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SAC Capital: Firm Criminal Liability, Civil Fines, And The Insulated CEO

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SAC CAPITAL: FIRM CRIMINAL LIABILITY, CIVIL FINES, AND THE INSULATED CEO

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INTRODUCTION

Since 2009, the business pages of many major newspapers have been rife with stories about insider trading. The name most often in the headline of these stories is Preet Bharara, U.S. Attorney for the Southern District of New York.¹ Since taking on the job of fighting insider trading on a large scale, he boasts a 78-1 record for convictions.² However, one man has evaded that scorecard even though his company and several employees have earned criminal and civil convictions.

S.A.C. Capital Advisors, L.P. (“SAC”) was once a \$14-billion hedge fund with one of Wall Street’s best records for performance.³ Steven A. Cohen, the owner and namesake of SAC, was the subject of admiring profiles in everything from the *New York Times*⁴ to *Vanity Fair*.⁵ He was

1. See *Meet the U.S. Attorney Preet Bharara*, U. S. DEP’T JUSTICE, <http://www.justice.gov/usao/nys/meetatorney.html> (last updated May 14, 2015).

2. See Julia La Roche, *Here’s Preet Bharara’s Amazing 79-0 Insider Trading Conviction Score Card*, BUSINESS INSIDER (Feb. 6, 2014, 4:30pm), <http://www.businessinsider.com/bharara-insider-trading-convictions-2014-2> (stating that the headline reports a 79-0 record but that the number has changed and will continue to change to include more losses for Bharara because a federal appellate court has held that the conduct an insider trading defendant was engaged in did not rise to the level of criminal insider trading); see also *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014) (finding that the court reversed the conviction of hedge fund manager Anthony Chiasson because the government had not established that Mr. Chiasson actually knew that the information he was receiving from various networks was non-public information and it also found that some of the information came from other managers, brokers, and traders and that he would have no way of knowing if the information was non-public. On the heels of this reversal, lawyers for many of the other defendants were already working to have plea agreements set aside on the grounds that the law was misunderstood at the time of the pleas); Matthew Goldstein & Ben Protes, *Some Accused of Insider Trading May Rethink Their Guilty Pleas*, N.Y. TIMES Dec. 12, 2014, at B3 (emphasizing that the case turned on the element of scienter, or criminal intent).

3. Peter Lattman, *SAC Capital to Try to Reassure Investors*, N.Y. TIMES (Nov. 27, 2012, 3:30 PM), http://dealbook.nytimes.com/2012/11/27/sac-to-hold-client-call-amid-insider-trading-case/?_r=0.

4. Jenny Anderson et al., *A Fascination of Wall St., and Investigators*, N.Y. TIMES (Dec. 22, 2012), http://www.nytimes.com/2012/12/23/business/steven-cohen-of-sac-is-fascinating-to-investigators-too.html?_r=0.

5. Christopher Bateman, *Steve Cohen on Life, Love, His Art Collection, and Those Pesky Insider-Trading Rumors*, VANITY FAIR (June 2, 2010, 12:01am), <http://www.va>

once number thirty-six on *Forbes'* list of richest Americans worth an approximated \$11 billion;⁶ Mr. Cohen was called “the king of hedge funds.”⁷ Mr. Cohen received attention for his art collection (valued at \$1 billion) and his thirty-room mansion in Connecticut.⁸ However, as his wealth and successes increased, there was attention building and many questioned, “How does he do it?” The two questions that swirled around SAC were: (1) How did the hedge fund outperform every other fund?; and (2) Why were so many current and former SAC traders being indicted, convicted, or entering guilty pleas for insider trading?

As a result of these questions, the Financial Industry Regulatory Authority (“FINRA”) began making referrals to the United States Securities and Exchange Commission (“SEC”) in 2010 for possible insider trading by SAC. In July 2013, the Department of Justice (“DOJ”) filed a criminal indictment against SAC Capital.⁹

I. IMPLICATIONS OF THE FIRM’S INDICTMENT

SAC lawyers originally entered a not guilty plea to the charges.¹⁰ Employees and investors were sent an email saying that it would be business as usual for SAC’s 1000 employees and its offices in eight cities around the world.¹¹ Eventually, SAC’s strategy would shift from complete denial to acceptance as the company agreed to plead guilty to settle criminal and civil charges.¹² It is a rare move for federal prosecutors to indict a corporation, but as of mid-July 2013 (the time of the charges), SAC’s main portfolio was up eleven percent when most hedge funds were

nityfair.com/online/daily/2010/06/steve-cohen-on-life-love-his-art-collection-and-those-pesky-insider-trading-rumors.

6. *The World’s Billionaires Steve Cohen*, FORBES, <http://www.forbes.com/profile/steve-cohen/> (last updated June 18, 2015).

7. Bateman, *supra* note 5.

8. Julia La Roche, *The Fabulous Life of Hedge Fund Legend Steven Cohen*, BUSINESS INSIDER (Dec. 7, 2012, 10:26 AM), <http://www.businessinsider.com/the-fabulous-life-of-steve-cohen-2012-12?op=1>.

9. *United States v. SAC Capital Advisors LP*, No. 13-cr-00541 para. 1, <http://www.justice.gov/sites/default/files/usao-sdny/legacy/2015/03/25/SAC%20Indictment%20%28Stamped%29.pdf> [hereinafter *Indictment*].

10. Bernard Vaughn, *SAC Capital pleads not guilty to insider-trading charges*, REUTERS (July 26, 2013, 12:42 PM), <http://www.reuters.com/article/2013/07/26/us-sac-fund-charges-idUSBRE96O0SD20130726>.

11. Matthew Goldstein, *SAC Capital CEO Steven Cohen Throws a Party Despite Indictment*, HUFFINGTON POST (July 28, 2013, 3:15 PM), http://www.huffingtonpost.com/2013/07/28/steven-cohen-party-despite-indictment_n_3667713.html.

12. Christopher M. Matthews, *Judge Oks Guilty Plea in SAC Capital Insider-Trading Case*, WALL ST. J. (Apr. 10, 2014, 12:39 PM), <http://blogs.wsj.com/law/2014/04/10/judge-oks-guilty-plea-in-sac-capital-insider-trading-case/>.

up approximately 3.2 percent.¹³ As more individual traders from SAC began to face individual criminal convictions and details of the pervasive criminal corporate culture began to surface, it became clear the investigation into SAC would continue.

In November 2013, there was an announcement of the settlement of the SAC criminal charges.¹⁴ The government outlined the terms. SAC agreed to pay \$900 million in forfeiture and a \$900 million fine.¹⁵ The firm received credit for a \$616 million already paid to the SEC to settle civil charges, bringing the total fine to just under \$1.2 billion.¹⁶ SAC, and by extension Mr. Cohen as the owner of the firm, agreed to pay the fine.¹⁷ However, Mr. Cohen was not charged criminally, and in statements released after the settlement, SAC pointed the finger at a small group of employees.¹⁸ He maintains that he bears no personal criminal responsibility.¹⁹ Mr. Cohen wisely seized on the weakness that the appellate court found in a previous case;²⁰ that the government needs to show that Mr. Cohen actually knew that the information his traders and managers were using was nonpublic.²¹ Again, since the traders and managers gathered the information from different sources, including other brokers, traders, and managers, that direct line to nonpublic information is not easily established.

The case presents a series of unresolved legal questions about civil and criminal liability of financial firms, how the two types of cases are intertwined, and the role and culpability of firm leadership in these charges. Bharara has alleged that the company is a “magnet for market cheaters.”²²

13. Goldstein, *supra* note 11.

14. Press Release, U.S. Dep’t Justice, Manhattan U.S. Attorney Announces Guilty Plea Agreement With SAC Capital Management Companies (Nov. 4, 2013), <http://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-guilty-plea-agreement-sac-capital-management-companies>.

15. *Id.*

16. *Id.*

17. *Id.*

18. Michael Rothfeld, *SAC Agrees to Plead Guilty in Insider-Trading Settlement*, WALL ST. J., <http://www.wsj.com/articles/SB10001424052702303482504579177602847708162> (last updated Nov. 4, 2013, 10:03 PM).

19. Linette Lopez, *Here’s The 46-Page White Paper Steve Cohen Gave To SAC Employees Yesterday Explaining Why He Didn’t Do Anything Wrong*, BUSINESS INSIDER (Jul. 23, 2013, 2:12 PM), <http://www.businessinsider.com/cohen-sac-white-paper-2013-7>.

20. *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

21. *Id.*

22. Julie Creswell, *A Relentless Prosecutor’s Crowning Case*, N.Y. TIMES (July 25, 2013, 8:24 PM), http://dealbook.nytimes.com/2013/07/25/a-relentless-prosecutors-crowning-case/?_php=true&_type=blogs&_r=0.

Is being a magnet for cheaters criminal activity? Can a culture that seems to breed insider trading be a basis for criminal charges? The case against SAC takes the firm's criminal culpability into uncharted waters.

Exploration of this potential criminal culpability and culture will begin with a review of the history of SAC and Mr. Cohen with respect to interactions with regulators. A summary of the insider trading cases brought against former and current SAC employees will follow. Finally, there is analysis of how and when activities and knowledge can be attributed to firms for purposes of imposing criminal culpability and how this has left Mr. Cohen seemingly untouchable.

