WHITE PAPER REGARDING THE SEC'S ADMINISTRATIVE PROCEEDING AGAINST STEVEN A. COHEN FOR FAILURE TO SUPERVISE

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PRELIMINARY STATEMENT

In an Order Instituting Administrative Proceedings filed on July 19, 2013, the Securities and Exchange Commission (the "SEC") alleges that Steven A. Cohen failed to discharge his duty to supervise two of SAC's investment professionals in connection with trading in three stocks: Elan, Wyeth, and Dell. The SEC alleges that these employees engaged in insider trading under Cohen's watch, and that Cohen ignored "red flags" that should have led him to suspect potentially unlawful conduct.

Steve Cohen did nothing wrong, and any fair review of the evidence will show that the SEC's charges are unfounded. The evidence shows that (i) Cohen had every reason to believe that the employee involved in the Elan and Wyeth trades, Mat Martoma, reached his conclusions based on wholly legitimate information sources; (ii) Cohen did not even read the single email on which the SEC's contentions relating to Dell are based, nor was told about the email, and he decided to liquidate his Dell position for unquestionably legitimate reasons; and (iii) any claim that Cohen overlooked red flags showing unlawful conduct by SAC employees is contrary to his and SAC's longstanding demonstrated commitment to the firm's compliance efforts.

Elan/Wyeth. The SEC's allegations against Cohen relating to trading in Elan and Wyeth are baseless. The facts do not support a claim that Mr. Cohen failed adequately to supervise Mathew Martoma. Even if Mathew Martoma had material non-public information—an allegation Mr. Martoma disputes and the government has not proven—there is no evidence to support the charge that Mr. Cohen should have assumed that Martoma had improper information about the results of the Phase II study of bapineuzumab, a drug being developed by Elan and Wyeth for the treatment of

Alzheimer's disease. There were no "red flags" suggesting that Mr. Martoma had improper information. To the contrary, Mr. Martoma's recommendation to reduce SAC's exposure on a position that had appreciated approximately 40% over the previous six weeks, and that most knowledgeable observers believed had little further short-term upside, at a time of volatile and declining general market trends, was perfectly reasonable.

Dell. The SEC's allegations concerning Dell are based on a single email, the "second hand read" email, forwarded to Cohen's email account on August 26, 2008. There is no evidence that Cohen read the "second hand read" email, or spoke to anyone about the email. This is not unusual: Cohen typically received an average of a thousand emails and innumerable IMs daily, and he did not (and could not) read the vast majority of them. While Cohen did trade Dell that day, as he did on many days, the evidence shows that it would have been almost impossible for him to have read the email in the brief interval—a matter of seconds—before the trades. The evidence shows instead, not that Cohen relied on the email in trading Dell stock that afternoon, but that he traded because he became aware that a consumer portfolio manager (the "Consumer PM") at an SAC affiliate—the person who initially recommended that Cohen establish the Dell position, and whose trading Cohen relied on frequently in establishing his own positions—was selling a portion of his Dell stock.

Even if Cohen had been aware of the information in the "second hand read" email—and there is no evidence that he was—the email does not indicate that it contains material nonpublic information. The email on its face shows that it is based on a second hand read, or interpretation; it does not identify the source of the information; and it does not indicate that the source breached his or her fiduciary duty in providing it. And the information the email conveyed not only was a fairly wide range (that Dell would miss gross margins by between 50 and 80 basis points), *but it was wrong*.

Compliance. As the facts below demonstrate, the conduct the SEC alleges is not only unsupported by the evidence, but would be contrary to Cohen's and SAC's longstanding and demonstrated commitment to ensuring that SAC's employees act lawfully and appropriately.

For many years, SAC, at Cohen's urging, has gone to great lengths to deter insider trading and to establish an appropriate compliance culture. As discussed below, SAC has spent tens of millions of dollars developing and implementing a robust and constantly improving compliance program. It has hired a staff of no fewer than 38 full-time compliance personnel (including compliance IT), in addition to legal department personnel who devote part of their time to compliance issues. The firm's senior compliance personnel collectively have decades of compliance experience in the investment industry. They are supported by an infrastructure of compliance surveillance systems in which SAC has invested millions of dollars.

SAC's compliance team, with Cohen's full support, deploys some of the most aggressive communications and trading surveillance in the hedge fund industry. These include, among others, daily reviews of electronic communications (*e.g.*, emails, IMs, Bloomberg messages, internal write-ups) and SAC trading using keyword- and concept-based search protocols; weekly reviews of randomly-selected portfolio manager teams; review of electronic communications between investment professionals and their former employers for a period after commencing work at SAC; review of trading made around market moving events and corporate access events; and regular reviews of the firm's most-profitable trades. The firm has also adopted—at significant cost, and at the risk of putting itself at commercial disadvantage—numerous prophylactic measures, as well as restricting its employees' use of expert networks.

Steve Cohen has strongly and consistently supported this compliance effort. Cohen regularly communicates with the firm's senior compliance staff about improving the tools at their disposal, and has always provided the compliance department with the funding and support it has requested. Cohen has himself exemplified the firm's expectation that compliance is the responsibility of all of its employees. As the firm's emails reflect, Cohen has frequently forwarded to compliance staff communications he receives that caused him concern.

This is not the behavior of a CEO who overlooks red flags. On the contrary, it reflects Cohen's consistent commitment to ensuring that SAC and its employees conduct the firm's business in a lawful and proper manner.

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Over the course of the SEC's investigation, SAC has produced an enormous volume of documents and voluntarily provided extensive information demonstrating that Cohen has conducted himself lawfully and appropriately. On this extensive record, the SEC's charge is unwarranted.

I. Trading in Elan and Wyeth

The SEC's allegations concerning Elan and Wyeth are not supported by an objective review of the evidence. As we explain in detail below, there was nothing unusual about SAC's trading in Elan and Wyeth;[1] and the "red flags" cited by the SEC do not, in fact, suggest improper conduct.

A. There Was Nothing Unusual About SAC's Trading in Elan and Wyeth

1. Numerous Objective Factors Argued Against Having A Long Position In Elan Or Wyeth Going Into ICAD

There were numerous reasons in mid-July 2008 why a reasonable investor would not want to maintain a long position in Elan or, to a lesser extent, Wyeth, going into the presentation of the full results of the bapineuzumab Phase II trials on July 29, 2008, at the International Conference on Alzheimer's Disease ("ICAD").[2]

First, by mid-July 2008, Elan's shares had risen in price about 40% from their price on June 2, 2008, with most of this increase following the June 17 announcement that Elan had completed its Phase II trials and that the results were "encouraging."

This price increase came over a period when the S&P 500 had declined by about 10%. Indeed only one stock in the entire S&P 500 performed better than Elan during the period from June 2, 2008 through July 18, 2008.

Elan's share price increase came despite the fact that, self-serving characterizations by the company notwithstanding, the June 17 announcement made clear that the Phase II study results were not particularly positive. The June 17 announcement

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1 Although the SEC's allegations concern trading in both Elan and Wyeth, Martoma had little involvement in the Wyeth position.

2 The SEC claims that Martoma had material non-public information in part because he supposedly received, by unspecified means, a draft of this presentation from Dr. Gilman following a phone call on July 17, 2008. SAC's backup tapes of its entire email system on July 22, 2008, make clear there is no evidence that Dr. Gilman sent a draft PowerPoint presentation to Martoma via email on SAC's servers between at least July 16 through July 22, 2008.

acknowledged that the study "did not attain statistical significance on the primary efficacy endpoints"—i.e., any overall positive trends could simply have been the result of chance—and that "adverse [safety] events were very common." Elan's steep share price increase in the face of these ambiguous and less-than-spectacular results and in a deteriorating market would suggest to a knowledgeable observer that a further share price increase would be difficult to achieve.

