

II. SAC's Insider Trading

A. Introduction

On July 25, 2013, the government indicted the hedge fund SAC Capital Advisors LP (“SAC”) for its unparalleled practice of insider trading.¹ Federal law proscribes “us[ing] or employ[ing], in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”² Such manipulative and deceptive devices “include, among other things, the purchase or sale of a security . . . on the basis of material nonpublic information about that security.”³

In addition to the criminal charges, the government also filed a civil suit against SAC on July 25, 2013.⁴ Under federal law, “[a]ny property, real or personal, involved in a transaction or attempted transaction in violation of [18 U.S.C. § 1956] . . . , or any property traceable to such property [is subject to forfeiture to the United States].”⁵ 18 U.S.C. § 1956 provides for a penalty, payable to the government, for individuals who engage in illegal activity with the understanding that such illegal activity generated the property involved.⁶ The penalty is “not more than the greater of—the value of the property, funds, or monetary instruments involved in the action; or \$10,000.”⁷

Although insider trading laws target individual offenders, a hedge fund may also face criminal and civil liability where the fund management has allowed its employees to engage in insider trading,

¹ Patricia Hurtado, Christie Smythe & David Glovin, *SAC Capital Indicted for Unprecedented Insider Trading Scam*, BLOOMBERG (July 25, 2013), <http://www.bloomberg.com/news/2013-07-25/sac-capital-indicted-in-six-year-u-s-insider-probe.html>.

² 15 U.S.C. § 78j(b) (2012).

³ 17 C.F.R. § 240.10b5-1(a) (2013).

⁴ Verified Complaint at 1, *United States v. S.A.C. Capital Advisors, L.P.*, (S.D.N.Y. 2013) (No. 13-CV-5182).

⁵ 18 U.S.C. § 981(a)(1)(A) (2012).

⁶ *Id.* § 1956(a)(1)(A)(i)–(b)(1) (2012).

⁷ *Id.* § 1956(b)(1)(A)–(B).

either by explicitly authorizing the insider trading or by failing to stop such activity.⁸

This article explores SAC's insider trading scheme and the implications that liability will have for SAC and its owner. Part B recounts SAC's prominence in the industry prior to its indictment. Next, Part C discusses the various allegations against SAC and its employees for insider trading, as well as a settlement agreement between SAC and the government. Part D analyzes the implications of the scandal and the settlement. Finally, Part E concludes by considering the implications of this scandal for SAC's future in the market and its owner's future in the profession.

B. SAC's History

Steven A. Cohen founded SAC in 1992 and began operating with merely \$25 million.⁹ When the government indicted the firm in July 2013, it was worth about \$14 billion and yielded yearly profits of about 30%.¹⁰ SAC is organized as a series of "individual portfolios" run by portfolio managers who are "responsible for [their] portfolio's profit-and-loss results."¹¹ The portfolio managers are in contact with Mr. Cohen and part of their job entails "sharing the best trading ideas with [Mr. Cohen] directly."¹²

When the government indicted SAC, the fund had about one hundred "internal portfolios" and each portfolio had a manager "specializ[ing] in a particular investment sector."¹³ In addition, each portfolio manager utilized "research analysts," who helped formulate potential investments for that particular portfolio.¹⁴ Because of SAC's dependable success in generating returns, it has been able to impose incredibly high fees for the industry, with SAC receiving a

⁸ Bradley J. Bondi & Steven D. Lofchie, *The Law of Insider Trading: Legal Theories, Common Defenses, and Best Practices for Ensuring Compliance*, 8 N.Y.U. J. L. & BUS. 151, 155 (2011).

⁹ Ben Protess & Alexandra Stevenson, *SAC Capital Closes a Trading Unit as it Starts to Retrench*, N.Y. TIMES (Aug. 12, 2013, 12:59 PM), <http://dealbook.nytimes.com/2013/08/12/sac-capital-closes-a-trading-unit/>.

¹⁰ Hurtado, Smythe & Glovin, *supra* note 1.

¹¹ Sealed Indictment at 5, *United States v. S.A.C. Capital Advisors, L.P.*, (S.D.N.Y. 2013) (No. 13-CR-541).

