Six Charged in Vast Insider-Trading Ring

Billionaire Financier, IBM, McKinsey Executives in Alleged Plot to Profit on Google, Hilton; Echoes of Ivan Boesky

By Jenny Strassburg

In a case echoing the scandals of the 1980s, federal authorities exposed what they claim is the biggest insider-trading ring in a generation—a conspiracy in which a hedge-fund kingpin and executives at blue-chip firms including IBM and Intel allegedly connived to profit on Google and other big-name stocks.

At the center of the alleged ring was Raj Rajaratnam, the founder of Galleon Group, a New York-based fund firm that manages $3.7 billion. A native of Sri Lanka, Mr. Rajaratnam spent years carving a reputation as a meticulous investor in technology stocks, building a fortune estimated $1.5 billion.

Mr. Rajaratnam, 52 years old, was led away in handcuffs from his apartment in New York’s Sutton Place neighborhood after a 6 a.m. raid by the Federal Bureau of Investigation, according to people familiar with the matter.

Hours later, the U.S. Attorney in Manhattan charged him and five others with conspiracy and securities fraud, and the Securities and Exchange Commission levied civil charges against the six. Friday night, the judge on the case indicated he was willing to set bail at $100 million.

The arrests cast a spotlight on a financial crime, insider trading, with a long history on Wall Street. It is illegal for corporate insiders to make trades based upon information that hasn’t been disseminated to the public. But over the decades, a rogue’s gallery of investors has succumbed to that lure.

The crime erupted in a highly visible epidemic in the late 1980s, following a surge in takeovers that put armies of bankers and lawyers in possession of market-moving information about merger plans and tactics. At the center was Ivan Boesky, an arbitrageur who pursued information on takeovers zealously and cultivated executives and investment bankers. He paid a $100 million penalty for trading on inside information supplied by a Drexel Burnham Lambert banker and was sentenced to three years in prison.

Since the 1980s, Wall Street has changed, with hedge funds acquiring power and influence. But the game of gleaning information still relies on cultivating sources in positions to know corporate secrets. Like Mr. Boesky, Mr. Rajaratnam is an outsider who made it big on Wall Street.

The case against him reads like a thriller. An unnamed cooperating witness, described as a one-time Galleon employee, helped spark the investigation, taping conversations with Mr. Rajaratnam. That led to a series of broader wiretaps that capture the bravado of traders looking for an advantage. Prosecutors said the case is the first to use wiretaps for pursuing insider-trading charges.

The others taken into custody and charged were:

—Robert Moffat, 53, an executive at International Business Machines Corp., in charge of its supply chain, who recently was also given responsibility for its hardware, server and its semiconductor business—and who has been considered a potential future candidate for chairman.

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Kirkland, 51, an executive in the treasury department of Intel Corp., who graduated from the University of Pennsylvania’s Wharton School in 1983, the same year as Mr. Rajaratnam.

—Anil Kumar, 51, a director at management-consulting firm McKinsey & Co., of Saratoga, Calif., whom the SEC described as a friend of Rajaratnam and investor in Galleon funds.

—Mark Kurland, 60, of New Castle Partners LLC, a stock-trading hedge-fund group started in 1995 at Bear Stearns Asset Management Inc.

“Rajiv Goel, 51, an executive in the treasury department of Intel Corp., who graduated from the University of Pennsylvania’s Wharton School in 1983, the same year as Mr. Rajaratnam.”

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Of particular value to funds are insights of executives working directly in an industry, who might provide gossip or "market color." There is nothing inherently wrong with such conversations, but when information is passed that may impact a stock price, traders and executives expose themselves to potential insider-trading allegations.

Jim Walden, a lawyer for Mr. Rajaratnam, said at a bail hearing Friday that the prosecutors' theory in the case was novel, noting they had argued in part that Mr. Rajaratnam encouraged an alleged co-conspirator to leave an email trial in order to help conceal the scheme. He said prosecutors and investigators appeared to have misconstrued terms his client used in his business. "They don't understand the business Mr. Rajaratnam was legitimately employed in," Mr. Walden said.

Relying on phone wiretaps, the criminal complaint described a period between 2007 and 2008 when Mr. Rajaratnam and his group of friends, colleagues and technology executives allegedly swapped information that could instantly move a stock price.

Wiretap transcripts appeared to show Mr. Rajaratnam working closely with Ms. Chiesi, with her serving as a key link between him and a network of contacts.

Excerpts of taped phone conversations contained in court filings purported to show rapid-fire exchanges of information, and strategies about how best to trade on it. The wiretaps captured the high-pressure world of hedge-fund trading, as the duo discussed how certain information would weigh on coming earnings announcements of IBM, Akamai Technologies and others.

The transcripts showed Ms. Chiesi talking with Mr. Kurland, quoting him as telling her in August 2008: "Don't put anything in email... Don't email even Raj."

Mr. Rajaratnam and Ms. Chiesi appeared in filings to have treated their company informants like outsourced analysts on their payroll, discussing earnings projections and deal negotiations unknown to the rest of the market.

Plans by Blackstone Group to take hotel chain Hilton private amounted to "a sure thing," a cooperating witness told Mr. Rajaratnam on July 2, 2007, according to court filings, which add that the hedge-fund manager knew he was receiving inside information. Hilton Worldwide said it had "assisted the authorities with this investigation and we will continue to assist as needed."

Galleon Technology Funds bought and sold 400,000 Hilton shares based on tips for a profit of about $4 million, according to court filings.

