Rajat Gupta and Goldman's Insider Trading Bombshell

Rajat Gupta was trusted by McKinsey, Goldman, and AMR. But the SEC says he shared insider secrets so a hedge fund could make millions improperly in the market.

The reputation of McKinsey, the world's most important consulting firm, is built on the perception that its high-priced consultants are the brightest and most trustworthy group available anywhere. Now Rajat Gupta, who served as McKinsey's global managing director for nearly a decade, is enmeshed in Wall Street's biggest insider trading scandal ever.

The ultimate kings of capitalism—Warren Buffett's Berkshire Hathaway and the boards of directors of Goldman Sachs and Procter & Gamble—are the latest alleged victims of a vast insider-trading ring that penetrated Wall Street during the last decade.

Perhaps most shocking is the allegation that the Judas who betrayed the royal court of corporate America during the economic turmoil of late 2008 was Rajat K. Gupta, the now 62-year-old, much celebrated, international business leader who ran McKinsey from 1994 to 2003.

At McKinsey, the spokeswoman Yolande Daeninck, put out a statement that reads like a spiritual obituary and puts Gupta clearly in McKinsey's past tense: "We were saddened to learn about the civil charges against our former colleague."

According to the Securities & Exchange Commission administrative filing, Gupta—as a board member of Goldman Sachs—learned on Sunday, Sept. 21, 2008, that Berkshire Hathaway chairman Warren Buffett was going to pump $5 billion into Goldman during Wall Street's dark hours barely a week after the collapse of Lehman Brothers.

"Mr. Gupta was honored with the highest trust of leading public companies, and he betrayed that trust by disclosing their most sensitive and valuable secrets," said SEC director of enforcement Robert Khuzami in a statement.

Galleon made more than $14 million in profits and avoided more than $3 million more in losses, allegedly thanks to Gupta's information about the Berkshire deal and Goldman's quarterly earnings.

On Monday morning Sept. 22, 2008, the SEC says, Gupta "very likely" had a telephone conversation with Galleon Hedge Fund founder Raj Rajaratnam—the Sri Lankan-born leader of the alleged insider-trading ring. Not long after that call, Galleon bought more than 80,000 shares of Goldman Sachs. The next morning, before any announcement of the Berkshire deal had been made public, Rajaratnam called Gupta for 14 minutes. "Less than a minute after the call began," says the SEC, Galleon bought 40,000 more Goldman shares.

Ultimately, Galleon made more than $14 million in profits and avoided more than $3 million more in losses, allegedly thanks to Gupta's information about the Berkshire deal and Goldman's quarterly earnings. Galleon allegedly earned another half million dollars on inside information from Gupta about P&G's earnings.

The SEC action was unusual—filed as an administrative proceeding to be heard by an administrative judge, rather than as a civil suit that might be tried before a jury in U.S. District Court. Many SEC civil actions are accompanied by criminal charges filed by Justice Department prosecutors who usually allege a similar—if not identical—set of facts.

The Galleon criminal investigation—called the largest insider trading case ever by prosecutors—involves thousands of wire-tapped calls, and although, there have been mentions of calls involving Gupta, it may be none of the calls mentioned in Tuesday's filing were recorded. The evidence, at least what has been revealed so far, seems to be based on telephone records that show the timing and duration of calls; not what was said on them.

Gary Naftalis, a onetime federal prosecutor who has been a top-ranked defense attorney for more than three decades, represents Gupta. Born in Calcutta, India, Gupta earned a degree in mechanical engineering at the Indian Institute of Technology in New Delhi and an M.B.A at Harvard before starting at McKinsey in 1973.

In a statement, Naftalis said: "The SEC allegations are totally baseless. Mr. Gupta's 40-year-record of ethical conduct, integrity, and commitment to guarding his client's confidences is beyond reproach. Mr. Gupta has done nothing wrong… There is no allegation that Mr. Gupta traded in any of these securities or shared in any profits as part of any quid pro quo."

Rajaratnam goes on trial in federal court in New York March 8 and several news organizations quoted his lawyer, John Dowd, as saying the SEC attack on Gupta was “simply an effort to destroy a favorable witness. There is no case, absolutely none. No conversations, no benefits, no nothing.”

No criminal charges have been filed against Gupta, and as things stand now, he would face a fine if he lost the administrative proceeding and elected not to appeal.

The SEC says Gupta had money invested with Galleon’s founder, although Naftalis says his client lost $10 million in a Galleon Fund, proving that insider trading was not driving his actions. The SEC also says Gupta and Rajaratnam were partners in an investment firm called “ New Silk Route Partners.”

When elected Managing Director of McKinsey in 1994, Gupta was hailed in the Indian magazine Business Today as “the first-ever India-born CEO of a US transglobal corporation.” After stepping down as Managing Director in 2003, Gupta spent four years as a senior partner before departing McKinsey and joining the boards of Goldman, P&G, and AMR, the parent company of American Airlines. He also served as a trustee or advisor to other significant non-profit institutions, including the University of Chicago, the Rockefeller Foundation and the United Nations.

