Inside Capitol, Investor Access Yields Rich Tips

BY BRODY MULLINS AND SUSAN POLLMAN

When Senate Democrats finally brokered a compromise over the proposed healthcare law, a group of hedge funds were let in on the deal, learning details hours before a public announcement on Dec. 8, 2009.

The news was potentially worth millions of dollars to the investors, though none would publicly divulge how they used the information. They belong to a select group who pay for early, firsthand reports on Capitol Hill.

Seeking advance word of government decisions is part of a growing, lucrative—and legal—practice in Washington that employs a network of brokers, lobbyists and political insiders who arrange private meetings between hedge funds and officials, including lawmakers and their aides.

With markets moving sharply on actions in Washington, hedge funds and other big Wall Street players are willing to pay for access. News tips, combined with data and analysis, help steer firms to profitable investment decisions.

The meetings can be fishing expeditions, with clients sometimes leaving empty-handed. But if there's news pending, these hedge funds are often among the first in line to hear.

New York-based brokerage firm JNK Securities has emerged as one of the most aggressive of the dozens of companies that escort clients around Capitol Hill. JNK Securities arranged the Dec. 8, 2009 health-care briefing and more than 200 similar sessions over the past three years.

Hedge-fund managers at Viking Global Investors and Karsch Capital Management were among investors who met privately that afternoon in a nondescript Capitol basement with senators whose support was crucial to passage.

The lawmakers said they would soon reach a deal that eliminated a proposed government-run insurance plan, according to people there.

The deal, announced after markets closed, helped buoy shares of such giant health insurers as Aetna Inc. and Cigna Corp. through the end of the year: A government plan could have posed serious competition.

Viking and Karsch placed bullish bets on health-insurance stocks including Aetna during the fourth quarter of 2009, which they sold in the first quarter of 2010, according to regulatory records that don't pinpoint trading dates. Shares of Aetna rose more than 6% within days of the announcement.

"Hedge funds and other investors have found that Washington can be a gold mine of market-moving information, easily gathered by those who are politically connected," according to Sanford Bragg, CEO and president of Integrity Research Associates, an independent group that analyzes research providers.

Wall Street firms have for years hired lobbyists to scour Congress and the White House for news that could affect stock prices. Now, investors want to hear from decision makers firsthand.

Many turn to William Williams, president of JNK Securities, a firm that brings lawmakers and investors together "to bridge the information gap between Washington and Wall Street," according to a recent news release.

Mr. Williams used to charge clients as much as $10,000 for meetings with lawmakers. That changed last year after a reporter from the publication Inside Higher Ed asked the office of Sen. Tom Harkin (D., Iowa) about an email from JNK showing it was charging to attend a possible meeting with the senator. Mr. Harkin refused to attend.

Now, hedge funds don't pay fees to JNK Securities. If they use information gleaned at these face-to-face meetings they are expected to execute their trades through the brokerage firm, which collects commissions.

Mr. Williams is a former football player who attended the Air Force Academy before transferring to the University of Pennsylvania. After college, he founded a hedge fund focused on telecommunications, media and technology industries. Later, he was a portfolio manager at Eagle Asset Management.

In 2009, he said he could drum up business for JNK Securities by organizing meetings between investors and government officials, tapping into a growing appetite on Wall Street for public policy news.

These days, he organizes more than a dozen meetings a month with members of Congress and others. Mr. Williams recently hired a former Washington lobbyist and onetime Capitol Hill aide to organize most of his meetings.

"It's a great business model and that's the problem," said Richard Painter, a former White House ethics lawyer for President George W. Bush and now a law professor at the University of Minnesota.

When investors, for example, wanted to know how Congress would weigh in on the proposed merger between Express Scripts Inc. and Medco Health Solutions Inc., Mr. Williams set up a face-to-face session Dec. 1 with a top aide to Sen. Herb Kohl, the Wisconsin Democrat who chairs the Senate's antitrust subcommittee.

The meeting was set up by Paul Bock, a lobbyist who once served as Mr. Kohl's chief of staff.

Some lawmakers seek to crack down on the practice, described by Mr. Painter as "buying information from members of Congress in a perfectly legal way." A bill sponsored by Rep. Louise Slaughter (D., N.Y.) would bar lawmakers and staff from disclosing market-moving, non-public information about pending or prospective legislation if they believe it will be used in Wall Street trades.

The legislation would require hedge funds and other firms pursuing political intelligence to disclose their activities, similar to lobbyists. It also would ban members of Congress from trading on insider information.

Mrs. Slaughter's legislation has been endorsed by a majority of lawmakers in the House. A key Senate committee chairman, Sen. Joe Lieberman (I., Conn.), is pushing legislation to require a government study of the issue.

Mr. Williams, who recently endorsed Mrs. Slaughter's legislation, was busy during the debt-ceiling debate earlier this year, with clients seeking clues whether political deadlock would lead to a U.S. default. They met, for example, with Rep. Tom Price (R., Ga.), a member of the House's tax-writing Ways and Means Committee on June 28 in New York.

Last month, JNK Securities brought a group to Capitol Hill to meet with top House telecommunications aides to discuss whether the government would grant a license to LightSquared Inc., a start-up funded largely by hedge fund Harbinger Capital Partners that wants to provide national broadband wireless service.

A spokeswoman for the House Energy and Commerce Committee declined to comment, as did Mr. Price.

Earlier this fall, Rep. Adrian Smith (R., Neb.) was peppered with questions from hedge funds about whether the congressional supercommittee would raise taxes on companies incorporated as master limited partnerships during a Sept. 26 lunch hosted by JNK Securities in New York. Such a tax increase would hit shares of master limited partnerships that are publicly traded.

Mr. Smith, a member of the Ways and Means Committee, told the group such tax changes should come through a separate tax-reform bill, which made the prospects seem unlikely. That was a valuable insight for investors involved with publicly traded investment funds.

Lawmakers defend the meetings. Republicans say they seek the views of hedge fund man-
agers to help shape laws that spur investment.

Democrats say the conversations lead to better public policy because investors tell them about loopholes, inefficiencies or unseen consequences of existing laws.

Last year, Mr. Williams spent much of his time arranging meetings over the financial regulatory legislation known as the Dodd-Frank bill. He held more than a dozen sessions between lawmakers and hedge funds during seven months of Senate debate on the measure, according to people who attended.

On Jan. 28, 2010, his group met on Capitol Hill with Sen. Christopher Dodd, the Connecticut Democrat, now retired, who chaired the Senate’s Banking Committee, according to attendees.

At the time, investors assumed Mr. Dodd would support legislation from Sen. Richard Durbin (D., Ill.) to cap fees that Visa Inc. and MasterCard Inc. collect on debit-card purchases. The possible fee cap weighed on the share price of the two credit card giants because it would shrink revenues.

Mr. Dodd signaled to the hedge funds that he wouldn’t include Mr. Durbin’s provision in his bill, a position favorable to Visa and MasterCard that didn’t surface for weeks, according to people at the meeting.

Among the funds attending was Conatus Capital Management, with $2.5 billion under management. In the first quarter of 2010, the hedge fund added more than 300,000 shares of Visa, according to public filings, a 50% hike that brought its holding to 950,000 shares.