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

set fee of 3% of the capital that clients invest, in addition to up to 50% of the returns that SAC produces.¹⁵

C. Insider Trading Exposed

In July 2013, the government indicted SAC for its illicit insider trading scheme, which spanned over a decade and implicated hundreds of millions of dollars in profits and avoided losses.¹⁶ After engaging in one of the “longest-running investigations of a financial firm in Wall Street history,”¹⁷ the government “determined they didn’t have sufficient evidence to personally charge Mr. Cohen.”¹⁸ However, the Securities and Exchange Commission (“SEC”) is attempting to prevent Mr. Cohen from ever managing client money again.¹⁹

SAC’s lack of emphasis on compliance has come under fire with allegations that SAC employees “relentless[ly] pursu[ed] an information ‘edge,’” while SAC did not make any strong effort to “ensure that such ‘edge’ came from legitimate research and not [material, nonpublic information].”²⁰ Although SAC initially denied that it fostered a business environment that was friendly towards insider trading, “[t]he government claims that this criminal enterprise . . . [fostered insider trading from] soup to nuts, from hiring to compliance.”²¹ With the looming concern that the civil case would interfere with the criminal trial, the civil case was delayed until at least January.²² Additionally, several individuals who worked for

¹⁵ Jenny Strasburg & James Sterngold, *SAC Hit With Criminal Case*, WALL ST. J. (July 25, 2013, 7:39 PM), <http://online.wsj.com/article/SB10001424127887324564704578627680475592130.html>.

¹⁶ See Hurtado, Smythe & Glovin, *supra* note 1.

¹⁷ Strasburg & Sterngold, *supra* note 15.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Sealed Indictment at 4, United States v. S.A.C. Capital Advisors, L.P., (S.D.N.Y. 2013) (No. 13-CR-541).

²¹ Robert W. Wood, *SAC Indictment Could Have Silver Lining*, FORBES (Aug. 26, 2013, 8:57 AM), <http://www.forbes.com/sites/robertwood/2013/08/26/sac-indictment-could-have-silver-lining/>.

²² Chad Bray, *Judge Delays Forfeiture Case Against SAC Capital*, WALL ST. J. (Sept. 4, 2013, 11:44 AM), <http://online.wsj.com/article/SB10001424127887324577304579054953380930712.html>.

SAC have either been charged with or convicted of insider trading, or both.²³

The government charged former SAC employee Matthew Martoma with insider trading stemming from his use of nonpublic information about a clinical drug, which enabled him to profit and prevent the fund from suffering losses totaling about \$276 million.²⁴ He received information in July 2008 that the test results from an experimental Alzheimer's drug were "worse than the market anticipated" and utilized that information to "reap hundreds of millions of dollars in illegal profits."²⁵ Martoma pled not guilty to the charges and was set to go to trial in November 2013,²⁶ but his trial was delayed until January 2014.²⁷

Richard Lee, a former portfolio manager at SAC, pled guilty to insider trading and has been cooperating with the government.²⁸ Prior to working for SAC, Mr. Lee worked as a portfolio manager at Citadel and had a reputation for engaging in insider trading.²⁹ While at SAC, he received information from an Internet research analyst at Collins Stewart that Microsoft and Yahoo were in negotiations for "a strategic partnership that was expected to help bolster Yahoo's earnings by \$500 million."³⁰

Former portfolio manager Michael Steinberg received tips from his research analyst, Jon Horvath, about Dell.³¹ The information that Horvath provided enabled Mr. Cohen to avoid losses of approximately \$1.7 million.³² In the first conviction after trial of an

²³ Sealed Indictment, *supra* note 20, at 7–8.

²⁴ *Id.* at 27–28.

²⁵ Hurtado, Smythe & Glovin, *supra* note 1.

²⁶ *Id.*

²⁷ Peter Lattman, *Trial Delayed for Former SAC Executive*, N.Y. TIMES (Sept. 24, 2013, 3:11 PM), <http://dealbook.nytimes.com/2013/09/24/trial-delayed-for-former-sac-executive/>.