II. A HISTORY OF FRAUD: COHEN'S LEGAL AND REGULATORY INTERACTIONS

Mr. Cohen first drew the attention of regulators early in his career. In 1991, as a young trader, Mr. Cohen was censured by the New York Stock Exchange and barred from trading for four weeks because he was alleged to have made a trade that inflated the price of a stock in order to protect him from losses.²³ The result of the inflation trade was that his position loss was cut in half. Mr. Cohen was terminated because of the trade, and SAC was born.²⁴

Questions arose surrounding SAC, Mr. Cohen, and insider trading long before the current criminal indictment of the corporation. For example, in 2003, Holly B. Becker, formerly of Lehman Brothers, was investigated by the SEC for passing along advance information to her then husband, who was a principal in SAC.²⁵ There were indications that the trading positions of Ms. Becker's husband coincided with the information he may have received through advance copies of the reports, however, no charges were ever filed.²⁶

Almost twenty years later, accusations still abounded. Mr. Cohen's former wife, Patricia Cohen, filed suit alleging that Mr. Cohen had made \$20 million in profit by trading in advance of General Electric's ("GE") purchase of RCA Corporation based on an insider tip regarding the acquisition that he had received in advance of the GE announcement.²⁷ The case was peripheral to the couple's divorce, and no charges were ever brought.²⁸ As these individual issues were percolating through innuendo,

23. Anderson et al., *supra* note 4.

24. *Id.*

25. Gretchen Morgenson, *Analyst and Her Husband Under Scrutiny*, N.Y. TIMES, Jan. 15, 2003, at C1.

26. *See id.*; *see also* Anderson et al., *supra* note 4.

27. Anderson et al., *supra* note 4.

28. *Id.*

general questions about SAC continued to emerge in the business press. The “numbers” SAC achieved were labeled as “off the charts” and the compensation paid to SAC employees as “unmatchable,” and those in the financial world sought to understand SAC’s ability to defy market trends.²⁹ Interest into what was going on behind closed doors only continued to grow when individual former and current employees of the company began to be systematically indicted.³⁰

III. CRIMINAL CULPABILITY THROUGH ATTRIBUTION OF CULTURE AND CONDUCT: WAS COMPLIANCE OR LACK OF COMPLIANCE A BASIS FOR CRIMINAL LIABILITY?

The forty-one-page indictment against SAC alleged that the corporate entities have

criminal responsibility for insider trading offenses committed by numerous employees and made possible by institutional practices that encouraged the widespread solicitation and use of illegal inside information. Unlawful conduct by individual employees and an institutional indifference to that unlawful conduct resulted in insider trading that was substantial . . . [and] pervasive.³¹

A. Culture Factor One: Continuing Success Does Not Yield Scierer Even When Results Defy Odds

Tying Mr. Cohen to SAC’s misdeeds, however, was a challenge for the federal government. SAC employees have noted that Mr. Cohen was not present at many of the compliance training sessions.³² In a 2011 deposition, Mr. Cohen said that he had read SAC’s compliance model but did not “remember exactly what it says.”³³ Although it seems clear to many that Mr. Cohen was SAC and SAC was Mr. Cohen, finding him personally responsible has been a difficult task. It seems clear that Mr. Cohen may have tolerated, ignored, fostered, or otherwise allowed the insider trading culture of SAC, but proof of actual knowledge of the details of each trader’s or manager’s actions has been elusive. The distance between the Chief Executive Officer (“CEO”) and employees in actual knowledge is great in these situations. An inkling that something nefarious may be afoot does not scierer make.

29. *Id.*

30. *See id.*

31. *Indictment, supra* note 9 para. 1.

32. James B. Stewart, *At SAC, Compliance with an Edge*, N.Y. TIMES, Feb. 26, 2013, at B1, available at <http://www.nytimes.com/2013/07/27/business/at-sac-rules-compliance-with-an-edge.html>.

33. *Id.*

B. Culture Factor Two: The Compliance Component

Until 2008, SAC had a policy of purging all instant messages (“IMs”) after thirty-six hours and all emails not specifically saved after thirty days. The indictment specified, that although the compliance department had recommended reviewing electronic communications by employees, they were “rarely reviewed.”³⁴ However, SAC later boasted that it had a thirty-eight employee compliance department, which was one of the “earliest, most sophisticated, most expensive, and most far-reaching in the industry.”³⁵ The claims by SAC in touting its compliance operations to investors was that those operations included the following:

[D]aily reviews’ of email and IMs; a 100% electronic retention policy; restrictions on the use of expert networks; and even surveillance of employee communications. It is true that most of these key compliance measures were instituted after the trades that are the focus of the indictments, but it also appears they were instituted before SAC became aware of the current investigation.³⁶

The indictment alleged that, regardless of their relatively new compliance policies, it has become clear that the culture fostered by SAC produced “hundreds of millions of dollars of illegal profits and avoided losses at the expense of members of the investing public.”³⁷ The issue is, however, does sloppy compliance equal scienter? The indictment falls short of tying the activities of the traders to Mr. Cohen thus attributing to him the knowledge of ongoing and uncorrected criminal activity that is required for executive and corporate criminal culpability.³⁸

Federal Bureau of Investigation (“FBI”) Assistant Director George Venizelos said,

SAC [. . .] and its management fostered a culture of permissiveness. SAC not only tolerated cheating, it encouraged it. According to the FBI, the aim all along has been to root out the wrongdoers, and send a message to anyone else inclined to break the law. If your information ‘edge’ is inside information, you can’t trade on it.³⁹

Ironically, Mr. Cohen said in a 2011 deposition that he found the law on

34. *Indictment*, *supra* note 9 para. 24.

35. Roger Parloff, *USA v SAC A simply Unanswerable Indictment*, FORTUNE (July 26, 2013, 6:08 PM), <http://fortune.com/2013/07/26/usa-v-sac-a-simply-unanswerable-indictment/>.

36. *Id.*

37. *But see id.*

37. *Indictment*, *supra* note 9 para. 7.

38. *United States v. Park*, 421 U.S. 658 (1975).

39. Patricia Hurtado et al., *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>.

insider trading to be “very vague.”⁴⁰ It is difficult to find the records of internal audits on questionable trades at SAC, and sanctions against traders appear to be non-existent. Former SEC chairman, Harvey Pitt, who was a speaker at SAC explained, “[m]y sense was that it was a check-the-box mentality, not a serious commitment.”⁴¹

IV. THE SAC EMPLOYEES AND FORMER EMPLOYEES WHO HAVE BEEN CHARGED WITH INSIDER TRADING

There is a “trail” of insider trading that surrounds SAC. Arguably, investigators just follow where the facts lead them, and many insider trading cases seem to lead back, in some way, to SAC through current or former employees.⁴² This is evidence of the type of corporate culture fostered at SAC in which using questionable means to obtain an “edge” was commonplace.

The history of current and former SAC employees contains many who were accused, and convicted, of insider trading. Those who have been charged with insider trading with connections to SAC include Noah Freeman, Donald Longueuil, Jon Horvath, Wesley Wang, Mathew Martoma, Richard Choo-Beng Lee, and Michael Steinberg.⁴³ Mr. Martoma was found guilty on two counts of securities fraud and one count of conspiracy, and he was sent to prison for nine years.⁴⁴ Mr. Longueuil pleaded guilty but did not assist in the investigation.⁴⁵

Former portfolio manager, Mr. Lee, plead guilty to insider trading on July 23, 2013, and he is cooperating with the investigation as are Mr. Freeman, Mr. Horvath, and Mr. Wang.⁴⁶ Among the traders Mr. Lee implicated was Richard Grodin who worked for SAC in the 1990s, and he was able to provide the FBI with information about the culture of the company, including the extensive use of expert networks.⁴⁷ Bharara has described the analysts and portfolio managers as maintaining a “tight-knit circle of greed.”⁴⁸

40. Stewart, *supra* note 32.

41. *Id.*

42. See Bryan Burrough & Bethany McLean, *The Hunt for Steven Cohen*, VANITY FAIR (June 2013), <http://www.vanityfair.com/news/business/2013/06/steve-cohen-insider-trading-case> (detailing the history of investigations into insider trading with multiple links to SAC through current or former employees).

