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The six-year,
ever-expanding,
multi-agency
case against
the most brilliant
hedge fund
manager alive

Steven Cohen, SAC Capital p46

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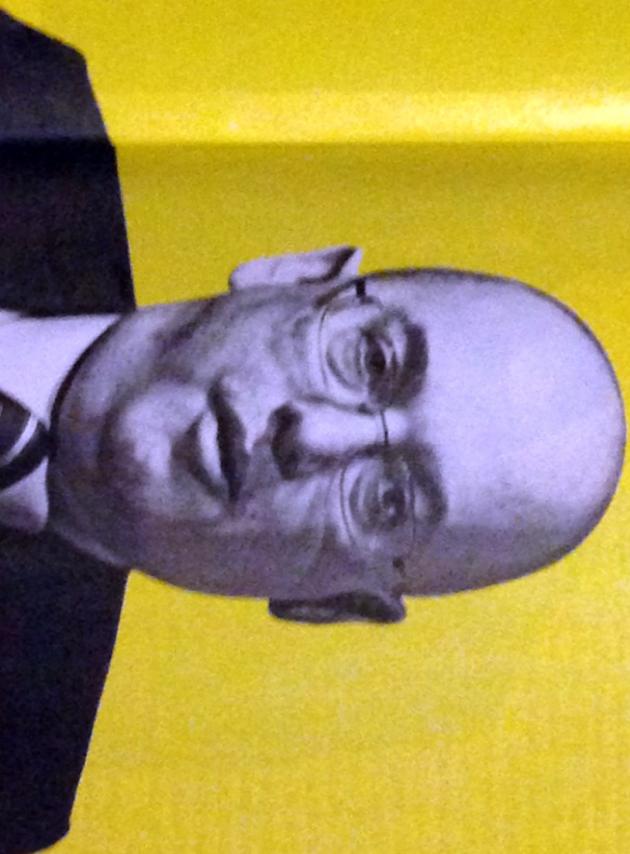
THE

On the trail
of SAC Capital's
Steven Cohen

DANGLING

MAN

By Sheelagh
Kolhatkar



O

ne day in 2008, David Munno decided to vent to his boss. Munno, a health-care analyst then employed at SAC Capital Advisors, was mystified as to why the hedge fund was building up large positions in drug companies Elan and Wyeth. The positions were unhedged, which made the trades even riskier. And there

was no obvious strategic explanation, other than that a relatively untested 34-year-old portfolio manager named Mathew Martoma had been pushing heavily for the trades.

Martoma was viewed skeptically by many of his colleagues, according to a current SAC employee who was not authorized to speak for attribution. But the one person who trusted him was the only person who mattered: SAC founder Steven A. Cohen.

Within the gladiatorial atmosphere of SAC's offices, where dozens of the brightest and most aggressive traders on Wall Street are in constant battle for the favor of their billionaire boss, Munno and another analyst, Benjamin Slate, pressed their arguments: "ELN, (important, please read) negative reads from company and other buysiders," said an e-mail they sent to Cohen, which was quoted in a government complaint. The e-mail, referring to the ticker symbol for Elan, listed the men's concerns about why the drug stock was a dangerous long-term bet.

Cohen wasn't interested—and ultimately told them he didn't want to hear any more on the subject of Elan and Wyeth. He was sticking with Martoma.

Munno didn't understand why Cohen was so bullish on Elan and wrote in aggravation to his supervisor, Jason Karp, then the director of research at SAC unit CR Intrinsic Investors, according to a person familiar with the inquiry that led to the complaint. Karp agreed and wrote that Martoma was acting like he had "black edge."

A trader's edge is his advantage; it's the work he's done and the things he knows about a company. "Black edge," according to people familiar with the inquiry, is likely a term for information that cannot be doubted and that no one else has. It's the kind that can make a trader millions and the kind that can put a trader in jail.

SAC Capital, based in Stamford, Conn., took in \$789 million in fees and returns during the first 10 months of 2012, making it more profitable than any other hedge fund, according to data compiled by *Bloomberg Markets*. It's also at the center of a six-year, multi-agency investigation into illegal trading activity on Wall Street. The Securities and Exchange Commission and the Department of Justice have been ramp-

ing up their enforcement and prosecution of Wall Street crime—Raj Rajaratnam, the co-founder of Galleon Group, was convicted in 2011 of insider trading, to name one high-profile recent case—and Cohen represents the biggest potential prey to date.