Visa share prices rose from $81 at the end of January to a high of about $96 in April before falling to around $70 by mid-May.

On June 15, 2010, two weeks before a final agreement on the Dodd-Frank bill, JNK Securities arranged an all-day roster of meetings for clients.

The brokerage firm reserved a hearing room in a House office building for briefings by several lawmakers and aides. Hedge-fund managers sat in chairs on the dais normally reserved for lawmakers during congressional hearings, according to attendees.

Among those who spoke was Rep. Carolyn Maloney (D., N.Y.), a senior Democrat who was negotiating with Mr. Durbin on behalf of the House on the debit-card fee cap.

Mrs. Maloney said the House would support Mr. Durbin’s provision if, among other things, it exempted debit cards used by states to distribute government benefits to the poor. Her position ended up in the law.

Mrs. Maloney said she met the investors “because many were constituents and it was an opportunity to express my strong support for the financial reforms we were working on.”

SAC Capital Advisors LP was among a group of about 20 hedge funds who attended the series of meetings.

The sessions gave clues to the final provisions of the bill, which added to a sharp decline in financial shares.

SAC cut its holdings in some financial stocks in the second quarter of 2010, which ended two weeks later, and added others, including Bank of America Corp., Citigroup Inc. and Morgan Stanley, according to regulatory filings.

Mr. Williams also proved himself valuable during the health-care debate.

A month before his Dec. 8, 2009 meeting with senators, the House had approved legislation requiring the government to create a new public insurance plan for millions of Americans who lacked coverage.

The health-insurance industry opposed the idea because expanding the government’s role could drive down prices. Shares of large national health-care insurers had been languishing over the proposal.

The outcome was uncertain as the legislation moved to the Senate in December 2009. Several moderate senators were thought to hold the decisive votes on the issue, including Mr. Lieberman and Sen. Ben Nelson (D., Neb.).

The weekend before the Dec. 8, 2009 session, Senate Majority Leader Harry Reid (D., Nev.) held Senate sessions on Saturday and Sunday, seeking a deal. Another senator, Tom Carper (D., Del.), also was trying to help.

The central issue: Would the bill call for the government to create a public health insurance plan, the position supported by President Barack Obama?

To counter Republican opposition, Democrats needed votes from Messrs. Lieberman and Nelson, who said they had major concerns with a robust government-insurance plan.

As negotiations neared a resolution, JNK Securities and its hedge-fund clients met a half-dozen lawmakers in the U.S. Capitol. Among those who spoke to the hedge funds were Mr. Lieberman and Mr. Carper on Dec. 8, according to their offices.

The roster included Viking Global’s Scott Zinobor and Karsch Capital’s Eric Poteker.

The broad outlines of an agreement had been circulating for days, but the lawmakers confirmed they were close to a deal.
that discarded the public insurance plan, a boost to private insurers.

Viking, a hedge fund that manages $13.8 billion, bought six million shares of Aetna in that fourth quarter of 2009, according to regulatory filings. Karsch, which manages $2.4 billion, bought half a million Aetna shares during the same period, according to regulatory records. Shares of Aetna rose 14% in the fourth quarter.

Spokeswoman Whitney Phillips said Mr. Lieberman doesn't "give any special information to one group that he would not share with any other group, constituent or the press."

Emily Spain, a spokeswoman for Mr. Carper, said that "whether it was in conversations with constituents, members of the business community, public health experts, Congressional colleagues or the media, he regularly discussed his goals for health-care reform legislation."

That evening, the hedge fund managers retired to a nearby restaurant, Bistro Bis, where they were scheduled to have drinks with Mr. Nelson.

The senator had to take a rain check. The deal was announced past cocktail hour.
Investors Bullish on Fed Tips

BY SUSAN PULLIAM

Hours after an Aug. 15 meeting with Federal Reserve Chairman Ben Bernanke in his office, Nancy Lazar made a hasty call to investor clients: The Fed was dusting off an obscure 1960s-era strategy known as Operation Twist.

The news pointed to a boom in long-term bonds.

It was a good call. Over the next five weeks, prices on 10-year Treasury notes soared, offering double-digit returns in an otherwise dismal year.

By the time the Fed announced its $400 billion Operation Twist on Sept. 21, the window for quick profits had all but slammed shut.

Ms. Lazar is among a group of well-connected investors and analysts with access to top Federal Reserve officials who give them a chance at early clues to the central bank's next policy moves, according to interviews and hundreds of pages of documents obtained by The Wall Street Journal through open records searches. Ms. Lazar, an economist with Investment Capital & Management, wouldn't comment for this article.

The access is part of a push by hedge funds and other traders to get more information about the inner workings of government. Developments in Washington have become more important after the financial crisis in 2008 spawned new regulations and a stronger hand by lawmakers in businesses.

The words and actions of the Federal Reserve, in particular, have an enormous impact on markets, prompting the creation of new guidelines at the central bank to combat the perception of favoritism.

Conversations are important to both sides, making it difficult for the Fed to completely close its doors to traders and analysts. Fed officials want to know how investors might respond to changes in monetary policy and to avoid surprising markets. Investors, meanwhile, revel in developments that might pose unseen dangers to the U.S. economy, say people familiar with the matter.

Such talks are perfectly legal but create a delicate dance for the Fed, which tries to sate its need for information to help guide monetary policy without giving Wall Street an unfair advantage over Main Street.

Mr. Bernanke discusses only matters already public, a spokeswoman said. But hedge fund managers and Wall Street executives who meet regularly with him and other Fed officials—both in his office and through advisory committees—say they get valuable insights during the face-to-face talks.

"It's like an inquisition, they have a topic," said Laurence Fink, chief executive of BlackRock Inc. "By the questions they ask, by definition, you know what's on their mind."

Mr. Fink had phone calls and meetings with Fed officials ten times over the past two-and-a-half years, according to their calendars and open records requests. He said most of the conversations related to BlackRock's role as a paid adviser to the New York Fed about complex financial structures formed during the financial crisis.

New York Federal Reserve Bank President William Dudley also meets regularly with investors, both in his office with individuals and in committee groups. The New York Fed, one of 12 regional banks that constitute the Federal Reserve System, has the strongest ties to investors because it conducts the Fed's bond-market transactions.

Mr. Dudley, who also is vice chairman of the Federal Open Market Committee, which sets the nation's monetary policy, acknowledged the discussions could give the misperception that investors with access to Fed officials have an advantage.

"We take great care to frame subjects and questions in a neutral manner that does not provide any insight into our own thinking and we are careful to keep in mind that their comments may sometimes reflect their firms' own interests," Mr. Dudley said in a statement.

The meetings are "particularly important during periods of market stress," he said, and help him get a "broad range of perspectives on the markets and the outlook for the economy."

Over the past two-and-a-half years, Mr. Dudley has had dozens of private meetings, according to his calendar, which lists SAC Capital Advisors, Citadel Investment Group, Duquesne Capital Management, and Tudor Investments, among others. Lloyd Blankfein, chief of Goldman Sachs Group Inc., and Mr. Fink, of BlackRock, also had private meetings, according to Mr. Dudley's calendar.