43. *Id.*

44. Kevin McCoy, *SAC Capital Trader Gets 9 Years*, USA TODAY, Sept. 9, 2014, at 2B.

45. Hutardo et al., *supra* note 39.

46. *Id.*

47. See Burrough et al., *supra* note 42.

48. Hutardo et al., *supra* note 39.

Although not named in the indictment, Mr. Cohen is alleged to have sold his entire portfolio of \$12.5 million in Dell Inc. (“Dell”) after an insider tip from Mr. Horvath.⁴⁹ This sell-off avoided losses of approximately \$1.7 million.⁵⁰ After Dell publically reported lesser earnings, Mr. Cohen sent an email to Horvath that said “Nice job on Dell.”⁵¹ Mr. Cohen’s lawyers say that he never read that first email.⁵²

V. THE SAC HIRING PROCESS

There are times when traders go south because of the culture of a firm, but there are other times when traders have already gone south, and they are hired precisely because of their sordid past. For example, one of the young traders hired at SAC was Richard S. Lee, a 34-year-old trader who was hired from Citadel, a Chicago-based hedge fund.⁵³

Mr. Lee was fired after one day on the job at Citadel because he signed onto the company’s accounting system and altered the value of his holdings by \$4.5 million.⁵⁴ Citadel’s accounting system caught the problem, and he was terminated.⁵⁵ Ordinarily, this type of behavior by a trader would mean the end of a trader’s career. No financial firm would want to risk having such an individual anywhere near client’s funds or its accounting systems. SAC, on the other hand, was more than willing to hire someone whose career was over by market standards. Despite warnings from both Citadel (whose CEO had approved Lee’s termination), as well as warning from SAC’s own legal team about the compliance risks of bringing Mr. Lee into the firm, Mr. Lee was hired.⁵⁶ Mr. Lee has disclosed that he emphasized his reliance on expert networks in doing his job during his subsequent

49. *Id.*

50. *Indictment, supra* note 9, para. 32a.

51. Press Release, SEC, SEC Charges Steven A. Cohen with Failing to Supervise Portfolio Managers and Prevent Insider Trading (July 19, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539726923#.U4ye0PldVqU> (alleging that Steinberg replied, “Thanks . . . this ole dog can still hunt.”); *see also* Sheelah Kolhatkar, *Specter of Steven Cohen Haunts SAC Capital Portfolio Manager’s Trial*, BLOOMBERG (Dec. 3, 2013) <http://www.businessweek.com/articles/2013-12-03/specter-of-steven-cohen-haunts-sac-capital-portfolio-managers-trial>.

52. *See* Katherine Burton, *SAC’s Cohen Doesn’t Recall Dell E-Mail Cited in SEC Order*, BLOOMBERG (July 23, 2013, 5:20 PM), <http://www.bloomberg.com/news/2013-07-23/sac-s-cohen-doesn-t-recall-dell-e-mail-cited-in-sec-order.html> (alleging that Cohen only opened approximately 11 percent of his email messages).

53. Hutardo et al., *supra* note 39.

54. Ben Protes & Peter Lattman, *Trader’s Hiring Offers a Glimpse of SAC Practices*, N.Y. TIMES, Aug. 2, 2013, at A1.

55. *Id.*

56. *Id.*

interview with SAC.⁵⁷ Mr. Lee was indicted for insider trading, has entered a guilty plea, and has cooperated with the government on the SAC case.⁵⁸

Mr. Lee has indicated that federal authorities have sought his cooperation by asking for information about the questions asked and statements made during his hiring process.⁵⁹ When SAC was asked for information about its hiring processes, it responded by indicating that it does not take the hiring process lightly and that it has refused to hire some individuals because of concerns about “compliance issues.”⁶⁰ However, SAC has declined to give any examples of its refusal to hire someone because of compliance concerns.⁶¹

Insider trading cases against six former SAC employees have shed light on the expectations that came through the hiring process. Noah Freeman, shortly after graduating from Harvard, joined SAC and has told the FBI “that trafficking in corporate secrets was part of his job description at SAC.”⁶² An FBI agent’s notes on SAC include the following, “Freeman and others at SAC Capital understood that providing Cohen with your best trading ideas involved providing Cohen with inside information.”⁶³ Bharara noted that the “indictment is not just a narrative of names and numbers, it is more broadly an account of a firm with zero tolerance for low returns but seemingly tremendous tolerance for questionable conduct.”⁶⁴

E-mails within SAC emphasize some interesting credentials of new hires, including items such as the fact that a trader owned a share of a house in the Hamptons with one company’s CEO or that another was “tight with management” of another company.⁶⁵ Education, former employers, and achievements are generally the focus of circulated information about new employees. However, at SAC, connections were touted as qualifications for the job.

VI. TESTING THE EVIDENCE: THE CONVICTION OF MICHAEL STEINBERG

Michael Steinberg was one of SAC’s most senior portfolio managers.⁶⁶

57. *Id.*

58. *Id.*

59. *Id.*

60. Stewart, *supra* note 32.

61. *Id.*

62. Peter Lattman, *Trail to a Hedge Fund, From a Cluster of Cases*, N.Y. TIMES, Dec. 5, 2012, at A1.

63. *Id.*

64. Hurtado et al., *supra* note 39.

65. Stewart, *supra* note 32.

66. Nate Raymond & Matthew Goldstein, *More Trouble for Cohen’s SAC Capital*

He was close to Mr. Cohen, and the pair attended the same high school.⁶⁷ Mr. Horvath worked under Mr. Steinberg and was tasked with researching investments for him.⁶⁸ Mr. Horvath testified in court that Mr. Steinberg urged him to seek insider tips. In a meeting, Mr. Steinberg told Mr. Horvath “What I need you to do is go out and get me edgy, proprietary information that we can use to make money in these stocks.”⁶⁹ Mr. Horvath explained that he took this as a push to go out and seek nonpublic information.⁷⁰

A jury convicted Mr. Steinberg in December 2013 of conspiracy and securities fraud.⁷¹ He was found guilty of five counts related to illegal tips on technology stocks provided by Mr. Horvath to bring in \$1.4 million in illegal profits to SAC.⁷² This was the first case in which federal prosecutors attempted to convince a jury in a criminal proceeding that there was enough evidence to prove insider trading at SAC.⁷³ Mr. Steinberg appeared to briefly faint after being convicted.⁷⁴

On May 16, 2014, Mr. Steinberg was sentenced to forty-two months in prison but remains at home awaiting the result of his appeal.⁷⁵ This sentence length was considerably lower than the six and a half years sought by prosecutors. Approximately, seventy character letters were submitted on Mr. Steinberg’s behalf for sentencing, and Justice Richard Sullivan acknowledged the support. However, Justice Sullivan noted that –

The fact is you didn’t need to commit these crimes There are very

indicted in NY, REUTERS (Mar. 29, 2013, 2:35 PM), <http://www.reuters.com/article/2013/03/29/us-sac-steinberg-insidertrading-idUSBRE92S06O20130329>.

67. Sheelah Kolhatkar, *Why SAC Capital’s Steven Cohen Isn’t in Jail*, BLOOMBERG (Jan. 2, 2014), <http://www.businessweek.com/articles/2014-01-02/why-sac-capitals-steven-cohen-isnt-in-jail#p1>.

68. *Id.*

69. *Id.*

70. *Id.*

71. Patricia Hurtado, *SAC Manager Guilty as Insider Focus Turns to Martoma*, BLOOMBERG (Dec. 19, 2013, 12:00 AM), <http://www.bloomberg.com/news/2013-12-18/sac-fund-manager-steinberg-guilty-in-insider-trading-case.html>.

72. *Id.*

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

74. Agustino Fontevecchia, *Preet Bharara Closing In On SAC’s Steve Cohen After Michael Steinberg Found Guilty Of Insider Trading*, FORBES (Dec. 18, 2013, 6:25 PM), <http://www.forbes.com/sites/afontevecchia/2013/12/18/preet-bhararas-insider-trading-crusade-takes-down-ex-sac-trader-michael-steinberg-is-steve-cohen-next/>.

75. Sheelah Kolhatkar, *Former SAC Capital Manager Steinberg Sentenced to Three and a Half Years*, BLOOMBERG BUSINESSWEEK (May 16, 2014), <http://www.businessweek.com/articles/2014-05-16/former-sac-capital-portfolio-manager-steinberg-sentenced-to-3-dot-5-years> (as of the time of this writing).

few people in the history of mankind who've had all the material things you had – not to mention the immaterial things, a family who loved you, people who relied on you. There were lots of reasons not to engage in this conduct.⁷⁶

Mr. Steinberg was also ordered to pay a \$2 million fine and forfeit approximately \$365,000 gained through illegal trading.⁷⁷

VII. BUILDING A BRIDGE TO COHEN: MATHEW MARTOMA'S CONVICTION

Mathew Martoma was, at one time, another high-ranking player at SAC.⁷⁸ As noted, he was found guilty of insider trading in February 2014, and his case is on appeal after receiving a nine-year sentence in September 2014.⁷⁹ However, Mr. Martoma's insider trading allegations provide a possible direct connection to Mr. Cohen himself. He was the only SAC official connected, in criminal court, directly to Mr. Cohen prior to making an illegal insider trade. This direct connection makes Mr. Martoma's conviction extremely valuable to prosecutors.

Mr. Martoma received private information from Dr. Gilman, an Alzheimer's expert at the University of Michigan. Dr. Gilman was overseeing the clinical trial of the Alzheimer's drug, bapineuzumab.⁸⁰ Two weeks before the final drug results were due, Mr. Martoma spoke to Dr. Gilman who told him the drugs were underperforming.⁸¹ It could be inferred that Mr. Martoma directly discussed this inside information with Mr. Cohen during a twenty-minute phone conversation based on the fact that SAC began purging its holdings in the companies associated with the drug a day after the conversation took place.⁸² The indictment alleges that Mr. Cohen encouraged Mr. Martoma to speak with the doctor running the clinical trials and took no action to determine whether the employees under his supervision were engaged in unlawful conduct.⁸³ After this

76. *Id.*

77. Kevin McCoy, *Ex-SAC Capital trader gets prison sentence*, USA TODAY (May 16, 2014, 2:46 PM), <http://www.usatoday.com/story/money/business/2014/05/16/michael-steinberg-sentencing/9091093/>.