Second, by mid-July 2008, the consensus among the most respected analysts who followed Elan was beginning to converge on just this conclusion. In particular, three important and respected broker-dealers issued reports on Elan in July. On July 8, Cowen initiated coverage of Elan with a "neutral" rating. The Cowen report noted the price increase in Elan since the June 17 announcement and concluded that "ELN shares have limited near-term upside potential." On July 11, Brean Murray initiated coverage of Elan with a "sell" rating. The same day, Piper Jaffray downgraded Elan to a "sell." Both reports characterized the price increases that had already occurred as "unwarranted." Analyst ratings, of course, tend to be weighted noticeably toward "buy" ratings, so these reports were particularly significant.

Third, on June 30, 2008, Myriad Genetics, the developer of Flurizan, an alternative Alzheimer's treatment, announced that it had discontinued development of the drug because of negative Phase III results. Flurizan had shown promise in its Phase II studies. Indeed, its announcement of its Phase II results—which it characterized as "encouraging" because of "positive trends" and "statistically significant effects" in certain sub-groups—was remarkably similar in tone and content to the June 17 announcement, even though the Flurizan study group as a whole, like the bapineuzumab study group, "did not achieve statistical significance in the primary endpoints." The announcement that Myriad Genetics was now discontinuing development of Flurizan because of negative Phase III results was a stark reminder that Alzheimer's treatments that appeared "encouraging" in Phase II could nonetheless fail completely in later development.

Fourth, following the ICAD Presentation, there was no important event on the horizon for Elan and bapineuzumab for at least two years, no assurance that the next relevant event—Phase III results—would be positive, and substantial further time before bapineuzumab could be developed commercially even if Phase III results were positive. During this long, looming waiting period, any number of adverse developments could occur: Phase III results could be negative, as in fact turned out to be the case; unexpected safety issues could develop; a cheaper alternative to the high-priced bapineuzumab, such as Dimebon, could emerge, as in fact it did. Any of these developments could undermine bapineuzumab's development as a commercially viable Alzheimer's treatment, and its actual viability would not be known for years to come. As a result, significant selling was likely to follow the ICAD Presentation no matter what the results, making it difficult to profit from the event in the best of circumstances. Indeed, on July 18, 2008, a health care analyst at a top-tier sell-side firm, a self-described "ELN bull," predicted to Martoma that, even if the results were positive, Elan's share price would decline from about $35 to $26 following ICAD.

2. In Addition, Macro Considerations Argued Against Outsized Long Positions In Anything In July 2008

July 2008 was a mere two months before the financial crisis and stock market collapse precipitated by Lehman's bankruptcy in September. Although no one knew with certainty in July what the future would bring, the stock market had been struggling since its high point in the fall of 2007, and especially since Bear Stearns's collapse in March 2008, and there was ample evidence of a jittery market. In early July, for example, false rumors swept the market that two large clients, PIMCO and SAC, had stopped doing business with Lehman and that Lehman was on the verge of collapse. Lehman's share price plunged, and the general market reacted negatively. Between June 2, 2008, and mid-July 2008, the S&P 500 declined approximately 10%.

SAC's Chief Risk Officer, David Atlas, had specifically identified the firm's large related positions in Elan and Wyeth as a subject for inquiry around July 17, 2008, and spoke with Martoma about these positions. SAC's President, Thomas Conheeney, was also concerned at that time about the size of the Elan and Wyeth positions from a risk point of view.

3. Many Other SAC Portfolio Managers Besides Martoma Expected Elan's Share Price To Decline Following ICAD

Two healthcare portfolio managers ("Healthcare PM 1" and "Healthcare PM 2") at the SAC affiliate CR Intrinsic Investors, LLC ("Intrinsic") had been outspokenly critical of the firm's position in Elan since at least early 2008. Initially, this negative view was based on a scientific disagreement with Martoma over the likely efficacy of bapineuzumab, but by the summer their bearish view was based as well on the objective factors discussed above. Tellingly, both Healthcare PM 1 and Healthcare PM 2 recognized that the results disclosed in the June 17 announcement were <u>not</u> strongly positive and questioned whether the unjustified positive market reaction could be sustained.

Moreover, by July 2008, other portfolio managers at SAC who had an opinion about Elan shared the bearish view that its price would likely decline following ICAD because expectations were so high and the stock had recently appreciated so much. In a July 20 email to a healthcare specialist on the Cohen team ("the Healthcare Specialist"), a third portfolio manager in the healthcare sector ("Healthcare PM 3"), wrote: "On wye-eln, I think it sells off hard post icad." The Healthcare Specialist himself, believing (erroneously) that SAC still had a large long position in Elan, wrote to Cohen on July 27 that, in light of recent weakness in Elan's share price, "I am much more concerned about a sell-off after Tuesday," the date of the ICAD Presentation. The phrasing of the Healthcare Specialist's email suggests he had previously shared his nervousness about a sell-off with Cohen. And, a healthcare portfolio manager ("Healthcare PM 4"), who had not previously joined the debate over the firm's position in Elan, shorted the stock in the portfolio he managed on July 29, on the theory that "the risk reward was unfavorable to be long and perhaps more favorable to be short."

4. Martoma's Discomfort Was Understandable, And Mr. Cohen Was Not Reckless In Failing to Suspect That Allegedly Improper Information Lay Behind This Discomfort

In light of these considerations, it is completely logical that, once Martoma announced he was no longer "comfortable" with the Elan position, Mr. Cohen would not hesitate to unwind it. Martoma's change in his expressed view about Elan was entirely consistent with objective investment considerations.

First, like any other reasonable investor, Martoma would have had all of the reasons described above to be nervous about the Elan position. His recommendation to get out of the Elan position was not only not contrarian, but it was, if anything, a consensus view. In light of the factors discussed above, it would have been imprudent to have gambled on a further price increase in Elan into or following the ICAD presentation.

Second, the dramatic price run-up in Elan following the company's June 17 announcement of top-line Phase II results provided both a perfectly logical explanation for the timing of Martoma's change of heart and a compelling personal reason why he would be reluctant to continue to hold the Elan position. On the first point, no stock, no matter how attractive, continues to increase in price forever, and even the most ardent bull reaches a point where he thinks his favorite stock is fairly priced. Objectively, this appears to have been the case with Elan. By mid-July, arguably, its price had already increased as much as it was going to, especially in light of the fact that the June 17 announcement made clear that the more detailed presentation at ICAD was not going to disclose unexpected good news, much less blockbuster results.

The price increase following the June 17 announcement also meant that SAC was sitting on an unrealized gain in Elan of $80 million or more. Martoma personally had an enormous stake in this gain, because his 2008 bonus would be based in large part on it: a higher percentage in the case of shares held in his own portfolio, a lower but still substantial percentage in the case of certain other portfolios. It is a rare individual who would be willing to gamble those substantial sure profits, and risk seeing them wiped out entirely, for the highly dubious prospect of more modest, further gains.

In short, Mr. Martoma's discomfort about continuing to maintain a large Elan position after its dramatic price increase in June and July was not a "red flag" that something was amiss. It was completely consistent with the circumstances.

5. Supposedly "Unusual" Aspects Of SAC's Trading In Elan And Wyeth In July 2008 Were Not In Fact Unusual

SAC exited its positions in Elan and Wyeth in July 2008 in a manner that, under the circumstances, was appropriate, understandable, and consistent with the objective of not making an investment bet, pro or con, on the ICAD presentation. Suggestions that there was something "suspicious" about SAC's trading do not withstand scrutiny.

a) The Confidentiality Surrounding SAC's Sales Was Not Nefarious

The SEC has previously alleged that SAC sold its Elan shares in a manner designed to limit knowledge of SAC's sales program. The sales were executed using dark pools and algorithms, and knowledge of the sales within SAC was limited to a handful of people.