These investors employ strategies tied to interest-rate policy and economic trends—making snippets of information as subtle as head nods and body language extremely valuable.

There are central bank rules that bar officials from discussing confidential Fed actions not yet public. But gleaning clues about the thinking of Fed officials during private talks can be as valuable to investors making bets on the direction of the economy.

Worries about Fed access surfaced a year ago. On Aug. 18, 2010, former Fed governor Laurence Meyer, who runs a research service predicting and analyzing Fed actions, told clients in a note the central bank's "bazooka is loaded" to buy bonds to stimulate the economy.

The note described how the Fed's "doves," members inclined to ease monetary policy, had said the Fed couldn't "sit on its hands," according to Mr. Meyer's account. An Aug. 20 note included some specific information about the Fed's balance sheet.

A week later, Mr. Bernanke said during a speech in Jackson Hole, Wyo., that "policy options are available to provide additional stimulus" to the economy. Stocks rose on the news, which
by then had given Mr. Meyer’s clients plenty of time to profit. The Fed announced its move in November—a second, so-called quantitative easing plan, known as QE2, that entailed buying $600 billion worth of long-term Treasuries.

At its Jan. 25, 2011, meeting, Fed members weighed the need for communications as part of the “monetary policy transmission process” against the “fair and equal access” that should be offered to the public, according to minutes of the meeting.

Fed members asked a subcommittee to consider better guidance to Fed members on communicating with investors. A new set of guidelines was approved in June. It said Fed members should “to the fullest extent possible” avoid meeting privately with “any individual, firm, or organization who could profit financially from acquiring” information from the Fed “unless those views have already been expressed in their public communications.”

In October, the New York Fed stopped providing early access of its economic forecasts to Wall Street analysts serving on a Fed advisory committee.

The new rules didn’t keep Ms. Lazar and others from alerting clients to Operation Twist. Richard Tang, bond-trading chief at Royal Bank of Scotland and a member of the Treasury Borrowing Advisory Committee, made a similar forecast about a week before Ms. Lazar. Through his committee membership, Mr. Tang meets several times a year with Treasury Department and Fed officials, including Mr. Bernanke.

Jan Hatzius, chief economist at Goldman Sachs, was also ahead of the pack, telling clients on Aug. 9 that he believed another round of bond buying by the Fed was coming. Mr. Hatzius is a regular guest of Mr. Bernanke and he meets privately with Mr. Dudley—his former boss at Goldman—according to calendar records.

Mr. Bernanke in a widely anticipated Aug. 26 speech in Jackson Hole, Wyo., left open the possibility of action to boost the economy but didn’t say what the Fed might do or when.

Rumors of Operation Twist spread, working in the Fed’s favor. The possibility of the central bank buying long-term Treasuries, along with troubles in the world economy, spurred investors to buy them first. The subsequent rally pushed up prices and dropped yields, which move in the opposite direction. Investors, in effect, helped Fed efforts to lower borrowing costs.

“Some may claim for self-interested reasons to have special access to Fed thinking,” a Fed spokesman said. “You should take all such claims with a heavy dose of skepticism. Fed thinking is the source of frequent and extensive speculation, much of which, even by prominent ‘Fed watchers’, is often and substantively wrong.”

Until the mid-1990s, the Fed didn’t even announce policy changes, which were signaled only by the manner and time of day that Fed traders intervened in money markets.

In the years since, the central bank instituted policy announcements, along with statements to explain decisions under Mr. Bernanke’s predecessor, Alan Greenspan. Mr. Bernanke initiated news conferences this year, which Mr. Greenspan never did.

When Treasury Secretary Timothy Geithner was president of the New York Fed beginning in 2003, he worried the Fed wasn’t close enough to big investors, especially financial firms like hedge funds that operated outside of the regulated banking industry. He set up a new staff position to coordinate private meetings with hedge fund managers and other Wall Street power brokers.

After the financial crisis, Mr. Dudley, who followed Mr. Geithner as New York Fed president in January 2009, went further. Concerned about the growing role of hedge funds and investment banks in a so-called shadow banking system, he established the Investor Advisory Committee on Financial Markets to open a pipeline into the thinking of big investors.

The relationship also drew these investors closer to Fed thinking. As winter turned to spring this year, discussions centered on the Fed’s optimism and gave an early view of where the central bank was headed, according to agendas and minutes from committee meetings obtained through open records requests by the Journal.

The pace of the U.S. economic recovery picked up speed at the end of 2010, and the stock market gained nearly 10% in the first four months of 2011. A run-up in commodity prices had raised inflation fears, triggering talk about an exit from the Fed’s support of historically low rates.

But an early sign of trouble came May 10 to members of the New York Fed’s Economic Advisory Panel, who meet twice a year with Mr. Dudley. They received a 27-page economic forecast by staff economists at the New York Fed that concluded, “Clearly the economy faces some new headwinds that were not present in early November.” The document included data and charts detailing the slowdown, according to a copy obtained in an open records search.

The message was clear: The U.S. economy, which weeks earlier looked like it was recovering, appeared to be slowing, according to New York Fed economists. By contrast, Mr. Dudley was more positive at a May 6 news conference, emphasizing the view that recent weakness in the economy wouldn’t last.

For big investors, the accuracy of the New York Fed prediction was less important than the view it represented: If the broader Fed committee also anticipated a slowdown rather than growth, it would lean toward keeping interest rates low.
or take action to stimulate the economy, rather than raising rates to fend off inflation.

On May 25, the Investor Advisory Committee on Financial Markets held a conference call to discuss the agenda of its June 9 meeting. Talk shifted from the Fed's exit strategy, a main topic at its December meeting, to worries about the economy.

In a June 5 note to clients, Mr. Hartzlau expressed renewed confidence in his long-standing view the Fed would keep rates near zero until 2013. "In fact," he wrote, "organic growth seems to have slowed anew to a below trend pace in the first half of 2011."

During the summer, investors grew more nervous over the softening economy, building stress in Europe and the downgrade of U.S. government debt. Stocks were reeling after the Fed issued its Aug. 9 post-meeting statement with news that indeed it wouldn't raise rates until mid-2013, a position based on a gloomy view of the U.S. economy. At one point, the Dow Jones Industrial Average sank 205 points, about 2%.

The first paragraph of the statement said the Fed was ready to employ "the range of policy tools available."

Some analysts correctly predicted the line signaled a new round of bond purchases, a dramatic turnaround from the conventional view only weeks earlier. As the more sanguine interpretation spread, stocks soared, closing up 4% for the day.

Among those who got the word out was Mr. Tang, who told clients that afternoon the Fed would purchase longer-term bonds, according to people familiar with the matter. The strategy, now known as Operation Twist, would shift a portion of the Fed's portfolio from short-term bonds into long-term bonds.

"Can't afford to miss this move," he told clients in an Aug. 17 email.
Buy on the Rumor, Sell on the News

Federal Reserve Chairman Ben Bernanke raised the possibility of more bond buying in a July speech. In August, well-connected analysts and investors turned bullish on 10-year Treasurys, which delivered better returns than stocks over the same period.

Aug. 9: Richard Tang, bond-trading chief at Royal Bank of Scotland, tells clients the Fed will soon purchase long-term bonds. Jan Hatzius, chief economist at Goldman Sachs Group, makes a similar prediction to his clients.