In the highest circles of international business, from the ski slopes of Davos to the maharajahs of Indian commerce, Gupta had unprecedented access, a high-ranking consultant to CEOs and Fortune 100 company boards tells The Daily Beast. “There are not many consultants on major boards like that, so he is unique in the trust they had in him.” About the damage this allegation could do to corporate chieftains’ perceptions of McKinsey, he says: “A consultant’s reputation is very much based on their ability to keep confidential information sacred. If you can’t trust a strategy consultant to do that, then what can you trust them to do?”

As a co-founder of the Indian School of Business in Hyderabad in the 1990s, Gupta became acquainted with Rajaratnam, a major donor. Another co-founder of the school, Anil Kumar, was a partner at McKinsey from 2003 to 2009 when he fed inside information about technology companies to the insider-trading scheme. As part of the Galleon case, he pleaded guilty to two counts in January 2010 and still awaits sentencing. Should Gupta be charged in a criminal case, Kumar might be a key witness.

The accusation of insider trading against Gupta reverberates through the small, close-knit world of Indian-born CEOs who run multi-national corporations in the United States. Two of them: Vikrim Pandit, the CEO of Citigroup and Indra Nooyi, the Pepsi CEO who was a onetime consultant for two of McKinsey’s competitors, each run companies that have been McKinsey clients. Then there is Ajit Jain, a highly regarded Berkshire Hathaway executive who also is a Harvard Business School graduate and former McKinsey consultant.

Even though he was no longer the global boss at McKinsey when his alleged tipping to insider traders took place, the charges against Gupta still cast a shadow on McKinsey culture. For three, three-year terms as the elected top executive of a company that operates in more than 50 countries, Gupta was the man promulgating corporate culture. Even now, the company website, in a section about “keeping clients’ trust” quotes Gupta praising Marvin Bower, the man regarded as the founder of the modern McKinsey.

How these charges against Gupta might affect McKinsey is not clear. The consultants there make much of their multi-million dollar fees helping the likes of Goldman Sachs and P&G in three stages: 1. Thinking of strategies that lead to reasons for buying or spinning off assets. 2. Putting together the merger and acquisition deals and 3. Handling the post-merger integration of companies.

McKinsey clients who are unhappy may find the competition—Boston Consulting Group, Bain, Oliver Wyman and Booz Allen Hamilton—already fully booked.

One former McKinsey consultant says: “The pipeline of IPOs and M&A deals at most investment banks is huge right now. They are all anticipating it is going to coming flooding out soon.” Each stage, the McKinsey alum notes, is rife with potentially valuable information for insider traders. Now comes the question about what lip service consultants will pay to assure clients their secrets are safe from the information predators on Wall Street.

Rajat Gupta Was Found Guilty of Insider Trading in Less Than a Day

The highest-ranking insider trader was the quickest to fall to the judgment of a jury. For former Goldman Sachs board member Rajat Gupta, justice was swift, writes Allan Dodds Frank.

Finding former McKinsey & Co. global managing partner Rajat Gupta guilty of insider trading took so little time Friday that the jury did not even stick around for a free lunch at U.S. District Court in Manhattan.

Beginning their deliberations just before midday Thursday, the jury of eight women and four men considered the charges against Gupta for less than a full day before reaching a split verdict of guilty on four counts, including conspiracy, and not guilty on two of the five securities-fraud charges.

They found Gupta guilty of leaking confidential information he learned as a Goldman Sachs board member on Sept. 23, 2008, then phoning hedge-fund operator Raj Rajaratnam, who within a minute of getting the tip from Gupta began buying $43 million in Goldman stock.

Noting that the jury in the Rajaratnam trial took 12 days to find him guilty after a prosecution case full of “smoking hot evidence,” Columbia University Law Professor John Coffee said he was a little surprised by the swiftness of the split verdict against Gupta since much of the case was circumstantial evidence, rather than direct testimony from co-conspirators. Still, there was a wiretap tape of a conversation between Rajaratnam and one of his co-conspirators in which he claimed to have information from a Goldman Sachs board member.

“Juries like to appear to be fair, and acquitting on at least one count suggests that they did consider all the facts and were not just rushing to convict as much as possible. I think the desire to be perceived as fair often leads juries to convict on less than all counts,” Coffee told The Daily Beast. “They know at some level that he is likely to get 10 years or more and I do not know how much they want to pile it on.”

Gupta, regarded as the ultimate trustworthy and sagacious insider in international business when he was named to the Goldman Sachs board, faces 20 years in prison on each of the three securities charges and five years on the conspiracy count. U.S. District Judge Jed Rakoff allowed Gupta to remain free on bail, pending sentencing scheduled for Oct. 18.