These steps were perfectly appropriate in the circumstances. SAC was trying to sell about ten million shares of Elan. If word of this selling program leaked into the market, it could easily cause sales by other holders, driving Elan's share price down and costing SAC's investors tens of millions of dollars as SAC sought to dispose of its remaining holdings. From a purely economic point of view, it was imperative that the market not learn SAC was a substantial seller until its sales were completed, and SAC had a duty to its funds to protect their economic interests. In these circumstances, it was reasonable, and a customary trading practice, to trade electronically, using algorithms and dark pools. It also was reasonable to limit the number of people at SAC who knew about the selling program, recognizing that investment professionals, at SAC and elsewhere, talk constantly among themselves. The fewer people who knew about the Elan selling, the less risk of a leak.

On July 27, 2008, a weekly trading update from a senior research trader ("the Head Trader") makes clear that there was nothing nefarious about the selling program. The Head Trader, far from being circumspect about or embarrassed by what he did, or not discussing it at all, reports straightforwardly that he executed the sales "quietly and efficiently" in a manner that "clearly saved us some slippage." "Slippage" here means an incremental decline in share price caused by SAC's selling that would have reduced the proceeds SAC realized from its sales.

b) SAC Was Not Betting That The ICAD Presentation Would Be Negative

The SEC also alleges that SAC was short both Elan and Wyeth in advance of ICAD and insinuates that these short positions reflect the fact that SAC believed or "knew" that the ICAD Presentation would be negative and would cause a decline in both companies' share prices. This argument is simply wrong as a matter of fact. SAC's positions are not consistent with a certainty or strong belief that the ICAD results would be negative, and a desire to profit from those results by being short both stocks. Instead, they are consistent with a desire to be roughly neutral going into ICAD, with an Elan short roughly offsetting a Wyeth long.

Between the period of July 18 to July 29, 2008, SAC reduced its position in Elan from a long position of more than 10 million shares to a short position of about 4.5 million shares. During the same period of time, it reduced its Wyeth position from about 19 million shares to about 8.75 million shares.[3]

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[3] The SEC inaccurately characterizes the firm's position in Wyeth as net short by ignoring a twelve-million share equity swap long position in Wyeth. This omission is inexplicable because elsewhere the SEC cites the same Wyeth equity swap position to show that SAC was long Wyeth in the run-up to ICAD. *See* Paragraph 55 (citing SAC's "equity swap position with respect to 12 million shares of Wyeth stock"). SAC continued to hold the twelve-million share equity swap position through the

By Friday, July 25, 2008, SAC was flat in Elan, having neither a long nor a short position, but still retained a long position of more than 15 million shares in Wyeth, an investment worth more than $675 million, down only slightly from SAC's starting position on July 18. SAC still had an enormous long exposure to the ICAD results. Over the next two trading days, SAC sold more Wyeth, and shorted Elan, but at the close of business on July 29, immediately prior to the ICAD Presentation, its 4.5 million share Elan short, worth about $150 million, was offset by an 8.7 million share Wyeth long, worth about $380 million. *It was not, as the SEC alleges, short both Elan and Wyeth.*

In fact, the combined performance of SAC's positions in Elan and Wyeth in late July was roughly neutral. Cumulatively for this period, SAC <u>lost</u> more than $33 million, because its losses on its long position in Wyeth significantly outweighed its gains on its short position in Elan. Looking just at July 30, the day that reflected the market's reaction to the ICAD presentation, SAC's $61 million gain on its Elan short and, collectively, its Elan option hedges, was substantially offset by its loss of almost $48 million on its Wyeth long.

In short, SAC's trading from July 21 through July 30 does not reflect a desire to profit from inside information that the ICAD Presentation would be negative. It reflects a desire to not have any directional bet at all in advance of ICAD.

ICAD Presentation, and thus was actually *long* Wyeth at the time of the ICAD Presentation on July 29, 2008.

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In summary, there is no evidence that Mr. Cohen suspected that Martoma possessed material non-public information about Elan or Wyeth. Moreover, the circumstantial evidence discloses no red flags that Mr. Cohen ignored, because Martoma's discomfort with SAC's substantial exposure to Elan was reasonable under the circumstances.

B. The Other "Red Flags" Cited By The SEC Do Not, In Fact, Suggest Improper Conduct

In addition to questioning the circumstances surrounding SAC's trading in Elan and Wyeth in July 2008, the SEC cites a number of other facts that, in its view, should have caused Mr. Cohen to inquire further. In fact, these instances also were not out of the ordinary and did not call for further investigation.

1. Healthcare Portfolio Managers' Communications With a Prominent Physician

In April 2008, Healthcare PM 1, who had a strongly negative view of Elan, apparently had a telephone consultation with a prominent physician consultant based in California (the "California Physician") affiliated with the Gerson Lehrman Group who was not a participant in the Phase II bapineuzumab study but later became a participant in Phase III. The California Physician appears to have shared with Healthcare PM 1 his view that interim Phase II results, which he was told about late in the prior year as part of an attempt by the company to recruit him to participate in Phase III, were directionally encouraging but not statistically significant. Believing that this view was inconsistent with what he perceived to be Martoma's thesis that the data, when reported, would be statistically significant, Healthcare PM 1's co-worker, Healthcare PM 2, reported this conversation to Mr. Cohen. Mr. Cohen believed the discussion related to an earlier, published study and was irrelevant. Healthcare PM 1 then weighed in with his account of the conversation with the California Physician. The SEC apparently believes that Mr. Cohen should have been alarmed that Healthcare PM 1 might have received non-public information about interim Phase II results and should have ordered a further investigation.

The California Physician incident is much ado about nothing. To begin with, there is no reason to believe that the California Physician actually saw interim Phase II data, as distinct from having them described generally to him or surmising for himself what they likely showed. Healthcare PM 1 tells Cohen that the California Physician "implied, though he did not say outright" that he asked to see the interim data, and Healthcare PM 1 adds, in a follow-up email to Mr. Cohen, that "I have no idea" whether the California Physician was actually shown the interim data. Healthcare PM 2, who was apparently not present for the portion of the conversation that related to the Phase II bapineuzumab study, has stated unequivocally: "I don't think that [the California Physician] had access to blinded data." Mr. Cohen himself was plainly skeptical that the California Physician had seen non-public data: "Seems strange tha[t] he would have seen the data when other investigators haven't."

Second, if the California Physician was shown interim Phase II data, or if officials at Elan or Wyeth described to him what these data showed, there is no reason to believe the California Physician was under any obligation to keep this information confidential. He was not a Phase II participant, had not yet become a Phase III participant, and would not have been signatory to a standard participant's confidentiality agreement. There is no suggestion that Elan or Wyeth, which had a legitimate commercial interest in sharing the data, or a description of that data, with the California Physician, asked him to maintain the information in confidence. Indeed, the California Physician appears to have volunteered the information to Healthcare PM 1, suggesting he felt completely free to share it: Healthcare PM 1 emphasizes that "I didn't call [the California Physician] on Alzheimer's, was talking to him about migraine drugs."

Third, the highly general impressions the California Physician conveyed were neither material nor non-public but were widely shared inferences among professionals, including Healthcare PM 1 and Healthcare PM 2, who followed bapineuzumab, and consistent with Elan's and Wyeth's own public statements. The California Physician apparently communicated to Healthcare PM 1 that the interim data were "interesting" and "warranted further study" but were not statistically significant. These were hardly novel observations. Most professionals assumed the interim data must have been in some measure encouraging, or Elan and Wyeth would not have elected to begin a large and expensive Phase III study before seeing the final Phase II results. At the same time, the Phase II study was so small that, from a statistical point of view, it was highly unlikely to achieve statistical significance.

In short, far from conveying material information, the California Physician was simply reporting what was both obvious and public. As Healthcare PM 1 put it, the California Physician's views were "consistent with what <u>the companies</u> and other experts are saying." (emphasis added.) Healthcare PM 1 adds that it would be "astounding" if the interim data were statistically significant, i.e., the California Physician's conclusion was not a surprise. Similarly, Healthcare PM 2 testified: "I don't think that [the California Physician] was saying something different than what I already thought."