July 13: Fed chief Ben Bernanke tells Congress one Fed option is to ‘initiate more securities purchases or to increase the average maturity of our holdings.’

Aug. 15: Nancy Lazar, economist with International Strategy & Investment, meets with Fed Chairman Ben Bernanke then calls clients about an anticipated Fed bond buying plan.

Aug. 17: ‘Can’t afford to miss this move,’ Mr. Tang says in a follow-up email to clients.

Sept. 21: Fed announces $400 billion bond-buying program known as Operation Twist.

Sept. 22: 10-year Treasury index reaches peak of 2190.93.

Aug. 26: Mr. Bernanke in a speech leaves the door open to the possibility of Fed action but says neither what nor when.

Up 12.1%

Down 3.4%

Sources: Bank of America Merrill Lynch Global Indexes (return on Treasurys); Rydex ALM (bond yield); FactSet Research Systems (S&P)
Hedge Funds Pay Top Dollar
For Washington Intelligence

By Brody Mullins
And Susan Pulliam

WASHINGTON—At a breakfast fundraiser last year at the Liaison Capitol Hill hotel, former lobbyist Paul Equale pulled up a chair next to Sen. Richard Durbin. As they chatted, the Illinois Democrat told him about a recent breakthrough in his efforts to push through a bill to cap debit-card fees.

In Washington, such shop talk between political insiders is commonplace, but it hardly warrants mention. For Mr. Equale, however, it yields intelligence that fetches good money on Wall Street.

Mr. Equale works as a consultant for Gerson Lehrman Group Inc., which connects Wall Street investors hungry for information with Washington insiders who possess it. After hobnobbing with Mr. Durbin, Mr. Equale shared his conclusions about the debit-card legislation with hedge funds including Perry Capital and Jana Partners. Both funds subsequently traded in the stocks of Visa Inc. and MasterCard Inc., according to regulatory filings. It is unclear what role Mr. Equale’s report played in their investment decisions.

Information about what’s happening in Washington is at a premium on Wall Street these days. Government regulatory changes and economic initiatives following the 2008 financial crisis have affected numerous industries, and even minor shifts in policy can be of interest to hedge-fund managers. When the health-care bill was making its way through Congress in 2009, for example, hedge funds wanted to know about every twist and turn. They followed the debt-ceiling showdown over the summer just as closely.

Keen for information about what’s happening behind the scenes, hedge funds have been drilling ever deeper into the government. Thousands of political insiders are being paid by hedge funds, private-equity firms and other big investors. Former Federal Reserve Chairman Alan Greenspan, for example, is an adviser to Paulson & Co., and former Treasury Secretary John Snow works for Cerberus Capital Management. SAC Capital Advisors and Eton Park Capital Management have hired former congressional staffers.

Some investment groups contract with lobbyists to pass along information they pick up during conversations with lawmakers, congressional aides and other government officials. “I have information from doing my day job as a lobbyist,” explains one lobbyist. “That information has value on Wall Street. So I sell it.”

Securities laws generally prohibit trading on the basis of material nonpublic information about public companies, if the person with access to the information has a duty to keep it secret. Expert networks that traffic in corporate information have attracted government scrutiny. Prosecutors have charged five consultants at Primary Global Research LLC, an expert-network firm in Mountain View, Calif., with violating those prohibitions.

Securities laws don’t, however, bar most political insiders from sharing nonpublic information about government affairs. On the contrary, part of the job of lawmakers, staffers and lobbyists is to discuss policy options and pending legislation with anyone who might be considered an interested party. “A legislator normally talks to a lobbyist without any expectation that the information will be kept confidential,” says Karl Groskaufmanis, a lawyer at Fried, Frank, Harris, Shriver & Jacobson LLP in Washington who focuses on securities regulations.

“The ultimate [investing edge] is insider information, so you want to get as close to the line as possible without crossing the line,” says Sanford Bragg, chief executive officer of Integrity Research Associates LLC, which evaluates investment research firms. “That’s why Washington is so interesting—because there is no line.”

Insider-trading rules are more restrictive in the Executive Branch, but enforcement is difficult. Over the years, there have only been a few insider-trading cases involving nonpublic information from federal agencies. Federal prosecutors recently charged a chemist at the Food and Drug Administration with trading on inside information about drug-approval decisions that moved pharmaceutical stocks.

Political “expert networks” like the one Mr. Equale works for have emerged as a big business. Companies like Gerson Lehrman, Coleman Research Group Inc. and Public Insight LP offer investors the chance to talk one-on-one with any of a roster of experts on various aspects of government. More than 2,000 people work for expert-network companies in the capital.

The political-intelligence industry has become a roughly $100-million-a-year business in Washington, according to Integrity Research Associates.

Gerson Lehrman, the largest expert-network firm, says political consulting is growing. The firm has assembled a global roster of more than 300,000 experts on a wide variety of subjects. Hedge funds and other investors pay up to $240,000 a year for unlimited access to the Washington experts. Most Gerson experts, who aren’t technically employees, charge between $200 and $1,000 per hour to talk to clients.

Mr. Equale, who is 60 years old, runs a small consulting firm that, among other things, helps companies navigate regulatory channels in Washington. He has been in Washington since the 1970s, when he worked for the Energy Department during the Carter administration. He served as a top lobbyist for an association of insurance agents before going out on his own. Over the years, he has donated personally more than $70,000, mostly to Democrats.

His work for Gerson Lehrman, which began in 2005, is a sideline job—a lucrative one. Gerson pays him $600 an hour for passing information and advice to Wall Street investors. He has done that some 650 times, he says, earning himself about $400,000. “It’s put my kids through college,” he says. On one particularly good day in spring 2010, he earned $5,200 in a few hours during a break from his vacation at his beach house on the Outer Banks of North Carolina.

One day recently, Mr. Equale logged onto his laptop, called up
a private Gerson Lehrman Web page and scrolled through a list of investors that had consulted him. Some are identified only by numbers, others by name: Goldman Sachs Group Inc. and hedge funds Och-Ziff Capital Management Group, Viking Global Investors and Third Point. Gerson’s clients indicate online what kind of information they are looking for. Experts like Mr. Equale reply with information about their expertise and their backgrounds, and certify that they won’t illegally divulge inside information. Investors decide to whom they want to speak.

“Modern government is so complicated even the smartest people on Wall Street need an interpreter to fully understand the political discourse in Washington,” Mr. Equale says. “I am their interpreter.”

Last year, the financial-services industry was worried about an amendment being pushed by Mr. Durbin in the Senate to cap the fees banks and credit-card companies, including Visa and MasterCard, collect from retailers on debit-card purchases. Analysts warned that the provision, attached to a rewrite of financial regulation in the Senate but not the House, could cost the credit-card industry billions in debit-transaction revenue. It was pummeling the firms’ share prices. Wall Street wanted more information about what to expect.

Mr. Equale paid $1,000 to attend a campaign fund-raiser in May 2010 for Senate Majority Leader Harry Reid, a Nevada Democrat. A number of senior Senate Democrats, including Mr. Durbin, attended.