The complaints allege that an analyst for Moody's Investors Service, not named in the filings, received $10,000 in exchange for the tip. A spokesman for Moody's said the credit-rating firm "fully supports the government's prosecution of insider trading and will provide every assistance in its investigation of this matter."

What were described as wiretap snippets suggested audacity but also at times nervousness.

"I swear to you in front of God... you put me in jail if you talk," Ms. Chiesi told an unnamed alleged co-conspirator, the filings say. "I'm dead if this leaks. I really am... and my career is over. I'll be like Martha f--ing Stewart."

During a call in August 2008, according to the filings, Mr. Rajaratnam and Ms. Chiesi discussed their concerns that their trading would draw regulators' attention. "On Akamai or IBM, anything, be radio silent," Mr. Rajaratnam told her, according to the transcript in court filings.

"I'm radio silent," Ms. Chiesi replied, according to the filings.

The transcripts also showed the two discussing Mr. Moffat, the IBM executive. "Put him in some company where we can trade well," Mr. Rajaratnam was said to tell Ms. Chiesi on a recorded telephone call Sept. 26.

Ms. Chiesi replied, according to the filings: "I know, I know. I'm thinking that too. Or just keep him at IBM, you know, because this guy is giving me more information... I'd like to keep him at IBM right now because that's a very powerful place for him. For us, too."

Mr. Moffat's lawyer, Kerry Lawrence, said his client was "shocked" by the charges. "We look forward to a favorable resolution of the case."

Charles Clayman, a lawyer for Mr. Kumar, also described his client as shocked, saying: "He is a man of integrity and honesty. He emphatically denies these charges." Mr. Kumar's employer, McKinsey, said: "The firm was distressed to learn that Mr. Kumar has been arrested and is looking into the matter urgently."

Chuck Malloy, an Intel spokesman, said Mr. Goel had been "placed on administrative leave as we look into this matter. Intel was not and has not been contacted by authorities."

A lawyer for Mr. Goel couldn't be reached to comment. Lawyers for Ms. Chiesi and Mr. Kurland declined to comment. A spokesman for Galleon said the fund was "shocked" at Mr. Rajaratnam's arrest and intends to cooperate fully, was arrested this morning at his apartment," said a fund spokesman.

He added: "Galleon continues to operate and is highly liquid."

—Don Clark and Kara Scannell contributed to this article.
Hedge-fund manager Raj Rajaratnam, who is accused of running a major insider-trading scheme, was known on Wall Street for his rapid-fire trading and in Silicon Valley for his knowledge of the technology industry.

His favorite quote, he told a magazine, came from Intel founder Andrew Grove: “Only the paranoid survive.”

The Sri Lankan-born founder of Galleon Management LP churned out impressive gains since the firm’s founding in 1997, making the 52-year-old Mr. Rajaratnam a billionaire. He was respected for his charitable work and willingness to pick up the phone and answer calls from even his smaller investors.

“It’s quite shocking to me,” said Mike Napoli of Absolute Return Group, a Los Angeles firm that invests in hedge funds and met with Mr. Rajaratnam in the past, though he didn’t invest in Galleon. “There were no clues this could happen, he gathered a collection of trading talent with a lot of integrity and he is a star—and his star hadn’t fallen, he was highly regarded.”

Mr. Rajaratnam had one run-in with regulators in the past, agreeing to pay a fine of nearly $2 million in 2005 after the Securities and Exchange Commission alleged the improper short-selling of 17 stocks just before the companies sold additional shares. But Galleon also was one of the minority of hedge funds that agreed to register with the SEC, which then regularly audited it.

Mr. Rajaratnam boasted to at least one client that the SEC specifically investigated whether Galleon had been doing any insider trading or other illegal trading and had given the hedge fund a clean bill of health. Galleon employed a chief compliance officer charged with making sure all trading at the firm was done properly, a position that many funds don’t have.

Mr. Rajaratnam has three children and lives on Sutton Place, an exclusive street on Manhattan’s Upper East Side. He was in Sri Lanka in December 2004 when the tsunami that caused more than 200,000 deaths across Asia hit the island nation. He wasn’t near the coast, but the tragedy moved him to pledge $5 million to replace homes destroyed in the flood. After returning home, he organized a fund raiser at the Stone Rose Lounge in New York’s Time Warner Center that raised an additional $3 million.

Galleon manages $3.7 billion, according to a company spokesman; it managed as much as $7 billion a few years ago, according to an investor. Mr. Rajaratnam’s technology-focused fund, which is accused of committing the improper trading, manages $350 million. The biggest of Galleon’s funds is the $1.2 billion Galleon Diversified fund. Until this year, Mr. Rajaratnam recorded annualized returns of 21% for his largest fund. This year, it rose almost 25% through October.

Mr. Rajaratnam was long considered among the top “growth” investors, with a focus on technology and health-care shares, though it expanded into energy, consumer and financial shares. While Mr. Rajaratnam continued to do his own investing in recent years, his firm churned out much of its gains from dozens of fast-moving traders who operated semi-autonomously, using the firm’s capital.

Before launching Galleon in 1997, Mr. Rajaratnam was president and chief operating officer of Needham & Co., an investment bank focused on the technology and health-care industries. He started at Needham in 1985 as an analyst in the electronics sector and was promoted two years later to oversee investment research. From there he kept rising. It was at Needham in 1992 that he started a hedge fund focused on emerging-market securities, becoming its general partner.

Prior to Needham, Mr. Rajaratnam was a lending officer at Chase Manhattan Bank.