78. See Kolhatkar, *supra* note 67.

79. Bob Van Voris, *SAC's Martoma Denied Bid to Remain Free in Insider Case*, BLOOMBERG BUSINESS (Nov. 12, 2014, 12:06 PM), <http://www.bloomberg.com/news/articles/2014-11-12/steven-a-cohen-testimony-to-be-focus-of-martoma-appeal>; see also Kevin McCoy, *Ex-SAC Capital trader gets 9-year sentence*, USA TODAY (Sept. 8, 2014, 8:14 PM), <http://www.usatoday.com/story/money/business/2014/09/08/martoma-sentencing-insider-trading/15148411/>.

80. Kolhatkar, *supra* note 67.

81. *Id.*

82. *Id.*

83. *In re Steven A. Cohen*, Investment Advisors Act Release No. 3634, 2013 WL 3776681, para. 69 (July 19, 2013), <https://www.sec.gov/litigation/admin/2013/ia->

conversation with Mr. Cohen, SAC removed \$700 million of investments affected by these trials surrounding the pharmaceutical companies Elan and Wyeth.⁸⁴ Mr. Martoma's insider trading deals provided SAC with approximately \$275 million in illicit earnings.⁸⁵

Mr. Martoma was drawn to SAC originally by a guarantee of specific profits from his own portfolio and a portion of proceeds in the Cohen and CR Intrinsic accounts.⁸⁶ This compensation package was a direct pathway to money that no other hedge fund was offering.⁸⁷ Mr. Martoma had a biology degree from Duke. He had work experience at the National Human Genome Research Institute, and he is married to a physician.⁸⁸ This background is what may have drawn him to pharmaceutical stocks.⁸⁹

The year of the big pharmaceutical trade, Mr. Martoma was rewarded for his suspicious conduct with a \$9.3 million bonus.⁹⁰ In 2009 and 2010, Mr. Martoma did not receive a bonus.⁹¹ He was subsequently fired in 2010 for poor performance.⁹² In a 2010 email, which suggested that Mr. Martoma be fired, a firm member wrote that Mr. Martoma was a "one trick pony."⁹³ This evaluation is some indication of the SAC culture; the rewards came only for the large deals based on "edgy" information (at best). The reprimands came for not replicating the same proficiency with other trades. When Mr. Martoma was first approached by federal investigators after allegations of insider trading, he fainted on his front lawn.⁹⁴ However, Mr. Martoma's conviction has not had a profound effect on Mr. Cohen because prosecutors at the U.S. Attorney's Office in Manhattan have not been able to convince Mr. Martoma to provide them with enough information to implicate Mr. Cohen personally.⁹⁵

Turning on another executive in exchange for a more lenient sentence

3634.pdf [hereinafter *SEC Proceeding*].

84. *Id.* para. 82.

85. *Id.* para. 90.

86. Kolhatkar, *supra* note 67.

87. *Id.*

88. *Id.*

89. *Id.*

90. *SEC Proceeding, supra* note 83, para. 91.

91. *Id.* para. 93.

92. *Id.* para. 94.

93. *Id.* para. 94.

94. *E.g.*, Ausustino Fontevecchia, *After Martoma's Insider Trading Conviction, Will Preet Bharara Finally Go After Steve Cohen?*, FORBES (Feb. 6, 2014, 6:30 PM), <http://www.forbes.com/sites/afontevecchia/2014/02/06/after-martomas-insider-trading-conviction-will-preet-bharara-finally-go-after-steve-cohen/>.

95. Kolhatkar, *supra* note 67.

has been a common occurrence on Wall Street.⁹⁶ The Former Chief Financial Officer (“CFO”) of Enron, Andrew Fastow, received a more lenient sentence in exchange for testifying against his superiors.⁹⁷ Recent insider trading cases featured similar exchanges with Anil Kumar testifying against the Galleon Group Founder, Raj Rajaratnam, and Goldman Sachs Board Member, Rajat Gupta.⁹⁸ These cooperators plead guilty and avoided trial in their exchange for a lesser sentence.⁹⁹ The odds of Mr. Martoma providing prosecutors with information regarding Mr. Cohen may now be diminished because of the conviction, which may result in a reduced incentive to cooperate.

As noted, Mr. Martoma was sentenced in September of 2014.¹⁰⁰ Probation officials recommended eight years, while the federal sentencing guidelines suggested somewhere between 15.6 and 19.7 years, the sentence was for nine years.¹⁰¹ Mr. Martoma’s lawyers asked for a more lenient sentence considering his devotion to his family, his 100 support letters, and his history of helping others.¹⁰² The judge went with the lesser figure for what appeared to be consideration for his family.

VIII. WHY MR. MARTOMA WILL NOT TALK

Months before Mr. Martoma was fired he wrote an email to Mr. Cohen that read,

SAC is a special place to me. Having attended graduate and undergraduate programs at Harvard, Stanford and Duke; founded/sold my own healthcare company; and worked as a Director at the largest federally funded science initiative in the last 3 decades, I have a variety of experiences to compare against my time at SAC[.]

He continued, “through it all, it’s clear to me that I am in my element here at SAC.”¹⁰³ These strong feelings towards SAC, and the hefty profits made during his tenure, may provide some explanation for why Mr. Martoma has stood firm in his refusal to provide information to the federal

96. See, Sheelah Kolhatkar, *On the Trial of SAC Capital’s Steven Cohen*, BLOOMBERG BUSINESS (Jan. 17, 2013), <http://www.bloomberg.com/bw/articles/2013-01-17/on-the-trail-of-sac-capitals-steven-cohen#p2>.

97. Michael Bobelian, *What Does Martoma’s Conviction Mean For SAC Capital’s Steven Cohen?*, FORBES (Feb. 7, 2014, 11:36 AM), <http://www.forbes.com/sites/michaelbobelian/2014/02/07/what-does-martomas-conviction-mean-for-sac-capitals-steven-cohen/>.

98. *Id.*

99. *See id.*

100. McCoy, *supra* note 77.

101. *See id.*

102. *Id.*

103. Kolhatkar, *supra* note 67.

prosecutors. Mr. Martoma was also able to rely on SAC to pay his legal fees.¹⁰⁴

The value of his testimony has also already been significantly diminished by facts that came out in his own criminal trial. Convictions on counts of fraud and conspiracy do not bolster his credibility.¹⁰⁵ In the course of his trial, it also became apparent that he was expelled from Harvard Law School for falsifying his transcript when he applied for a clerkship with a federal judge.¹⁰⁶ The end result was that the two SAC employees with direct contact to Mr. Cohen, Mr. Martoma and Mr. Steinberg, refused to cooperate with the government.¹⁰⁷ Business journalist Robert Boxwell noted, “to police Wall Street, go after the little guys.”¹⁰⁸ The hope was that the “little guys” would sing, but there is a loyalty here that finds the little guys falling on their swords for the big fish.

The recent decision on insider trading will only increase this trend. The decision has muddied the waters on scienter and put in place a standard that requires a direct connection to an insider in order to establish criminal securities fraud. The research networks that resulted in so many indictments, pleas, and convictions are now a gray area of the law. Second-hand information is not the stuff of insider trading. In Mr. Martoma’s case, even when the direct connection is established to the physician/scientist, the trader was unwilling to implicate principals in the firm in exchange for a lesser sentence.

IX. HOW COULD MR. COHEN BE HELD CRIMINALLY RESPONSIBLE FOR THE MISDEEDS OF SAC?

Interestingly, prosecutor Bharara published an article on the liability of corporate defendants in 2007.¹⁰⁹ He traced the genesis of corporate liability in the United States starting with the 1909 case of *NY Central & Hudson River Railroad Co. v. United States*.¹¹⁰ That case focused on the concepts of vicarious liability and respondeat superior, and the court concluded that

104. Sheelah Kolhatkar, *A Novel Insider-Trading Defense? Any Defense at All*, BLOOMBERG BUSINESSWEEK (Jan. 30, 2014), <http://www.businessweek.com/articles/2014-01-30/a-novel-insider-trading-defense-any-defense-at-all>.

105. Massimo Calabresi, *New Guilty Verdict Could Be Bad News For SAC Capital's Steven Cohen*, TIME (Feb. 6, 2014), <http://time.com/5312/mathew-martoma-sac-capital/>.

106. *Id.*

107. Robert Boxwell, *To police Wall Street, go after the little guys*, REUTERS (May 16, 2014), <http://blogs.reuters.com/great-debate/2014/05/16/to-police-wall-street-go-after-the-little-guys/>.

108. *Id.*

109. Parloff, *supra* note 35.

110. 212 U.S. 481 (1909).