"The public's faith in economic fair play is critical to the proper functioning of our capital markets," says SEC Enforcement Division Director Robert Khuzami in an e-mail, "but that faith is undermined when a privileged few take advantage of early and superior access to insider information."

Over the 20 years he's run SAC, Cohen has averaged returns of 30 percent, and his fees, at up to 50 percent of profits, are among the highest in the business. He's renowned as brilliant, paranoid, and motivated by those who want to take what he has. Whether Cohen has "black edge" is one of the most frequently discussed subjects on Wall Street, as civil, criminal, and investor pressure gathers strength and threatens to overwhelm him and his company. Cohen refused interview requests for this story.

Martoma was charged on Nov. 20 with securities fraud for trading shares of Elan and Wyeth in advance of news about the development of an Alzheimer's drug. He pleaded not guilty on Jan. 3. Of the many allegations of wrongdoing by former SAC traders that have made their way into civil and criminal complaints, Martoma's case is unique: For the first time, Cohen is allegedly placed at the scene of a crime, raising the possibility that he may be charged with insider trading.

The central event is a 20-minute phone call that took place between Martoma and Cohen on Sunday, July 20, 2008, at 9:43 a.m., during which the young portfolio manager, according to prosecutors, suddenly switched his position. He persuaded Cohen, one of the most sophisticated investors in the world, to do just what Munno and Slate had been advocating—drop a \$700 million long position in Elan and Wyeth. Martoma furthermore persuaded his boss to short both stocks to the tune of hundreds of millions more. It was a billion-dollar trading swing that led to enormous profits and avoided losses. Only two people, Martoma and Cohen, were privy to that call.

In light of the evidence the government says it has amassed, including the testimony of a scientist who says he leaked drug trial data, the expectation was that Martoma,

now 38, would follow the path of many before him and agree to plead guilty and cooperate, offering up whatever he knows about Cohen and others. So far, Martoma has refused, baffling some attorneys close to the case. Flipped

witnesses have been instrumental—along with wiretaps and document analysis—in the government's campaign against insider trading, which has so far led to 73 convictions or guilty pleas secured by Preet Bharara, the U.S. attorney for the Southern District of New York. Those who cooperate often provide testimony, leads, and sometimes surreptitiously record conversations with

associates in exchange for leniency for their own crimes.

Martoma grew up in Florida, attended Duke University, then dropped out of Harvard Law School. He later attended business school at Stanford. Along the way he

