Bloomberg.com

Pequot Capital to Shut Amid SEC Insider-Trading Probe

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5/28/09

Arthur Samberg, once the world's biggest hedge-fund manager, said a federal insider-trading investigation is forcing him to shut Pequot Capital Management Inc. more than two decades after starting its first fund.

"With the situation increasingly untenable for the firm and for me, I have concluded that Pequot can no longer stay in business," Samberg wrote in a letter to clients yesterday. Pequot oversees $3.47 billion, according to a May 15 regulatory filing, down from $4.3 billion in November and $15 billion in 2001, when it was the top-ranked hedge-fund firm by assets.

The U.S. Securities and Exchange Commission in January resumed a probe into whether Samberg's funds illegally profited in 2001 by trading on inside information about Microsoft Corp., people familiar with the matter said at the time. That was about a year after the agency told Samberg and Morgan Stanley Chief Executive Officer John Mack they wouldn't be accused of wrongdoing related to insider trading.

"Public disclosures about the continuing investigation have cast a cloud over the firm and have become a source of personal distraction," Samberg, 68, wrote in the letter, a copy of which was obtained by Bloomberg News.

Jonathan Gasthalter, a spokesman for Wilton, Connecticut- based Pequot, declined to comment, as did Erik Hotmire, an SEC spokesman in Washington.

Return Cash

Samberg's firm will sell the holdings of the Pequot Partners, Pequot International and Pequot Endowment funds, according to the letter. The funds, with about $2 billion in assets, will return a "significant amount" of cash to investors by June. The rest will be paid out over the next several months.

"A good portion of Pequot's investments are in illiquid assets so there is no way that them selling will move the public markets," said Robert Olman, founder of Roslyn, New York-based Alpha Search Advisory Partners, which advises hedge funds. "This is not a systemic-risk event that the administration talks about."

Pequot's top five U.S.-traded stock holdings as of March 31 were SPDR Gold Trust, an exchange-traded fund that buys bullion; Chipotle Mexican Grill Inc., based in Denver; Bermuda-based insurer Everest Re Group Ltd.; hamburger chain McDonald's Corp., based in Oak Brook, Illinois, and Emeryville, California-based Onyx Pharmaceuticals Inc.

Fund Returns

The $493 million Pequot Partners fund returned an average of 16.8 percent annually since its inception 22 years ago, compared with the 8.5 percent gain by the Standard & Poor's 500 Index, according to the letter. The fund rose 1.8 percent this year through April 30, compared with a decline of 2.5 percent by the S&P 500, including reinvested dividends.

The firm's Special Opportunities and Matawin funds will be set up as independent entities, Samberg said in the letter. Special Opportunities, with about $600 million in assets, will be led by Rob Webster and Paul Mellinger, while the $450 million Matawin will be run by Mike Corasaniti.

Samberg started Pequot Partners fund in 1986 while he was at Dawson-Samberg Capital Management Inc., a Southport, Connecticut-based money-management firm. He spun off Pequot Capital at the start of 1999, and by 2001 the firm had more than 200 employees and managed two dozen offshore and domestic funds.

Pequot's No. 2 executive, Daniel Benton, announced in April 2001 that he was leaving to start his own hedge fund, taking about half of the firm's assets. Benton, a former Goldman Sachs Group Inc. technology analyst, ran Andor Capital Management LLC until August 2008, when he told investors he planned to shut the firm.

SEC Probe

Hedge funds are private, loosely regulated pools of capital whose managers can buy or sell any assets, bet on falling as well as rising asset prices and participate substantially in profits from money invested.

Samberg said in June 2006 that he and the firm were under investigation by the SEC for possible insider trading, and denied any wrongdoing. The SEC probe also looked at Morgan Stanley's Mack.

The SEC fired attorney Gary Aguirre in 2005 as he was leading an investigation into Pequot. Aguirre said the SEC had blocked him from investigating Mack on suspicion that Mack had leaked confidential information to Pequot. Mack worked at Zurich-based Credit Suisse Group until 2004 and then joined Pequot for less than a month before taking the CEO post at Morgan Stanley in June 2005.

Closing the Case

The agency said in December 2006 that it closed the case without finding that Samberg or Mack did anything wrong. Mack had denied wrongdoing and said Aguirre's allegations were baseless.

The SEC later opened a new investigation involving Samberg and David Zilkha, a former Microsoft employee who left the Redmond, Washington-based company in 2001 to work at Pequot. Investigators learned of documents that show Zilkha may have obtained confidential information about Microsoft, a person familiar with the matter said in January.

The documents were discovered on a hard drive Zilkha's ex- wife copied from their shared computer during the divorce, her lawyer, Mark Sherman, said in January.

Pequot said in January it was confident its trading in Microsoft was proper and it would cooperate with the SEC. Zilkha, whose lawyer declined comment in January, couldn't be reached. He worked at Pequot for less than a year.