“the action of an agent, while exercising the authority delegated to him to make rates for transportation may be controlled in the interest of public policy by imputing his act to his employer and imposing penalties upon the corporation for which he is acting in the premises.”¹¹¹ After discussing the collective entity doctrine, Bharara concluded that “the corporation is particularly ill equipped to defend itself, and certainly less well equipped than the traditional individual defendant, against the power of prosecutors to prove virtually any corporate entity guilty upon showing criminal conduct on the part of at least one employee.”¹¹²

Bharara argued that there is a need to address overbroad corporate liability standards.¹¹³ In this case, a federal judge admonished the government for coercing a company to interfere with its employee’s constitutional rights.¹¹⁴ The conduct was criticized because it allowed prosecutors to use unjustifiably heavy-handed techniques to compel corporations to cooperate in criminal investigations against their own employees.¹¹⁵

Bharara noted that corporations do not have the same ability to challenge various information gathering techniques by the government.¹¹⁶ He analyzes the Thompson and McNulty Memorandum which narrowed prosecutor’s criteria for charging corporate entities.¹¹⁷ Prosecutors, under this Memorandum, are required to weigh the company’s corporate culture, where criminal conduct is either discouraged or encouraged, and then it assesses the adequacy of the compliance program.¹¹⁸ He discusses the problems with this method, as prosecutors are not trained in corporate governance problems and have a difficult task when it comes to assessing the company’s corporate culture.¹¹⁹ Prosecutors in the SAC case have met this challenge head on, unraveling the details of the corporate culture at SAC and using discretion to issue charges.¹²⁰ Bharara recommends that

111. *Id.* at 494.

112. Preet Bharara, *Corporations Cry Uncle and Their Employees Cry Foul: Rethinking Prosecutorial Pressure on Corporate Defendants*, 44 AM. CRIM. L. REV. 53, 64-65, 71 (2007).

113. *See* Parloff, *supra* note 35.

114. Bharara, *supra* note 112, at 54.

115. *Id.* at n.64.

116. *Id.* at 65.

117. *Id.* at 112, memorandum from Larry D. Thompson, Deputy Attorney General, US Department of Justice, to Heads of Department Components, US Department of Justice (Jan. 20, 2003), http://www.justice.gov/sites/default/files/dag/legacy/2007/07/05/mcnulty_memo.pdf [hereinafter “Thompson McNulty Memorandum”].

118. *Id.* at 112.

119. *Id.* at n.321.

120. *See* Parloff, *supra* note 35.

corporate criminal liability be brought in line with “common sense and common practice.”¹²¹ Prosecutors are given sole discretion to evaluate the factors set out in the Thompson and McNulty Memoranda when considering a charge, and Bharara hypothesizes that a codified rule or statute could shift some of this discretion to a judge or jury.¹²²

Perhaps, it is the balance between long held beliefs in corporate liability and prosecutorial discretion that prompted Bharara to pursue criminal charges against SAC but not against Mr. Cohen. It is possible that with a codified rule or statute, Mr. Cohen could have been charged, as less discretion would lie in the hands of the prosecution.

X. THE DIFFICULTY IN CRIMINAL PROSECUTION UNDER INSIDER TRADING LAWS

The framework set out in *Dirks v. SEC* governs insider-trading offences.¹²³ Under this framework set out by the U.S. Supreme Court, a tippee is liable for insider trading if the tipper conveys nonpublic information to him and improperly breaches a fiduciary or fiduciary-like duty of trust and confidence to the shareholder.¹²⁴ Liability will attach when a tipper breaches his/her fiduciary duty by providing material nonpublic information leading to the conclusion that the tippee knew, or should have known, of the breach.¹²⁵

There are allegations that Mr. Cohen received nonpublic information from those at his firm who have already been indicted.¹²⁶ The caveat is that only those insiders who were in the actual possession of the improperly obtained information when they made insider trades are liable, and the facts in the media do not indicate that Cohen was an “actual or constructive insider of the firms about which the information as received.”¹²⁷ One potential solution to bring Cohen under some form of criminal liability would be that he is a possible insider trading tippee, one who controlled and financed the insider traders.¹²⁸ However, Mr. Cohen did not always

121. *Id.* at 113.

122. *Id.* at 113.

123. 463 U.S. 646 (1983).

124. Joan MacLeod Heminway, *Willful Blindness, Plausible Deniability, and Tippee Liability: SAC, Steven Cohen, and the Court's Opinion in Dirks*, 15 TRANSACTIONS TENN. J. BUS. L. 47 (2013).

125. Christopher L. Garcia & Boyd M. Johnson III, DEFENDING CLIENTS IN INSIDER TRADING INVESTIGATIONS AND ENFORCEMENT ACTIONS, FROM DEFENDING CORPORATIONS AND INDIVIDUALS IN GOVERNMENT INVESTIGATIONS CH. 13, 649, Daniel Fetterman & Mark Goodman, Thomson West, 2012.

126. See, e.g., *Kolhatkar, supra* note 67.

127. Heminway, *supra* note 124, at 48.

128. *Id.*

make the trades. The difficulty in connecting him is exacerbated by the fact that others did the trading, and he basically congratulated them for a good call.

For the breach of duty component of an insider trading action, the prosecutor would have to establish that the tipper had a duty of trust which included a duty not to disclose any material nonpublic information and not engage in insider trading, that he or she breached this duty, that the tippee knew that there was a duty, and that the tippee knew that the duty was breached by supplying that information.¹²⁹ With Mr. Cohen, it is not clear that Mr. Martoma and others were sharing with him how they got their information.

Under this framework, Mr. Martoma's case is instructive. If Mr. Cohen knew, or should have known (based on prior experiences with Mr. Martoma and his conduct), the origin of the information regarding the Alzheimer's clinical trials, culpability could be established. It is again difficult to establish that Mr. Cohen was aware that the people who shared information with Mr. Cohen's employees breached duties of trust by sharing information. From the information of the employees outlined above, it is unlikely that Mr. Cohen had actual knowledge of any informant's duty or breach. The issue becomes one of whether turning a blind eye and denying constructive knowledge is the intent of these insider trading provisions. The effect of the recent interpretation is that principals and executives in a firm can stand back and witness phenomenal avoidance of losses and spectacular gains with public events following shortly thereafter and be able to claim no knowledge of direct inside information. At some point, the duty of inquiry arises, and the culture issues play a part in establishing knowledge.

In *SEC v. Obus*, the court held that an analysis of what a tippee should have known involves "a fact specific inquiry turning on the tippee's own knowledge and sophistication, and on whether the tipper's conduct raised red flags that confidential information was being transmitted improperly."¹³⁰ The court in *United States v. Whitman* noted that a remote tippee's knowledge that the tipper was receiving some sort of benefit might be difficult to prove.¹³¹ The court aptly said that this "'loophole,' is a product of the topsy-turvy like way the law of insider trading has developed in the courts and cannot be cured short of legislation."¹³²

129. *Id.* at 49.

130. *SEC v Obus*, 693 F.3d 276, 288 (2d Cir. 2012).

131. *United States v. Whitman*, 904 F. Supp. 2d 363 (S.D.N.Y. 2012), as corrected (Nov. 19, 2012), *aff'd*, 555 F. App'x 98 (2d Cir. 2014).

132. *Id.*

In reality, the manner in which securities laws are framed allows “aware” traders to set up an operation in which they shield themselves from liability. They can pay their fines, pay their employees’ legal fees, and still have a corporation left to manage their personal fortune. This appears to be what has happened with SAC and Mr. Cohen.¹³³ Under this standard, the congratulatory emails, such as those between Mr. Horvath and Mr. Cohen on the Dell deal (for which he avoided \$1.7 million in losses) and the information provided by Mr. Martoma on the medical insider information, show an awareness of phenomenal trades but not necessarily an awareness of the sources of information used to make the market moves.¹³⁴

XI. THE FUTURE OF SAC CAPITAL

As a result of the criminal settlement, SAC must cease its investment advisor functions and will not be investing public money; instead, it is left investing Mr. Cohen’s large personal fortune under the name Point72 Asset Management.¹³⁵ In March 2014, the SAC website disappeared from the Internet, and in its place was a page for Point72 Asset Management.¹³⁶ A disclaimer at the bottom of the new web page reminds visitors “Point72 Asset Management does not seek, solicit, or accept clients that are not eligible as family clients.”¹³⁷ Even if the SEC bans Mr. Cohen from the securities industry, it will not impact his ability to trade his personal fortune.¹³⁸

After announcing the criminal settlement, Bharara said,

Individual guilt is not the whole of our mission. Sometimes, blameworthy institutions need to be held accountable too Today, [SAC], one of the world’s largest and most powerful hedge funds, agreed to plead guilty, shut down its outside investment business, and pay the

133. Michael Rothfeld et al., *SAC Capital’s Steven Cohen Expected to Avoid Criminal Charges*, WALL ST. J. (July 4, 2013, 11:35 PM), <http://online.wsj.com/news/articles/SB10001424127887323899704578585953480399358> (“U.S. prosecutors have concluded that they don’t have enough evidence against hedge-fund billionaire Steven A. Cohen to file criminal insider-trading charges against him before a July deadline.”).

134. *Indictment*, *supra* note 9, para. 32a.

135. Selena Maranjian, *See What This Infamous Money Manager Has Sold*, THE MOTLEY FOOL (May 27, 2014), <http://www.fool.com/investing/general/2014/05/27/see-what-this-infamous-money-manager-has-sold.aspx>.

