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FIGHTING THE WALL STREET MOB

Feds use wiretaps and "cooperating witnesses" to expose insider trading

By Julius (Jay) Wachtel. While Joe and Jane Citizen nervously watched the value of their 401(k)'s plummet, Raj Rajaratnam was raking it in. According to the Feds, the wealthy founder of the Galleon Group, a hedge fund that invests in technology companies, traded stocks in a way that would warm the cockles of a Mafia don's heart. Instead of doing his homework and taking his chances, he bribed employees of firms such as Google and Hilton Hotels to give him details about company finances before the information went public.

That's insider trading, and it's illegal as heck. Every cent that Rajaratnan made came out of someone else's pocket. His scheme was wildly profitable. Rajiv Goel, one of Rajaratnam's many tipsters, allegedly told him that Goel's employer, Intel, was about to invest in another company. Thanks to the tip, Rajaratnam made a quick $579,000.

For Rajaratnam that was small potatoes. Information that the Hilton chain was about to be sold made him $4 million. Advance knowledge that Google's quarterly report would show a dip in profits was worth twice as much, a cool $8 million.

Rajaratnam had many sources. Danielle Chiesi, a trader who worked for another hedge fund, passed on tips from her own insiders. "I'm dead if this leaks. I really am and my career is over," she once said.

Suspicious trading activity can lead to SEC investigations and civil fines. Indeed, it was a massive SEC inquiry that put the FBI on Rajaratnam's trail. But convicting someone of a crime is something else again. Convicting someone of insider trading requires proof beyond a reasonable doubt that they purposefully stacked the deck, making admissions such as Chiesi's crucial. After all, there's nothing wrong in playing the market like it's a racetrack, relying on sheer luck and a filly's (or a stock's) past performance. So how did the Feds manage to put the bracelets on Rajaratnam and his cohort? By using, for the first time ever, the same tool that's been so successful against organized crime: the wiretap.

A wiretap is an electronic interception where *neither* party to a communication has given consent to be monitored. (Wiring up informers or undercover agents is not wiretapping, since they are a "party" to the communication and obviously gave consent.) Feds who want to wiretap must satisfy a District Court judge of several things. There must be probable cause to believe that someone committed an enumerated crime. Wiretapping must also be a last resort, meaning that "normal investigative procedures have been tried and have failed or reasonably appear to be unlikely to succeed if tried or to be too dangerous."

Rajaratnam and Chiesi are pending trial. They have objected to the wiretaps on several grounds, among them government misconduct. A Federal judge half-agreed but still allowed the intercepts to come in as evidence. We'll leave arguments about the affidavit for another time. Here we're interested in how the FBI's case came together.

Rajaratnam was wiretapped first. Probable cause for his interception came from Roomy Khan, a "cooperating witness" who was one of Rajaratnam's insiders. This wasn't her first go-round. In 2001 she had secretly pled guilty to passing Rajaratman information from her then-employer, Intel. Khan agreed to cooperate and her case was sealed. Unfortunately, the FBI's investigation stalled, probably because the events of 9/11 shifted the agency's focus to counter-terrorism. Six years later the SEC alerted the FBI that Khan and Rajaratman were at it again. Agents confronted Khan, who folded and agreed to cooperate (she has pled guilty and is angling for a reduced sentence.) Her subsequent phone calls to Rajaratman yielded many golden admissions, for example, that "he knew someone 'very good' at Broadcom who could give him 'the numbers.'"

There were three wiretaps on Chiesi. Probable cause was based on information discovered during the Rajaratnam intercepts. Unfortunately, the contents of the tapes are under seal, so what she actually did is unknown.

Fast-forward to November 26 and the arrest of Don Chu. His employer, Primary Global Research, is an "advisory firm" that hooks up traders at hedge funds with persons who are experts about various industries.

Of course, being an "advisor" can provide excellent cover for passing on insider information. A Federal complaint says that's exactly what happened. Prosecutors accuse Chu of running a stable of "experts" who supply insider information about their employers. It was all going swimmingly until the FBI flipped one of the traders who was buying Chu's services. His name is Richard Lee.

For months everything that transpired between Chu and Lee was literally "on the record." FBI agent B.J. Kang (the same one who brought down Rajaratman) taped Chu providing insider information about two major technology companies, Broadcom and Atheros. Chu was afraid of the SEC, so he looked for company insiders in Asia, "where nobody cares." One of his best was employed by Broadcom in Taiwan. Listed as a "consultant" on the books of Primary Global Research (and designated "CC-1" in the Federal complaint), the tipster was paid more than $200,000 between 2008-2010.

Now here's the rest of the story. Richard Lee, the "cooperating witness" who brought down Chu, was one of fourteen traders and employees who pled guilty during the Rajaratnam investigation. Plea agreements invariably require that defendants play ball. Not counting Khan, that leaves a dozen additional "cooperating witnesses." Did they also wear wires and make recorded phone calls for agent Kang and his colleagues? With word out that as many as *fifty* hedge funds are under investigation for insider trading, we'll soon find out.