April 6. Tr. 89-93; Div. Ex. 27. Also on April 6, Samberg e-

mailed Zilkha at 2:15 p.m. ET, 11:15 a.m. PT, "i own some [Microsoft] . . . , despite recurring indications from knowledgeable people that the company will either preannounce or take guidance down. any tidbits you might care to lob in would be appreciated." (referred to as the tidbits e-mail) Tr. 93-95; Div. Ex. 25. Zilkha interpreted this as asking whether he still thought Microsoft was a buy. Tr. 95. He replied from his Microsoft e-mail account, "I will get back to you on MSFT ASAP." Tr. 96; Div. Ex. 28 at 1. Shortly thereafter, he contacted two Microsoft colleagues, Edison Yu (Yu) and Spain, from his Microsoft e-mail address. Tr. 103, 105-16; Div. Exs. 32, 33, 35, Div. Ex. 160 at 2. Zilkha's stated belief was that neither he, nor they, nor any employee at their level in the company had material non-public information. Tr. 102, 118-19. The e-mail to Yu asked, "Any ideas on how the quarter has shaped up for MSFT?" Div. Ex. 35. Yu did not reply to that question; rather, he congratulated Zilkha on his career decision, saying, "Would love to do lunch and catch up, if you have time." Div. Ex. 35. The e-mail to Spain – titled "Any visibility on the recent quarter?" – asked, "Have you heard whether we will miss estimates? Any other info?" Div. Exs. 32, 33. Spain replied the next morning, "march was the best march of record. made up the shortfall in us sub. w2k pro major contributor. on track for revised forecast." Div. Exs. 32, 33 (referred to as the Spain e-mails). Thereafter, on April 9, 2001, at 1:15 a.m., Zilkha sent Samberg an e-mail; there is no record of the text of this communication in the documents produced pursuant to subpoena in the Commission staff's investigations into the events at issue. Tr. 135-37; Div. 31 at 5, Div. Ex. 160 at 2. As Zilkha noted on a copy of the tidbits e-mail, he and Samberg also talked over the weekend; Zilkha told Samberg to buy more Microsoft.[4] Tr. 153-54, 159; Div. Ex. 24 at 1, Div. Ex. 113 at 1, 4. On April 16 Samberg e-mailed Zilkha asking, "any further [c]olor on alma mater?" Tr. 173-74; Div. Ex. 39 at 1. On April 17 Zilkha went to his offices at Microsoft, where he still had his badge and access. Tr. 174-76; Div. Ex. 43. That evening he responded to Samberg, "I heard this afternoon from the MSN finance controller that our CFO has been much more relaxed before this next earnings release than he has been in the last year. Augurs well." Tr. 176-77; Div. Ex. 41 at 1.

3. Microsoft's Unexpectedly Strong Earnings Announcement

On April 19 Microsoft issued its earnings announcement, reporting unexpectedly strong quarterly revenue and growth. Tr. 181-82; Div. Exs. 45, 55, 59, 60, 152. As divulged by Spain in his April 8 e-mail, Windows 2000 Professional was a major contributor to the strong results. Tr. 182-83; Div. Exs. 32, 33, 45. Trading in Microsoft then spiked in price and volume following the announcement. Div. Exs. 145, 148.

4. Samberg Trades Microsoft

Between Monday, April 9, and Friday, April 20, 2001, the day after the earnings announcement, Samberg engaged in a series of Microsoft transactions that netted him, Pequot, and Pequot funds more than $14 million in gains. Div. Ex. 144, Div. Ex. 160 at 3. On April 20 Samberg e-mailed Zilkha, "i shouldn't say this, but you have probably paid for yourself already!"

[4] Commission staff, however, did not find evidence of any telephone communication during April 6-9 between Samberg and Zilkha. Tr. 373-74.

Div. Ex. 55 at 1. On April 23, Zilkha's first day at Pequot, Samberg e-mailed colleagues, "he's already got a great p&l based on his [Microsoft] input." Tr. 207-08; Div. Ex. 66. After being told in September 2001 that he was to be terminated, Zilkha compiled a lengthy presentation to show how valuable he was to Pequot. Tr. 155-60; Div. Ex. 113. He sent this to Samberg in an e-mail titled "David Zilkha's recommendations since 4/9 and their performance." Div. Ex. 113 at 1. The first recommendation for which he took credit was the one that led to Samberg buying Microsoft on April 9, 2001. Tr. 156-60; Div. Ex. 113 at 1, 4, 48-51.

5. Zilkha Continues to Provide Information in Response to Samberg's Entreaties

On April 24 Samberg e-mailed Zilkha "tell me what to do with my [Microsoft] position, which has been so successful already thanks to your help." Div. Ex. 69. On April 26 Samberg e-mailed "buying a little more [Microsoft] based on our info. Hope you agree." Div. Ex. 71.

Zilkha continued to contact Microsoft employees during April, May, and June. For example, he called Shawn Sanford (who was not a close acquaintance), group product manager for Windows, to ask whether XP was likely to be delayed. Tr. 220, 223-29, 231; Div. Exs. 73, 74. Sanford replied to him at his Microsoft e-mail address, and Zilkha corresponded further with Sanford from his Microsoft e-mail address.[5] Tr. 226-29; Div. Ex. 73. Upon obtaining the desired information, Zilkha immediately informed Samberg, using his Pequot e-mail address. Div. Ex. 74. Asked by Samberg for more information concerning XP on May 4, Zilkha replied on May 6; commenting on some improvements to Office, he said, "MSFT is working on this, but I believe hasn't announced anything yet and I haven't heard of any dates internally either." Tr. 234; Div. Ex. 90 at 1-2. Concerning XP specifically, he said, "My checks with the XP marketing leads last week confirmed that XP on the client side is still coming out bet[ween] August and Oct[ober] as originally stipulated." Tr. 233-34; Div. Ex. 90 at 1.