136. *Point72 Asset Management*, POINT72, <http://www.point72.com/> (last visited May 29, 2015).

137. *Id.*

138. Sheelah Kolhatkar, *SAC Capital to Pay \$1.8 Billion, the Largest Insider Trading Fine Ever*, BLOOMBERG BUSINESS (Nov. 4, 2013), <http://www.bloomberg.com/bw/articles/2013-11-04/sac-capital-to-pay-1-dot-8-billion-the-largest-insider-trading-fine-ever>.

largest fine in history for insider trading offenses. That is the just and appropriate price for the pervasive and unprecedented institutional misconduct that occurred here.¹³⁹

In reality, the \$1.2 billion settlement is less than the \$1.3 billion Mr. Cohen personally made last year.¹⁴⁰ Mr. Cohen's net worth was recently reported at \$9.4 billion, and it now appears that he will be left with a sizable \$7 billion fortune.¹⁴¹

Mr. Cohen will personally pay for the fine even though he still denies personal wrongdoing.¹⁴² He privately complained that he had to pay over \$1 billion in fines for the actions of what he calls "rogue employees."¹⁴³ A press release issued after the settlement by SAC read "[t]he tiny fraction of wrongdoers does not represent the 3,000 honest men and women who have worked at the firm during the past 21 years. SAC has never encouraged, promoted or tolerated insider trading."¹⁴⁴ This statement angered federal prosecutors because it conflicted with SAC's admission of guilt. SAC offered a new statement that read. "Even one person crossing the line into illegal behavior is too many and we greatly regret this conduct occurred."¹⁴⁵

A. Future Prosecution of Mr. Cohen

The door has not been shut to future prosecution of Mr. Cohen and others as Bharara stated in the settlement agreement that the "agreement today provides no immunity from prosecution for any individual."¹⁴⁶ In 2010, the government passed Section 1079A of the *Dodd-Frank Act*, which extended the statute of limitations for financial crimes to six years from five.¹⁴⁷ As of this writing, Bharara has run out of time to bring criminal

139. Press Release, FBI New York Office, Manhattan U.S. Attorney Announces Guilty plea Agreement with SAC Capital Management Companies (Nov. 4, 2013), <http://www.fbi.gov/newyork/press-releases/2013/manhattan-u.s.-attorney-announces-guilty-plea-agreement-with-sac-capital-management-companies>.

140. Andre Damon, *No Criminal Charges for Hedge Fund SAC Capital – Fined \$1.2 Billion for "Pervasive and Unprecedented" Insider Trading*, GLOBAL RESEARCH (Nov. 6, 2013), <http://www.globalresearch.ca/no-criminal-charges-for-hedge-fund-sac-capital-fined-1-2-billion-for-pervasive-and-unprecedented-insider-trading/5357057>.

141. *Id.*

142. See Kolhatkar, *supra* note 138.

143. Peter Latman & 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/?_php=true&_type=blogs&_r=0.

144. *Id.*

145. *Id.*

146. Kolhatkar, *supra* note 138.

147. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No.

charges against Mr. Cohen on the basis of his alleged conversation between Mr. Cohen and Mr. Martoma and the subsequent illegal insider trades of Elan and Wyeth occurred in July 2008.¹⁴⁸ At a conference in July 2013, Bharara confirmed that the *Dodd-Frank Act* enlarged securities limitations, and he reiterated “we still have a lot of legal theories we can pursue.”¹⁴⁹

In 2013, there was speculation that prosecutors were considering the possibility of racketeering charges, which carry lengthy prison sentences.¹⁵⁰ Decades ago, in New York, when Rudy Giuliani held Bharara’s position, he brought racketeering charges against Princeton/Newport Limited Partners.¹⁵¹

Further, the racketeering claims brought by Mr. Cohen’s ex-wife Patricia Cohen against Mr. Cohen were dismissed by a federal court in January 2014.¹⁵² In the divorce Ms. Cohen accused him of hiding assets which were the product of insider trading.¹⁵³ She was unable to provide enough evidence to show that Mr. Cohen engaged in a pattern of insider trading, bank fraud, and money laundering in violation of the *Racketeer Influenced and Corrupt Organizations Act*.¹⁵⁴ She is still continuing with her separate claims of fraud and breach of fiduciary duty and has been able to obtain investors for her battle against Mr. Cohen.¹⁵⁵

B. Administrative Action against Mr. Cohen

As of this writing, the only charges that have been laid against Mr. Cohen personally are an administrative action pursuant to the *Investment Advisors Act*¹⁵⁶ for failure to supervise his portfolio managers Mr. Martoma and Mr. Steinberg.¹⁵⁷ These are the same managers who have been

111-203, § 1079 A, 124 Stat. 1376 (2010).

148. See Fontevecchia, *supra* note 94.

149. Sheelah Kolhakar, *Is the Government About to Move the Goal Posts on Steve Cohen?*, BLOOMBERG BUSINESS, (July 17, 2013), <http://www.businessweek.com/articles/2013-07-17/is-the-government-about-to-move-the-goal-posts-on-steve-cohen>.

150. Emily Flitter, *Prosecutors consider using racketeering law against SAC: source*, REUTERS (May 21, 2013, 7:50 PM), <http://www.reuters.com/article/2013/05/21/us-saccapital-investigation-rico-idUSBRE94K1CD20130521>.

151. John Cassidy, *Has Steven Cohen Bought Off the US Government?*, THE NEW YORKER (Nov. 4, 2013), <http://www.newyorker.com/online/blogs/johncassidy/2013/11/has-steven-a-cohen-bought-off-the-us-government.html>.

152. Patricia Hurtado & Chris Dolmetsch, *SAC’s Cohen Wins Partial Dismissal of Ex-Wife’s Claims*, BLOOMBERG (Jan. 27, 2014, 3:04 PM), <http://www.bloomberg.com/news/2014-01-27/sac-s-cohen-wins-dismissal-of-ex-wife-s-fraud-claim.html>.

153. *Id.*

154. *Id.*

155. *Id.*

156. 18 U.S.C. §§ 1961-68.

157. *SEC Proceeding*, *supra* note 83.

criminally charged and found guilty of insider trading.¹⁵⁸ It has been speculated that the worst possible outcome of this civil charge would be a lifetime ban from the securities business.¹⁵⁹ Because this action was filed through an administrative proceeding, it will limit Mr. Cohen's right to discovery.¹⁶⁰ There is some speculation that this was done to limit Mr. Cohen's ability to prepare a better defense in any future criminal case.¹⁶¹ The choice, in proceeding through administrative action, also affords the case a lower burden of proof than a criminal case, providing for a potential warm-up.¹⁶²

In the Order, *Instituting Administrative Proceedings*, the SEC alleges, "Cohen received highly suspicious information that should have caused any reasonable hedge fund manager in Cohen's position to take prompt action to determine whether employees under his supervision were engaged in unlawful conduct and prevent violations of federal securities law."¹⁶³

Mr. Cohen appears to have taken the lesson to heart or at least to the point of prevention. He has been seeking to hire former prosecutors and others with government experience for the compliance function in his new firm.¹⁶⁴ Several FBI agents have already been hired.¹⁶⁵

C. *Shifting Prosecution Priorities*

There have been shifting political winds and public pressures surrounding the manner and frequency with which the DOJ charges and prosecutes corporate defendants.¹⁶⁶ The DOJ received a great deal of public scrutiny for its failure to bring criminal charges against any financial institutions for their role in the 2008 financial crisis, which only intensified in the wake of their decision to pursue a deferred prosecution agreement

158. *Id.*

159. Matt Taibbi, *Steve Cohen: The Feds Get Tough, Sort Of*, ROLLING STONE (Aug. 1, 2013), <http://www.rollingstone.com/politics/news/steve-cohen-the-feds-get-tough-sort-of-20130731>.

160. *Id.*

161. *Id.*

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

163. *SEC Proceeding*, *supra* note 83, para. 3.