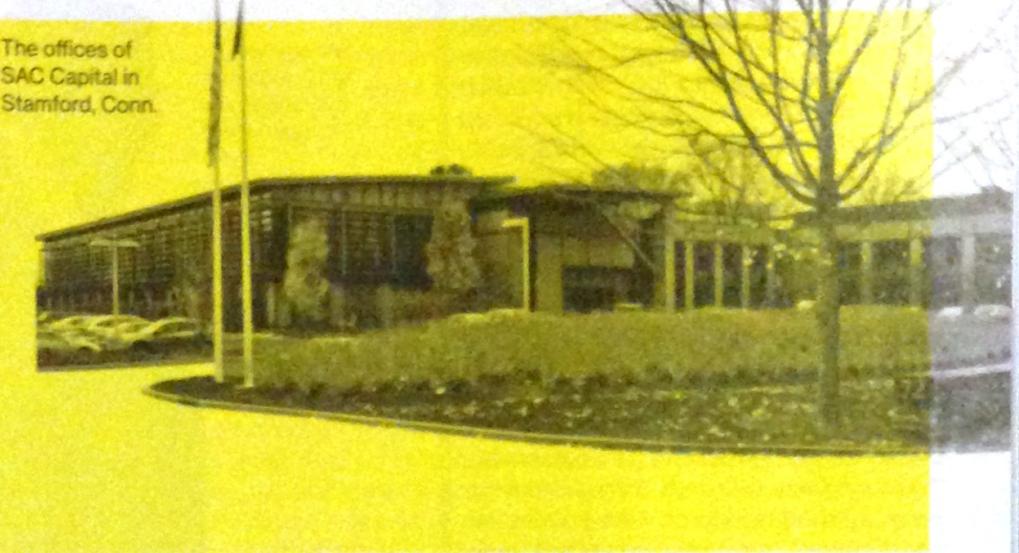
SAC CAPITAL IS AT THE CENTER OF A SIX-YEAR INVESTIGATION INTO ILLEGAL TRADING



changed his name from Ajai Mathew Mariamdani Thomas. He worked at Sirios Capital Management in Boston before joining SAC in 2006. Now, the handsome father of three young children could face a possible sentence of 10 years or more. Martoma's attorney, Charles Stillman, insists that his client is not holding out for a better deal from the government or keeping quiet in expectation of a reward from Cohen. He is, Stillman says, simply innocent. "Is there any sort of discussion about a plea?" he asks rhetorically. "My answer is no." Martoma's appearances at the courthouse have provided little clue to what he's thinking: His jaw appears locked and his eyes hard, even as his wife, Rosemary, smiles beside him with poise, as if she's walking a red carpet.

Martoma is the eighth person linked to allegations of insider trading while at SAC. There are more former or current employees who are either cooperating with the government and spilling what they know or are themselves in investigators' sightlines. One of SAC's longest-serving traders, tech fund portfolio manager Michael Steinberg, was put on leave in September after being named as an unindicted co-conspirator in the trial of Todd Newman, a portfolio manager at Diamondback Capital Management, and Anthony Chiasson, co-founder of Level Global Investors, which ended with their

The offices of SAC Capital in Stamford, Conn.



conviction on Dec. 17. Steinberg hasn't been charged, but the clock is ticking, according to the person familiar with the inquiry. Steinberg's lawyer, Barry Berke, says that "Steinberg did absolutely nothing wrong."

As for SAC, it received a Wells notice from the SEC on Nov. 20, indicating that the agency is considering filing civil charges against the firm; SAC submitted its response on Dec. 12. Even if Cohen isn't sued or charged, the firm he founded in 1992 has already been damaged. Inves-

tors are preparing to pull money out, and some employees are looking for other jobs, prompting SAC to raise trader bonuses, which are already among the highest in the industry. "Mr. Cohen and SAC are confident that they have acted appropriately and will continue to cooperate with the government's inquiry," says Jonathan Gashalter, a spokesman for SAC.

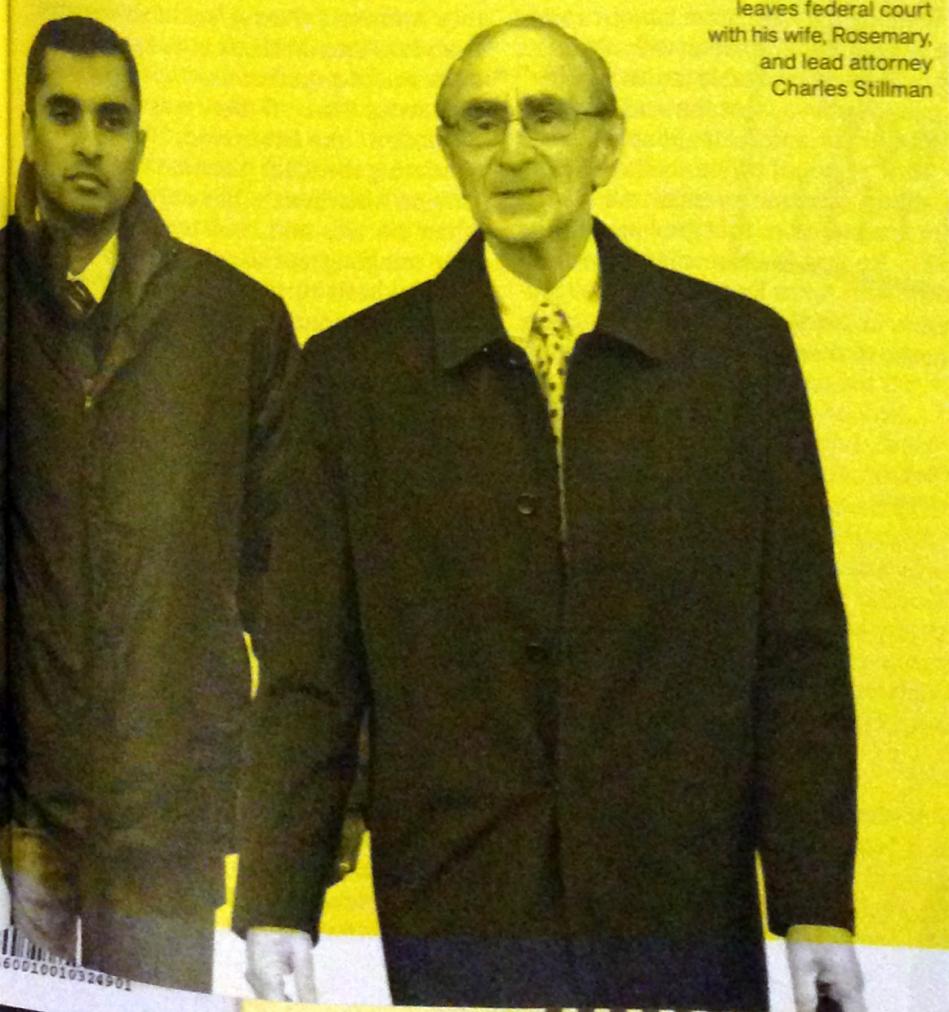
There's no great secret to FBI agent B.J. Kang's technique for flipping witnesses. Typically it involves surprising someone and then confronting them with evidence of their illegal behavior. It's just that Kang wields shame and disorientation with particular skill.