Another topic on which Zilkha sought information from Microsoft employees was whether Microsoft might purchase Earthlink or another Internet Service Provider (ISP). Tr. 234-51; Div. Exs. 70, 75, 76, 85. On April 24 Pequot's Jerry Schendel (Schendel) had asked for Zilkha's opinion as to whether Microsoft might buy Earthlink and @Home Network. Tr. 234-37; Div. Ex. 70. On April 25 Zilkha informed Schendel, Samberg, and others of the reasoning of an unidentified former colleague that Microsoft was unlikely to buy Earthlink and stated that VP Ted Kummert (Kummert) was strongly opposed to the idea. Tr. 237-39; Div. Ex. 70. He advised that he would contact VP Hank Vigil (Vigil) on the topic. Tr. 239; Div. Ex. 70. He also contacted Kummert on April 27 by phone and then from his Microsoft e-mail address, asking, "Are <u>we</u> pursuing either a [joint venture]

[5] Zilkha testified that it was his practice at that time to inform anyone whom he called that he now worked for an investment company and that he would have done so in leaving a voice mail for Sanford. Tr. 230-32. There is, however, no evidence in the record that confirms this claim. In fact, if Zilkha had left his Pequot contact information, it is unlikely that Sanford would have contacted him at his Microsoft e-mail address.

or acquisition?"[6] Tr. 246-49; Div. Ex. 76 (emphasis added). On the same date he contacted VP Amar Nehru (Nehru), pestering him with e-mails from his Microsoft e-mail address,[7] despite being told Nehru was unavailable due to illness. Tr. 239-42; Div. Ex. 75. He asked "Has anybody thought about [purchasing Earthlink or another ISP] at MSFT? If so are we pursuing this?" Tr. 244-45; Div. Ex. 75 (emphasis added). Nehru was noncommittal, stating that the idea has been "mulled." Div. Ex. 75. Informed that Zilkha was leaving, Nehru asked, twice, where he was going, but Zilkha did not respond to that question. Id. On April 29 he summarized Kummert's reasoning in an e-mail (from his Pequot e-mail address) to Schendel, Samberg, and others. Tr. 249-51; Div. Ex. 85.

On June 4 Pequot employee Mark Broach sent Zilkha an e-mail stating that Samberg just told him that they had made more money in Microsoft in the past month than in the previous seven years. Tr. 255-56; Div. Ex. 98.

During June, Zilkha continued his queries to Microsoft employees. On June 15 he e-mailed Spain: "Missing earnings rumor. Do you believe this? Should I sell my shares today or wait until after earnings come out?"[8] Div. Ex. 100. Later the same day he e-mailed Samberg and Schendel: "Just spoke to one of my buds at the company [according to whom] Orlando Ayala, in charge of sales worldwide, told managers this week that the quarter looks set to end on a strong note [and] Bob McDowell, in charge of Microsoft Consulting Services [said] that MCS was having a blow-out quarter." Tr. 257-59; Div. Ex. 101. Samberg replied, "Good info." Tr. 259; Div. Ex. 101.

On June 18 Zilkha e-mailed Samberg and Schendel concerning a call with then Goldman Sachs analyst Rick Sherlund, who followed Microsoft; he said, "I told Sherlund on the call that MSFT was anticipating beating earnings for the Q as of last Thursday. He asked me whether he could put out a note talking up MSFT. I told him I'd let him know tomorrow after I heard back

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[6] Referring to the next sentence in the e-mail, which misleadingly stated, "I'm not intending to invest off your reply," Zilkha testified, "I don't recall why I wrote that. I don't think I would have written something that I know would have been on the Microsoft server if I thought it was stupid or compromising." Tr. 247-48. Zilkha testified that he left Kummert a voicemail saying he was no longer at Microsoft; this information was not included in his e-mail. Tr. 545-47; Div. Ex. 76.

[7] Zilkha, unconvincingly, explained his use of the Microsoft e-mail address by saying it was convenient; he did not need to log in every time when using his Microsoft laptop. Tr. 244. Somewhat inconsistently, he also testified that he kept the Microsoft laptop so that he would not have to buy one for himself before he was given a Pequot laptop. Tr. 476-77. Yet he received a Pequot laptop on April 23 and did not relinquish the Microsoft laptop until May 7. According to a memorandum prepared by his counsel that summarized Zilkha's February 2006 proffer session, he was given a Pequot laptop after his four-hour orientation during the afternoon of April 23. Div. Ex. 41 at 1, Div. Ex. 66; Resp. Ex. H at 8.

[8] Zilkha e-mailed Spain his work and cell phone numbers on June 18. Div. Ex. 102.

from my contact – and had gotten your take on what we'd like him to do." Tr. 260; Div. Ex. 106. In reply, Samberg warned, "we absolutely should not be relaying info to him about what you learn via contacts within the company." Tr. 261; Div. Ex. 106. Additionally, Kevin O'Brien, Pequot's general counsel, told Zilkha, "we need to have a discussion about material, non-public info." Tr. 261-62; Div. Ex. 106.

On June 20 Samberg e-mailed Zilkha, asking "any flavor on msft? mkt seems to be turning up and we've traded it well in the past." Tr. 262; Div. Ex. 108 at 1. Zilkha replied, "Didn't hear back re MSFT. I have a positive feeling and could see the stock at 73 again after earnings – but I'd still like to dig a little more first." Div. Ex. 108 at 1. On June 21 Spain e-mailed Zilkha asking him to telephone. Div. Ex. 109. On June 26 Zilkha followed up, e-mailing Spain: "Did you see there was more bad news for MSFT out of Europe yesterday, this time from the company? Are you still ignoring it heading into earnings?" Tr. 262-63; Div. Ex. 109.

Around mid-June or July, his Microsoft contacts stopped returning his calls. Tr. 263-64. Also around that time, in Samberg stopped asking for Zilkha's input and essentially turned his back on Zilkha. Tr. 265-66. On August 20 Zilkha e-mailed Samberg, "You read about MSFT over weekend, but do we care any more?" Div. Ex. 111. Shortly thereafter, on September 25, Samberg informed Zilkha that he would be let go. Tr. 271-73; Div. Ex. 112.

6. Samberg Hired Zilkha to Obtain Material Non-Public Information on Microsoft

Samberg's sole purpose in hiring Zilkha was to obtain material non-public information on Microsoft. Tr. 272-73. Samberg acted on Zilkha's Microsoft recommendations only when they appeared to have been based on information obtained from Microsoft employees. Tr. 269-70. Samberg fired him when he could no longer obtain information on Microsoft. Tr. 273. Samberg notified him on September 25 that he would be terminated, and he was actually terminated on November 16. Tr. 271-72. He received a prorated portion of his $250,000 salary (approximately $173,000), and Samberg agreed to pay him a $250,000 bonus for the year, as originally offered. Div. Exs. Tr. 274; 112, 161.

At the time he accepted Samberg's officer of employment, Zilkha believed that he was being hired as a legitimate research analyst. Tr. 272. Samberg assured him that he would work as a research analyst following software companies and report to and be mentored by Schendel, Pequot's technology portfolio manager. Tr. 60-61, 514; Div. Exs. 13, 18, 69. On Zilkha's first day at Pequot, however, Schendel told Zilkha that he was not consulted on Zilkha's hiring and had no interest in him, preferring to hire his own software analyst. Tr. 209, 514; Div. Ex. 69. Instead, Zilkha worked directly for Samberg during his brief tenure at Pequot. Tr. 273. While at Pequot, Zilkha received no mentoring or training. Tr. 267.