Finally, Martoma's follow-up with the California Physician was itself, even according to the SEC's allegations, entirely innocuous. According to the SEC's Order Instituting Administrative Proceedings, Martoma spoke to the California Physician and reported that his information was a "non-issue," i.e., the California Physician did <u>not</u> have information, public or non-public, that materially altered the Elan investment thesis.

2. Martoma's Alleged "Edge"

Next, the SEC alleges that Healthcare PM 1 and Healthcare PM 2 complained, behind the scenes, that Martoma bolstered his argument in favor of a large position in Elan with hints that he had "edge" or "black edge."[4] The suggestion is that Mr. Cohen should have been alarmed by these hints and investigated them.

To begin with, the SEC does not allege, and there is no evidence, that <u>Martoma</u> ever said or hinted to Mr. Cohen that he had improper information. Similarly, neither Healthcare PM 1 nor Healthcare PM 2 complained to Mr. Cohen that Martoma had improper information or suggested that any inquiry was necessary or appropriate. The "black edge" emails were not sent to Cohen or to anyone else in management. Indeed, as the SEC's allegations themselves make clear, Healthcare PM 1 and Healthcare PM 2 repeatedly stressed to Mr. Cohen that Martoma did <u>not</u> have any information beyond what was publicly available.

Nor does Mr. Cohen's response to the arguments about the firm's position in Elan suggest he thought otherwise. According to the Order Instituting Administrative Proceedings, Mr. Cohen told Healthcare PM 1 and Healthcare PM 2 that Martoma was

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[4] The full record makes clear that Healthcare PM 1 and Healthcare PM 2 coined the term "black edge" as a joke and used it as part of a running humorous commentary between them on a wide range of trading activities.

"closer to it" than they were and had "a lot of good relationships in this area." This simply meant that Martoma had done more research than Healthcare PM 1 and Healthcare PM 2, had talked to more physician experts and company officials than they had, and had a greater familiarity with Alzheimer's Disease than they did. These observations about the breadth and depth of Martoma's completely legitimate research were in fact completely true, and the SEC cannot dispute them.

3. **Martoma's Bonus**

Finally, the SEC cites the size of Martoma's 2008 bonus—$9.3 million, most of it tied to profits on the Elan position—as relevant to whether Mr. Cohen should have ordered an investigation. This makes absolutely no sense.

To begin with, many SAC portfolio managers are highly compensated. While $9.3 million is an enormous sum of money for any individual to make in a single year, numerous SAC portfolio managers have earned more. The size of Martoma's compensation, standing alone, would not be cause for special notice.

Second, SAC was obliged to pay Martoma the compensation it owed him for 2008 and could have been sued if it had reneged. SAC agreed to pay him a certain percentage of the net profit on his own portfolio, plus a lesser percentage of the net profit of positions, such as Elan, attributed to him in the Intrinsic and Cohen portfolios. This was exactly what he was paid. In other words, Martoma was paid the amount of money he was owed.

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In summary, just as nothing about Martoma's discomfort with the size of SAC's Elan position in July 2008 was a red flag, so too nothing about any of the other facts cited by the SEC called for investigation or further inquiry by Cohen.

II. Trading in Dell

The SEC's allegations concerning Dell are based on a single email, the "second hand read" email, forwarded to Cohen's email account on August 26, 2008. As we explain in detail below, there is no evidence that Cohen read the "second hand read" email, or spoke to anyone about the email. Indeed, Cohen did not read the vast majority of emails that were sent to his email account. While Cohen did himself trade Dell that day, as he did on many days, the evidence shows that it would have been almost impossible for him to have read the email before his trades. Further, the evidence shows that Cohen was trading Dell stock that afternoon because he became aware that the Consumer PM, the person who recommended that Cohen establish the Dell position, was selling a portion of his Dell stock.

Moreover, even if Cohen had been aware of the information in the "second hand read" email—and there is no evidence that he was—the email does not indicate that it contains material nonpublic information. The email is based on a second hand read, or interpretation; it does not identify the source of the information; and it does not indicate that the source provided information in exchange for any personal benefit or otherwise breached his or her fiduciary duty in providing it. And the information the email conveyed not only reflected a fairly wide range, *but it was wrong*.

A. Cohen's Dell Position Was Based On the Consumer PM's Recommendation And Cohen Sold Dell Stock When the Consumer PM Began To Sell Dell Stock

On August 25, 2008, and the morning of August 26, 2008, Cohen's portfolio (the "COHE Account") established a long position in Dell of 500,000 shares. The position was based on the recommendation of the Consumer PM and constituted less than 1% of Cohen's portfolio at the time.

Cohen later became aware that another portfolio manager at an SAC affiliate, Michael Steinberg, had a short position in Dell. On August 26, an email from Steinberg indicates that Cohen encouraged him to reach out to the Consumer PM to go over their differing views. Steinberg and the Consumer PM discussed Dell over email and, at 1:09 p.m., Steinberg's analyst, Jon Horvath, sent the "second hand read" email to the Consumer PM, but not Cohen. The Consumer PM was immediately skeptical of the information in the email, believing it was nothing more than a rumor that was likely wrong. In an email response sent at 1:13 p.m., the Consumer PM wrote to Horvath: "Well – if your checks are right, that is certainly a negative. I will say however that it seems like recently (more in consumer) everytime someone hits me with a check, it ends up being off. . . . So we will have to see."

At 1:33 p.m., the Consumer PM, who routinely trimmed positions going into earnings announcements, began selling some of his Dell position. The Consumer PM's selling was visible, in real time, both to Cohen and to one of his research traders who was responsible for monitoring the Consumer PM's trading in the consumer sector for Cohen (the "Research Trader"). Cohen's trading screens were set up so that the Consumer PM's sales (in this instance of Dell) would have flashed across the monitor that sits directly in front of Cohen in bright red, indicating that the Consumer PM was changing positions in Dell in a direction against Cohen's existing position. Once Cohen learned that the Consumer PM had begun to sell shares of Dell, Cohen started to sell Dell shares in the COHE Account. The sales are recorded as beginning at 1:39 p.m., just six minutes after the Consumer PM started selling.

Cohen had good reason to sell his Dell position. He had initiated the position based on the Consumer PM's recommendation just one day earlier. Multiple witnesses will testify that the Consumer PM's sales of Dell would have been a complete explanation for Cohen's sales of a position initiated on the Consumer PM's recommendation. In fact, the Research Trader has testified to the SEC that Cohen would follow the Consumer PM's sale of a stock by selling stock in the COHE Account even if technical analyses counseled against selling. The Research Trader has also testified that Cohen instructed him to monitor consumer portfolio managers' trading in real time "all day long"; that the Consumer PM was one of the portfolio managers whose trading he and Cohen followed most closely; and that the Research Trader would regularly alert Cohen to the Consumer PM's trading. Indeed, there are more than one thousand instances of written communications from the Research Trader to Cohen reflecting that the Research Trader kept Cohen informed of the Consumer PM's trading. In this particular instance, it is noteworthy, too, that the Research Trader called Cohen a few minutes after the Consumer PM started to sell Dell, rather than immediately after the Research Trader received or forwarded the email.

The Research Trader testified that, when it came to portfolio managers' trading, Cohen instructed him to "[w]atch what they do, not what they say." Consistent with this instruction, when a consumer portfolio manager who was tagged for a position in the COHE Account changed course, and traded that stock in a way that was inconsistent with that portfolio manager's initial recommendation, the Research Trader would always alert Cohen to the trade. This was true even if the portfolio manager traded only *one share* in a way that was inconsistent with his or her recommendation. Thus, it makes sense that when the Research Trader called Cohen at 1:37 p.m. on the afternoon of August 26, it was to alert Cohen that, only minutes earlier, the Consumer PM, the proponent of the Dell position Cohen initiated the previous day, had begun selling Dell stock.

