UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

.

SECURITIES EXCHANGE ACT OF 1934
Release No. 62186 / May 27, 2010

INVESTMENT ADVISERS ACT OF 1940
Release No. 3032 / May 27, 2010

INVESTMENT COMPANY ACT OF 1940
Release No. 29288 / May 27, 2010

ADMINISTRATIVE PROCEEDING
File No. 3-13913

In the Matter of **DAVID E. ZILKHA,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest (i) that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and (ii) that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 9(b) of the Investment Company Act of 1940 ("ICA") against David E. Zilkha ("Respondent" or "Zilkha").

II.

After an investigation, the Division of Enforcement alleges that:

A. <u>SUMMARY</u>

1. This matter concerns insider trading in the securities of Microsoft Corporation ("Microsoft") in April 2001 by Zilkha, then a Microsoft employee who had

accepted an employment offer from Pequot Capital Management, Inc. ("Pequot"), a registered investment adviser. On Friday, April 6, 2001, amidst rumors that Microsoft would miss its earnings estimates for the quarter that had ended on March 31 (the "Third Quarter"), Pequot's chairman and chief executive officer, Arthur J. Samberg ("Samberg"), emailed Zilkha seeking information about whether Microsoft would meet its estimates. That weekend, Zilkha contacted colleagues at Microsoft and learned that Microsoft would meet or beat those estimates. He promptly conveyed to Samberg a recommendation to purchase Microsoft securities based on this material, nonpublic information. On April 9, 2001 and thereafter, Samberg traded in Microsoft options on behalf of funds managed by Pequot with the expectation that Microsoft's stock price would rise.

2. On April 19, 2001, after the market had closed, Microsoft announced its Third Quarter earnings. Consistent with the information Zilkha had conveyed to Samberg, Microsoft beat its earnings estimates. Microsoft's stock closed at $69 per share on April 20, the first trading day after the announcement, a rise of 96 cents per share from the close the previous day and of $12.43 per share from the morning of April 9. As a result of the trading by Samberg and Pequot, the Pequot funds received gains of $14,769,960, approximately $4.1 million of which were attributable to stakes held by Pequot and Samberg in the funds and to certain performance and management fees they generated.

3. By virtue of his conduct, Zilkha willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. <u>RESPONDENT</u>

4. *David E. Zilkha*, age 41, currently a resident of Southbury, Connecticut, was a Microsoft employee from approximately July 20, 1998 until May 7, 2001. From approximately August 15, 2000 until his departure from Microsoft, he was a product manager within its MSN division. Starting in or about January 2001, Zilkha was seeking to become associated with Pequot, an investment adviser. On February 28, 2001, Pequot extended an employment offer to Zilka, which he accepted on March 4, 2001. Zilkha was employed by Pequot from April 23, 2001 until November 16, 2001.

C. <u>OTHER RELEVANT ENTITIES AND PERSONS</u>

5. *Pequot Capital Management, Inc.* is an investment adviser incorporated in Connecticut. It was headquartered in Westport, Connecticut until May 2009, at which time its offices were moved to Wilton, Connecticut. Pequot has been registered with the Commission since 1998 as an investment adviser.

6. *Arthur J. Samberg*, age 69, a resident of Ossining, New York, has been Chairman and CEO of Pequot since its founding in 1998.

7. *Microsoft Corporation* is a public company incorporated and headquartered in Redmond, Washington. Its securities trade on the NASDAQ and are registered under

Section 12(g) of the Exchange Act. It has traded at all pertinent times under the ticker symbol, "MSFT."

D. <u>ALLEGATIONS</u>

<u>Samberg Hires Zilkha</u>

8. In January 2001, Zilkha, a product manager at Microsoft, was seeking to enter the investment management field for the first time.

9. On January 18, 2001, he interviewed with Samberg in the hopes of getting a position with Pequot as an analyst.

10. On February 28, 2001, Samberg extended Zilkha an offer to work as a Vice President at Pequot, reporting directly to Samberg.

11. That night, Samberg emailed Zilkha confirming that he had sent out the offer letter. In the email, Samberg expressed the view that the technology market had declined too far and that the Pequot funds he was managing should purchase securities of Microsoft and another high tech company based on the new products they were introducing.

12. In the February 28, 2001 email to Zilkha, Samberg stated that while Pequot's analysts did a good job covering the other high-tech stocks,

> i'm not as impressed with our research on msft. do you have any current views that could be helpful? Might as well pick your brain before you go on the payroll!!