7. Zilkha's Understanding of Material Non-Public Information

Zilkha knew that, as a Microsoft employee, he had a duty to keep confidential all material non-public information about Microsoft. Tr. 165-70; Div. Ex. 3 at 1, Div. Ex. 5 at 4, Div. Ex. 160 at 1. Zilkha conceded that Samberg wanted him to call his Microsoft contacts to obtain information

that Samberg wanted. Tr. 217. However, Zilkha expressed the view that an employee at his level at Microsoft could not have inside information and maintained that the employees from whom he is alleged to have obtained information, such as Yu and Spain, were also at his level.[9] Tr. 101-03, 118-19, 212-17. Accordingly, Zilkha claimed that he avoided acquiring material non-public information by not approaching people at a higher level, such as VPs. Tr. 119, 214-15, 525. This claim is false; in fact he contacted VPs Kummert, Nehru, and Vigil for information. Div. Exs. 70, 75, 76. Zilkha continues to believe that no material non-public information was contained in the April 7-8, 2001, e-mail exchange with Spain entitled "Any visibility on the recent quarter?" and in which Spain stated, "w2k pro major contributor. On track for revised forecast." Tr. 309; Div. Exs. 32, 33. Further, he testified that he sought, received, and conveyed to Samberg not "information" but "opinion" in those e-mails and others, such as Division Exhibits 41,[10] 73, 74,[11] 75, 76,[12] 85, 90,[13] and 101.[14] Tr. 37-38, 103, 107-08, 110, 115, 119, 172, 260. Zilkha considers his recommendations to Samberg regarding Microsoft to have been entirely legitimate, reflecting the bullish view of Microsoft that he had consistently expressed to Samberg from the time they first met. Tr. 38-39, 212, 309, 512, 521, 537.

Zilkha's understanding of material non-public information was at odds with the message that Microsoft communicated to its employees in the Insider Trading section of its Employee Handbook:

> As an employee of Microsoft, you have access to technical, financial, and business information about our company. Because of this access, you are treated as an "insider" for purposes of state and federal securities laws that prohibit insider trading. As an insider, you may not buy or sell Microsoft stock when you know

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[9] He reasoned that he could not have material non-public information because, at his level, he was not restricted in terms of selling his Microsoft shares or converting his options into shares. Tr. 214-16, 478-79.

[10] "I heard this afternoon from the MSN finance controller that our CFO has been much more relaxed before this next earnings release than he has been in the last year."

[11] Contrary to "a [great deal] of speculation in the press," the launch of Windows XP would not be delayed.

[12] "Are we pursuing" a joint venture with or acquisition of Earthlink or other ISP?

[13] "My checks with the XP marketing leads last week confirmed that XP . . . is still coming out bet[ween] August and Oct[ober]."

[14] "Just spoke to one of my buds at the company [according to whom] Orlando Ayala, in charge of sales worldwide, told managers this week that the quarter looks set to end on a strong note [and] Bob McDowell, in charge of Microsoft Consulting Services [said] that MCS was having a blow-out quarter."

> information about the company that is both material and nonpublic. . . . Rumors, even if true and widely reported in the media, may not constitute public disclosure unless publicly confirmed by Microsoft. . . .[E]xamples of material information could be: fiscal quarter or year-end financial results; the announcement of a significant new product or new version; the delay in shipment of a significant new product or new version; a significant agreement with another company, such as a joint development agreement, or an acquisition of or an investment in another company by Microsoft. . . . It makes no difference how you receive the information; for example it could be in the course of your specific job responsibilities or by overhearing conversation in the hallway or lunchroom, or anywhere at or away from your normal workplace. Just as you may not trade in the stock of Microsoft when you know material nonpublic information, you may not disclose such information to any third party who then trades in Microsoft stock. This is considered illegal "tipping". . . . You can also be liable if you are found to have recommended to another that he or she buy or sell Microsoft stock, even if you do not disclose the material nonpublic information.

Div. Ex. 5 at 4. When he entered Microsoft's employment, Zilkha executed an employee agreement that he would not disclose or use confidential or proprietary information defined as "all data and information . . . that is not generally known to the public and that relates to the business, technology, practices, products, marketing, sales, services, finances, or legal affairs of MICROSOFT." Div. Ex. 3 at 3-4.

C. Post Pequot

1. 2005 Investigation of Pequot and Samberg

In January 2005, the Division opened an investigation, designated "HO-9818," into potential securities law violations by Pequot, including insider trading by Pequot and Samberg in a number of securities, Microsoft among them. Tr. 331; Div. Ex. 143. The Division also involved the office of the U.S. Attorney for the Southern District of New York (Southern District) and the FBI. Tr. 335-36, 414-15; Div. Ex. 143 at 2-3. Division staff and FBI agents interviewed Zilkha in the investigation during 2005 and 2006. Tr. 329-92, 413-449. These interviews included proffer sessions with the Southern District in October 2005, December 2005, and February 2006. Tr. 206-07, 335-36, 353-54, 421; Div. Exs. 131, 132; Resp. Exs. G, H. During the interviews, Zilkha made clear that he hated Samberg. Tr. 367, 566.

An FBI Special Agent who participated in the investigation participated in three interviews of Zilkha – a September 2005 interview, conducted at Zilkha's residence, and the October 2005 and December 2005 proffer sessions. Tr. 413-16, 421, 426. The purpose of the interviews was to obtain information regarding the information passed to Samberg involving Microsoft and to seek Zilkha's cooperation against Samberg and others at Pequot. Tr. 416-17, 422, 426. During the interviews Zilkha was asked about people he knew at Microsoft in the context of obtaining information from them. Tr. 427, 440-41. The agent did not recall Zilkha's identifying Spain as a contact at Microsoft during any of the interviews. Tr. 419-20, 426, 431.

The agent agreed with a Division staffer, infra, that, when shown the tidbits e-mail at the December 2005 proffer session, Zilkha indicated that he did not recall responding to Samberg. Tr. 428-31. The agent's recollection as to the facts to which he testified was refreshed by reviewing memoranda prepared by himself or his partner based on notes taken during the interview and proffer sessions. Tr. 418-47; Div. Exs. 130, 131, 132. Spain was not mentioned in any of the memoranda. Tr. 421; Div. Exs. 130, 131, 132.

At the December 2005 proffer session, a Division staffer showed Zilkha the tidbits e-mail and asked him what he did in response to it. Tr. 339-40. Zilkha stated that he had not contacted anyone at Microsoft and had not passed any information to Samberg in response to the tidbits e-mail. Tr. 340. The staffer showed him various e-mails to refresh his recollection, but Zilkha continued to maintain that during April 6-9 he had done nothing other than to repeat his long-held opinion that Microsoft was a good investment. Tr. 341-46.