²⁸ Hurtado, Smythe & Glovin, *supra* note 1.

²⁹ *Id.*

³⁰ Peter J. Henning, *The Gray Line of "Confidential" Information*, N.Y. TIMES (Aug. 5, 2013, 12:51 PM), <http://dealbook.nytimes.com/2013/08/05/the-sometimes-gray-line-of-confidential-information/>.

³¹ Hurtado, Smythe & Glovin, *supra* note 1.

³² Sealed Indictment at 29–30, *United States v. S.A.C. Capital Advisors, L.P.*, (S.D.N.Y. 2013) (No. 13-CR-541).

SAC insider, a jury found Steinberg guilty on December 18, 2013.³³ This conviction constitutes “validation from a federal jury that [prosecutors] have enough evidence to prove there was insider trading at SAC.”³⁴

On November 4, 2013, the government released the terms of a settlement agreement that it reached with SAC, in which SAC pled guilty to insider trading and agreed to pay \$1.2 billion—\$900 million of which is a criminal penalty and the remaining \$284 million of which is a civil forfeiture of SAC’s tainted profits³⁵—for its illegal activity.³⁶ Among the terms of the settlement is a requirement that SAC must continue its gradual return of outside investments, though there is nothing preventing SAC from continuing to manage Mr. Cohen’s personal money as a family office.³⁷ While the agreement settles the criminal charges and civil forfeiture claims against SAC,³⁸ it is silent with respect to the civil action that the SEC filed, in which the agency is attempting to prevent Mr. Cohen from managing outside investments for the rest of his life.³⁹ Furthermore, although the judge approved the \$284 million civil forfeiture,⁴⁰ the judge responsible for approving the criminal fine has refused to do so until March.⁴¹

³³ Christopher M. Matthews, *SAC’s Steinberg Convicted in Insider-Trading Case*, WALL ST. J. (Dec. 18, 2013, 9:16 AM), <http://online.wsj.com/news/articles/SB10001424052702304773104579266554036539982>.

³⁴ *Id.*

³⁵ Ben Protess, *SAC Pleads Guilty, Then Judge Calls a Timeout*, N.Y. TIMES (Nov. 8, 2013, 8:37 PM), <http://dealbook.nytimes.com/2013/11/08/sac-capital-pleads-guilty-then-judge-calls-a-timeout/>.

³⁶ Peter Lattman & Ben Protess, *SAC Capital Agrees to Plead Guilty to Insider Trading*, N.Y. TIMES, (Nov. 4, 2013, 11:06 AM), <http://dealbook.nytimes.com/2013/11/04/sac-capital-agrees-to-plead-guilty-to-insider-trading/>.

³⁷ *Id.*

³⁸ Michael Rothfeld, *SAC Agrees to Plead Guilty in Insider-Trading Settlement*, WALL ST. J. (Nov. 4, 2013, 10:44 AM), <http://online.wsj.com/news/articles/SB10001424052702303482504579177602847708162>.

³⁹ Lattman & Protess, *supra* note 36.

⁴⁰ Protess, *supra* note 35.

⁴¹ *Id.*

D. Implications

Given the terms of the settlement agreement, SAC will never be able to return to its former prominence. Even prior to the plea deal requiring SAC to pay a \$1.2 billion penalty,⁴² SAC had suffered serious blows to its reputation and resources.⁴³ In the wake of the charges, clients began making requests to withdraw their money⁴⁴ in such substantial numbers that “only about \$1 billion of outside capital [remains] in the \$14 billion fund.”⁴⁵ Ed Butowsky, a financial advisor to high-net worth individuals and one of SAC’s most loyal clients, requested to withdraw both his and his clients’ money from SAC, given the criminal charges against the hedge fund.⁴⁶ As a result of the settlement, SAC will have to return the remaining \$1 billion of outside capital to investors.⁴⁷

SAC had already begun to fire employees before the settlement was reached, and now that the plea agreement has confirmed that SAC will not be allowed to manage any of the substantial outside investments that it did before, this trend in employee reduction will likely continue.⁴⁸ Even before the agreement mandated SAC to return outside investments,⁴⁹ Mr. Cohen and his executives had already begun discussing the possibility of turning SAC into a “family office” for managing Mr. Cohen’s personal funds.⁵⁰ After the settlement was released, SAC informed its workers that the fund would in fact be converted into a family office.⁵¹ Mr. Cohen and his top executives have about \$9 billion invested in SAC, so “the fund [would] remain very large by industry standards,” even

⁴² Lattman & Protess, *supra* note 36.