13. Zilkha replied to Samberg by email the next day. Agreeing with Samberg, he said that he sensed that "the worst is over for Microsoft."

14. On or about March 4, 2001, Zilkha accepted Samberg's offer to work at Pequot and they determined that he would commence his employment on or about April 23, 2001.

15. On or about March 15, 2001, Samberg met with Zilkha at Pequot. On March 16, 2001, Samberg bought Microsoft call options on behalf of the Pequot funds and sold a corresponding number of put options at the same strike price. A call option gives the buyer an option to purchase from the seller 100 shares of stock at a strike price at any time up until expiration. A put option gives the buyer an option to assign to the seller 100 shares of stock at a strike price at any time up until expiration. By buying call options and selling a corresponding number of put options, an investor is able to reap essentially the same profit or loss as a stock owner would, but with a much smaller investment. This combination of option trades is known as a "long synthetic stock position."

16. Microsoft's earnings were set to be announced on April 19, 2001. In March and early April 2001, the belief of a number of analysts at Pequot and elsewhere was that Microsoft would fall short of Microsoft's previously announced earnings estimates for the Third Quarter.

17. On March 21, 2001, after receiving emails from a colleague that expressed dim views of Microsoft's earnings prospects, Samberg sold the Pequot funds' long position.

18. On April 2, 2001, Samberg received research that included the view of the Chief Technology Officer of a major investment bank lauding Microsoft's new Windows 2000 product.

19. On April 3 and April 5, 2001, Samberg took another long synthetic position in Microsoft options on behalf of the Pequot funds he managed.

Zilkha Provides Samberg with Inside Information and Samberg Trades on It

20. On Friday, April 6, 2001, while Zilkha was still employed by Microsoft, Samberg contacted Zilkha at his Microsoft email address. Samberg wrote:

> I own some msft based on the win2000 cycle, 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

(emphasis added) (the "Tidbits Email").

21. On Saturday, April 7, 2001, Zilkha responded by email to the Tidbits Email, telling Samberg he would get back to him "on MSFT ASAP."

22. That night, using his Microsoft email address, Zilkha emailed two Microsoft colleagues explicitly asking for information about Microsoft's earnings results for the Third Quarter.

23. In an email to one of the colleagues, Zilkha asked, "Any ideas on how the quarter has shaped up for MSFT?"

24. Zilkha sent a separate email to his neighbor and colleague Mark Spain ("Spain"), a regional technology specialist in Microsoft's U.S. Sales and Services division. In the subject heading of the email, Zilkha asked, "Any visibility on the recent quarter?" In the body of the email, Zilkha further asked Spain directly, "Have you heard *whether we will miss estimates*? Any other info?" (emphasis added).

25. On April 8, 2001, Spain responded to Zilkha in an email, noting that Microsoft was "on track" to meet its earnings estimates:

march was the best march of record. made up the shortfall in us sub. w2k pro major contributor. on track for revised forecast (MYR).

26. On April 8 or April 9, 2001, Zilkha then communicated to Samberg Zilkha's understanding, based on the email Zilkha had received from Spain, that Microsoft would meet or beat its earnings estimates for the Third Quarter, information that had not yet been disclosed to the public. Zilkha conveyed this information with the intent of both benefiting Pequot and enhancing his stature with his new employer.

27. During the period from April 9 through April 11, 2001, Samberg purchased an additional 28,200 Microsoft call options and sold a corresponding number of put options at the same strike price for the Pequot funds that he managed.

28. On April 16, 2001, another portfolio manager at Pequot "sold short" 800,000 Microsoft shares in trades totaling almost $50 million. A "short sale" is the sale of securities which the seller does not own or one consummated by the delivery of a security borrowed by, or for the account of, the seller. A seller makes a short sale in anticipation of a decline in the stock price.

29. The trades made by the other portfolio manager took place in Pequot funds that were not managed by Samberg, but Samberg was aware of the orders. Samberg then sought further comfort from Zilkha on the substantial position he had amassed in the company in anticipation of an increase in stock price. Minutes after the other portfolio manager placed the order to short Microsoft, Samberg emailed Zilkha, who was in Washington state, asking Zilkha for any "further [c]olor" on Zilkha's "alma mater" (*i.e.*, Microsoft).

30. Zilkha did not get back to Samberg until the evening of April 17, 2001, by which time Samberg had already (earlier that day) reduced the long Microsoft position held by the Pequot funds. Even reduced, Samberg's long Microsoft remained substantial, comprising 21,000 call options.