The staffer also asked Zilkha about e-mails in June and later periods, and Zilkha identified various Microsoft employees as sources of information. Tr. 343-45, 347-50. According to the staffer's recollection, however, Zilkha never mentioned Spain during the December 2005 and February 2006 proffer sessions. Tr. 348, 360. The staffer's recollection as to the facts to which he testified regarding the December 2005 proffer session was refreshed by reviewing memoranda prepared by an FBI agent and by counsel for Zilkha who were present based on notes taken during the interview and proffer sessions. Tr. 338-39, 347-50, 366-67; Div. Ex. 132, Resp. Ex. G. His recollection was refreshed as to the facts to which he testified regarding the February 2006 proffer session by reviewing a memorandum prepared by counsel for Zilkha and notes taken by an Assistant U.S. Attorney who were present at the proffer session. Tr. 355-56, 359, 366-67; Div. Ex. 119; Resp. Ex. H. Spain was not mentioned in any of the memoranda or notes. Div. Exs. 129, 132; Resp. Exs. G, H.

After the December proffer session, the Division sent Zilkha a subpoena on December 19, 2005. Tr. 278, 350, 371; Div. Ex. 154. The subpoena required him to produce all documents, including e-mails concerning Microsoft and concerning Pequot, phone numbers, appointment books, e-mail addresses, and many other things. Tr. 350-51; Div. Ex. 154 at 3-5. Zilkha produced a large volume of documents in response. Tr. 371-75. These included some of the Microsoft e-mails that are in evidence but not the April 7-8 Spain e-mails. Tr. 278-79. The Division also subpoenaed Microsoft for Zilkha-related documents. Tr. 350-51; Div. Ex. 141 at 25-30. The subpoena required the production of "all e-mail for which David Zilkha was the sender or a recipient" during 2001. Div. Ex. 141 at 29. Microsoft produced some documents but "had challenges in terms of finding and producing" all of Zilkha's e-mails.[15] Tr. 351.

[15] The evidence of record does not elaborate on the "challenges." Correspondence between the Division and Microsoft concerning the subpoena discusses such problems as Microsoft's difficulty in identifying individuals by vague descriptions that apply to thousands of employees. Div. Ex. 142. The evidence of record does not address any specific difficulty in finding e-mails to and from Zilkha during April 6-9, or otherwise in 2001, or e-mails saved by Zilkha on the Microsoft server during that period that would indicate that Microsoft could not have produced the e-mails, though it is clear that it did not produce them.

The Division obtained a tolling agreement from Zilkha, tolling any applicable statute of limitations until October 1, 2006.[16] Div. Ex. 163 at 1-2. However, HO-9818 was closed without action on November 30, 2006, and termination letters were sent to Pequot, Samberg, and another individual unconnected with the Microsoft aspect of the investigation. Div. Ex. 143.

At the hearing in this proceeding, Zilkha testified that in 2005 and 2006 he did not remember anything that he had done in April 2001. Tr. 118. Also, Zilkha disavowed any memory of whether or not he had mentioned Spain's name during the 2005-2006 investigation. Tr. 40, 284-87.

At the hearing, Zilkha tried to minimize his association with Spain, stating that Spain was a neighbor, not a friend. Tr. 113-14. Even so, Zilkha testified that he could not remember whether Spain lived next door or two or three houses away from his. Tr. 114, 287-88, 481. Yet Spain was one of a group of "Microsoft friends" he was "truly fond of" whom Zilkha invited to his house for an April 15, 2001, potluck farewell dinner. Div. Ex. 4 at 37. Additionally, Zilkha admitted Spain to an investment vehicle he ran for a few relatives and friends; Spain contributed $100,000, almost all of which was lost. Tr. 288-89, 492-95; Div. Ex. 4 at 2-15, 34-36.

In sum, the Division staffer and the FBI Special Agent did not recall Zilkha's identifying Spain as a Microsoft contact during the investigation, and Zilkha claims not to remember anything. Bearing on this is Zilkha's inconsistent and evasive testimony concerning his relationship with Spain, which he tried, inaccurately, to minimize. Thus, the evidence shows that it is more likely than not that Zilkha did not divulge Spain's name when asked about Microsoft contacts during the 2005-2006 investigation, and it is found that he did not.

2. Zilkha Plans to Sue Samberg

At the time Samberg notified him that he would be terminated, Zilkha prepared a spreadsheet containing all of the recommendations he had made concerning various securities and calculating the profits that would have resulted. Tr. 159-61, 549-51, 553; Div. Exs. 113, 114. Starting in November 2001, he commenced a search to retain counsel to bring suit against Samberg and Pequot for fraudulently inducing him away from his offers at Alliance Capital and Lazard. Tr. 553-54. Eventually, in 2003 or 2004 he retained a lawyer, but through the machinations of his ex-wife, a court ordered the retainer turned over to her divorce attorneys. Tr. 554. He suspended his plan to sue Samberg during the 2005-2006 investigation of Pequot and Samberg, on the advice of counsel. Tr. 568. After that investigation was closed, he pursued a claim against them. Tr. 568-69.

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[16] Additional tolling agreements in connection with a subsequent investigation, BO-2428-A, tolled any applicable statute of limitations from February 12, 2009, to May 31, 2010. Div. Ex. 163 at 3-13.

In 2007, attorneys retained by Zilkha, based on his input, drafted a complaint against Samberg and Pequot for fraudulently inducing him to accept employment at Pequot and for indemnification of his legal expenses incurred in the investigation into their trading of Microsoft. Tr. 52-53, 569; Div. Ex. 134. The attorneys had engaged an economic expert to calculate the damages Zilkha had sustained as a result of Samberg's mistreatment. Tr. 571-72; Resp. Ex. F. The draft complaint alleged that Samberg had failed to live up to his representations that Zilkha would be trained, mentored, and integrated into a software analyst team. Div. Ex. 134 at 9. It also alleged that Samberg "continued to ask Zilkha to obtain information from his contacts at MSFT and to ask Zilkha for his opinion of MSFT stock based on this information. Zilkha observed that Samberg acted on his MSFT recommendations only when they appeared to be based on information obtained from MSFT employees." Div. Ex. 134 at 9.

On April 30, 2007, Zilkha entered a confidential settlement for $2.1 million, to be paid in three annual payments. Tr. 573; Div. Ex. 135. Samberg paid the first two payments, totaling $1.4 million, but refused to make the final payment; Zilkha is pursuing the final $700,000 in arbitration. Tr. 573. The confidential settlement did not preclude disclosure of its existence or terms to the IRS or state revenue agencies or pursuant to subpoena or court order. Div. Ex. 135 at 3. Zilkha was compelled to disclose it during court proceedings with his ex-wife. Div. Ex. 160 at 3. It was then made public in news articles published in December 2008. Id.