Finally, Dell was not a unique situation.

On August 26 alone there are at least two other instances where Cohen's trading followed the Consumer PM's trading closely. In an order that began to be filled at 8:49 a.m. that morning, the Consumer PM increased his existing short position in a publicly traded company (the "First Issuer") by 5,000 shares. At 9:11 a.m., Cohen began building his own short position in the First Issuer by placing an order to sell short 15,000 shares. The Consumer PM was tagged for this position. Similarly, at 10:24 a.m., the Consumer PM began increasing his existing short position in a second publicly traded company (the "Second Issuer"), eventually selling short an additional 25,000 shares. Going into the day, Cohen also had a short position in the Second Issuer, which was tagged to the Consumer PM. However, earlier that morning, between 9:41 a.m. and 9:49 a.m., Cohen had been *reducing* his short position, covering 50,000 shares. But, at 10:39 a.m., approximately 15 minutes after the Consumer PM began increasing his short position in the Second Issuer, Cohen reversed course and began to increase his short position in the Second Issuer as well. Approximately one hour later, when the Consumer PM again increased his short position in the Second Issuer at 11:31 a.m., and sold short an additional 25,000 shares, Cohen once again followed suit, and sold short an additional 4,500 shares at 11:57 a.m.

These examples of Cohen following the Consumer PM's trading are not unusual, and they demonstrate the likelihood that Cohen started to sell shares of Dell because he saw or was told the Consumer PM was selling, not because of information contained in the "second hand read" email. In August and September 2008 alone, there are at least thirty-three examples in which Cohen followed the Consumer PM's trading within 30 minutes of the Consumer PM's trade. And at least twenty of these examples show Cohen following the Consumer PM after the Consumer PM traded in a direction contrary to his initial position, as he did in Dell on August 26.

B. There Is No Evidence That Cohen Ever Read The "Second Hand Read" Email

Cohen's purported receipt of the "second hand read" email is the sole basis for the SEC's claim that Cohen failed to supervise trading in Dell, yet there is no evidence that Cohen ever read the email. The Consumer PM forwarded the "second hand read" email to the Research Trader, without comment, at 1:14 p.m. The Research Trader forwarded the email to Cohen's email account at 1:28:47 p.m., also without comment. This email, the SEC alleges, should have raised "red flags." However, the evidence shows that Cohen likely never read the "second hand read" email.

Cohen has no memory of having seen it and no witness will testify that they discussed it with him. During this time period Cohen received approximately 20,000 emails per month, roughly 1,000 per business day. He read only a small percentage of them, which is unsurprising particularly considering that he traded 80 different securities or more in a day, as he did on August 26, 2008. In fact, around this time period Cohen opened only an average of approximately 11% of his emails generally, and only approximately 21% of his emails from the Research Trader.

1. The Chronology Does Not Support That Cohen Read The Email

It is significant that Cohen was focused on other matters when the Research Trader forwarded the "second hand read" email. Cohen was at his home on Long Island on August 26, not in the office. At 1:29 p.m. (the approximate time the "second hand read" email was forwarded to Cohen's email account), Cohen was on a nineteen-minute telephone call (from his cell phone) with SAC's head of business development, which did not relate to Dell and lasted from 1:17 p.m. until 1:36 p.m. The fact that Cohen was on a telephone call with his head of business development when the "second hand read" email was forwarded makes it even less likely that Cohen opened and read the email. In fact, it would not be unusual if Cohen were away from his home office while on his cell phone.

At 1:37:46 p.m., three or four minutes after the Consumer PM had started to sell Dell, the Research Trader called Cohen's cell phone. The call lasted for less than a minute, and ended at 1:38:34 p.m. There is no evidence that the Research Trader, or anybody else, discussed the "second hand read" email with Cohen. No one will testify that the Research Trader discussed the "second hand read" email with Cohen, and the Research Trader himself testified that he does not remember the "second hand read" email or any other discussions of Dell with Cohen in August 2008. In light of the very short duration of the call, the Research Trader's lack of familiarity with Dell, and (as discussed above) the fact that the Consumer PM started selling Dell a few minutes earlier, the Research Trader likely mentioned to Cohen that the Consumer PM had begun to sell his Dell position.

The first sale of Dell stock from the COHE Account was recorded as being placed by an execution trader at 1:39:11 p.m., but prior to the trade being recorded, the trader had to be instructed to sell and had to act on that instruction. It generally takes between ten to twenty seconds from the time an order is given until the time a trade is executed, which means the trade order was likely given at the very end of 1:38 p.m. or the first seconds of 1:39 p.m.

Thus, after his call with the Research Trader ended at 1:38:34, Cohen would have had only approximately 15 to 25 seconds to go to his desk and locate, open, read and process the "second hand read" email before he issued the order to sell shares of Dell. And in the seconds between the end of the Research Trader's call (if it happened) and entry of the order to sell shares of Dell, Cohen would have had to search for, find and read the "second hand read" email. But this also took time.

Cohen's office set-up on Long Island consisted of seven monitors, and the Outlook email program was on the monitor to the far left. Under the standard configuration for setting up Cohen's monitors, the Outlook application ran in a window in the background of that monitor, behind two other applications, "CQG" and "Bridge." For Cohen to view an email, he would have had to make Outlook the active window, and minimize Bridge and possibly CQG. Even then, the "Reading Pane," a feature that permits a user to preview an item in the Inbox without opening it, is turned off—Cohen uses the AutoPreview feature, which is configured to show only the first three lines of the text of an email. The AutoPreview version of the email the Research Trader forwarded would not have displayed the lines "second hand read," (because it was three emails down in the chain) or any other content of the email. Moreover, Outlook was reduced in size so that Cohen could only see, at most, five emails at a time and, by 1:37 p.m., Cohen had received so many emails on his Office account (his default set-up at his Long Island office) that the one forwarded from the Research Trader would not have appeared on the screen. Accordingly, to read the "second hand read" email on his computer screen after the Research Trader's call ended, Cohen would have had to turn to the far left of his seven screens, minimize one or two computer programs, scroll down his emails, double-click into the "second hand read" email to open it, read down three chains of forwards and digest the information all in 15 to 25 seconds.

It is not plausible to think that Cohen did all of that in 15 to 25 seconds. Instead, it is much more plausible that the Research Trader alerted Cohen to the fact that the Consumer PM had sold some Dell stock minutes earlier and that the Consumer PM's sales were the basis for Cohen's decision to sell.

Further, Cohen was probably away from his desk when the Research Trader called, making it even less likely that Cohen read the "second hand read" email before giving the order to sell shares of Dell. The Research Trader testified that he would contact Cohen by squawk box or instant message when Cohen was at his desk, but he would call Cohen on his cell phone when he understood Cohen was away from his desk. Thus, the Research Trader's phone call to Cohen on the afternoon of August 26 suggests that Cohen was away from his desk when the Research Trader called him at 1:37:46 p.m. The most likely sequence of events is that Cohen, having just ended his call with the firm's head of business development, was away from his desk when the Research Trader called; the Research Trader told Cohen that the PM was selling Dell; and Cohen then told the Research Trader to give the order to sell Dell, without ever searching for, finding, opening or reading the "second hand read" email. As multiple witnesses will testify, this sequence of events is entirely consistent with Cohen's custom and practice.[5]

Moreover, it is clear that Cohen's attention was directed elsewhere when the Research Trader placed his call. Not only had he just finished a lengthy telephone call with SAC's head of business development, but in just the ten minutes following 1:36 p.m. (when Cohen hung up from his call with the head of business development and may have spoken to the Research Trader), the COHE Account transacted in at least 15 separate securities (several of which the Research Trader covered for Cohen), and Dell was far from Cohen's largest trade during that time.[6] Further, among the trades Cohen ordered during this extremely brief of time was the purchase of 500 E-Mini S&P futures contracts at 1:39 p.m. The Research Trader has testified that his responsibilities included alerting Cohen to the status of the futures market.

