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A 'Brazen' Insider Scheme Revealed

Illegal-Trading Charges Leveled Against 13; Friends' Debt Goes Sour
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Mitchel Guttenberg was $25,000 in debt to Erik Franklin when the two friends got together in 2001 to settle the obligation. The scheme they allegedly concocted that day in New York's cavernous Oyster Bar restaurant grew into one of Wall Street's biggest insider-trading cases in years.

Mr. Guttenberg, now 41 years old, agreed to relay advance word of potentially market-moving stock analysis by the Wall Street arm of Swiss bank **UBS** AG, where he was a research executive, to Mr. Franklin, now 39, a hedge-fund manager in those days at **Bear Stearns** Cos., authorities said.

Federal prosecutors and the Securities and Exchange Commission yesterday unveiled insider-trading charges against the duo and eleven others, including three other former brokers at Bear Stearns.

WALL STREET JOURNAL VIDEO

1Speaking at a news conference2 in Manhattan, U.S. Attorney Michael Garcia outlines federal charges in an insider-trading case involving 13 defendants from Morgan Stanley, UBS, Bear Stearns and Bank of America.

The participants in what the SEC called a "brazen" scheme allegedly earned about $15 million based on two strands of alleged inside information. The main one, from the UBS research, accounted for most of those gains. A second stemmed from leaks of takeover deals in the works at the blue-chip Wall Street firm **Morgan Stanley**.

The takeover-trading tips came from former Morgan Stanley lawyer Randi Collotta, 30, who was a compliance official responsible for monitoring adherence to securities rules, the SEC said. In a statement, Morgan Stanley said it was "outraged" and had cooperated in the probe and would continue doing so. Ms. Collotta pleaded not guilty in federal court.

UBS depicted itself as a "victim" of the scheme and said it is "committed to safeguarding the integrity of its proprietary information." Bear Stearns, whose employees allegedly traded on both the UBS and Morgan Stanley tips, said the actions described by regulators "are clear violations of our policies and procedures." Both UBS and Bear said they are cooperating as well.

The case is the broadest to emerge from the SEC under Chairman Christopher Cox. Though the defendants aren't Wall Street titans like former Drexel Burnham Lambert banker Martin Siegel and trader Ivan Boesky, who became infamous during the 1980s for insider trading, the SEC said this case is "one of the largest" since then.

THE ADOBE LEAK

• How one of the insider-trading leaks happened, according to the SEC:

• On April 18, 2005, Adobe Systems announced it would buy Macromedia, sending Macromedia's stock up 10%.

• Before the news, Morgan Stanley's Randi Collotta learned the information. She and her husband, Christopher, passed it to Florida broker Marc Jurman. He bought (for himself and his father) "call" option contracts, betting on a rally in Macromedia and two other stocks. Profit: $30,000.

• Mr. Jurman also tipped Bear Stearns broker Robert Babcock on Macromedia and two other deals. He bought call options. Profit: $75,000.

Source: SEC complaint

The case also suggests how easy it can be to get and trade on market-moving information before its public disclosure. Participants used disposable cellphones and coded text messages to cover their tracks and at times passed cash in a Doritos bag, people familiar with the case said. Along the way, some of the participants allegedly paid $150,000 to two defendants to keep their trading under wraps, payments U.S. Attorney Michael Garcia in Manhattan called "blackmail."

SEC enforcement director Linda Chatman Thomsen said the illegal trading in the case "shamelessly" compromised "the markets' integrity and investors' trust for a quick buck."

The SEC filed civil charges against 11 people, two hedge funds and one day-trading firm. Federal prosecutors also charged 10 of the 11 individuals, and three others, with criminal violations.

The alleged scheme, which stretched from late 2001 to last fall, was uncovered within the last six months -- after the SEC checked into suspicious trading by Mr. Franklin's father-in-law before news in June 2005 of an acquisition of **Catellus Development** Corp. involving Morgan Stanley bankers.