⁴³ Peter Lattman, *Facing Loss of Capital, SAC is Said to Talk of Layoffs*, N.Y. TIMES (Aug. 9, 2013, 6:43 AM), <http://dealbook.nytimes.com/2013/08/09/sac-to-keep-managing-money-while-facing-indictment/>.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ Jenny Strasburg, *SAC Loses One of Its Most Loyal Investors*, WALL ST. J. BLOG (Aug. 28, 2013, 4:05 PM), <http://blogs.wsj.com/moneybeat/2013/08/28/sac-loses-one-of-its-most-loyal-investors/>.

⁴⁷ Lattman & Protess, *supra* note 36.

⁴⁸ See Svea Herbst-Bayliss, *Some SAC Capital Investment Staff Jumping to Rival Firm*, REUTERS (Sept. 13, 2013, 4:22 PM), <http://www.reuters.com/article/2013/09/13/us-hedgefunds-sac-idUSBRE98C0Q620130913>.

⁴⁹ Lattman & Protess, *supra* note 36.

⁵⁰ Lattman, *supra* note 43.

⁵¹ Protess, *supra* note 35.

after paying the \$1.2 billion penalty.⁵² While the government determined that it did not have enough to charge Mr. Cohen for his participation in the illegal activity, the settlement arrangement enabled it to reach Mr. Cohen's fortune.⁵³

However, by settling with the government, SAC was able to avoid a massive forfeiture. Under the civil forfeiture statute, "the Government need only show that there is probable cause to believe that the property is subject to forfeiture in order to obtain the seizure warrant."⁵⁴ Once the government seizes the property in question, the burden shifts to the defendant to show that the property is not subject to forfeiture.⁵⁵ An individual can defend against a forfeiture claim by showing by "a preponderance of the evidence that he did not know of the criminal conduct giving rise to the forfeiture or upon learning of the conduct, he made a diligent effort to end the property's use for this illicit purpose."⁵⁶ However, under the theory of "conscious avoidance," a jury can find a defendant guilty of insider trading for "deliberately clos[ing] his eyes to what would otherwise have been obvious to him."⁵⁷ Here, SAC would not likely have been able to meet its burden of showing by a preponderance of the evidence that it did not know about the insider trading. There are numerous examples of insider trading that took place at SAC,⁵⁸ which makes it unlikely that SAC was unaware of the insider trading taking place. Furthermore, the charged and convicted employees who are cooperating with the government would have likely supplied it with information that would have weakened SAC's defense against the allegations. Accordingly, by settling with the government prior to trial, SAC dodged a bullet that had the potential to fatally wound the hedge fund and substantially impact Mr. Cohen's fortune.

This immense insider trading scheme will forever stain SAC's reputation. Mr. Cohen's ability to escape criminal liability

⁵² See Herbst-Bayliss, *supra* note 48.

⁵³ Strasburg & Sterngold, *supra* note 15.

⁵⁴ MaryBeth C. Allen, *Take from the Fraudulent and Give to the Defrauded: The Code's Use in Asset Recovery in Criminal Securities Fraud Cases*, 21 AM. BANKR. INST. L. REV. 191, 194 (2013) (quoting Douglas Kim, *Asset Forfeiture: Giving up Your Constitutional Rights*, 19 CAMPBELL L. REV. 527, 539 (1997)).

⁵⁵ *Id.*

⁵⁶ *Id.* at 196 (citing 18 U.S.C. § 983(d) (2006 & Supp. V 2012)).

⁵⁷ *United States v. Goffer*, 721 F.3d 113, 126 (2d Cir. 2013) (quoting *United States v. Gansman*, 657 F.3d 85, 94 (2d Cir. 2011)).