When, in April 2009, he approached a hedge fund manager named Richard Choo-Beng Lee in Silicon Valley to try to gain his cooperation in the insider-trading investigation of Rajaratnam's Galleon Group, Kang had no way of knowing it would lead to Martoma and to Cohen's Greenwich doorstep. Lee had worked as a trader at SAC before joining a New York-based fund called Stratix Asset Management, run by two former SAC traders. Then he started his own hedge fund, Spherix Capital, with a former Galleon employee named Ali Far. Lee felt bad about the lines he had crossed at different points during his career, and he and Far both succumbed easily to FBI pressure.

Lee pleaded guilty to securities fraud later in 2009 and signed a cooperation agreement with the government. He and Far quietly closed 18-month-old Spherix, because they were now working on behalf of the SEC and the Department of Justice. Lee, in particular, began offering a treasure trove of information to investigators. Lee's lawyer, Jeffrey Bornstein, says: "All I can say is that Lee has been and continues to cooperate with the government to the best of his ability."

Among other things, he told investigators about how hedge fund traders used expert networks to connect

Martoma (center) leaves federal court with his wife, Rosemary, and lead attorney Charles Stillman



them with employees at companies who could provide insight about their industries for fees that might run from thousands to hundreds of thousands of dollars. In the 1990s, before Enron and the Wall Street research scandals, traders often found their edge by pestering company executives for crumbs of information; others demanded that brokerage firms with whom they did business give them a wink before downgrading a security. The passage of Fair Disclosure rules by the SEC in 2000 outlawed the selective release of information to a favored few; expert networks emerged to fill the void. Lee cited one in particular called Primary Global Research. It turned out that several PGR consultants were passing material nonpublic information to their hedge fund clients in exchange for payment, according to complaints filed by the government against company employees and consultants. It became known among investigators as a "dirty shop."

At SAC, it was standard practice at the time to make use of consultants at firms such as PGR and its larger competitor, Gerson Lehrman Group, according to a former employee of SAC Capital who overlapped with Martoma; anyone who didn't was seen as not performing his job thoroughly. Everyone in the hedge fund world was doing it, this person adds.

Lee had hired PGR experts in the past, and he continued to do so with the FBI listening in on his phone calls. He had conversations with Mark Anthony Longoria, for instance, a manager at Advanced Micro Devices who provided him with AMD revenue numbers, unit sales figures for different product lines, and revenue forecasts, according to court documents. Longoria had been paid more than \$200,000 over two years. The expert network investigation led to charges against 25 defendants, including Longoria, who pleaded guilty to securities fraud in 2011.

