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The Problems With The SAC Capital Indictment

Law360, New York (July 26, 2013, 12:14 PM ET) -- Ralph Waldo Emerson once said, "If you shoot at a king, you must kill him." In a strange twist on this oft-quoted maxim, federal prosecutors appear to have composed a new version: "If you can't kill the king, you can always try to blow up his castle."

On Thursday, July 25, 2013, the U.S. Attorney's Office for the Southern District of New York announced the unsealing of an indictment of SAC Capital Advisors LP, SAC Capital Advisors LLC, CR Intrinsic Investors LLC and Sigma Capital Management LLC as part of the government's now multiyear investigation into insider trading at the hedge funds owned by billionaire Steven A. Cohen. The indictment charges these companies (which U.S. Attorney Preet Bharara calls the "SAC Companies") with wire fraud and securities fraud committed over decades, and seeks a fine of the greater of \$25 million or twice the gross gain or loss derived from the offense on each charge — an amount potentially far greater than \$25 million.

On the same day, charges were also unsealed against a portfolio manager employed by SAC Capital LP who pleaded guilty two days earlier to conspiracy and securities fraud charges. Richard Lee is one of eight individuals associated with the SAC Companies who have been charged and/or convicted in insider trading cases involving the SAC hedge funds.

Notably missing among those charged is Steven Cohen himself, who faces an administrative enforcement proceeding at the U.S. Securities and Exchange Commission for failing to supervise employees but has not been charged with any crime. While Cohen is not charged with any crime, he is not at all absent from the SAC indictment. Referred to only as "an individual residing in Greenwich, Connecticut" and the "SAC Owner," Cohen is mentioned dozens of times in the indictment — but not by name. The pervasive references to the otherwise absent owner of the companies is ironic, in part because of the use of his initials in the names of two of the indicted companies (and in the "SAC" label colloquially used to refer to the companies, the hedge funds and the entire case).

The indictment is based on three broad allegations. First, it alleges that the SAC companies focused on recruiting individuals with proven networks of public company contacts without any corresponding effort to ensure that they made no improper use of such contacts. Second, it alleges that employees were financially rewarded for recommending certain trading recommendations without any inquiry as to whether the "high conviction" underlying the recommendation was based on inside information. Third, the indictment alleges that the companies employed limited compliance measures to detect or prevent insider trading. The indictment repeatedly attempts to tie these allegations back to conduct or omissions by the otherwise unnamed (and uncharged) "SAC Owner" in a style consistent with the way in which the government would customarily draft an indictment that does charge such an individual.

This leads to the obvious question: Why, then, hasn't the government charged Steven Cohen with insider trading or some other related from? The answer is equally obvious: It can't because investigators and prosecutors clearly have been unable to collect sufficient evidence to do so. Otherwise, the government unquestionably would have done so by now.

The other thing that is obvious is that the government's decision to indict the SAC Companies is a proxy for charges against Cohen. The investigation into insider trading at SAC Capital has reportedly already hurt the companies' business, and an indictment will undoubtedly do more damage — possibly even triggering defaults in some of the companies' agreements. And if the company is convicted — and subjected to a massive fine — that could easily destroy the company a la Arthur Andersen. Having failed to develop evidence to support a criminal case to send Steven Cohen to prison, the government is instead seeking to destroy the company he has built.

To do so, the government is relying upon a theory that would set a dangerous precedent for criminal prosecution of corporations and other companies. The government's attack on the SAC companies — as opposed to an attack on individual employees or even on executives who managed the companies — treats these entities as though they were akin to Mafia crime families. The identifying characteristic of such criminal organizations, though, is that they exist for the purpose of committing crimes, and the government does not even allege that here.

The biggest problem with the government's approach is that it fails to draw a distinction between the acts of some individuals — for which a number of them have been or will be convicted and punished — and the institution. An SAC spokesman responding to the unsealing of the indictment noted that a handful of men who worked for the SAC companies have admitted that they broke the law, but that there have been thousands of men and women who have worked at those companies during the period covered by the indictment whose honesty, integrity and character are not subject to question. The accusation that the companies institutionally committed crimes unfairly impugns these individuals and — even more unfairly — may hurt those who still work there but may lose their jobs in the even of the companies' demise.

In the end, it will be interesting to see how the government expects to prove its case, which it has rested upon allegations of wrongdoing by the not-so-mysteriously unnamed "SAC Owner." If the government can prove beyond a reasonable doubt that the "SAC Owner" committed crimes, that of course begs the question why he is not a criminal defendant in this case. And if the government cannot do so — which explains the failure to charge him — it is hard to see how it will prove its case against the company as opposed to showing the criminal conduct of a number of its employees.

Money has always been the big stick that government prosecutors use as leverage against companies and individuals in civil and criminal enforcement matters. Here, the government seeks a massive fine and has also filed a separate civil forfeiture action that will undoubtedly ratchet up the pressure on Mr. Cohen. In terms of the potential precedent (and the encouragement it will offer prosecutors to use similar methods in other circumstances), one can only hope that Cohen's substantial personal resources permit him (through the companies) to fight these charges and put the government's case to its proof.

--By David Deitch, Ifrah PLLC

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