Ex-hedge fund trader charged in $276M insider ploy (Update)

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U. S. Attorney for the Southern district of N.Y. Preet Bharara, left, looks on as Robert Khuzami, director of the SEC division of enforcement speaks at a news conference, Tuesday, Nov. 20, 2012, in New York. Mathew Martoma, a former hedge fund portfolio manager was arrested Tuesday on charges that he helped carry out the most lucrative insider trading scheme in U.S. history, nabling investment advisers and their hedge funds to make more than $276 million in illegal profits. (AP Photo/Louis Lanzano)

A former hedge fund portfolio manager was arrested Tuesday in what prosecutors called perhaps the most lucrative insider trading scheme of all time—an arrangement to obtain secret, advance results of tests on an experimental Alzheimer's drug that helped his fund and others make more than $276 million.

The case also led authorities to investigate the activities of one of the nation's wealthiest hedge fund managers, Steven A. Cohen.

The portfolio manager, Mathew Martoma, was accused in U.S. District Court in Manhattan with using the information to advise other investment professionals to buy shares in the companies developing the drug, then later to dump those investments and place financial bets against the companies when the tests returned disappointing results.

"The charges unsealed today describe cheating coming and going," U.S. Attorney Preet Bharara said at a news conference. The scheme unfolded "on a scale that has no historical precedent."

Martoma's trades helped reap a hefty profit from 2006 through July 2008, while he worked for CR Intrinsic Investors LLC of Stamford, Connecticut, an affiliate of SAC Capital Advisors, a firm owned by Cohen.

Cohen is not referred to by name in court papers but is frequently alluded to for his dealings with the defendant in the weeks leading up to an announcement about the drug trial.

The government has been scrutinizing SAC since at least November 2010, when the FBI subpoenaed SAC and other influential hedge funds. Martoma is the fourth person associated with SAC Capital to be arrested on insider trading charges in the last four years.

SAC spokesman Jonathan Gasthalter said the company and Cohen "are confident that they have acted appropriately and will continue to cooperate with the government's inquiry."

The FBI said the scheme developed after Martoma met a doctor in Manhattan involved in an Alzheimer's drug trial in October 2006. According to a criminal complaint, he later obtained confidential information related to the final results of a drug trial.

Martoma's attorney, Charles Stillman, called his client "an exceptional portfolio manager who succeeded through hard work and the dogged pursuit of information in the public domain. What happened today is only the beginning of a process that we are confident will lead to Mr. Martoma's full exoneration."

Martoma was arrested at his home in Boca Raton, Florida, and made an initial appearance in federal court in West Palm Beach, Florida, where he was released on $5 million bail on charges of conspiracy to commit securities fraud and securities fraud. He was scheduled to return to court Monday in Manhattan.

The Securities and Exchange Commission filed civil papers in the case against CR Intrinsic Investors, Mathew Martoma and Dr. Sidney Gilman. The civil complaint said the illegal money was earned in July 2008, when various hedge funds traded ahead of a negative public announcement involving the clinical trial results of an Alzheimer drug being jointly developed by Elan Corp. and Wyeth.

The SEC complaint said that Martoma carried out the scheme with Gilman, an 80-year-old professor of neurology at the University of Michigan Medical School who served as chairman of a safety committee overseeing the clinical trial. Gilman was selected by Elan and Wyeth to present the final clinical trial results at a July 29, 2008, medical conference.

Messages left with the University of Michigan Medical School were not immediately returned.

Gilman's lawyer, Marc Mukasey, said his client is cooperating with the SEC and the U.S. Attorney's Office, and has entered into a non-prosecution agreement with federal prosecutors.

A copy of the non-prosecution agreement released by federal prosecutors Tuesday showed that Gilman has agreed to forfeit nearly $187,000 that he received from Elan for consulting work in 2007 and 2008 and from an expert networking firm for consultations between 2006 and 2009 with Martoma's hedge fund.

Bharara said Martoma gained from "cultivating and corrupting" Gilman, eventually receiving $9 million in bonus pay for the year when the trades were made.

The prosecutor said Martoma arranged through an expert networking firm to meet with the doctor about 42 times, beginning in the summer of 2006. He eventually convinced him to start talking about the drug trial.

The SEC said leaks by Martoma caused hedge fund portfolios managed by CR Intrinsic and by an affiliated investment adviser to liquidate more than $700 million in holdings in Elan and Wyeth.

The massive repositioning, the SEC said, allowed CR Intrinsic and various hedge funds to reap huge illicit profits and avoid steep losses.

"By cultivating and corrupting a doctor with access to secret drug data, Mathew Martoma and his hedge fund benefited from what might be the most lucrative inside tip of all time," Bharara said.

The prosecutor said the doctor sent him a draft of the 24-page presentation he planned to make at a conference announcing the results.

"And that is when Martoma had to do a spectacular about-face because he understood that—with these negative results looming—the hedge fund's massive $700 million stake had become a terrible bet," Bharara said. "And so, just like that, overnight, Martoma went from bull to bear as he tried to dig his hedge fund out of a massive hole."

The news caused Elan's stock price to plunge by more than 40 percent, while the price of Wyeth fell about 12 percent.

The bets against the drug developers netted additional profits totaling $76.2 million. That is roughly the same amount that prosecutors said former hedge fund manager Raj Rajaratnam made in illegal profits before he was arrested. The one-time billionaire is serving an 11-year prison sentence in what was once considered the biggest insider trading case in U.S. history.

A year later, a hedge fund employee recommended that Martoma be terminated and he was let go in 2010, Bharara said.

April Brooks, head of the New York FBI office, said the arrest was a continuation of the FBI's five-year campaign against insider trading and that no end was in sight.

"What we see again is an unholy alliance between an insider willing to divulge valuable non-public information and a money manager to whom that information is as good as gold," she said.