3. 2009 Investigation of Zilkha

In approximately January 2009, the Commission received material made available by Zilkha's ex-wife. Div. Ex. 160 at 4. This included the April 7-8, 2001, Spain e-mails. Id. The Division opened an investigation, designated "B-2428," into trading of Microsoft, eventuating in this proceeding. Div. Ex. 160 at 5. During that investigation, the Division subpoenaed Zilkha to give testimony on May 27, 2009. Tr. 139, 315. By that time Zilkha was aware that the Division had a copy of the Spain e-mails. Tr. 138-39. During the testimony, Zilkha was asked whether he currently had a copy of the April 8 Spain e-mail, whether he had a copy during 2005 and 2006, and whether he tried to keep that document from being produced to the Commission; on the advice of counsel, he invoked his Fifth Amendment privilege against self-incrimination and did not otherwise answer those questions, among others. Tr. 316-20.

4. Did Zilkha have the Spain E-Mails during 2005-2006?

It is undisputed that Zilkha did not produce the Spain e-mails during the 2005-2006 investigation into insider trading at Pequot. Tr. 125. At the hearing he testified that he had no memory of sending and receiving the Spain e-mails and that he did not deliberately conceal them in 2005, 2006, or any other time. Tr. 523-25. Whether or not he had the e-mails in 2005-2006 is not established by the evidence of record.[17]

[17] Despite the lack of evidence, as discussed infra, in the Conclusions of Law section, an adverse inference could be drawn from Zilkha's "taking the Fifth" in response to the Division's questions in investigative testimony concerning whether he had a copy of the Spain e-mail in 2005 and 2006 and whether he tried to keep that document from being produced to the Commission.

The following facts were established through testimony at Tr. 630-708 of an expert called by the Division, an expert called by Respondent, and a fact witness called by the Division who had been employed by attorneys for Zilkha's now ex-wife to examine their home computer. In August 2003 a computer forensics examiner was hired by her attorneys to examine their home computer for e-mails related to possible infidelity. He made a copy of the hard drive to examine at his office, and, at her request made a second copy on a new 30 gigabyte hard drive. The new 30 gigabyte hard drive was installed in the computer, and she retained the original 12 gigabyte hard drive in her possession. In January 2004 a new operating system was installed on the computer, which had the effect of removing e-mails that were on the hard drive from retrieval by the lay computer user.[18] In January 2009, during continued legal proceedings related to the divorce, Zilkha's ex-wife made the original 12 gigabyte hard drive available and it came into the hands of Division staffers. The 30 gigabyte copy, which had been in Zilkha's possession, was examined by the two experts in 2009 and 2010, and no trace of the Spain e-mails was found by either (except for the hiberfil.sys file that noted the previous location on the 30 gigabyte hard drive of e-mails and e-mail profiles that were found on the original 12 gigabyte hard drive). Because of the passage of time, it is not possible to determine whether the e-mails were available to Zilkha during the 2005-2006 investigation so as to conclude that he intentionally withheld them. The e-mails could have been effectively deleted by the installation of the new operating system in January 2004, or intentionally deleted before or after that time and then overwritten such that it would be impossible for a forensic expert to find evidence of their existence several years later.

The Spain e-mails were, at least at one time, available to Zilkha on CDs. Tr. 280-82, 555-56; Div. Ex. 160 at 4. Upon the termination of his employment at Pequot, Zilkha was provided with CDs containing the documents he had saved in personal folders on his Pequot computer, including hundreds of e-mails that he had written from his Microsoft e-mail address and that he had subsequently stored in a folder on the Pequot system. Tr. 280-82, 555-56; Div. Exs. 119, 120, 121, 122, 124, Div. Ex. 160 at 4. These included the Spain e-mails, as shown by the metadata on Division Exhibit 32. Tr. 279-81. Zilkha testified that he did not have the CDs after 2004 when his ex-wife barred him from the family home. Tr. 556-57. There is no additional evidence in the record concerning the fate of the CDs. When he was first approached by the FBI and asked for all his documents, Zilkha provided hard copies that he claimed he printed from his Pequot files for a lawsuit he planned against Pequot and Samberg. Tr. 563-65. He testified that he had printed everything he thought he would need to sue Samberg and did not realize that he had not in fact printed everything. Id.

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[18] Zilkha testified that early in 2004 he noticed that everything was gone from the hard drive and that his ex-wife told him that the hard drive had crashed and she had replaced it. Tr. 561. Zilkha took sole possession of the computer thereafter, on or about July 1, 2004. Div. Ex. 160 at 4.

5. What the Division had in 2005-2006

HO-9818 was, generally, an investigation of potential violations by Pequot; Zilkha was not specifically targeted. Div. Ex. 143. The Division did obtain a number of documents related to Zilkha's being the source of insider information passed to Samberg and Pequot and documents that mentioned Spain's name. Tr. 333-35; Div. Ex. 160 at 5. In January 2006 Zilkha's counsel produced a hard copy of the tidbits e-mail bearing the notation in Zilkha's handwriting "We talked during weekend. I told you to buy more." Div. Ex. 24, Div. Ex. 129 at 3, Div. Ex. 160 at 5; Resp. Ex. H at 5. Although Zilkha did not affirmatively provide Spain's name as a contact from whom he obtained information, Spain was one of the recipients of the e-mail invitation to the April 15, 2001, farewell potluck dinner at Zilkha's home sent to "Microsoft friends." Div. Ex. 4 at 37. The potluck e-mail was provided by Microsoft to Division staff in 2006 in response to a subpoena issued in connection with HO-9818. Div. Ex. 160 at 5; Resp. Ex. B. Zilkha did mention Yu, who was also listed on the potluck invitation, as a potential source of information at Microsoft at the December 2005 and February 2006 proffer sessions. Tr. 360, 380-84; Div. Ex. 129 at 3, Div. Ex. 132 at 4; Resp. Ex. H at 8. The e-mails seeking information from Spain and Yu on April 7, 2001, were sent within a few minutes of Zilkha's e-mail inviting them and other "Microsoft friends" to the potluck. Div. Ex. 4 at 37, Div. Exs. 32, 33, 35; Resp. Ex. B. A June 21, 2001, e-mail from Spain asking Zilkha to call him was produced by Pequot on March 21, 2006. Div. Ex. 150 at 1, 3, Div. Ex. 160 at 5; Resp. Ex. A.