164. Matthew Goldstein, *Cohen Seeks Law Experts for Fund*, N.Y. TIMES, Dec. 16, 2014, at B1.

165. *Id.*

166. See, e.g., Court E. Golumbic & Albert D. Lichy, *The "Too Big to Jail" Effect and the Impact on the Justice Department's Corporate Charging Policy*, 65 HASTINGS L.J. 1293 (2014).

with HSBC in 2012.¹⁶⁷ This scrutiny was not only coming from members of the public but also members of Congress and media outlets.¹⁶⁸

There is a possibility that another shift may be occurring—one that would see the DOJ interested in ending the ability of a senior official to foster a culture of corporate fraud and insider trading. Rajat Gupta of Goldman Sachs was indicted for six criminal counts of insider trading, for passing nonpublic information to Raj Rajaratnam.¹⁶⁹ Federal prosecutors denounced the culture of Galleon, the hedge fund Mr. Rajaratnam founded, in which regular discussion included illegal tips.¹⁷⁰ Janice Fedarczyk, the FBI's Assistant Director in the agency's New York office, noted that "his eagerness to pass along inside information to Mr. Rajaratnam is nowhere more starkly evident than in the two instances where a total of thirty-nine seconds elapsed between his learning of crucial Goldman Sachs information and lavishing it on his good friend."¹⁷¹ He was convicted on four of six charges, even though he was not accused of making any trades himself.¹⁷²

The swath of insider trading cases that have emerged since Bharara's installment actually began with Mr. Rajaratnam in 2009.¹⁷³ Mr. Rajaratnam's Galleon Group, a hedge fund that at one time managed \$3.7 billion dollars, was, for a time, the toast of Wall Street.¹⁷⁴ He was charged with securities fraud and with conspiracy to commit securities fraud.¹⁷⁵ He received the longest-ever term, eleven years, imposed in an insider-trading

167. *Id.*

168. *Id.* (detailing a look at the political backlash of DOJ's decision to defer prosecution of HSBC); see also, Mark Gongloff, *Obama Administration Essentially Admits That Some Banks Are Too Big To Jail, Which Is Troubling*, HUFFINGTON POST, http://www.huffingtonpost.com/2012/12/11/hsbc-too-big-to-jail_n_2279439.html (last updated Dec. 12, 2012, 9:23 AM) (highlighting media criticism of DOJ's corporate prosecution policies).

169. Michael Rothfeld et al., *Gupta Case Targets Insider Culture*, WALL ST. J. (Oct. 27, 2011), <http://online.wsj.com/news/articles/SB10001424052970203687504576654872764778968>.

170. *Id.*

171. *Id.*

172. David Benoit, *Rajat Gupta Guilty: By the Charges*, WALL ST. J. (June 15, 2012, 3:17 PM), <http://blogs.wsj.com/deals/2012/06/15/rajat-gupta-guilty-by-the-charges/>.

173. See, e.g., Ben Protess & Matthew Goldstein, *Preet Bharara's Wall St. Task Force Has a Shifting Roster of Lawyers*, N.Y. TIMES (Feb. 16, 2015, 6:42 PM), http://dealbook.nytimes.com/2015/02/16/preet-bhararas-wall-st-task-force-has-a-shifting-roster-of-lawyers/?_r=0.

174. See Jenny Strasburg & Chad Bray, *Six Charged in Vast Insider-Trading Ring*, WALL ST. J. (Oct. 17, 2009, 12:01 AM), <http://www.wsj.com/articles/SB125570373292090093>.

175. *Id.*

case.¹⁷⁶ Mr. Rajaratnam's case involved a rags-to-riches story, similar to Mr. Cohen's, that was colored by greed, fraud, and power.¹⁷⁷ The large difference between Mr. Rajaratnam's case and Mr. Cohen's situation is the presence of cooperating witnesses. A onetime Galleon employee cooperated with prosecutors and taped conversations with Mr. Rajaratnam, which led to more wiretaps.¹⁷⁸ Prosecutors had wiretap recordings of Mr. Rajaratnam actually collecting secrets from his sources.¹⁷⁹ Another difference between the Galleon case and that of SAC is that many of the co-accused testified against Mr. Rajaratnam and provided information throughout the investigation.¹⁸⁰ According to prosecutors, he gained \$63.8 million throughout a seven-year conspiracy where he traded on inside information from corporate executives, bankers, consultants, and traders.¹⁸¹

D. Who Is Accountable, How, and Why?

The defense of willful ignorance among CEOs and CFOs was gutted by Sarbanes-Oxley ("SOX") because of the signature certification requirements.¹⁸² The signature on the financial reports, when those reports contain false information is now, in and of itself, a crime.¹⁸³ The purpose of the signature requirement was to place responsibility on CFOs and CEOs and to eliminate the "I didn't know" defense.¹⁸⁴ Part of their jobs is to vouch for the veracity of the financial statements.¹⁸⁵ The market partially bases its purchasing decisions and valuations on the risk CEOs and CFOs incur: "In order for a certification signal to be credible, the certifying party

176. Susan Pulliam and Chad Bray, *Trader Draws Record Sentence*, WALL ST. J. (Oct. 14, 2011), <http://online.wsj.com/news/articles/SB10001424052970203914304576627191081876286>.

177. *See, e.g., id.*

178. Strasburg, *supra* note 174.

179. David Glovin et al., *Rajaratnam Guilty in Insider-Trading Case*, BLOOMBERG BUSINESS (May 11, 2011, 5:21 PM), <http://www.bloomberg.com/news/2011-05-11/rajaratnam-is-found-guilty-of-all-counts-in-galleon-insider-trading-trial.html>.

180. *Id.*

181. *Id.*

182. 18 U.S.C. § 1350 (2002); *see also* David Dayden, *Why is Preet Bharara, the 'Scourge of Wall Street', taking a friendly tone towards mortgage bankers?*, THE GUARDIAN (Oct. 10 2014, 1:00 PM), <http://www.theguardian.com/money/2014/oct/10/preet-bharara-wall-street-defend-arrest-prosecute-bankers-crisis> (explaining the SOX rule and its impact on corporate prosecutions). Although a full discussion of SOX is beyond the scope of this paper, generally the Act is designed to ensure the accuracy and reliability of corporate disclosures in securities law to protect investors.

183. Dayden, *supra* note 182.

184. *What is Sarbanes-Oxley?*, SOX-ONLINE, <http://www.sox-online.com/whatis.html> (last visited May 29, 2015).

185. *See id.*

must suffer a loss of reputation or incur legal sanctions if it is negligent, colludes, or engages in other types of self-dealing.”¹⁸⁶

The willful ignorance defense has taken a beating beyond SOX because the “who knew” defense has the same effect on the corporation or organization as the loss of credibility in financial statements—trust is dissipated.¹⁸⁷ The Responsible Corporate Officer Doctrine (“RCOD”) imposes risk on those who manage corporations through the imposition of criminal liability on them for conduct that harms or endangers the public.¹⁸⁸ This form of criminal liability for officers and directors results without proof of knowledge, recklessness, or intent, the three usual foundations for criminal responsibility. Initially, the RCOD was applied only in the health care sector, but it has now expanded to all areas of law where the purpose of the violated statute is public welfare.¹⁸⁹ For example, environmental protections, food safety, and industrial safety are all areas where there is corporate officer accountability.¹⁹⁰ Although much of the attention and concern regarding the RCOD focuses on the health care sector, the doctrine may also be used to enforce other public welfare statutes.

XII. THE CANADIAN PERSPECTIVE

Compared to the United States, Canada’s approach to prosecuting insider trading, and securities violations, is far less aggressive. In 2010, the Ontario’s Securities Commission (“OSC”) took only four cases to court and only two in 2009. It did not bring any in 2008.¹⁹¹ Nationwide, in 2010, Canadian provincial regulators concluded only thirteen insider trading cases and enforced fines of merely \$1.9 million.¹⁹² Differences in prosecution rates may be directly related to how the regulators operate in each country.

186. Manuel Utset, *Fraudulent Corporate Signals: Conduct As Securities Fraud*, 54 B.C. L. REV. 645, 659 (2013).

187. See *id.* (arguing, among other things, for the importance of corporate credibility in financial statements).

188. Valorie Cogswell, *Catching the Rabbit: The Past, Present, and Future of California’s Approach to Finding Corporate Officers Civilly Liable Under the Responsible Corporate Officer Doctrine*, 33 ENVIRONS ENVTL. L. & POL’Y J. 343, 345 (2009).

189. Andrew R. Ellis, *The Responsible Corporate Officer Doctrine: Sharpening a Blunt Health Care Fraud Enforcement Tool*, 9 N.Y.U. J. L. & BUS. 977, 980 (2013).

190. *Id.* at 979-80.

191. Martin Mittelstaedt, *A World Of Difference On Insider Trading Prosecutions*, THE GLOBE AND MAIL, <http://www.theglobeandmail.com/report-on-business/small-business/sb-growth/a-world-of-difference-on-insider-trading-prosecutions/article1360483/> (last updated Aug. 23, 2012, 4:55 PM).

192. James H. Thompson, *A Global Comparison of Insider Trading Regulations*, 3 INT’L J. ACCT. & FIN. REP. 9 (2013).

In the United States, the SEC is a national regulator, working in cooperation with the DOJ and the FBI.¹⁹³ In Canada, this same cooperation is not available. There is no national regulator of the same scale, and each province has their own provincial regulator tasked with regulating the securities industry.¹⁹⁴ The Canadian Securities Administrators exists as an umbrella organization of the provincial regulators that seeks to harmonize and coordinate regulation.¹⁹⁵

Utpal Bhattacharya is an Associate Editor of the *Review of Financial Studies* and the *Journal of Financial Markets*, and he was commissioned by the Task Force to Modernize Securities Legislation in Canada.¹⁹⁶ In his report, he found that the SEC enforces securities laws on a much larger scale,

[w]hen scaled by the size of the stock market, the SEC prosecutes 10 times more cases for all securities laws violations than the OSC prosecutes, and 20 times more insider-trading violations. A detailed examination of insider trading cases shows that the SEC resolves the cases faster than the OSC, and fines 17 seventeen times more per insider trading case than the OSC does.¹⁹⁷

Incarceration is rarely sought in Canada, and prosecution is more likely the option for the administrative tribunal set up by the Ontario Securities Commission.¹⁹⁸

This difference in treatment comes from a stark difference in the law. The OSC has a public interest jurisdiction.¹⁹⁹ Insider trading requires the accused to be in a special relationship with the company whose shares are purchased or sold, and the accused must have knowledge of a material fact or change about the firm that has not been generally disclosed²⁰⁰ whereas, in the United States, an accused is required to plead to breaching a specific

193. Mittelstaedt, *supra* note 191.

194. *See id.*

195. *About CSA Overview*, CANADIAN SECURITIES ADMINISTRATORS, <https://www.securities-administrators.ca/aboutcsa.aspx?id=45&linkidentifier=id&itemid=45> (last visited May 29, 2015).

