



# WHITE COLLAR ALERT

## MARCH 2012

### Financial Firm Entitled to Restitution from Rogue Employee

#### **Federal Court Awards Investment Bank Restitution for Legal Fees Expended Conducting Internal Investigation and Interacting with the SEC and DOJ, Plus Partial Return of Insider Trader's Past Compensation**

A federal judge last week ordered a former Morgan Stanley portfolio manager convicted of insider trading to pay the bank more than \$10 million in restitution to compensate it for legal fees and related costs it paid as a result of the defendant's criminal conduct. The order, which came as part of the criminal sentence, also compelled the portfolio manager to return a portion of his compensation for depriving the bank of his honest services.

This ruling is important as the judge made clear that, in appropriate circumstances, when wrongdoers lie to companies that conduct internal investigations to ferret out wrongdoing, the companies may recover money spent to investigate and interact with law enforcement and regulators.

#### **Background**

Joseph "Chip" Skowron III served as a portfolio manager for FrontPoint hedge funds, and became a Managing Director at Morgan Stanley after it acquired FrontPoint in 2006. In 2007 and 2008, Skowron cultivated Dr. Yves Benhamou, an advisor to Human Genome Sciences, Inc. (HGSI), and bribed Dr. Benhamou to provide Skowron with nonpublic information on the results of clinical trials of an HGSI drug. In December 2007 and January 2008, Dr. Benhamou tipped Skowron about negative results in the clinical trials. In the period immediately preceding the public disclosure of the negative results, Skowron caused FrontPoint traders to sell off the fund's significant holdings in HGSI stock, avoiding more than \$30 million in losses.

Following these trades, the Securities and Exchange Commission initiated an insider trading investigation in February 2008. To conceal the insider trading scheme, Skowron and Dr. Benhamou lied to the SEC and provided false information to lawyers retained by Morgan Stanley to conduct an internal investigation in response to the SEC investigation.

In April 2011, the SEC and the U.S. Attorney's Office for the Southern District of New York alleged in parallel proceedings that Dr. Benhamou used his position at HGSI to illegally tip Skowron. FrontPoint, through Morgan Stanley, was charged civilly by the SEC, and settled the SEC charges for \$33 million. In August 2011, Skowron pled guilty to conspiring to commit securities fraud and obstruct justice. He was sentenced to five years' imprisonment, and ordered to pay restitution.

#### **Mandatory Victims Restitution Act**

In her March 20, 2012 opinion, U.S. District Court Judge Denise Cote held that Morgan Stanley was a victim of Skowron's actions, and was therefore entitled to restitution under the Mandatory Victims Restitution Act (MVRA), which mandates restitution following

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federal felony convictions. The Court reasoned that Morgan Stanley was "directly and proximately harmed" by Skowron's actions, which deprived Morgan Stanley of the honest services of its employee; that Morgan Stanley had diverted valuable corporate time and energy in its initial defense of Skowron and FrontPoint; and that Morgan Stanley's reputation had been injured.

The Court ordered Skowron to reimburse Morgan Stanley the substantial legal costs the bank had incurred in responding to the SEC and Department of Justice investigations, conducting its own internal investigation, and initially paying the legal fees of Skowron and other employees. The Court further ordered the return of 20 percent of Skowron's compensation from 2007 through 2010 -- approximately \$6.4 million -- reasoning that under the MVRA the former employee "manifestly failed to provide honest services for which Morgan Stanley compensated him." The Court also noted that Skowron had failed to abide by FrontPoint and Morgan Stanley policies prohibiting insider trading, and, in direct contravention of those policies, had caused FrontPoint to sell off its HGSI holdings on the basis of inside information provided by Dr. Benhamou.

### **What This Means to You**

Rogue and dishonest employees' violations of securities laws and other fraudulent acts put companies at constant risk. Depending on the fact pattern, federal prosecutors or regulators may bring charges against both the employee and employer. To protect your company against allegations of wrongdoing, it is almost always appropriate to conduct a robust internal investigation, determine whether the charges can be substantiated, and take appropriate action in response.

Based on the District Court's opinion in the Skowron case, companies may be eligible to recover restitution from rogue employees convicted of federal felonies. The award could potentially cover all legal costs associated with investigating and responding to government investigations, and the institution may also be entitled to the return of some or all of the employee's compensation during the time period in which the improper activities occurred. Such a remedy provides a business with the ability to significantly recoup losses caused by a dishonest employee without the need for separate civil litigation.

For more information on the Skowron case, the Mandatory Victims Restitution Act and other white collar matters, please contact:

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