Additionally, it is found that the Division had the following documents because the memoranda of both the FBI and Zilkha's counsel concerning the December 2005 and February 2006 proffer sessions refer to them: Division Exhibit 41 at 1, an April 17, 2001, e-mail from Zilkha to Samberg,[19] Division Exhibit 55, an April 20, 2001, e-mail from Samberg to Zilkha,[20] and Division Exhibit 66, an April 23, 2001, e-mail from Samberg to colleagues.[21] Div. Ex. 129 at 3, Div. Ex. 132 at 3-4; Resp. Ex. G at 3-4, Resp. Ex. H at 6-7.

D. Ability to Pay

Zilkha asserts an inability to pay disgorgement, interest, or penalties. Respondent Exhibit LL, received under seal, which is Commission Form D-A (17 C.F.R. § 209.1), was offered in support of that assertion and was addressed in confidential testimony taken pursuant to a protective order. However, on its face and as supplemented by testimony, the form is incomplete. For

[19] "I heard this afternoon from the MSN finance controller that our CFO has been much more relaxed before this next earnings release than he has been in the last year." The Division staffer showed this to Zilkha at the December 2005 proffer session. Tr. 342-43.

[20] "I shouldn't say this, but you have probably paid for yourself already."

[21] Zilkha's "already got a great p&l based on his [Microsoft] input."

example, items listed in Sections G.2.[22] and K.1.[23] are missing. Accordingly, Zilkha has not demonstrated an inability to pay any disgorgement, interest, or penalties that may be ordered in this proceeding.

III. CONCLUSIONS OF LAW

The OIP charges that Zilkha willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. As discussed below, it is concluded that he willfully violated those provisions.

A. Antifraud Provisions - Insider Trading

Exchange Act Section 10(b) and Rule 10b-5 make it unlawful "in connection with the purchase or sale of any security," by jurisdictional means, to:

> 1) employ any device, scheme, or artifice to defraud;
>
> 2) make any untrue statement of a material fact or omit to state a material fact necessary to make the statements made not misleading; or
>
> 3) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Scienter is required to establish violations of Exchange Act Section 10(b) and Rule 10b-5. Aaron v. SEC, 446 U.S. 680, 690-91, 695-97 (1980). It is "a mental state embracing intent to deceive, manipulate, or defraud." Id. at 680, 686 n.5; Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 & n.12 (1976); SEC v. Steadman, 967 F.2d 636, 641 (D.C. Cir. 1992). Recklessness can satisfy the scienter requirement. See David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997); Steadman, 967 F.2d at 641-42; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is "conduct which is 'highly unreasonable' and represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1978) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977)).

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[22] G.2. states, "List all securities or commodities brokerage accounts and accounts at banks or other financial institutions in your name, under your control, in which you have or had a beneficial interest, or to which you are or were a signatory since the date of the first violation alleged against you."

[23] K.1. states, "Attach any federal tax returns filed by you (including personal, trust, or business returns) for the year of the first violation alleged against you and all subsequent years."

Exchange Act Section 10(b) and Rule 10b-5 prohibit so-called "insider trading." It is well established that corporate insiders who trade on the basis of material non-public information violate Exchange Act Section 10(b) and Rule 10b-5. Dirks v. SEC, 463 U.S. 646, 653-54 (1983). The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); Steadman, 967 F.2d at 643. The fiduciary duty of an insider, such as Zilkha, not to disclose material non-public information transfers to subsequent tippees, such as Samberg, who receive the information aware that it came from a source that breached the source's fiduciary duty. Chiarella v. United States, 445 U.S. 222, 230 n.12 (1980); United States v. Teicher, 785 F. Supp. 1137, 1150 (S.D.N.Y. 1992), aff'd, 987 F.2d 112, 120 (2d Cir. 1993); SEC v. Musella, 748 F. Supp. 1028, 1038 (S.D.N.Y. 1989), aff'd, 898 F.2d 138 (2d Cir. 1990).

Zilkha, as an employee of Pequot, was an associated person of an investment adviser. See Advisers Act Sections 202(a)(17), 203(f). Investment advisers and their associated persons are fiduciaries. Fundamental Portfolio Advisors, Inc., 56 S.E.C. 651, 684 (2003); see SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-92, 194, 201 (1963); see also Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979). As such, investment advisers and their associated persons are held to a higher standard than broker-dealers and their associated persons.

In addition to requesting a cease-and-desist order pursuant to Section 21C(a) of the Exchange Act and disgorgement pursuant to Sections 21C(e) of the Exchange Act, 203(j) of the Advisers Act, and 9(e) of the Investment Company Act, the Division requests sanctions pursuant to Sections 203(f) and 203(i) of the Advisers Act and Sections 9(b) and 9(d) of the Investment Company Act. The Commission must find willful violations to impose sanctions pursuant to Sections 203(f) and 203(i) of the Advisers Act and 9(b) and 9(d) of the Investment Company Act. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. See Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Steadman v. SEC, 603 F.2d 1126, 1135 (5th Cir. 1979); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

B. Violation

The record shows a violation by Zilkha, who tipped material non-public information to his future employer, who traded profitably on it and credited Zilkha with the profits. Over the weekend of April 6-9, 2001, Zilkha, a Microsoft employee, at the behest of his future employer, Samberg, sought non-public information that would bear on Microsoft's upcoming earnings announcement from fellow Microsoft employees. As a result, Zilkha obtained from Spain information that was clearly material: "march was the best march of record. made up the shortfall in us sub. w2k pro major contributor. on track for revised forecast." The record shows that Zilkha conveyed this information to Samberg, who immediately engaged in transactions in Microsoft securities. A few days later, on April 17, Zilkha conveyed more material non-public information to Samberg that "our CFO has been much more relaxed before this next earnings release than he has been in the last year." Using Zilkha's information, between Monday, April 9, and Friday, April 20, the day after

the earnings release, Samberg engaged in trading in Microsoft that netted $14 million in profits. Supporting the conclusion that Zilkha intentionally sought material non-public information during the weekend of April 6-9 and the period up to the April 19 earnings announcement was his continued effort during April, May, and June to obtain such information from Microsoft employees, even using his Microsoft e-mail account to contact them and using the term "we" to refer to Microsoft, in an attempt to mislead unknowing employees to believe that he was inquiring as a fellow Microsoft employee. As the record shows, Samberg rewarded Zilkha for his information and then fired him when he was no longer able to obtain inside information.

Zilkha's stated belief that he could not possibly be in possession of material non-public information because his and his informants' rank in the company was not sufficiently high is inherently incredible.[24] (Additionally, his corollary claim that he did not contact higher-ranking employees, such as VPs, is false.) His stated belief that the information in the Spain e-mail was not material non-public information is equally incredible. These claims are so preposterous that they support the conclusion that Zilkha acted with scienter. Assuming, arguendo, that he really believed that his actions were acceptable, his conduct was reckless – highly unreasonable and an extreme departure from the standards of ordinary care. In sum, it is concluded that Zilkha willfully violated Exchange Act Section 10(b) and Rule 10b-5. His actions were clearly intentional. Thus, his violations were willful.

