

Who Will Insider Trading Probes Turn up Next?

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Government raids, wired witnesses, early morning arrests of fleeing defendants; the scenarios sound like a screenplay for a Mafia movie or an FBI whodunit.

But no, in this brave new world of unleashed federal prosecutors and regulators those scenarios have been happening in an unlikely playing field: the hedge fund industry.

The round of criminal and civil insider trading cases involving hedge funds started with the October 2009 arrest of Galleon Group founder Raj Rajaratnam and New Castle executive Danielle Chiesi, as well as technology industry executives, in an alleged \$20 million insider trading case.

At the time of the Galleon arrests, Manhattan U.S. Attorney Preet Bahara called it the largest insider trading case involving a hedge fund firm.

More than a year later, there seems to be little end to the government's appetite for insider trading cases that relate, in one way or another, to the hedge fund industry.

The latest manifestation of these kinds of cases revolves around a California firm, Primary Global Research.

Until recently, Primary Global was known mostly to those who were interested in its offerings as a provider of research and ideas to top investment funds, according to the firm's Web site.

But the firm has garnered quite a bit of notoriety over the last few months, as the government has come out with criminal insider trading charges against six people who worked for Primary Global, either directly, or as outside consultants.

Besides those six, which include Primary Global sales manager James Fleishman and another Primary Global employee, Don Chu, the government has revealed four cooperating witnesses who pleaded guilty and are working with prosecutors in an effort to reduce their sentences.

The four cooperating with prosecutors include former hedge fund manager Richard Choo-Beng Lee, who pleaded guilty in an early round of Galleon Group cases; Dell global supply manager Daniel DeVore; Karl Motey, who founded his own technology research firm Coda Group; and a former semiconductor analyst with Primary Global, Bob Nguyen.

Besides their relationships to each other or Primary Global, those accused in the expert network/insider trading cases share another thing in common: they are all in one way or another involved in the technology industry.

Sandy Bragg, the chief executive officer of Integrity Research Associates, a firm that studies expert networks, says the technology connection isn't surprising.

"What we see, generally, is that primary research is more active in the growth segments of the market," Bragg tells *HedgeFund.net*. "If you can get a sense of where revenues are trending then it has more impact because with a growth stock, you're looking at the top line."

Technology stock trades that the government claims were involved in its insider trading cases include Google, Broadcom, semi-conductor company Marvell and visual computing technology company NVIDIA, among others.

Barry Pollack, a partner with law firm Miller & Chevalier, says it is both the newer nature of most technology companies and the types of people who would act as consultants to investors.

"Because [the technology sector] is not as established or as mature an industry, they may not perform as many functions in-house, so they outsource quite a bit more," Pollack says. "Therefore, every time I look to an outsider to get advice, I'm sharing confidential information and I lose some control."

What also may have happened was the simple fact that the government's first entrée into the expert networks was through technology. Lee, who pleaded guilty last year in the Galleon Group cases, is featured in a number of FBI affidavits as being a chief wire-wearer and phone recorder. He had been with SAC Capital and Galleon Group before setting up his own technology-focused hedge fund firm.

At least some of what Lee and other cooperating witnesses did was to contact the other defendants about company information at the behest of the FBI.

It was Lee's conversation with Chu that provided a moment of relative levity in the FBI's case against Chu.

Lee called, looking for an expert to talk to about Marvell's earnings in August 2009.

But Chu, apparently without suspicion of Lee's involvement with the investigation, told him, "No, no, no, Broadcom, Broadcom . . . Marvell, we, I, I haven't followed Marvell for a while," according to the FBI's affidavit.

(One can imagine Lee's FBI handler rolling his eyes in the background.)

But that is exactly how prosecutors get into these cases, John Bartko, a founding partner of law firm Bartko, Zankel, Tarrant & Miller and a former federal prosecutor, says.

"If someone decides they are in big trouble, they'll do anything they can to get a less Draconian sentence," Bartko says.

"You have [the witness] provide cooperation before it becomes public," that he is being charged, he says. "You're much better if you're talking to your friends, going in with a wire and recording the conversations."

Primary Global may have the most to fear from its former manager Nguyen. It was Nguyen who prosecutors allege told them that Primary Global trafficked in insider information, in direct contravention of its own policies.

But there is still a puzzle piece left out there in the Primary Global cases.

Court documents name at least one more cooperating witness who is identified as an analyst at a New York hedge fund. That person has yet to be named.

In November, the FBI raided three hedge fund firms, New York-based Level Global, Connecticut-based Diamondback Capital Management and Boston-based Loch Capital.

All three firms have issued statements that they have been informed by the government that they were not the target of its investigations.

However, Diamondback Capital has said that the FBI was looking for information about tech portfolio manager Todd Newman and a former analyst Jesse Tortora, according to *The Wall Street Journal*.

Newman is on leave from his job at Diamondback, while Tortora left the firm early last year.

Bartko says, in all these cases, it appears as though the government is looking for leads.

"It's pretty clear they think there's a lot of hanky panky in the hedge fund industry about people getting illegal tips," he says. "Ultimately, the government's goal is to make sure the practice stops and the market isn't rigged."

As a whole, Bragg says, the majority of the primary research that hedge funds and other investment managers are doing is legitimate.

"They're not seeking inside information; they're doing fundamental research, not relying on third parties like the street," he says, "For that reason, they are trying to get a sense from customers, competitors, suppliers, what are business conditions and what are the specific conditions for companies."

However, there is a fine line between good intelligence gathering and inside information, Pollack says.

But there is a danger, Pollack says, when prosecutors don't understand the underlying business and go into investigations with preconceived notions about what is involved, relying on cooperating witnesses whose freedom depends on turning in others.

"Nobody ever gets out of criminal prosecution by saying, 'you just don't understand the industry -- all of this information was perfectly appropriate,'" he says.