The sequence of Cohen's decision to sell shares of Dell, as set forth in the accompanying chart, demonstrates starkly the implausibility of the SEC's theory.

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[5] The Research Trader testified that Cohen would buy or sell a stock solely because a portfolio manager was buying or selling it. *See also, e.g.*, Deposition of the Consumer PM (May 30, 2013) ("[Cohen's style was] [m]ore rapid. He trades a lot. He's in and out of stuff a lot. He always has been. . . . Steve has no emotion in this stuff. Stocks mean nothing to him. They're just ideas, they're not even his ideas, and he buys stuff, sells stuff. I don't know how frequently he trades but that's what he does. He's a trader, he's not an analyst. And he trades constantly. That's what he loves to do."); Deposition of Head Trader (July 17, 2012) ("[e]verything is on the fly, dynamic, and they change all day based on S&P moves and news stories and everything like that, so. And it's been like that since I've been there for ten years.").

[6] Nor was the Dell position significant in comparison to the overall size of the COHE Account. On the afternoon of August 26, the Dell position was well less than 1% of the total gross market value (GMV) of the account.

Time	Event
1:17 p.m.	Cohen begins cell phone call with SAC's head of business development.
1:28:47 p.m.	The Research Trader forwards "second hand read" email to Cohen's account.
1:33 p.m.	The Consumer PM begins to trim his Dell position.
1:36 p.m.	Cohen's cell phone call with SAC's head of business development ends.
1:37:46 p.m.	The Research Trader places a call to Cohen's cell phone; Cohen is likely still away from his desk.
1:38:34 p.m.	The Research Trader's call to Cohen's cell phone ends.
1:38:34 p.m. until approximately 1:38:52 p.m. – 1:39:02 p.m.	Window of time in which Cohen must turn to the far left of his seven screens, minimize one or two computer programs, scroll down his emails, double-click into the "second hand read" email to open it, read down three chains of forwards and digest the information to read the "second hand read" email before issuing an order to sell shares of Dell.[7]
Approximately 1:38:52 p.m. – 1:39:02 p.m.	Order to sell shares of Dell is issued.
1:39:11 p.m.	Order to sell shares of Dell is placed.

7 And if, as the evidence suggests, Cohen was away from his desk when the Research Trader called his cell phone, he could have read the email on his computer screen only after (in addition to the other steps listed above) he first returned to his desk.

2. There Is No Evidence That Cohen Spoke With Anybody About The "Second Hand Read" Email

Not only is there no evidence that the Research Trader spoke to Cohen about the "second hand read" email, there is no evidence that Cohen spoke to the Consumer PM, Steinberg, or Horvath about the email either. Since Cohen was out of the office on August 26, 2008, he could not have spoken with any of them face to face. Cohen and the Consumer PM did speak by telephone at 12:54 p.m., for seven minutes, but this was before the "second hand read" email was sent to either the Consumer PM or Cohen. And the evidence suggests that they discussed stocks other than Dell.[8]

Additionally, there is no evidence of telephone communications between Cohen and either Horvath or Steinberg on August 26, 2008. In fact, the evidence strongly suggests that Cohen did not know that Horvath had a source who worked at Dell. On November 17, 2008—less than three months after the Dell trading at issue—Steinberg reported to Horvath that Cohen was "pissed" at Steinberg for having a bullish view of Dell, despite the worsening global financial situation. Steinberg responded to Cohen by citing the many sources of information—all legal—that he and Horvath had. As Steinberg recounted to Horvath: "I said jon has a number of industry contacts/ and that is what he has heard thru his supply datapoints/ and he was not pleased/ total bullshit/ I mean, it was bullshit." This exchange—which discusses legitimate sources of information, not tainted ones—is inconsistent with the contention that Cohen at any point suspected that Horvath had an inside source of information at Dell.

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[8] Of the sixteen separate positions in the COHE account for which the Consumer PM was "tagged" that day, the COHE account traded five of them—but *not* Dell—within ten minutes of Cohen's finishing the call with the Consumer PM at 1:01 p.m.

3. Cohen's Own Trading Patterns Were Not Unusual

There is nothing remarkable about the Consumer PM's or Cohen's August 26, 2008 trading in Dell. Dell was a highly liquid, large cap tech stock that Cohen traded into and out of frequently for many years. Cohen made trades in Dell based on the Consumer PM's recommendations in May, June, July, August and September 2008. In 2008 alone, there were at least four instances where Cohen traded into and out of a position of over 400,000 shares of Dell over the course of two trading days; and an additional eight instances where he traded into and out of a position of 100,000 shares over the course of two trading days. Indeed, when Cohen was trading into and out of a particular stock with great frequency, his research traders would refer to it as "like the new DELL."

C. Even If Cohen Had Read It, The "Second Hand Read" Email Would Not Give Rise to Supervisory Liability

Even if Cohen read the "second hand read email"—and the evidence strongly suggests he did not—the email by itself does not raise the kind of "red flags" that would suggest a failure to supervise. The "second hand read" email, on its face, does not appear to contain material nonpublic information. The email does not purport to provide definitive, first-hand information about Dell's gross margins, but instead states that it is providing someone's "read," or interpretation, or opinion of the situation, and a second hand one at that. Significantly, the gross margin information in the email was only a range, not an exact number, even though exact numbers must have existed at Dell at the time, as the Company was days away from reporting its earnings for the quarter.

And, in fact, the range reported in the email turned out to be wrong. Actual gross margins, when reported, were 110 basis points below expectations, significantly outside the 50 to 80 basis point range predicted by the "second hand" source. Had the actual gross margin number been equally inaccurate, but in the opposite direction—that is 30 basis points above the high end of the range, rather than 30 basis points below the low end—reported gross margins would have been 18.1%, which would have produced earnings above Street expectations, not below.

The email also does not give any details about the identity of the ultimate source of the information, other than that it is "someone at the company." The information could have come from any number of lawful sources, such as a low-level employee at Dell, who did not have access to the quarterly results and was simply guessing or surmising as to what the numbers would be (which might explain why, rather than containing precise gross margin numbers, the "second hand read" email provided a range). Or it could have lawfully come from an authorized person in Dell's Investor Relations group. Indeed, we now know that the person who in fact was the source of the information was a Dell Investor Relations officer, who, to this day, maintains he did nothing wrong and was simply doing his job. That person has never been charged with wrongdoing by the SEC or any other governmental agency. And Dell appears to have routinely made selective disclosures of precisely the kind of information contained in the "second hand read" email.[9]

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[9] The public record contains multiple examples of information selectively disclosed by Dell Investor Relations officials. *See, e.g.*, *United States* v. *Newman* Def. Ex. 798 (email from Jon Horvath to Jesse Tortora and Sam Adondakis asserting, "Apparently DELL IR saying offline that they will miss Oct ests 'by a country mile' is why stock is so amazingly weak." Dell's revenue missed by almost $1 billion that quarter, *see* Def. Ex. 8270, Gov't. Ex. 1807.); *United States* v. *Newman* Def. Ex. 866 (email sent by Jon Horvath to Jesse Tortora during Dell's quiet period quoting the head of Investor Relations at Dell, as saying, "We've pricing responsibly so even on a revenue miss GMs should be stable." This prediction also turned out to be accurate: Dell's revenues missed, and its gross margins were stable, *see* Def. Ex. 8270, Gov't. Ex. 1807.); Shira Ovide, *Dell to Miss Profit Estimates, Beat on Revenue*, Wall St. J., May 14, 2013 (projecting, two days before earnings announcements, that Dell

Thus, a reader of the "second hand read" email would not have any clue as to whether the source of the information fraudulently breached his fiduciary duties to Dell. While the "second hand read" email refers to a "read from someone at the company," an investment professional reading the email without context (and no witness will testify that he ever talked to Cohen about it) could well have believed that the information was a "read" from one of several lawful sources. Moreover, the fact that the information is a range (rather than a precise number) and involves a "read" makes it appear that the prediction being transmitted includes an interpretation from one or more intermediaries, based on unknown additional data points or assumptions, and does not represent a direct statement by the company source. As we note above, after reading the "second hand read" email, the Consumer PM's immediate, contemporaneous response was a highly skeptical one. Rather than reading the email as indicating that Horvath had a contact who had a reliable source from inside the Company, the Consumer PM dismissed the information, observing that "everytime someone hits me with a check, it ends up being off." There is no reason to believe that Cohen, had he read the email, would have had any other reaction.