196. Utpal Bhattacharya, *Enforcement and its Impact on Cost of Equity and Liquidity of the Market*, (May 24, 2006), available at [http://www.tfm.sl.ca/docs/V6\(3\)%20Bhattacharya.pdf](http://www.tfm.sl.ca/docs/V6(3)%20Bhattacharya.pdf) (noting that the task force commissioned the research study to help modernize securities legislation in Canada).

197. *Id.* at 137.

198. Mittelstaedt, *supra* note 191.

199. *Proceedings*, ONTARIO SECURITIES COMMISSION, http://www.osc.gov.on.ca/en/About_our_role_index.htm (last visited May 29, 2015). *But See* Mittelstaedt, *supra* note 191 (arguing the laws are not particularly different between the countries).

200. Penny Becklumb, *Canada Business Corporations Act: Insider Trading*, LAW AND GOVERNMENT DIVISION, PARLIAMENT OF CANADA, <http://www.parl.gc.ca/content/lop/researchpublications/prb9938-e.htm> (last updated Oct. 14, 2008).

securities rule and provision of statute. In Canada, an accused may not meet the strict definition of insider trading but could still receive and settle a claim against him/her for acting contrary to the public interest.²⁰¹

Canada only entered its first criminal conviction for illegal insider trading on November 6, 2009, accepting a guilty plea from Stan Grmovsek.²⁰² He and his co-accused started an illegal trading scheme after their graduation from law school in 1994.²⁰³ He took nonpublic information and made trades for a profit.²⁰⁴ As Emily Cole reports,

In Canada, Grmovsek was charged with three offences: (i) fraud (for trades executed before the new *Criminal Code* insider trading provisions), (ii) illegal insider trading contrary to the *Criminal Code* and, (iii) money laundering contrary to the *Criminal Code*. In 2010, he was sentenced to 39 thirty-nine months imprisonment by the Ontario Court of Justice.²⁰⁵

As part of his plea agreement relating to a conspiracy to defraud charge in the United States, Mr. Grmovsek agreed to disgorgement orders to the SEC, a total of \$8.5 million, with a waiver of all but nearly \$1.5 million, and he owed the OSC a total of \$1.03 million, as well as \$250,000 towards the costs of the OSC investigation.²⁰⁶ With so few criminal convictions and a fragmented regulation system, it is difficult to speculate how well equipped Canadian regulators would be if they were forced to regulate a Mr. Rajaratnam or Mr. Cohen-sized scheme.

CONCLUSION

Despite his host of legal problems, in March of 2014, Mr. Cohen increased his investment in the game-maker “Zynga” which makes games such as “FarmVille” and “Words with Friends.”²⁰⁷ Mr. Cohen increased his stake from 2.2 percent to 5.3 percent, making him the largest shareholder in Zynga.²⁰⁸ His stake in the company, valued at \$173 million, is worth just

201. *Proceedings*, *supra* note 199.

202. Emily Cole, *Canada's First Criminal Conviction for Illegal Insider Trading*, MILLER THOMPSON (2010), <http://www.millerthomson.com/en/publications/newsletters/securities-practice-notes/2010-archives/spring-2010/canadas-first-criminal-conviction-for-illegal> (last visited May 29, 2015).

203. *Id.*

204. *Id.*

205. *Id.*

206. *Id.*

207. Nick Summers, *Troubled SAC Capital Doubles Its Stake in Troubles Zynga*, BLOOMBERG BUSINESS (Mar. 28, 2014), <http://www.bloomberg.com/bw/articles/2014-03-28/troubled-sac-capital-doubles-its-stake-in-troubled-zynga>.

208. John Kell, *Cohen's SAC Capital Increases Stake in Zynga*, FOX BUSINESS (Mar. 27 2014), <http://www.foxbusiness.com/industries/2014/03/27/cohen-sac-capital-increases-stake-in-zynga/>.

more than what Mr. Cohen paid for the 1932 Pablo Picasso painting “Le Rêve” he purchased in 2013.²⁰⁹ Goldman Sachs joined JPMorgan Chase & Co. and Bank of America Corp in providing personal loans to Mr. Cohen largely based on his art collection.²¹⁰ Some note that many wealthy clients seek art loans because they can keep the paintings at their homes while “borrowing at rates as low as 2.5 percent.”²¹¹ Many agree that Mr. Cohen had nominal punishments for the alleged infractions he has been a part of. He continues to invest his personal fortune, and he continues to engage in the very public promotion of his private fortune.

As Joan MacLeod Heminway concludes in her article on SAC, perhaps this case is the reason to open the discussion on insider trading and what, “the law of insider trading should be—and why—as a matter of policy. If insider trading regulation and liability is to have any coherence in an era of expert networks, we must address and resolve this question.”²¹² If the classic goals of the criminal law are for deterrence, retribution, rehabilitation, and incapacitation, then it is questionable if some, or any of these goals, have been achieved in this situation.²¹³ Mr. Cohen is not personally suffering any of these consequences, and some would say that he is flaunting his good fortune which remains largely intact.²¹⁴ Although Mr. Cohen cannot invest public money, he has been keeping busy with his private fortune.

Some have said that the charges against SAC were merely a result of the inability of the government to collect enough evidence against Mr. Cohen himself.²¹⁵ However, destroying SAC might be the only way to attempt to punish Mr. Cohen. In August of 2013, the last outside investor of SAC pulled his support.²¹⁶ Ed Butowsky, the self-appointed “last man standing”

209. Summers, *supra* note 207.

210. Miles Weiss, *Goldman Sachs Supports Cohen With Loan Backed By Fine Art*, BLOOMBERG BUSINESS (May 6, 2014, 9:47 AM), <http://www.bloomberg.com/news/2014-05-06/goldman-sachs-supports-cohen-with-loan-backed-by-fine-art.html>.

211. *Id.* (stating that Mr. Cohen had previously bought a sculpture of a shark in formaldehyde for \$8 million and that Mr. Cohen did sell some of his prized art collection in 2013, including a Gerhard Richter painting “A.B. Courbet” for \$26.5 million, and Andy Warhol’s “Liz #1 (Early Colored Liz)” for \$20.3 million).

212. Heminway, *supra* note 124, at 58.

213. See, e.g., IT Hadar Dancig-Rosenberg & Tali Gal, *Criminal Law Multitasking*, 18 LEWIS & CLARK L. REV. 893 (2014).

214. See, e.g. Taibbi, *supra* note 159 (detailing Cohen’s decision to purchase an \$155 million Picasso and \$60 million mansion within weeks of SAC’s guilty plea. “It was a big fat middle finger to the government, flipped by a man who clearly thought he was getting away with a slap on the wrist.”).

215. Golumbic, *supra* note 166, at 51.

216. Jenny Strasburg, *SAC Loses One Of Its Most Loyal Investors*, Money Beat, WALL ST. J. (Aug. 28, 2013, 4:05 PM), <http://blogs.wsj.com/moneybeat/2013>

with SAC, defended the company by noting “the government says SAC has a culture of insider trading. What about a culture of working-my-a** off? Because that’s what they’re doing at SAC.”²¹⁷ Questions still abound about the culture of SAC, but the law, as it existed at the time of the prosecutions and settlement, did not allow conviction based on culture. The law still requires that direct nexus of insider to defendant in order to prove the scienter element of insider trading.²¹⁸

As with the SOX reforms that held CEOs and CFOs accountable through their signatures on the financial statements, perhaps the time has arrived for legislative action that requires CEO certification of compliance operations. In other words, until there is some additional statutory supplement, insider-trading convictions of corporations and CEOs will be elusive, absent the cooperation, taping, and wire-tapping of subordinates. Accountability for firm actions needs to be addressed in a manner not reliant upon the specific proof requirements of insider trading.

Certification could include requirements for examination of the timing of trading, periodic reviews of traders’ accounts, and that supposed element of “serendipity” that seems to be tolerated in a world of logarithms, betas, and all things technical. That certification of review may be the answer to the insider trading escape clause that allows those who profit to walk away without criminal charges because, well, they knew nothing. The legislative approach should be one of tackling: Should they have known? And how can we measure that? If not, perhaps Mr. Cohen is the king of eluding criminal conviction, not just the king of hedge funds.

/08/28/sac-loses-one-of-its-most-loyal-investors/.

217. *Id.* (“I’m not doing this for Stevie Cohen . . . It’s not like I go to bed with a Stevie doll. It’s more like, what the hell is going on in this world?”).

218. *See infra* note 2.