When Mr. Equale sat down with Mr. Durbin, he says, the senator told him something not widely known at the time: His amendment was gaining traction with a crucial House lawmaker, Financial Services Committee Chairman Barney Frank (D., Mass.), who previously had publicly opposed the provision. A spokesman for Mr. Durbin said the senator doesn’t recall the conversation.

Mr. Equale says he doesn’t relay to investors details of his private conversations with politicians. Based in part on his talk with Mr. Durbin, he says, he concluded that the chances were good the fee-cap provision would become law, which would be bad news for credit-card companies.

In a flurry of calls following the event, Mr. Equale says, he shared his opinion with a number of hedge-fund analysts, including at Perry Capital and Jana Partners. Later, he says, he told hedge funds he thought the Fed would propose a tough fee cap at first, but would ultimately water it down.

Just how useful the funds regarded Mr. Equale’s intelligence is difficult to know. At that time, markets appeared to have reached the conclusion—even without the information Mr. Equale gleaned from Mr. Durbin—that the fee-cap provision would pass in some form. Shares of Visa and MasterCard dropped in December after the Fed initially proposed a tougher-than-expected cap. In the fourth quarter, Perry

Paul Equale is a consultant for a firm that connects Wall Street investors with Washington insiders.

**Political Intelligence**

Wall Street investors buy information about Washington from former government officials, lobbyists and others, many of whom work for expert networks.

**Investors using political-intelligence firms**

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<th>Type of Firms</th>
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<td>Hedge funds</td>
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**Expertise sought by investors**

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<td>Asset managers</td>
<td>22.5%</td>
</tr>
<tr>
<td>Other</td>
<td>13.7%</td>
</tr>
</tbody>
</table>

Source: Integrity Research survey of 102 investment professionals conducted July-September 2009
snapped up 400,000 shares of Visa and 90,000 of Mastercard, public filings indicate. Jana bought about 1.6 million shares of Visa.

The outlook brightened in the first quarter when lawmakers pressed the Fed to soften its proposal. Perry and Jana sold their positions in the first quarter of 2011, public filings show. In June, shares of Visa and MasterCard surged when the Fed’s final rule set a less-restrictive fee cap of about 21 cents per transaction, almost double its initial proposal. Visa and MasterCard have been among the best performing stocks this year.

Late last year, Mr. Equale also doled out information about the likelihood of Congress legalizing gambling over the Internet. In 2006, Congress had essentially banned online gambling in the U.S. by prohibiting credit-card companies from processing payments from online gambling sites. Four years later, under pressure from the industry, including some U.S. casino companies, a House committee approved legislation to legalize Internet gambling. When Nevada’s Mr. Reid, the Democratic leader of the Senate with close ties to the gambling industry, won a close re-election last year, many on Wall Street thought a bill was in the bag.

In December, Mr. Equale attended a small gathering Mr. Reid hosted for longtime supporters in Las Vegas. Although he didn’t discuss the issue directly with the senator, he says, he talked about it with two top supporters whom Mr. Reid routinely consults.

According to Mr. Equale, they concluded that it wouldn’t be politically smart for Mr. Reid to push for a vote at that time on a bill narrowly benefiting the gambling industry.

“Here is what [investors] didn’t know and I did: Reid was never really going to do this,” Mr. Equale says.

Mr. Equale shared that conclusion with hedge fund D.E. Shaw. Once again, it is unclear how the information factored into the fund’s investment decisions. During the fourth quarter, the fund increased its holdings in MGM Resorts International to 304,529 shares, from 67,822 in the prior quarter. Shares of MGM jumped from $9 at the beginning of September to nearly $15 at the end of the year, due in large part to persistent rumors about the legislation, analysts say. Mr. Equale’s prediction that the legislation wouldn’t come to a vote proved correct, and shares of MGM trailed off to below $13 by the end of March.

In some cases, Mr. Equale’s predictions are based on little more than his reading of how the politics of a situation will play out, something he calls “sniffing the air.”

H&R Block Inc., the tax-preparation company, disclosed on Dec. 24 that an obscure government agency had blocked the line of credit it uses to fund “refund-anticipation loans” for customers—consumer loans that were under fire for their high interest rates. Investors figured the decision would hurt the company’s earnings during the 2011 tax season, and shares fell 7% the first full trading day after the disclosure.

Mr. Equale figured the government would eventually allow H&R Block to replace the financing. Republicans had taken over control of the House and were unlikely, he thought, to allow a crackdown on the industry. The incoming chairman of the Senate Banking Committee, Sen. Tim Johnson, had a good relationship with the financial-services industry.

In a Jan. 17 phone call, Mr. Equale shared his views with Watershed Asset Management. During this year’s first quarter, when H&R Block stock was trading as low as the low teens, Watershed bought 510,300 shares and an options contract to sell 510,300 shares at a future date at a predetermined price.

The stock began rising in early January and continued until April, partly due to the expectation that H&R Block would line up alternate financing. Since then, the stock has slipped, in part due to a settlement with regulators regarding its subprime lending business.

H&R Block announced on Sept. 13 that it won’t offer refund-anticipation loans during next year’s tax season.

Watershed sold its shares in the second quarter but continued to hold the option contract on 510,300 shares, according to the most recent public filings by the hedge fund.

That kind of insider’s political perspective “is the sort of stuff they want,” Mr. Equale says of investors. “I teach them how democracy works.”

—Maya Jackson-Randall contributed to this article.
They Were Best of Friends, Until the Feds Showed Up

Donald Longueuil and Noah Freeman were tight. They worked together as money managers at giant hedge fund SAC Capital Advisors. They skated together and vacationed together. And, prosecutors say, they traded on insider information together.

The two men had been there for each other, friends say, through the tough times—including a failed romance—and the good. Mr. Longueuil was the best man at Mr. Freeman’s 2009 wedding, and Mr. Freeman was to return the favor this month as a groomsman when Mr. Longueuil got married.

Instead of standing with Mr. Longueuil, though, Mr. Freeman took his friend down.

The 35-year-old Mr. Freeman turned against his buddy, wearing a wire for the government during a crucial phase in a sprawling, three-year investigation that authorities say could eclipse in scope any previous insider-trading case.

After Mr. Freeman himself was caught trading on inside information, he agreed to secretly record Mr. Longueuil, 34. He caught him saying he had ripped apart his computer drives with pliers and dumped the pieces in garbage trucks around New York, prosecutors say. The recordings led to obstruction-of-justice charges against Mr. Longueuil: Prosecutors say the drives held evidence of his insider trading.

The broken bond between the two men shows how the government’s insider-trading investigation is attempting to splinter the tight-knit circles of traders that share illegal investment data, prosecutors allege, in an environment where friendship is key.

The two traders, along with a third man criminally charged last week, Samir Barai, formed a “triangle of trust,” Manhattan U.S. Attorney Preet Bharara said at a news conference, sharing information from multiple sources with each other.

Lawyers for Messrs. Barai, Longueuil and Freeman declined to comment. SAC, the hedge-fund firm, hasn’t been accused of wrongdoing; a spokesman says the firm is “outed” and cooperating with authorities.