⁵⁸ See Hurtado, Smythe, & Glovin, *supra* note 1.

will not sit well with the public, although he still has support from some.⁵⁹ Skeptical critics view SAC's business model as shielding Mr. Cohen from liability while his army of traders manipulates the system to make as much money as possible.⁶⁰ SAC's president, Tom Conheaney, denies that SAC is structured so as to protect Mr. Cohen, and asserts that "[SAC] believe[s] the multi-manager model is the best model to produce attractive, risk adjusted returns over time."⁶¹

Given SAC's prominence, targeting the fund could serve as a potential deterrent to others. Those who hold a negative perception of Wall Street will only find confirmation in this scandal. SAC's insider trading scheme "is something that could easily feed into the public perception of the financial markets as a place where the average investor has no chance at a fair deal, where all the real profits are drained by insiders, and the public gets merely scraps—plus a management fee."⁶²

E. Conclusion

SAC is an incredibly successful hedge fund that has made its clients a lot of money and has consistently garnered profits. However, what will become of SAC after such a scandal? With the settlement requiring SAC to return outside money, SAC will be forced to operate at a smaller scale than it did before the indictment, though Mr. Cohen and his executives' wealth alone is sufficient to keep the hedge fund operating at a relatively large size.⁶³ If the SEC is unsuccessful in preventing Mr. Cohen from managing outside investments again, he could elect to shut down SAC and start anew, though the fund has expressed an intention to run SAC as a family

⁵⁹ See Strasburg, *supra* note 46.

⁶⁰ Nathan Vardi, *Why Billionaire Steve Cohen Doesn't Want to Manage a Family Office*, FORBES (May 28, 2013, 3:17 PM), <http://www.forbes.com/sites/nathanvardi/2013/05/28/why-billionaire-steve-cohen-doesnt-want-to-manage-a-family-office/> ("The most cynical view of Cohen's business is that he has constructed a huge organization in order to insulate himself while encouraging his traders to do whatever it takes to make money.").

⁶¹ *Id.*

⁶² Paul Vigna, *Will the SAC Case Affect Investor Confidence?*, WALL ST. J. BLOG (July 26, 2013, 3:54 PM), <blogs.wsj.com/moneybeat/2013/07/26/will-the-sac-case-affect-investor-confidence>.

⁶³ Herbst-Bayliss, *supra* note 48.

office.⁶⁴ The settlement agreement says nothing about Mr. Cohen's ability to manage outside investments, only SAC's ability to do so.⁶⁵ Such a new hedge fund could operate under the same ownership and with the same employees and investors would know that they are dealing with SAC, except under a different name. Given that SAC's aggressive trading has benefitted investors, some might be quick to return to Mr. Cohen if given the chance. However, others might be hesitant to associate with this quasi-new hedge fund, considering it still faces the stigma of rampant cheating. Nonetheless, SAC (or the new hedge fund) will be required to change its business model so that there is a stricter emphasis placed on compliance. Otherwise, Mr. Cohen may once again find himself in a similar situation.

The government's attack on SAC's insider trading has been incredibly aggressive. If this is the position that the government will be taking in its efforts to combat insider trading, those in the financial world will find themselves either thinking twice about utilizing nonpublic information or calculating the safest way to utilize it without getting caught. The attack on SAC has demonstrated that the government will not tolerate insider trading and will pursue offenders, regardless of their size. While SAC's admittance of guilt is uncommon,⁶⁶ doing so puts SAC in a position to possibly survive the current situation, and other large firms who find themselves in a similar situation might be less hesitant to follow suit. However, until the judge puts her stamp of approval on the settlement agreement, SAC's fate will remain unresolved. Should the judge choose to deny the settlement agreement, SAC can retract its admission of guilt.⁶⁷ Regardless, given the fact that SAC has already demonstrated it is willing to accept guilt, settlement seems inevitable, irrespective of this potential hiccup.

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⁶⁴ Protess, *supra* note 35.

⁶⁵ Lattman & Protess, *supra* note 36.

⁶⁶ *Id.*

⁶⁷ Protess, *supra* note 35.

⁶⁸ Student, Boston University School of Law (J.D. 2015).