IV. SANCTIONS

The Division requests a cease-and-desist order, disgorgement of $2,523,000 plus prejudgment interest, a civil money penalty of $120,000, and investment adviser and investment company bars. As discussed below, Zilkha will be ordered to cease and desist from violations of Exchange Act Section 10(b) and Rule 10b-5 and to disgorge $250,000 plus prejudgment interest.

A. Statute of Limitations

The sanctions authorized in the OIP are affected, in part, by 28 U.S.C. § 2462, a statute of general applicability that provides a five-year statute of limitations for "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." Johnson v. SEC, 87 F.3d 484, 486 (D.C. Cir. 1996).[25] The conduct alleged in the OIP occurred in April 2001, more than five years before the May 27, 2010, institution of this proceeding. The OIP authorizes "remedial action," which includes investment adviser and investment company bars pursuant to Sections 203(f) of the Advisers Act and 9(b) of the Investment Company Act,

[24] It is also contrary to the insider trading policy set forth in Microsoft's employee handbook and in the employee agreement that he signed.

[25] In Johnson, the court ruled that a Commission "proceeding resulting in a censure and a six-month disciplinary suspension of a securities industry supervisor was a proceeding 'for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise,' within the meaning of § 2462." 87 F.3d at 485.

and civil penalties pursuant to Sections 203(i) of the Advisers Act and 9(d) of the Investment Company Act. Such "remedial action" is subject to the five-year statute of limitations in 28 U.S.C. § 2462.[26]

The OIP also authorizes a cease-and-desist order pursuant to Section 21C of the Exchange Act and disgorgement pursuant to Sections 203(j) of the Advisers Act and 9(e) of the Investment Company Act. Disgorgement is not subject to 28 U.S.C. § 2462. Zacharias v. SEC, 569 F.3d 458, 471-72 (D.C. Cir. 2009); Johnson 87 F.3d at 491-92. Likewise, cease-and-desist orders are not subject to 28 U.S.C. § 2462. Riordan v. SEC, 627 F.3d 1230, 1234-35 (D.C. Cir. 2010).

The five-year statute of limitations period was initially tolled through October 1, 2006. Subsequently, it was tolled for the period beginning February 12, 2009, through May 31, 2010 (after the May 27, 2010, date of the OIP). Further, the Division argues that acts of fraudulent concealment by Respondent during 2005 and 2006 tolled the statute of limitations period until January 2009. Whether a party committed an act of fraudulent concealment involves questions of fact.

> To toll the limitations period for fraudulent concealment, the [Division] must demonstrate: (1) that [Respondent] concealed the existence of the cause of action; (2) that it did not discover the alleged wrongdoing until some point within five years of commencing [the proceeding]; and (3) that its continuing ignorance was not attributable to lack of diligence on its part.

SEC v. Jones, 476 F. Supp. 2d 374, 382 (S.D.N.Y. 2007) (citations omitted); accord, Larson v. Northrop Corp., 21 F.3d 1164, 1172 (D.C. Cir. 1994) (quoting Foltz v. U.S. News and World Report, 663 F. Supp. 1494, 1537 (D.D.C. 1987), aff'd, 865 F.2d 364 (D.C. Cir. 1989), cert. denied, 490 U.S. 1108 (1989)) (the Division must "show (1) that [Respondent] engaged in a course of conduct designed to conceal evidence of [his] alleged wrongdoing and that (2) [the Division] was not on actual or constructive notice of that evidence, despite (3) [its] exercise of diligence.").

[26] The censure and suspension in Johnson were described as "remedial action." Johnson, 87 F.3d at 486; Patricia A. Johnson, 52 S.E.C. 253, 260 (1995). In the instant proceeding the Division argues that the bars it seeks are remedial and thus not subject to 28 U.S.C. § 2462. However, the precedent it cites, Vladislav Steven Zubkis, 86 SEC Docket 2618 (Dec. 2, 2005), and Herbert Moskowitz, 55 S.E.C. 658 (2002), does not support the proposition that such associational bars are not subject to 28 U.S.C. § 2462. The Zubkis proceeding was instituted within five years of the injunction on which it was based. In Moskowitz, the sanction at issue was a cease-and-desist order, not a bar.

1. Zilkha's Conduct

Zilkha did not engage in a course of conduct designed to conceal evidence of his wrongdoing at the time of his violation. He communicated freely with Samberg and Microsoft employees by e-mail in his attempts to gather and convey insider information. He was aware that the e-mails resided on the Microsoft and Pequot servers, even commenting, when shown a particularly incriminating e-mail, "I don't recall why I wrote that. I don't think I would have written something that I know would have been on the Microsoft server if I thought it was stupid or compromising."

The record evidence is inconclusive as to whether the Spain e-mails were available to Zilkha during the 2005-2006 investigation, HO-9818. Thus, to conclude that he engaged in a course of conduct designed to conceal evidence of his wrongdoing in tipping Samberg requires an adverse inference from Zilkha's "taking the Fifth" during the 2009 investigation, B-2428, in response to being asked whether he had a copy of the April 8 Spain e-mail during 2005 and 2006 and whether he tried to keep it from being produced to the Commission. The Division argues that Zilkha's failure to answer impeded the Division in its investigation since it only learned Zilkha's answer ("No") at the hearing. During that investigation, however, the Division had obtained possession of Zilkha's original hard drive as well as e-mails produced by Pequot disclosing the existence of the CDs. An inference from Zilkha's "taking the Fifth" will not be made.

2. Notice

Assuming arguendo that Zilkha did conceal evidence of his wrongdoing, it is necessary to determine that the Division did not discover the wrongdoing and that its failure to do so was not due to its lack of diligence. In 2006, within the five-year statute of limitations as extended by the tolling agreement to October 1, 2006, the Division did have evidence suggesting that Zilkha communicated information during the weekend of April 6-9 to Samberg in response to the tidbits e-mail. Additionally, the Division had Zilkha's April 17 e-mail reporting information as to the CFO's demeanor that provided further assurance that the earnings release was likely to be favorable. Additionally, the Division had Spain's name as one of Zilkha's "Microsoft friends." The Division did not have the original Zilkha hard drive, which was in the possession of Zilkha's ex-wife. The Division did subpoena Zilkha's e-mails generally from Microsoft, but the record is skimpy as to the "challenges" that Microsoft encountered in retrieving Zilkha's e-mails of the weekend of April 6-9. In sum, the Division's failure or inability to obtain Zilkha's e-mails from Microsoft or Pequot during 2005-2006 is not explained in the record. For these reasons, it is concluded that the record evidence does not support a conclusion of fraudulent concealment so as to toll the running of the statute of limitations until January 2009, when the Division had obtained the Spain e-mails from Zilkha's ex-wife.