Interviews with roughly three dozen of the defendants’ friends, relatives, colleagues and teammates, as well as an examination of athletic records, photos, transcripts and civil and criminal complaints filed in a New York federal court, reveal the depth of the relationship among them and how their bonds were broken by the insider-trading case.

The ties between Messrs. Longueuil and Freeman were particularly deep. They met through a shared interest in ice skating, and both competed with the Bay State Speedskating Club in Massachusetts. They skied together in Utah and New Hampshire, friends say.

The women in their lives—Mr. Longueuil’s fiancée, P. Mackenzie Mudgett, and Mr. Freeman’s eventual wife, Hannah England—were friends as well, with a history of their own reaching back to Princeton University’s rowing team, friends say.

After graduating from Harvard University, Mr. Freeman worked as a consultant, entering the hedge-fund world in Boston in 2001 as a technology analyst.

Mr. Longueuil graduated from Northeastern University and, as his bid to make the 2002 U.S. Olympic Team in Salt Lake City as a speedskater fell short, he began making a name for himself as a wireless analyst.

It was around this time that the two met. Over the next few years, the two men grew close, staying in touch as Mr. Longueuil moved to Connecticut in 2004 to work for Empire Capital, a hedge fund where Mr. Freeman helped him land a job, associates say.

When Mr. Freeman’s then-financee broke their engagement, leaving him distraught, Mr. Longueuil helped pick up the pieces, a person familiar with the situation said.

Mr. Freeman later told co-workers he couldn’t have made it through the time without him. “I needed Don to get me out of bed this morning,” he said at one point, according to the person familiar with the situation.

In 2006, Mr. Freeman began dating Ms. England. The two couples’ social activities often centered around sports, friends say. Mr. Freeman and Ms. England competed in triathlons together. Mr. Longueuil and Ms. Mudgett rode on the same cycling team in New York.

Around this time, Messrs. Freeman and Longueuil—along with the third man, Mr. Barai, then of Citigroup Inc.’s Tribeca Global Management hedge-fund unit—began sharing, and trading on, inside information, according to the federal criminal and civil complaints filed last week.

Messrs. Freeman and Longueuil continued trading on inside information in 2008, prosecutors say, after joining SAC Capital. Mr. Freeman traded out of the Boston office, and Mr. Longueuil worked in New York for SAC’s CR Intrinsic division.

Mr. Barai, 39, meanwhile, left Tribeca when it shut down and started his own hedge fund. One of his first hires was an analyst who, according to last week’s criminal complaint, would eventually incriminate him: Jason Pfau. The two men knew each other through Wall Street ties, according to associates.

Launching Barai Capital Management together created a bond between Messrs. Barai and Pfau, people who know them say, because the small firm had few employees involved in investment decisions.

Prosecutors say Mr. Barai also put Mr. Pfau in touch with contacts to obtain insider information, including some he had allegedly used while at Citigroup. A Citigroup spokeswoman said the firm is cooperating with the investigation.

Mr. Pfau listened in to conference calls during which one of the contacts, a California technology company contractor named Winifred Jiau, allegedly gave Mr. Barai and Mr. Freeman information on chip maker Marvell Technology Group Ltd., according to the complaints filed last week.

The government in December criminally charged Ms. Jiau with providing inside information to publicly traded companies to hedge-fund managers.

Lawyers for Mr. Pfau and Ms. Jiau declined to comment.

There is no suggestion Marvell had knowledge of the alleged wrongdoing. The company said it is cooperating with authorities.

In May 2008, Mr. Freeman passed along nonpublic information about Marvell’s quarterly earnings from Ms. Jiau to Mr. Longueuil, prosecutors say in court filings.

Federal authorities say Mr. Barai’s firm made $820,000 trading on the information, and that Mr. Longueuil’s firm profited by nearly $11 million.

Besides participating in conference calls with Mr. Freeman, people who know Mr. Barai say he had dinner with Mr. Longueuil in New York about every other month, sharing pasta and wine at a low-key Manhattan restaurant as they discussed tech-investment ideas and relationships, according to a person who knows them.

The men’s lives seemed to be advancing along the same trajectory, marked by success in their careers and personal lives.

Mr. Barai was highlighted in a hedge-fund trade publication about overcoming adversity related to his lifelong hearing impairment. Mr. Longueuil bought
a 1,300-square-foot, $1.7 million condominium on the 10th floor of an upscale building on Manhattan's East Side, and Ms. Mudgett moved in, according to property and voting records.

And Mr. Freeman obtained a guaranteed two-year, $2 million contract from SAC plus 20% of profits generated in his portfolio, say people familiar with the matter.

He stopped in the middle of the St. Croix half-Ironman competition in 2008 and held up a sign asking Ms. England to marry him, according to an article about her athletic feats.

Ms. England didn't respond to requests for comment.

Messrs. Freeman and Longueuil also displayed a hard competitive edge, people who know them say. Members of "Team Psycho," a triathlon team Mr. Freeman practiced with, rejected him from becoming a member because he didn't always support others with what the club describes as positive "psycho karma," according to a club member.

Mr. Longueuil is health-conscious and maintained a strict diet, and complained repeatedly about tenants who smoked on their balcony a floor below him, according to people familiar with the matter.

In early 2008, the Federal Bureau of Investigation and prosecutors in Manhattan also began investigating Primary Global Research LLC, an "expert-network" firm—a company that arranges conversations between investment firms and employees at public companies who freelance as consultants.

Prosecutors say Mr. Barai had been using Primary Global to obtain investment information this way.

Five Primary Global consultants and three employees have been charged in the government's case. The company, which hasn't been accused of wrongdoing, declined to comment.

As part of the probe, prosecutors had obtained wiretaps on the phones connected to Primary Global and its consultants, including an employee of Advanced Micro Devices Inc., a semiconductor company.

Mr. Pflaum received insider information on AMD from the employee in 2008 and 2009, according to prosecutors. AMD, which isn't accused of wrongdoing, declined to comment.

Late last year, Mr. Pflaum
pleaded guilty to securities fraud and conspiracy.

In August 2009, Mr. Freeman and Ms. England were married in a wedding in Southport, Maine. Mr. Longueuil, wearing a blue blazer, light blue tie and khakis matching the groom, stood behind Mr. Freeman, smiling as the bride walked down the aisle. The festivities, according to photos of the event, included a rehearsal dinner at Mr. Freeman’s mother’s home and a run for the athletes in attendance.

A few months later, Mr. Longueuil and Ms. Mudgett celebrated their own engagement on a ski vacation to Vail, according to pictures of the trip. Mr. Longueuil asked Mr. Freeman to stand up at his wedding, which was planned for Feb. 26 of this year.

Soon their worlds began crashing down. Messrs. Freeman and Longueuil each were fired by SAC—Mr. Freeman in January 2010, and Mr. Longueuil in June 2010—for poor performance, according to a spokesman. By the fall last year, prosecutors and the FBI were ramping up their insider-trading investigation.

The FBI and the Manhattan U.S. Attorney’s office declined to comment.

Mr. Barai’s employee, Mr. Pflaum—who had been approached by the FBI and had begun working with the government—supplied the FBI in November with computer files from his desktop computer and laptop at Mr. Barai’s firm, as well as audio recordings that his boss had allegedly made of his conversations with Ms. Jiao, according to the criminal complaint and people familiar with the matter.