Four of those charged, including Mr. Franklin, have pleaded guilty to criminal charges including conspiracy, securities fraud and commercial bribery. Mr. Guttenberg was arrested at 6 a.m. EST yesterday at his home on the East Side of Manhattan. Wearing a dark blue long-sleeve T-shirt and jeans in court, he pleaded not guilty and was released on $500,000 bond. He declined to comment.

ADDITIONAL READING
Read the SEC complaint3 filed in the case, SEC vs. Guttenberg.

At UBS, Mr. Guttenberg was an executive director and institutional-client manager in the research department, serving since 2001 on its investment-review committee, the SEC said. The committee members got an advance look at midday of the next days' reports, some of them market-moving, by research analysts who rate stocks and forecast their earnings.

After their 2001 meeting at the Oyster Bar in the basement of New York's Grand Central Terminal, the SEC said, Mr. Guttenberg began feeding advance tips about UBS research to Mr. Franklin, who then managed a hedge fund at Bear Stearns with the tony name Lyford Cay.

The SEC said Lyford Cay earned $10,000 from advance word of a UBS downgrade of insurer Allstate Corp. in December 2001 by selling borrowed shares and quickly buying them back at a profit of about $1 a share. Mr. Franklin also traded ahead of new ratings on Lexmark International Group Inc., U.S. Bancorp and Union Pacific Corp.

After Mr. Franklin's profits on the trades were enough to repay the loan, the SEC said, he began making cash payments to Mr. Guttenberg at prearranged meetings.

Before Mr. Franklin left Bear Stearns in February 2002, the SEC said, some of his Lyford Cay trades were entered by another Bear Stearns broker, Robert Babcock, who also entered orders in Mr. Franklin's personal account at Bear Stearns.

Mr. Babcock, realizing that some of the Franklin trades were based on nonpublic information, began using them to trade stocks for Lyford Cay and for his own account and continued to do so after Mr. Franklin left, the SEC said -- netting the Bear Stearns hedge fund $600,000 in illicit profits from 2001-2003. Mr. Babcock has pleaded guilty, and his lawyer declined to comment. Two other Bear Stearns brokers who worked on the same desk as Mr. Babcock, Ken Okada and Andrew Srebnik, also piggybacked on Mr. Franklin's trades for their personal accounts in 2002, the SEC said. Mr. Okada pleaded not guilty to conspiracy and securities fraud and was released on bail of $100,000. Mr. Srebnik, who wasn't charged criminally, couldn't be reached.

After leaving Bear Stearns, Mr. Franklin joined another hedge fund, Chelsey Capital, where he provided UBS tips to portfolio manager Mark Lenowitz, garnering Chelsey $2 million in illicit profits and Mr. Lenowitz $325,000, the SEC said. In March 2003, Mr. Franklin opened a new hedge fund, Q Capital, with Mr. Lenowitz as a partner and investor -- netting another $300,000, the SEC said.

Mr. Lenowitz pleaded not guilty to conspiracy and securities fraud and was released on $250,000 bond. A spokesman for Chelsey, now doing business as DSJ International Resources Ltd., said it was "dismayed" and cooperating.

The biggest alleged beneficiary of UBS tips from Mr. Guttenberg was another friend, David Tavdy, who earned $6 million in illicit profits for himself, a friend and a relative at firms called Andover, Assent and Jasper Capital. At Assent, two employees who learned of the trading got $150,000 for their silence, the SEC said. Mr. Tavdy and those firms, one of which has closed, couldn't be reached.

In 2004 and 2005, the Morgan Stanley deal tips also found their way to Mr. Franklin and two of the Bear brokers, Messrs. Babcock and Okada, via a Florida broker, Marc Jurman, a friend of Ms. Collotta's husband, Christopher. They included advance word of acquisitions of Argosy Gaming Co., Macromedia Inc., and Pacificare Health Systems Inc.

Mr. Jurman pleaded guilty to conspiracy and securities fraud, and his attorney called him a "minor player" who earned only $30,000. Mr. Collotta pleaded not guilty, and his lawyer declined to comment.

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