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From Pinstripes to Prison Stripes

By Stephen Koepf

Just how far does the Government plan to go in its roundup of insider traders? The distance, apparently. Until now, jittery Wall Streeters could take comfort that the targets would be largely the most flagrant, Ivan Boesky- like abusers. But that reassuring notion rapidly evaporated in the aftermath of the Government's arrest this month of three high-ranking Wall Street officials, two of whom had allegedly made insider-trading profits only for their firms, not for personal gain. The cases suggested that prosecutors plan to go after not just greedy mavericks but overzealous employees and the companies for whom they work. As a result, major investment firms began to brace for the possibility of criminal charges and lawsuits for the misdeeds of a tiny fraction of their workers.

No one's nerves were calmed last week by the spectacle of another once powerful Wall Streeter getting a prison sentence. Dennis Levine, a former managing director at the Drexel Burnham Lambert investment firm who broke open the scandal last year by implicating Boesky, drew a term of two years, making him the fourth insider trader this year who will do hard time. Levine had faced as much as 20 years on four counts of securities fraud, perjury and income-tax evasion. "I beg you, let me put the pieces of my life together again," he implored U.S. District Judge Gerard Goettel before the sentencing. In deciding on two years, Goettel cited Levine's "extraordinary" cooperation with investigators, which had helped them uncover a "nest of vipers" on Wall Street.

Only days before the sentencing, the Government's dragnet had proved effective in snagging another suspect, this time outside the Boesky ring. Israel Grossman, a 34-year-old Manhattan lawyer, was charged with sharing information about a Colt Industries stock buy-back with at least six friends and relatives. His telephone tips allegedly enabled them to reap \$1.5 million in profits on their investments of just \$38,273.

Yet anyone who watched only the Dow Jones industrial average last week would have been unlikely to sense that history's biggest stock scandal was unfolding. Opening after a three-day weekend, the Dow jumped 54.14 points on Tuesday alone, a record rise for a single session. It set an all-time high of 2244.09 on

Thursday before slipping back to close the week at 2235.24. The market's reaction was in direct contrast to its performance after the Boesky revelations last November, when it plunged briefly as investors dumped speculative takeover stocks. This time, big institutions and foreign investors evidently believed the scandal poses no particular threat to their current strategy of snapping up basic industrial stocks, which the buyers think will be helped by a growing economy and a falling U.S. dollar. Says Byron Wien, a stock strategist for the Morgan Stanley investment firm: "The continued strength of the market shows that most investors do not believe the system is evil."

Even so, the new charges suggest that insider trading is not just the work of lone wolves. Some Wall Street firms may have created an atmosphere for such trading, advertently or not, by failing to maintain the so-called Chinese walls of discretion between their investment-banking divisions and their trading departments. That may have been the case in one of the insider-trading arrangements allegedly started by Martin Siegel, the former Kidder, Peabody merger whiz kid who pleaded guilty Feb. 13 to charges of illegal stock trading and tax evasion. The Wall Street Journal reported last week that Kidder, Peabody's chief executive, Ralph DeNunzio, ordered Siegel in March 1984 to create an arbitrage department to speculate on takeover stocks, and to keep this special assignment secret. Reason: his arbitrage role could be seen as clashing with his position as the firm's chief corporate adviser on mergers and acquisitions. Kidder denies the Journal account, as well as any other wrongdoing. The Government charges that Siegel, who was apparently eager to get the arbitrage division rolling quickly, took part in a plan to share inside tips among two Kidder, Peabody arbitragers, Richard Wigton and Timothy Tabor, and a counterpart at the Goldman, Sachs investment firm, Robert Freeman.

If it can be proved that either Kidder, Peabody or Goldman, Sachs reaped profits from their employees' illegal dealing, the firms could be forced to disgorge huge sums. A federal statute passed in 1984 entitles the Securities and Exchange Commission to ask courts to impose treble damages on such profits. The federal investigators have reportedly served subpoenas on both Kidder and Goldman in an effort to search a wide range of trading records. In addition, Wall Street lawyers said they have begun to get a flood of inquiries from investors who want to file private lawsuits against the implicated investment houses.

The Government is likely to face its toughest fight yet in making any charges stick against Freeman, the Goldman, Sachs arbitrageur. Proud of its starchy, spotless image, Goldman plans to help its employee fight the accusations, rather than persuade him to settle with the Government as other alleged insiders have done. The firm plans to provide Freeman with legal counsel and keep him on the job unless he is proved guilty. Confides a New York City securities lawyer familiar with the charges: "This is one case where the Government may have been a little too zealous." Kidder too aims to defend Wigton, its accused executive, against the charges.

The more beleaguered firm appears to be Drexel Burnham, the investment house with close ties to Boesky. Wall Street is restlessly waiting for the results of an SEC probe and a reported grand jury investigation into Drexel's activities, among them the highly profitable operation run by Michael Milken, the junk-bond guru. Even though no charges have been filed against Drexel, rumors have proliferated among competing firms that Drexel could conceivably face fines running into the hundreds of millions of dollars if its staff is found to have committed

widespread insider trading.


While such penalties remain pure speculation at this point, the heat of investigation surrounding Drexel is already driving away business, its competitors claim. The firm's headaches grew even more severe last week, when Staley Continental, an Illinois-based food company, sued the investment house for more than \$200 million in damages in a case centering on Drexel's junk-bond operation. Staley claims that last November Drexel tried to push the food company's management into a deal to buy up the corporation's stock, which would have been financed by the investment firm. Drexel called the lawsuit an "ill-conceived attempt to capitalize on the current climate" of the insider-trading scandal.

Many experts believe the really blatant cases of insider profiteering are rare, despite the hubbub. "The vast majority of the people on Wall Street are not doing it," says Edward Brodsky, a Manhattan securities lawyer. "Those who are, however, infect the integrity of the entire marketplace." Maintaining that integrity has been a difficult challenge in the deregulated, hurly-burly Wall Street of the 1980s, where traders have been tempted to use insider tips to maintain their competitive edge.

If their employers are now to be held accountable for insider transgressions, that development may be deserved. Many Wall Street firms have imposed unrealistic expectations on their traders and bankers without giving them a solid grounding in old-fashioned ethical values. By pushing salaries and bonuses to outlandish heights, investment firms have turned money into the ultimate measure of success. Declares Felix Rohatyn, senior partner of the investment firm Lazard Freres, in an essay for the New York Review of Books: "Too much money is coming together with too many young people who have little or no institutional memory, or sense of tradition, and who are under enormous pressure to perform in the glare of Hollywood-like publicity."

It was a soaring life-style that perhaps brought the downfall of Martin Siegel. Besides keeping a posh Manhattan apartment, he and his wife built a spectacular cedar-and-glass beachfront home on Connecticut's Long Island Sound, complete with tennis court and gym. He typically commuted to work in a chartered helicopter. Siegel reportedly met with Boesky in New York City's Harvard Club in 1982 and bemoaned his compensation at Kidder, Peabody, which he viewed as inadequate even though it was already well into six figures. That lunch date allegedly led to the tip-selling arrangement in which Siegel boosted his income by a total of \$700,000 over three years. But by making that purported deal, Siegel, only 38, will now forgo untold future income in the merger game. Since he is barred for life from the securities industry and could get up to ten years in prison, the lush life he enjoyed as a star dealmaker is already only a bitter memory.

With reporting by Susan Kinsley and Frederick Ungeheuer/New York

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