Nor are there other indications on the face of the email to suggest that the information was obtained improperly. That the sender of the email had received "this read" in the prior two quarters, and it had been "very good," only underscores that the reader would not necessarily understand that the information came from someone in the know. If the sender knew that the ultimate source was looking at actual numbers that

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would report revenue of "roughly" $14 billion, operating income of $600 million, and earnings per share of 20 cents. That quarter, Dell reported revenue of $14.1 billion, operating income of $590 million, and earnings of 21 cents. *See* Dell Inc., Form 8-K (May 16, 2013)).

were about to be released, then why would he need to bolster the credibility of his information by citing a track record? Nor would it be suspicious for an analyst such as Horvath to request that the information not be disseminated too broadly—"keep to yourself as obviously not well known." An analyst advocating a position that was below then-current market expectations would not want those market expectations shifted in any way, through market chatter or otherwise.

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In sum, there is no evidence that Cohen read the single Dell email cited by the SEC. Nor, even if he had read it, does the email indicate that it contains material nonpublic information. The mere fact that the email was forwarded to Cohen's account does not support a supervisory charge against him.

III. SAC's Compliance Program

SAC has a strong culture of compliance. As the facts below demonstrate, the conduct the SEC alleges is belied by Cohen's and SAC's longstanding and demonstrated commitment to ensuring that SAC's employees act lawfully and appropriately.

For many years, SAC, at Cohen's urging, has gone to great lengths to deter insider trading and to establish an appropriate compliance culture. As discussed below, SAC has spent tens of millions of dollars developing and implementing a robust and constantly improving compliance program. It has hired a staff of no fewer than 38 full-time compliance personnel (including compliance IT), in addition to legal department personnel who devote part of their time to compliance issues. The firm's senior compliance personnel were hired from such major institutions as Goldman Sachs, New York Life Investment Management, PricewaterhouseCoopers, and Citigroup, and collectively have decades of compliance experience in the investment industry. They are supported by an infrastructure of compliance surveillance systems in which SAC has invested millions of dollars.

SAC's compliance team, with Cohen's full support, deploys some of the most aggressive communications and trading surveillance in the hedge fund industry. These include, among others, daily reviews of electronic communications (*e.g.*, emails, IMs, Bloomberg messages, internal write-ups) and SAC trading using keyword- and concept-based search protocols; weekly reviews of randomly-selected portfolio manager teams; review of all communications between investment professionals and their former employers for a period after commencing work at SAC; review of trading made around market moving events and corporate access events; and regular reviews of the firm's most-profitable trades. The firm has also adopted—at significant cost, and at the risk of putting itself at commercial disadvantage—numerous prophylactic measures, as well as restricting its employees' use of expert networks.

Steve Cohen has strongly and consistently supported this rigorous compliance effort. Cohen regularly communicates with the firm's senior compliance staff about improving the tools at their disposal, and has never refused a request from the compliance department for more financial support. Cohen has himself exemplified the firm's expectation that compliance is the responsibility of all of its employees. As the firm's emails reflect, Cohen has frequently forwarded to compliance staff communications he receives that caused him concern.

This is not the behavior of a CEO who turns a blind eye to red flags. On the contrary, it reflects Cohen's consistent commitment to ensuring that SAC and its employees conduct the firm's business in a lawful and proper manner.

A. SAC Has a Robust, Industry-Leading Compliance Program

The SEC's allegations that Cohen closed his eyes to evidence of wrongdoing by his employees and condoned insider trading are inconsistent with Cohen's record. Cohen and SAC have spent tens of millions of dollars to create an industry-leading compliance program for the express purpose of preventing insider trading and other employee misconduct. This program includes, among other things, independent due diligence in hiring; an extensive compliance training program for employees; comprehensive surveillance of employee communications and firm trading; and strict restrictions on the use of outside experts and consultants.[10] These efforts demonstrate—with deeds, not just words—Cohen's and SAC's commitment to deter and root out unlawful or improper conduct by its employees, including insider trading. The SEC's contention that Cohen closed his eyes to such conduct is at odds with these facts. That said, even strong compliance efforts may not detect individuals determined to evade firm policies or break the law.

1. SAC's Compliance Staff and Infrastructure

In 2000, Cohen hired Peter Nussbaum, a former partner at a leading law firm to serve as SAC's General Counsel and to oversee compliance. In early 2005, SAC hired Steven Kessler, a former Associate General Counsel at Goldman Sachs to become

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10 An "Overview of SAC's Compliance Policies," which describes the compliance program as of June 2011, is attached as an Appendix to this paper.

SAC's Global Chief of Compliance ("CCO"). In a recent interview attended by the SEC, Kessler described the commitment he demanded, and received, from SAC in order to take on this new role: significant resources to build a robust compliance system, and a position in SAC's senior management. Kessler proceeded to hire three key subordinate managers, each with at least a decade of extensive compliance experience at established and highly reputable institutions. By the end of 2008, SAC's compliance team had more than doubled in size, from 4 to 10, at a time of much more modest growth in the firm's overall head count and assets under management and in a period of substantial economic uncertainty.

Since 2008, the number of full-time compliance and compliance IT staff has increased from 10 to 38 persons. Members of the firm's legal staff also dedicate a portion of their time to compliance issues. The compliance staff regularly consults with law firms, compliance advisory firms, sell-side financial institutions, and other private investment firms about best practices and evolving surveillance techniques. SAC, with the full support of Cohen, has spent tens of millions of dollars over the years on dedicated hardware, software, and other compliance infrastructure to enhance the effectiveness of its compliance efforts. Ten members of the compliance staff are devoted to managing, maintaining, and upgrading the firm's compliance technology. The compliance department's budget for 2013 alone is approximately $30 million.

Steve Cohen has consistently been a strong supporter of the firm's compliance efforts. In addition to authorizing the extensive compliance expenditures discussed above, Cohen has referred dozens of communications to the compliance department, and actively encourages others to do so. In one instance in the summer of

2009, two individuals had engaged in a trade that raised compliance concerns with Cohen. Cohen personally asked the CCO to investigate this trade. After a thorough investigation, the compliance department concluded that the individuals' behavior violated SAC's compliance policies, although the evidence was insufficient to show that the conduct violated the insider trading laws. Even prior to commencing the investigation, the CCO told the individuals to unwind the trade and placed the stock in question on the firm's restricted list (meaning that no one could trade it). The firm sanctioned the individuals, subjected them to heightened supervision, and imposed significant financial penalties.

2. Hiring Due Diligence

The firm does not take lightly its decision to employ someone, given how closely tied the employee's conduct is to the firm's health and reputation of the firm and that of Cohen himself. Before authorizing a new hire, the firm reviews, among other things, the candidate's background and information submitted by the candidate. The firm has an independent due diligence function that reviews the candidate and conducts reference checks. In several instances, thanks to its due diligence process, SAC has refused to hire an investment professional candidate because of compliance-related concerns with the candidate's information gathering strategy.

3. Training

SAC does not leave the responsibility of compliance solely to the compliance department. On the contrary, the firm communicates, as a matter of policy and practice, that compliance with law and firm policies is the responsibility of everyone at the firm. Accordingly, in addition to the surveillance procedures described above, the department encourages employees to forward communications to compliance that may be potentially concerning. As noted, Cohen himself is an active participant in this process, regularly forwarding communications to the compliance department and asking compliance to follow up.