31. Zilkha, who had gone to Microsoft's offices on April 17, 2001, responded to Samberg that evening with an email stating that he had "heard that 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."

32. On April 19, 2001, before the Microsoft earnings announcement, and by then having received Zilkha's reply, Samberg increased the Pequot funds' long position in Microsoft, buying 6,000 more call options and selling 6,000 put options on behalf of the Pequot funds. In addition, at Samberg's recommendation, a friend of Samberg's purchased 300,000 shares of Microsoft stock.

33. As a result of Samberg's trading activity, just prior to the Microsoft earnings announcement, the Pequot funds managed by Samberg owned 21,000 Microsoft

call options that had been purchased after Zilkha had first conveyed to Samberg material, nonpublic information. Each of the call option purchases reflected Samberg's expectation that Microsoft's stock price would increase.

Microsoft Announces Earnings and Samberg Credits Zilkha with Pequot Profits

34. On April 19, 2001, once the market had closed at 4:30 p.m. Eastern Standard Time, Microsoft announced its earnings results for the Third Quarter, which were better than its previously announced estimates. In particular, Microsoft announced revenue of $6.46 billion and diluted earnings per share of $.44, beating its estimates of $6.3-$6.4 billion in revenue and $.42-$.43 in diluted earnings per share.

35. By the end of the next trading day, Microsoft's stock price per share jumped 96 cents from $68.04 at the close on April 19, 2001 to $69 at the close on April 20, 2001.

36. The Microsoft securities that Samberg had purchased on behalf of Pequot funds on or after April 9, 2001 and held as of April 20, 2001 increased in value by approximately $14,769,960. The gains by Pequot and Samberg flowing from their interests in the funds amounted to approximately $4.1 million. The balance of the gains went to the benefit of the Pequot funds and their investors. In addition, the friend of Samberg's who had purchased Microsoft shares at Samberg's recommendation on April 19, 2001 had gains of $372,060.

37. In the days following the Microsoft earnings announcement, Samberg credited Zilkha with his Microsoft trading and began recommending him to other colleagues at Pequot.

38. In an email sent the morning of April 20, for example, Samberg wrote to a Pequot analyst telling him, "david zilkha joins me Monday from Microsoft. You might want to talk to him about what he thinks is going on at the company."

39. Samberg then forwarded the email to Zilkha, with a note in which he attributed his successful Microsoft trading to Zilkha:

> our tech group has a very dim view of pc demand, and consequently msft.
> in fact, they are short the stock in one account, while it is my largest long.
> *(I shouldn't say this, but you have probably paid for yourself already!)*
> [emphasis added.]

40. In another email, dated April 23, 2001, Samberg told two of his colleagues, "our new guy, david zilkha, is in ct today. Check him out. He's already got a great p&l based on his msft ;input."

41. Zilkha reported to work at Pequot on April 23, 2001, but technically remained an employee of Microsoft until May 7, 2001.

42. On April 24, 2001, Zilkha emailed Samberg with a list of companies he proposed to cover for Pequot. In the email, he also expressed a concern about overlapping with other Pequot analysts. Samberg responded with an email stating, in part, "do not worry over every little thing – just get to know the companies you listed, and tell me what to do with my msft position, which has been so successful already thanks to your help."

43. Zilkha also later received a complimentary email from a managing director at Pequot, who stated, "I am sitting here with 'the great one' aka art [Samberg]; who says we've made more money in msft in the last month than in the entire seven years before that!"

44. On or about September 25, 2001, Samberg told Zilkha that Zilkha's employment at Pequot was going to be terminated, but that he could continue to work at Pequot for a short period as he looked for a new job.

45. Zilkha's employment at Pequot was terminated on or about November 16, 2001.

<u>Zilkha's Fiduciary Duty to Keep Confidential All Material, Nonpublic Information about Microsoft</u>

46. Zilkha knew that as a Microsoft employee, he had a duty to keep confidential all material, nonpublic information about Microsoft and that it was illegal to convey such information to Samberg.

47. Microsoft's insider trading policy, in effect during the relevant period and to which Zilkha was subject, made it clear that Zilkha could be held liable for tipping others to trade on inside information:

> 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" and you could be held liable even if you yourself did not trade any Microsoft shares. You could also be held 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.

48. The Microsoft insider trading policy listed "fiscal quarter . . . financial results" among examples of material information and stated that "there is a considerable risk you will pay dearly if you engage in insider trading in Microsoft stock," listing some of the possible civil and criminal sanctions to which violators are subject.