The guilty verdict was a big win for U.S. Attorney Preet Bharara’s office, which has used extensive wiretaps in an investigation begun in 2007 to prosecute insider trading. So far more than 60 people have been convicted. Bharara said in a statement, “Rajat Gupta once stood at the apex of the international business community. Today, he stands convicted of securities fraud. He achieved remarkable success and stature, but he threw it all away.”

Veteran defense attorney Gerald Lefcourt told The Daily Beast that Gupta “is the highest level in the American—indeed, in the international—business world, with the magnitude of that kind of career, who has ever been brought to a dock for criminal prosecution for insider trading.”

That point was brought home during nearly three days of testimony for the prosecution by Goldman Sachs chairman and CEO Lloyd Blankfein, a Harvard-trained lawyer. Blankfein buried Gupta by portraying the severity of Gupta’s betrayal of his fiduciary duties as a director of the investment bank. After the verdict, Goldman Sachs issued this one-line statement: “We are very disappointed that Mr. Gupta breached his duties as a director and violated the trust of our shareholders and the firm.”

McKinsey & Co., which also has seen former partner Anil Kumar convicted of insider trading and flipped as a star witness against Gupta, had no comment about how the case affects the firm’s reputation for trustworthiness.

After Gupta was acquitted on the securities fraud count accusing him of leaking information he learned as a board member of Procter & Gamble, that company had no comment beyond recycling Gupta’s statement as he resigned from the Procter & Gamble board in March 2011. Then, Gupta “repeatedly assured P&G that he had not violated any rules or inappropriately communicated P&G confidential information.”

Professor Coffee rates the Gupta crime this way: “Symbolically, you can’t get a more egregious case. It is like catching a Supreme Court justice leaking the results of a decision breaking up IBM.”

The defense argument that Gupta—a philanthropist, trusted confidante of the global elite, and a man worth nearly $100 million—would never allow greed to jeopardize his sterling reputation was not credible.

Jurors understood the argument by Assistant U.S. Attorneys Reed Brodsky and Richard Tarlowe that Gupta stood to gain as a multimillion-dollar investor and officer of a fund run by Raj Rajaratnam’s Galleon Group.

After handing up the verdict to the judge, jury foreman Rich Lepkowski told reporters how he viewed Gupta’s life story: “Here’s a man who came to this country and was a wonderful example of the American dream … We wanted to believe that the allegations weren’t true, but at the end of the day the evidence was just overwhelming.”

As Ronnie Sesso, a juror who is a youth advocate at the Administration for Children’s Services in Manhattan, told *The New York Times*, “What did Mr. Gupta get by giving Raj this information? A need for greed.”

Gupta remained grim faced after the verdict, while his wife and four daughters sobbed and tried to comfort one another. Outside court, Gupta’s chief defense lawyer, Gary Naftalis, vowed an appeal and continued to insist his client was innocent.

Both Lefcourt and Coffee agree that Gupta may have caught a break when his case was assigned to Judge Rakoff, a critic of federal sentencing guidelines. Rakoff is not believed to favor unrealistically long sentences, such as the 150 years given to Ponzi king Bernard Madoff or the 110-year term just given to swindler R. Allen Stanford Thursday by a federal judge in Texas.

In 2009 Rakoff sentenced former lawyer Marc Dreier to 20 years in prison for swindling investors of more than $700 million, even though prosecutors asked for a 145-year sentence.

How much money was allegedly made is part of the determination of what kind of sentence should be applied. In Rajaratnam's case, he was found guilty of a scheme that generated more than $50 million in profits and sentenced to 11 years in federal prison in Butner, N.C.

Of Rajaratnam's more than $63 million in profits or avoided losses, perhaps only one-quarter of that may be attributable to actions by Gupta. Yet, as the Gupta defense contended, Gupta ended up losing $10 million with Galleon. The evidence did not include any profits directly attributed to Gupta accounts from the trading done by Rajaratnam on his insider tips.

On that basis, Lefcourt is predicting a relatively light sentence for the 63-year-old Gupta. "He is really lucky he has a judge who has a realistic view of sentencing," says Lefcourt. I don't think it is going to be serious time. He did not earn a penny. I don't think that is who he is: tipping to make a few quick bucks. You know the guy (Rajaratnam) who made the money is doing 11 years, but was doing it (insider trading) systemically … I do not know there is any evidence that Rajat Gupta has spent his career doing things like this."

Professor Coffee, who has co-taught a course on securities law—"Black Letter Law/ White Collar Crime"—-for more than two decades with Judge Rakoff at Columbia, predicts Gupta could be sentenced to 10 years.

"I can assure you Judge Rakoff thinks insider trading is a serious crime," says Coffee. "I can't tell you what sentence he will give, but he would never give the 150-year sentence that Bernie Madoff got. He would give a sentence commensurate with the crime."