A few days later, on the evening of Nov. 19, The Wall Street Journal reported that federal prosecutors were engaged in a wide-ranging probe of insider trading that focused on Primary Global, among others.

According to the criminal complaint last week, this appears to be the first time Mr. Barai became aware of the investigation. He sent Mr. Pflaum a BlackBerry message that he had read the article 10 times, and told him to delete his BlackBerry messages, according to the complaint.

Coached by the government, Mr. Pflaum the following morning opened the door for his boss to potentially incriminate himself, writing: “Yo. Deleted them. Didn’t sleep so well last night. What else do you think we need to do?”

“U just go into office,” Mr. Barai responded, according to a transcript in the government’s complaint. “Shred as much as u can.”

Mr. Pflaum asked more questions. “[W]ho else do we talk to there...that might be questionable?” he messaged Mr. Barai, referring to consultants from Primary Global.

After Mr. Pflaum mentioned the AMD employee, Mr. Barai wrote, “I would delete his notes [for sure].”

“I think already deleted them,” Mr. Pflaum responded.

“Good,” said Mr. Barai.

A day later, Mr. Barai told Mr. Pflaum to leave his laptop computer with his apartment doorman so Mr. Barai could pick it up and “do a dept of defense delete” on its contents, according to last week’s government complaint. Mr. Barai took the laptop and never returned it. But by then the FBI had already viewed its contents.

The next day, on Nov. 22, his fund was raided by the FBI. He later was charged with securities fraud and obstruction of justice.

Meantime, Mr. Longueuil also panicked after reading the Journal article, prosecutors say. Using two pairs of pliers, he destroyed the computer hard drives where the government said he kept inside information, according to last week’s complaint.

At 2 a.m., a few hours after the Journal article was published, Mr. Longueuil left his New York apartment with another person, according to the complaint against him. He walked 20 blocks and dumped mangled pieces of computer drives in four separate garbage trucks, according to the complaint.

The person who accompanied him was his fiancée, Ms. Mudgett, people familiar with the situation say.

“The events of last week have been personally devastating for me and my family,” Ms. Mudgett said in a statement through her lawyer, Suzanne Jaffe Bloom, a partner at Dewey & LeBoeuf LLP. Ms. Mudgett hasn’t been charged with wrongdoing.
The Confessions of an Inside Trader

ON THE INSIDE

LONG BEACH, N.Y.—Kenneth T. Robinson knew he should walk away. But in an interview with The Wall Street Journal, he says he just couldn’t stop trafficking in insider-trading tips.

By Michael Rothfeld, Susan Pulliam and Vanessa O’Connell

It was September 2009—a full 15 years after he’d first gotten involved in an alleged multimillion-dollar fraud that ranks among the longest-running insider-trading cases in U.S. history. The scheme was showing serious cracks: One of Mr. Robinson’s two partners in the alleged crime, his close friend Garrett Bauer, had started throwing around big money—buying fancy homes in Manhattan and Florida and paying with millions in cash.

“I told Garrett it was stupid,” Mr. Robinson said in the interview. He urged Mr. Bauer that they all stop before the cops caught on.

But Mr. Robinson, flipping burgers one recent afternoon in his backyard on Long Island, said he failed to take his own advice. Within just a few weeks, he resumed trying to profit from inside information. “I didn’t think anyone would notice,” he said.

For a decade and a half, investigators say, the plan worked flawlessly. Mr. Robinson acted as a middleman—taking tips about corporate mergers from one friend (a lawyer, Matthew Kluger) and passing them to another friend (Mr. Bauer, a trader), who bought stock on behalf of all three men.

This setup stymied investigators for years because they couldn’t figure out where the trader was getting his hot tips. The three men reaped at least $37 million over the years, according to Judith Germaine, a federal prosecutor in New Jersey.

In late 2009, Mr. Robinson, a mortgage banker, made his fatal blunder—he traded in his own name rather than through Mr. Bauer. That trading and another instance in 2010 (which netted him and Mr. Kluger a relatively paltry $693,000, investigators say), helped federal authorities connect the dots.

The interview with Mr. Robinson took place last Wednesday on a warm spring evening in the postage stamp of a yard outside his family’s 85-year-old home, three blocks from the beach. The conversation provides a rare inside view into the motives and mindset that drove the alleged scam.

Mr. Robinson, the 45-year-old father of two young boys, said he never thought he would trigger their undoing with his own trading. “It didn’t seem like it would raise eyebrows when it wasn’t millions of dollars.”

During the interview, as Mr. Robinson tended the cheeseburgers on a grill, his sons played with a remote-control flying toy in the driveway. Getting involved with the alleged fraud “was 100% stupidity,” Mr. Robinson said. He didn’t need the money, or even make that much, he said—the broker, Mr. Bauer, reaped more than 90% of the take, prosecutors say.

But when offered “a shortcut,” Mr. Robinson said, he couldn’t resist.

Last week, federal authorities brought charges of securities fraud, conspiracy and obstruction of justice against Messrs. Bauer and Kluger, who were also named in a civil complaint by the Securities and Exchange Commission.

Mr. Robinson has pleaded guilty to securities fraud and conspiracy. He helped the authorities make their case by secretly recording his alleged partners, whom he had counted as friends.

“I wished it would go away,” Mr. Robinson said of the inside information that tempted him. “I wish it all would have ended, and we could have remained friends.”

His saga is part of an unprecedented crackdown on insider trading on Wall Street and in corporate America. Never before have there been so many major, unrelated insider-trading cases brought by authorities.

This past week, in a separate case, a former hedge-fund manager was charged with paying a tipster with envelopes of cash. (He denied the charges.) And the high-profile Galleon Group insider-trading trial is about to enter its seventh week.

“I wish I could say we are just about finished investigating pervasive insider trading,” Manhattan U.S. Attorney Preet Bharara said. “Sadly, we are not.”

The Robinson case has captivated Wall Street because it allegedly lasted so long and involved so much money. The three men are accused of trafficking in inside information since 1994 on deals that Mr. Kluger learned of through jobs he held at prestigious law firms. The deals involved major corporate names: Oracle Corp.’s purchase of Sun Microsystems Inc. and Intel Corp.’s acquisition of McAfee Inc., for instance.

Neither Mr. Kluger nor Mr. Bauer has yet entered a plea. Mr. Kluger, of Oakton, Va., was scheduled to be released on a $1 million bond after a bail hearing Friday in federal court in Newark, N.J. His lawyer, Alan L. Zegas, said he couldn’t discuss the case.

On Monday, a judge granted Mr. Bauer’s release on a $4 million bond. His lawyer, Michael Bachner, said Mr. Bauer “is waiting for the opportunity to review the evidence in the case, and at that time will make decisions, with counsel, about his defense.”

Mr. Robinson’s yellow stucco home, with stained glass and tile trim, is among the tidiest in a neighborhood of stylish yet closely packed houses in the suburban community of Long Beach, N.Y. Property records indicate it has a market value of just under $700,000.