49. Zilkha had also signed an employee agreement that expressly prohibited him from disclosing confidential information about Microsoft to persons outside of the company.

Zilkha's Concealment of the Insider Trading

50. In the Spring of 2005, the Commission staff began investigating trading by Pequot in Microsoft securities.

51. In an effort to ascertain whether the Zilkha, Samberg and Pequot had engaged in insider trading, the Commission staff interviewed Zilkha and subpoenaed all relevant documents from him.

52. Despite these efforts, however, Zilkha concealed the facts that 1) on or about April 8, 2001, he had received material, nonpublic information indicating that Microsoft would meet or beat its earnings estimates for the Third Quarter and 2) he had then conveyed to Samberg his understanding about Microsoft's Third Quarter earnings based on the information Zilkha had received from Spain.

53. Pursuant to subpoenas issued by the Commission staff, Zilkha had been obligated to produce all documents, including emails, concerning Microsoft. However, Zilkha never produced or disclosed the contents of his April 7, 2001 email to Spain and Spain's April 8, 2001 response (collectively the "Spain Emails") to the Commission staff.

54. During an interview with the Commission staff in December 2005, Zilkha was specifically asked about Samberg's Tidbits Email. Zilkha suggested that he had not contacted anyone at Microsoft to get information in response to the email, that he had no new information about Microsoft to provide Samberg, and that he did not recall responding to Samberg or otherwise giving him any additional information about Microsoft.

55. In addition, in response to questions about his contacts at Microsoft during this and other interviews with government agents during 2005 and 2006, Zilkha listed a number of individuals but never mentioned Spain's name in any context. Zilkha also never disclosed to the Commission staff the existence or contents of the Spain Emails during any of these interviews.

56. In November 2006, the Commission staff's initial investigation was closed after Zilkha failed to produce evidence that he had material, nonpublic information about Microsoft on or about April 8, 2001, before he communicated to Samberg his understanding that Microsoft would meet or beat its earnings estimates for the Third Quarter.

57. The Commission staff first received direct evidence that Zilkha had material, nonpublic information about Microsoft in January 2009, when the staff was provided copies of the Spain Emails, which had been located on a computer hard drive that was then in the possession of Zilkha's ex-wife.

58. In or about January 2007, once the staff's initial investigation of Pequot's trading in Microsoft securities was closed, Zilkha prepared a draft complaint of an employment law claim against Pequot and Samberg. In it, among other things, he admitted

that he had "conveyed to Samberg his view that MSFT would meet or exceed its earnings estimates."

59. Zilkha eventually settled his claim with Pequot and Samberg, which was kept confidential until Zilkha was compelled to disclose it during divorce proceedings with his ex-wife. The claim was then made public in news articles published in December 2008.

Zilkha Invokes His Right against Self-Incrimination and Declines to Answer Questions of Commission Staff

60. On May 27, 2009, in response to questions from Commission staff regarding trading by Samberg and Pequot in Microsoft securities, as well as Zilkha's failure to produce the Spain Emails, Zilkha invoked his Fifth Amendment right against self-incrimination and declined to answer.

E. VIOLATIONS

61. As set forth above, Zilkha conveyed material, nonpublic information about Microsoft's earnings for the quarter ended March 31, 2001 to Samberg, at a time when he was under a duty to refrain from doing so. Accordingly, Zilkha willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate and in the public interest that cease-and-desist proceedings be instituted pursuant to Section 21C of the Exchange Act, and public administrative proceedings be instituted pursuant to Section 203(f) of the Advisers Act and Section 9(b) of the ICA to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. Whether, pursuant to Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

C. Whether, pursuant to Section 21C(e) of the Exchange Act, 203(j) of the Advisers Act, and Section 9(e) of the ICA, Respondent should be ordered to pay disgorgement and prejudgment interest;

D. Whether, pursuant to Section 203(i) of the Advisers Act and Section 9(d) of the ICA, to impose a civil penalty as a result of Respondent's willful violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and

E. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act and Section 9(b) of the ICA.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940, on the Respondent.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray
Chief Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2557

Luke Cadigan, Esq.
Boston Regional Office
Securities and Exchange Commission
33 Arch Street, 23rd Floor
Boston, MA 02110

By Certified Mail:
David E. Zilkha
c/o Henry Putzel III, Esq.
Law Offices of Henry Putzel, III
565 Fifth Avenue
New York, NY 10017-2413

By Certified Mail:
David E. Zilkha
214 North George Hill Road
Southbury, CT 06488-2626