In addition, the compliance department has mandatory compliance training sessions covering, among other things, the firm's insider trading policies and the firm's legal obligations to avoid insider trading. The firm has brought in prominent outside speakers to speak with investment professionals. Each investment professional must re-certify adherence to the firm's compliance manual each year, and disclose certain family relationships and whether they have personal investment accounts. Additionally, through the weekly reviews of all electronic communications of various PM teams, the compliance department has the opportunity to reinforce various compliance policies.

4. Surveillance

To deter and detect insider trading in potential violation of law and firm policy, SAC—at enormous cost—engages in two separate forms of surveillance: review of electronic communications and review of trading. This surveillance program is specifically targeted to detecting potential improper use of inside information and other forms of possible misconduct (such as front running, collusion, or commercial bribery). Once a communication or trade triggers the surveillance filters, the compliance department engages in further investigation and, if necessary, has the power to take appropriate remedial action. These are not the practices of a firm indifferent to its legal obligations.

a) Communications Surveillance

In September 2008, SAC implemented a policy of 100% retention of the electronic communications of its investment professionals. At the time—and, indeed, even today, following its registration with the SEC under the Investment Advisers Act—SAC was under no obligation to adopt this policy of 100% retention, and it was a distinctly minority practice among unregistered investment advisers. The policy ensured that extensive information would be available for the SEC and other regulators investigating SAC's trading activities, and it was also a precondition for the extensive surveillance activities that SAC began to conduct on its own initiative on a pilot basis in 2008 and on a more comprehensive basis in and after 2009. In addition, SAC maintained significant amounts of data prior to September 2008, much of which has been produced to the SEC.

After having ensured that all communications were being retained, SAC implemented communications surveillance in 2009, using cutting-edge dynamic software that flags on a daily basis electronic communications using keyword and concept-based search techniques. In 2011, SAC expanded its daily surveillance to include communications flagged by more than 3,000 key words and phrases focusing on topics including inside information, collusion, and front running.

In addition, since 2009, SAC has conducted weekly reviews of communications of randomly-selected portfolio manager investment teams. During these weekly reviews, the team members are not aware that their communications are being reviewed. And in 2010, the department began reviewing all communications between investment professionals and their former employers.

Finally, the department is currently developing relationship mapping software, which is meant to identify patterns in communications and trading and to identify the outside individuals that investment professionals in the firm communicate with the most. This development, and implementation of this software, is a complicated, multi-million dollar project, which was suggested and supported by Cohen.

b) Trading Surveillance

In addition to robust communication surveillance, the firm also engages in extensive trading surveillance designed to identify potentially questionable trades. Many of these initiatives were developed through, among other things, discussions with other financial institutions. For example, the department generates a "Price Change Report," which flags securities traded five days prior to significant price movement. Similarly, the department also generates an "Option Trading Report," which flags instances where an investment professional gets out of the trade, or trades in large volumes, and which monitors trades made around company meetings.

The department also looks at the trading of the various portfolios themselves to identify anything that may be out of the ordinary. For example, the department generates a "Most Profitable Trades Report," which identifies the ten most profitable trades in a 30-day period based on the rate of return as a percentage of portfolio size. Similarly, the department also maintains a portfolio manager portfolio database, which includes portfolio manager trading, earnings announcements, and other market-moving news, thereby providing a historical backdrop from which to view a particular investment professional's trades.

c) Surveillance Follow-up Procedures

After a communication or trade is flagged by any of the above-mentioned programs, the department has a variety of procedures that it may follow. For example, the department may review, among other things, the employee's (1) historical trading; (2) investment theses/write-ups; (3) consultant/expert usage; (4) communications; and (5) personal trading. Members of the compliance staff may and do communicate directly with the employee and his/her team members. If necessary, compliance staff will also contact in-house compliance or legal personnel at the organization that is the source of the flagged information.

d) Potential Remedial Actions

SAC's compliance department has a wide range of remedial actions at its disposal. First, it may choose to restrict trading of the stock at issue. Second, in conjunction with senior firm management, it may discipline the employee involved, including, among other things, instituting warnings, imposing fines, enhancing supervision and surveillance, or termination. Third, the department may also discipline the information source, including warnings, suspension of services, changes in employee coverage, and termination of the relationship.

5. Restrictions on Use of Experts and Consultants

SAC is a leader in the hedge fund industry in adopting restrictions relating to the use of expert networks, doing so as early as January 2007. Well before the government's current insider trading investigation, the CCO made it a goal to review the existing expert network relationships as well as any new relationships.

As a result of this review, SAC adopted and implemented an industry-leading policy prohibiting its employees from retaining public company employees as "experts" to advise about industry trends. The use of such experts, extremely widespread in the investment industry, was not per se illegal: typically, the investment professional undertook not to seek, and the "expert" undertook not to provide, material nonpublic information. SAC nonetheless recognized that this practice was vulnerable to abuse, because investment professionals were offering monetary inducements to persons who in fact might be in possession of material nonpublic information, albeit on subjects they were not supposed to discuss. Accordingly, as a prophylactic measure, SAC announced and implemented this policy in early 2007. In doing so, SAC put itself at a commercial disadvantage—its competitors (including large mutual funds) were engaging routinely in expert consultations with public company employees. It did so to advance compliance objectives it believed were compelling. Additionally, beginning in 2006, new expert network relationships required compliance pre-approval.

For years, it was accepted market practice for investors to use consultants and/or expert networks to help inform their investing decisions. Beginning around 2010, the government began exposing weaknesses in the expert network practice and uncovered a number of consultants and networks that crossed the line and provided material, non-public information. Yet SAC's compliance department, with Cohen's support, had already begun to increase its focus on the use of experts during the firm's regular, mandatory insider trading training sessions. During such training sessions, the CCO emphasizes to investment professionals that, when interacting with experts, the investment professional must make clear that he or she works at a buy-side investment firm that is permitted to obtain only public information. Similarly, SAC requires the expert network to inform consultants prior to each meeting that the SAC traders are on the public side and do not want possible non-public information. Further, to the extent SAC investment professionals attend conferences where potentially non-public material is provided in advance to attendees, the investment professionals are forbidden from soliciting such material.

Another area of expert analysis that has come under scrutiny in recent years is the usage of physician consultants. Recognizing the potential for abuse, the compliance department began explaining to expert networks that the physician expert could not consult on a topic where it is believed the doctor has access to unblinded data. Recently, SAC has gone even further, imposing greater restrictions on physician experts: if the expert has access to unblinded data, SAC investment professionals are prohibited from consulting with the expert, regardless of the topic.

As part of the department's expert review, it developed due diligence questionnaires to determine which networks they would use. As a result of the questionnaires, the department ultimately approved several firms and prohibited the use of all other networks. As part of the agreement to work exclusively with these expert networks, the networks had to agree to adopt SAC's due diligence questionnaire into their consultant screening process. SAC has also worked closely with the expert networks themselves in developing both firms' compliance procedures.

In light of the concerns that have been raised regarding expert networks, SAC, with Cohen's full support, has continued to implement new procedures to ensure that investment professionals only receive legal information. For example, the compliance department "chaperones" certain expert network calls and has implemented the use of updated expert network due diligence screening questionnaires that each proposed expert network must complete. The firm's Research Working Group screens new consultant and research relationships, and the compliance department monitors the firm's consultant usage volume.

Thus, the SEC's contention that Cohen failed reasonably to supervise two employees with a view to preventing unproven violations of insider trading is contrary to the indisputable facts. SAC's robust compliance program shows the opposite: that Cohen is serious about deterring and detecting insider trading.

CONCLUSION

The SEC's allegation that Cohen acted improperly with respect to supervising two portfolio managers lacks any basis.

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