“He’s not flashy,” said Dennis Smith, a teacher living two
doors down. “He's a great neighbor. He always does the extra stuff for you.” When it snows, Mr. Robinson shovels his elderly neighbor’s walk.

In the early 1990s, Messrs. Robinson and Kluger worked together at a real-estate firm. The friendship they struck up there formed the roots of their later alleged fraud.

The insider-trading scheme took shape in the summer of 1994, when Mr. Kluger, then a student at New York University law school, was a summer associate at the law firm Cravath, Swaine & Moore LLP, prosecutors say. He contacted Mr. Robinson with a tip about a merger he had just wind of at the firm, according to the complaint filed last week.

“I’ve got something,” Mr. Kluger told Mr. Robinson, the complaint says. At that time, Mr. Robinson worked at a small securities firm.

Mr. Kluger, the son of Richard Kluger, the Pulitzer Prize-winning author of “Ashes to Ashes,” a book about the fight against cigarette smoking in the U.S., suggested that Mr. Robinson find a trader who could trade stocks for them, according to the criminal complaint. Mr. Robinson put the idea to Mr. Bauer, who had been his co-worker at the securities firm, prosecutors say.

As the alleged scam evolved, Mr. Robinson developed starkly different relationships with the two men.

He and Mr. Bauer became best friends, people who know the two men say. Mr. Bauer would invite Mr. Robinson to his spacious apartment on Manhattan’s Upper East Side for New Year’s Eve and Super Bowl parties, a former friend says.

The two spoke as often as every day on the phone and exchanged emails about their daily lives, people familiar with the situation said. They used disposable phones to communicate when working on an insider deal, one of the people said.

They also traveled to Atlantic City together, hanging out at the beach and casinos—a move prosecutors allege helped cover up large cash withdrawals.

A person who knows Mr. Bauer said they went there to have fun, and that any use of the trip to hide their scheme was an afterthought.

Mr. Robinson said in the interview that he assumed Mr. Bauer made a lot of money trading legitimately, but wasn’t familiar with his friend’s finances. “I would ask and he wouldn’t tell me,” Mr. Robinson said.

Mr. Robinson’s relationship with Mr. Kluger, on the other hand, was more secretive, according to Mr. Robinson and the complaint. The two spoke only on payphones and disposable cell phones, Mr. Robinson said at his plea hearing, and only when necessary.

They saw each other when Mr. Kluger drove up from Washington to New York to pick up his share of the profits, the criminal complaint said.

Mr. Robinson blamed Mr. Kluger for pressuring him to trade on inside tips. “He always had information, and he always wanted to make trades,” Mr. Robinson said. “Matt was always pushing.”

Mr. Kluger’s lawyer and father declined to comment on Mr. Robinson’s statements.

In 2009, the trio made the bulk of their profit, investigators say. The take included $11 million on a purchase of 4.5 million shares of Sun when it was bought by Oracle that year. They also made $8.3 million on 1.3 million shares of software maker Omniture Inc., which was bought by software maker Adobe Systems Inc., according to the criminal complaint.

That same year, Mr. Bauer’s lifestyle shifted. In August 2009, he paid $6.65 million in cash for a five-bedroom duplex in Manhattan with a wrap-around terrace a few blocks from Central Park, real-estate records show. He bought expensive furnishings in hues of cream and yellow, according to Susan Langone, his interior designer, who says she met Mr. Bauer the afternoon before his arrest to pick out throw pillows for his den.

Mr. Bauer also paid $875,000 in cash that fall for a home in Boca Raton, Fla., according to the criminal complaint.

It was then, Mr. Robinson said in the interview, that he grew concerned and told Mr. Bauer “he should stop.”

For his part, Mr. Bauer was ready for a break, a person familiar with his thinking said. He considered the inside tips “a pain” because they weren’t always reliable.

If Mr. Robinson had heeded his own warning, it’s possible the three men might never have...
been caught. Investigators were already suspicious about the propriety of Mr. Bauer's trading, but couldn't make a case against him.

Then, in October 2009, Mr. Robinson received the tip that led to his downfall: Hewlett-Packard Co. was acquiring 3Com Corp. Mr. Robinson—who said he had already been trading in 3Com on his own—decided to buy some more.

He and Mr. Kluger made nearly $200,000 on that deal, the complaint says. Mr. Robinson also says he executed trades for himself and Mr. Kluger last summer on a tip that chip giant Intel Corp. was buying computer-anti-virus company McAfee Inc. Their take was nearly $500,000.

Mr. Robinson expected the trades would go undetected. “It seemed like such small amounts,” he said.

But someone did notice.

Investigators already had a list of Mr. Bauer's associates, and Mr. Robinson's name was on it, according to a person familiar with the matter. So, when Mr. Robinson began trading ahead of deals involving the law firm Wilson Sonsini Goodrich & Rosati PC (where Mr. Kluger had worked since 2005), regulators grew to suspect he was involved with Mr. Bauer in the scheme, the person says.

SEC officials called in the Federal Bureau of Investigation and federal prosecutors last summer, authorities have said. They still didn't know the name of the leak at Wilson Sonsini, according to the person familiar with the situation. For more than six months, they waited for the suspects to make another move.

Their moment came in January. Mr. Bauer started buying 1.4 million shares of video-technology firm Zoran Corp. on a tip that it would soon merge with CSR PLC, a maker of wireless products. The trade earned the trio almost $2 million, according to the criminal complaint.

On March 3, Mr. Robinson came to Mr. Bauer's apartment and picked up his share: $182,000 in cash to split with Mr. Kluger, according to Mr. Robinson and court documents.

Five days later, Mr. Robinson said, FBI agents showed up at his yellow home in Long Beach. Agents confronted Mr. Robinson with their evidence, the criminal complaint says.

They also told him that Mr. Bauer had made far more in the scheme than he and Mr. Kluger did, Mr. Robinson said.

Mr. Robinson agreed to help gather evidence against his friends. On March 17, he started recording their phone calls. He told Messrs. Bauer and Kluger that he'd been visited by the FBI, but hadn't cracked. Mr. Robinson was able to get both men to incriminate themselves, according to the criminal complaint.

In the calls, Mr. Bauer told Mr. Robinson he worried that his fingerprints were still on some cash he had given Mr. Robinson, according to the complaint. They discussed running the money through a dishwasher, although Mr. Bauer was skeptical. “I mean, I've seen that in the movies, but I don't know,” he said.

Mr. Bauer then suggested this: “You know what, if you feel better burn the money and I'll give it back to you.”

“Burn it?” Mr. Robinson asked.

“I would burn it in a fire,” Mr. Bauer said. As for his own cash withdrawals, Mr. Bauer said, “I will say I bought prostitutes if it comes down to it.”

Mr. Robinson faces a sentencing recommendation of about 70 to 87 months, although a judge will have the final say. He could have faced up to 20 years on each of two counts of securities fraud he was charged with, plus five years for conspiracy.

Standing at his grill this week, wearing a light jacket, New Balance sneakers and jeans, Mr. Robinson said he worried he will be portrayed as “a monster” who betrayed his friends. In the next breath, he said, “I'm horrible.”

“You make mistakes in life, and you hope one day you can get past them,” Mr. Robinson said. Picking up the cheeseburgers, he turned and walked into his home.