Lee also sketched out the internal landscape of SAC Capital as he recalled it and described its unusual structure of in-

Galleon hedge fund co-founder Rajaratnam and FBI agent Kang



vestment "pods"—groups of individual funds that are managed separately and compete against one another. Among them are Sigma Capital and CR Intrinsic. Lee led to other helpful witnesses who provided more information, including Noah Freeman, a former SAC trader who told investigators that he thought it was part of his job to bring home nonpublic information with which the firm could make profitable trades.

Sanjay Wadhwa, now the senior associate director for enforcement at the SEC's New York regional office, had launched the Galleon case and oversaw the web of insider-trading cases that grew out of it at the SEC. He was in close contact around this time with Agent Kang. During one conversation in 2009, Kang suggested, rather opaquely, that something big might have gone down during the summer of 2008 at SAC Capital. It's not clear whether Kang was motivated by information or intuition, but he'd had access to wiretaps the FBI had placed on one of Cohen's phone lines in 2008.

Wadhwa asked the SEC's office of market surveillance in Washington to forward any referrals it had received pertaining to SAC or CR Intrinsic. What arrived was a bundle of red flags about unusual or suspi-

cious trading activity. Several referrals produced leads that are still being pursued. One, in particular, stood out. Dated Sept. 5, 2008, the multipage letter from NYSE Regulation, the private regulatory body whose market oversight responsibilities were later absorbed by the Financial Industry Regulatory Authority (Finra), said that someone from RBC Capital Markets had pointed out evidence of a market-moving information leak about Elan. "If there was a leak of information," the letter read, "it was probably during the ICAD [International Conference on Alzheimer's Disease] conference," when doctors and investors would have been mingling and socializing.

This thesis turned out to be incorrect, but the letter did prompt the SEC to launch one of its largest investigations. It would end up issuing 140 subpoenas and amassing 2 million pages of documents as it built a case that kept leading in the direction of SAC Capital. Wadhwa assigned several attorneys to the Elan case: first, Amelia Cotrell, who had joined the SEC in 2005 from the law firm Paul, Weiss; Charles Riely, who had come from Akin, Gump in 2008; and, eventually, Matthew Watkins, who had also been with the agency since 2008 and had worked on both the Galleon and the expert network cases. They tried to piece together an explanation for the astonishing amount of money SAC had made trading Elan.

They began by sending out subpoenas and requesting phone records and trading data from third parties rather than alerting the hedge fund itself. The initial stages involved painstaking work: The firm's trading

Longoria (left) and Chiasson



records were a jumble of activity with nothing broken out. It was also difficult to discern which of SAC's 900 employees they should focus on.

As the investigation proceeded, Lee, Kang's flipped witness, tried to sneak back into SAC Capital. Under the guidance of FBI agents, he made contact with Cohen and attempted to engage him in incriminating conversations, according to the person familiar with the inquiry. Lee even went so far as to try to get rehired at Cohen's firm, although Cohen declined to have him back. Just as it was beginning to seem as if Lee's work might bear fruit, he was ousted as cooperating with the government in an Oct. 20, 2009, article in the *Wall Street Journal*. His cover was blown, and his career as an informant was over. For the SEC and the FBI, it was a major setback.

The SEC lawyers, who pursue civil charges, had their first meeting about the Elan case with members of the U.S. Attorney's Office for the Southern District of New York in the spring of 2010. The agency was still developing its theory about what had happened and who was involved. After sifting for months through every phone call to SAC from anyone connected to Elan, the SEC team pinpointed Martoma and his source, a neurologist and Alzheimer's expert named Dr. Sidney Gilman, who worked as a consultant to hedge funds through Gerson Lehrman. Cottrell, Riely, and Watkins assembled a minute-by-minute chronology that grew to dozens of pages, listing every phone conversation and interaction Martoma had around the July 2008 trade. As they tracked Martoma further back in time, a pattern emerged: Over the course of 2007 and 2008, Martoma and Gilman had spoken every time an Elan safety monitoring committee held a meeting. The committee convened on Nov. 21, 2006, for example, and the two men had a consultation the next day. The pattern repeated on Feb. 8, 2007, and Feb. 9, and several more times, according to court documents. Gilman was a member of the committee, which oversaw the Phase II clinical trial of Elan's Alzheimer's drug, bapineuzumab.