B. Sanction Considerations

In determining sanctions, the Commission considers such factors as:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman, 603 F.2d at 1140 (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Commission also considers the age of the violation and the degree of harm to investors and the marketplace resulting from the violation. Marshall E. Melton, 56 S.E.C. 695, 698 (2003). Additionally, the Commission considers the extent to which the sanction will have a deterrent effect. Schield Mgmt. Co., 87 SEC Docket 848, 862 & n.46 (Jan. 31, 2006). The Commission also considers the public-at-large, the welfare of investors as a class, and standards of conduct in the securities business generally. See Christopher A. Lowry, 55 S.E.C. 1133, 1145 (2002), aff'd, 340 F.3d 501 (8th Cir. 2003); Arthur Lipper Corp., 46 S.E.C. 78, 100 (1975). The amount of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. See Berko v. SEC, 316 F.2d 137, 141, 143 (2d Cir. 1963); see also Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

C. Sanctions

1. Cease and Desist

Section 21C(a) of the Exchange Act authorizes the Commission to issue a cease-and-desist order against a person who "is violating, has violated, or is about to violate" any provision of the Exchange Act or rules thereunder. Whether there is a reasonable likelihood of such violations in the future must be considered. KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1185 (2001). Such a showing is "significantly less than that required for an injunction." Id. at 1183-91. In determining whether a cease-and-desist order is appropriate, the Commission considers the Steadman factors quoted above, as well as the recency of the violation, the degree of harm to investors or the marketplace, and the combination of sanctions against the respondent. See id. at 1192; see also WHX Corp. v. SEC, 362 F.3d 854, 859-61 (D.C. Cir. 2004).

Zilkha's conduct was egregious and his attempts to obtain material non-public information about Microsoft were recurrent, continuing for about three months. His conduct involved at least a reckless degree of scienter. The lack of assurances against future violations and recognition of the wrongful nature of his conduct goes beyond a vigorous defense of the charges against him. Zilkha's chosen occupation in the financial industry will present opportunities for future violations. The violations were not recent, having occurred ten years ago. The degree of harm to the marketplace is quantified in the $14 million in profits that resulted from the use of Zilkha's information. In light of these considerations, a cease-and-desist order is appropriate.

2. Disgorgement

Sections 21C(e) of the Exchange Act, 203(j) of the Advisers Act, and 9(d) of the Investment Company Act authorize disgorgement of ill-gotten gains from Zilkha. Disgorgement is an equitable remedy that requires a violator to give up wrongfully obtained profits causally related to the proven wrongdoing. See SEC v. First City Fin. Corp., 890 F.2d 1215, 1230-32 (D.C. Cir. 1989); see also Hateley v. SEC, 8 F.3d 653, 655-56 (9th Cir. 1993). It returns the violator to where he would have been absent the violative activity.

The Division requests that Zilkha be ordered to disgorge $2,523,000 in ill-gotten gains, comprising the $173,000 salary and $250,000 bonus he received from Pequot and the $2.1 million settlement he reached with Samberg and Pequot of his employment claim and claim for reimbursement of expenses incurred in the 2005-2006 investigation of Pequot. The Commission has the authority to order disgorgement of salary. Rita J. McConville, 85 SEC Docket 3127, 3151 n.64 (June 30, 2005). However, it has distinguished between amounts earned through legitimate activities and those connected to violative activities, and it falls on the Division to show what a reasonable approximation of the salary was unjust enrichment. See Gregory O. Trautman, 97 SEC Docket 23493, 23529-32 (Dec.15, 2009) (finding that all of respondent's salary was not a reasonable measure of his unjust enrichment, but that fifty percent was related to illegitimate revenues earned through violative conduct). The Division did not provide a segregation of amounts earned through Zilkha's legitimate analytical activities at Pequot. Whether or not the recommendations he made concerning securities other than Microsoft were followed or were profitable, the fact that he made them indicates that he engaged in analyst activity that has not been shown to be illegitimate, and the periodic salary payments that he received during the year, amounting to $173,000, should be excluded from the calculation of ill-gotten gains.

The $250,000 bonus is considered as directly related to his violative conduct. This year-end bonus was paid to him even though he was let go before the end of 2001, and it was not even reduced to an amount proportionate to the time he worked at Pequot.

Concerning the settlement of the employment claim, the Division, in essence, argues that the claim was blackmail and that its timing – not long after the 2005-2006 investigation was closed – supports this theory. However, concerning the timing, Zilkha waited until after the investigation was closed on the advice of counsel. Indeed, had the investigation resulted in settled or adjudicated charges, Zilkha might have been able to rely on the findings in pursuit of his claim without expending substantial resources in discovery. The record contains evidence of a good-faith basis for Zilkha's claim that, at the time he accepted Pequot's offer, he was considering an offer of equivalent compensation for employment at another firm, and his attorney obtained an assessment of lost earnings sustained as a result of Samberg's complained of actions. Further, seeking reimbursement of expenses he incurred in the investigation of Pequot and Samberg was not unjustifiable. The fact that the settlement agreement was confidential was unexceptional, and the confidentiality language in no way precluded Zilkha, Samberg, or Pequot, from disclosing the existence of the settlement or the underlying facts in the

event of a government subpoena, IRS inquiry, or court proceeding, as indeed eventually occurred. Finally, the proven gains from the settlement agreement are $1.4 million, not $2.1 million. The final $700,000 was never paid and was eighteen months overdue at the time of the hearing.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on February 18, 2011, as corrected on March 2, 2011.[27]

VI. ORDER

IT IS ORDERED that, pursuant to Section 21C(a) of the Exchange Act, David E. Zilkha CEASE AND DESIST from committing or causing any violations or future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IT IS FURTHER ORDERED that, pursuant to Sections 21C(e) of the Exchange Act, 203(j) of the Advisers Act, and 9(e) of the Investment Company Act, David E. Zilkha DISGORGE $250,000 plus prejudgment interest at the rate established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), compounded quarterly, pursuant to 17 C.F.R. § 201.600(b). Pursuant to 17 C.F.R. § 201.600(a), prejudgment interest is due from May 1, 2001, through the last day of the month preceding which payment is made.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111(h) of the Commission's Rules of Practice, 17 C.F.R. § 201.111(h). If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

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Carol Fox Foelak
Administrative Law Judge

[27] See David E. Zilkha, Admin. Proc. No. 3-13913 (A.L.J. Mar. 2, 2011) (unpublished) (correcting description of Respondent Exhibit EE).