By July 2011, the team began to "surface"—officially contacting some of the figures at the center of the case and alerting them for the first time to the investigation. It's a major step that's often coordinated with the criminal authorities. To succeed in a civil case, the SEC must prove that it's more likely than not that the subject violated the law, while prosecutors in a criminal case face a higher burden of proof and must establish guilt beyond a reasonable doubt. Criminal investigators have the ability to employ wiretaps and grand jury testimony, which can't be shared; civil authorities do not. For this and other reasons, there are obvious advantages to working together.

Bharara's office assigned an assistant U.S. attorney named Arlo Devlin-Brown to the case that summer. SEC attorneys knew from e-mails they'd obtained by subpoena that Martoma and Gilman were scheduling their "expert networking" around the same times as the drug trial monitoring committee meetings and that they often misrepresented the subjects they planned to address to the expert network, which helped arrange the discussions. The trader and the doctor developed a warm relationship over the course of 42 paid consultations, with Martoma playing the role of eager pupil. He'd evidently done a great deal of research into the intricacies of Alzheimer's treatment and flattered Gilman with detailed, intelligent questions about his life's work. A decision was made to confront Martoma in November, when an FBI agent named Matthew Callahan surprised him on the lawn of his \$1.9 million house in Boca Raton, Fla. You can cooperate now, Callahan told him, otherwise the next time you see me I'll be arresting you. Martoma fainted, but he did not flip.

In February 2012, the SEC subpoenaed Martoma seeking his testimony, leading to a stilted meeting in which Martoma repeatedly invoked his Fifth Amendment right against self-incrimination. He was extremely poised, according to people familiar with the inquiry. Cohen himself was brought in for a deposition in May. He spent most of a day at the SEC's Lower Manhattan offices and said that he couldn't remember the answers to dozens of their questions, according to the person familiar with the inquiry, who added that Cohen appeared care-free and in control.

Gilman was contacted later that summer, and by mid-August he followed the advice of his lawyers and agreed to give testimony in exchange for immunity from criminal prosecution, providing a burst of momentum that helped lead the investigation through its end stages. During the fall, holes were filled in as final preparations were made. Agent Callahan headed down to Boca with a pair of handcuffs, and Martoma was charged on Nov. 20.

When a former trader from Galleon Group was asked what the word "edge" meant to him, he laughed and said that from the day he started at Galleon to the day he left, it was probably the most commonly used

term around the office. It was such a priority, the trader added, that if you didn't have it, you'd be quickly left behind. It meant that you knew something that others didn't. Another trader—a witness in the government's insider-trading investigation—was asked if he knew of any hedge fund that didn't traffic in illegal information, according to the person familiar with the inquiry: No, the source answered, they would never survive. In this way, trading on nonpublic material information is similar to doping in professional cycling: Once someone like Lance Armstrong starts doing it, everyone else has to as well. Proving that it's happening is just as difficult. "These cases take real detective work," says Tom Sporkin, a partner at Buckley Sandler and a former senior enforcement official at the SEC. "It's like finding the needle in the haystack."

"Insider-trading investigations by their nature are incredibly labor-intensive," Wadhwa adds. "The successful ones demand doggedness, creative thinking, and meticulous analysis of the facts."

Cohen's outlook is impossible to determine. It's hard enough to know where he is. For years he's been a regular at December's Art Basel in Miami, the art world's signature high-roller event. He's a renowned

collector, who is said to have paid as much as \$110 million for a Jasper Johns painting and \$8 million for Damien Hirst's *The Physical Impossibility of Death in the Mind of Someone Living*, a shark in a tank of formaldehyde. Cohen did not make it to Art Basel this year.

Perhaps he has enough possessions. His golf course, Richard Serra-like sculpture, and the footprint of an ice rink are visible in satellite photographs of the grounds of his 30-room compound in Greenwich. He may have enough money, too. More than half of the \$14 billion SAC has under management is Cohen's personal fortune; all he can do is continue to make it bigger, as he did last year, when SAC returned 13 percent net of fees. He already has more than a person could possibly spend, and perhaps even lose, in a lifetime. The last public hint of his thinking was in 2010. During an interview with *Vanity Fair* writer Bryan Burrough, Cohen said: "My dream is to liberate myself."

In January, SAC announced that it was closing its Chicago office. On Feb. 15, investors will be able to begin redeeming money they have under management with SAC Capital. Withdrawals of upwards of \$1 billion are expected. ■

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