

**Bloomberg.com**

## Chanos, SAC Got Nonpublic Fairfax Research, Court Papers Show

Email | Print | A A A

By Thom Weidlich

Feb. 13 (Bloomberg) -- Jim Chanos's Kynikos Associates Ltd., a short seller of Fairfax Financial Holdings Ltd., learned of negative analyst research on that company before it was published, according to unsealed court documents.

Chanos, Steven Cohen's SAC Capital Advisors LLC and other hedge-fund managers were accused in 2006 by Fairfax of cooperating to drive down the firm's shares through short sales, according to a complaint by Fairfax seeking \$6 billion in damages. Toronto-based Fairfax owns U.S. and Canadian insurers.

Chanos forwarded an e-mail about research by John Gwynn, an analyst with brokerage Morgan Keegan & Co., to rival SAC Capital, the documents show. Morgan Keegan fired Gwynn for telling clients before publication that he planned a negative report. Morgan Keegan and Gwynn were also sued. All defendants denied Fairfax's claims. Fairfax filed that e-mail and others provided by the defendants with a New Jersey state court to support its claims.

"Last night John Gwynn at Morgan Keegan faxed over to me an outline detailing the issues at FFH, basically those he will be publishing," Mark Heiman, then an analyst at Kynikos, wrote in a Dec. 21, 2002, e-mail to Chanos that was filed in the case.

FFH is Fairfax's stock ticker. Gwynn's name is misspelled in some of the e-mails, unsealed at the request of Bloomberg News.

Gwynn's first report on Fairfax was dated Jan. 16, 2003, and released the next day.

### Rejects Claim

"Kynikos rejects any claim that it participated in a conspiracy or that it did anything improper when it decided to sell short Fairfax stock," Peter Haveles, an Arnold & Porter LLP lawyer for Kynikos, said in an interview.

Jonathan Gasthalter, a spokesman for SAC Capital, declined to comment. Gwynn didn't immediately return a call seeking comment.

Morgan Keegan spokesman Eric Bran said the company didn't have an immediate comment. Memphis, Tennessee-based Morgan Keegan is a unit of Regions Financial Corp., Alabama's biggest bank.

Fairfax filed its complaint in New Jersey Superior Court in Morristown. Fairfax accuses the defendants of racketeering, commercial disparagement, tortious interference with contractual relationships and conspiracy.

The company accused Gwynn of collaborating with the hedge funds to write negative reports on the insurer. The funds knew when the reports would be released and what they would say, Fairfax claims.

### Increased Bet

When he learned of Gwynn's research, Chanos began increasing his bet that Fairfax's shares would fall,

a Fairfax lawyer said at a Sept. 25 hearing in the case. A Kynikos lawyer disputed him.

"The presence of the e-mails adds credibility to the plaintiffs' case," said **Blair C. Fensterstock**, a securities lawyer with Fensterstock & Partners LLP in New York, who's not involved in the Fairfax matter. "It may be proof of an act that may support a racketeering claim."

Gwynn sued Fairfax in April. He said Fairfax defamed him by asserting that he had issued fraudulent research. Judge Deanne Wilson, overseeing the Fairfax case, in August ruled against the company's request to dismiss Gwynn's suit.

"The evidence demonstrating that Gwynn leaked his research to hedge funds before publication, and his subsequent termination for that misconduct, speaks for itself," said **Marc Kasowitz**, a lawyer for Fairfax. "It further proves his prior denials about such misconduct and counterclaim were utterly without merit."

On Dec. 11, 2002, Heiman wrote his boss Chanos that an insurance analyst at another investment firm told him that Gwynn was going to initiate Fairfax coverage "at 'underperform,' with the thesis being that they are extremely under-reserved in the \$3-\$5 BN area," according to an unsealed e-mail.

'More Critical'

"Just spoke to John Gwinn at Morgan Keegan, and he was more critical of FFRX than I've ever heard a sell side analyst," Heiman told Chanos in a Dec. 16, 2002, e-mail, using Fairfax's former ticker symbol. "Everything from underwriting to accounting to dishonesty."

Chanos, on Dec. 18, 2002, forwarded that e-mail to Jeff Perry, then of New York-based SAC Capital, who's also a defendant. Perry didn't return a call seeking comment.

When a SAC Capital employee asked Gwynn for a spreadsheet on Fairfax, he replied in a Jan. 6, 2003, e-mail that he would send it to him.

Heiman wrote Chanos on Jan. 16: "Just got off the phone with Gwynn at Morgan Keegan -- his piece that rips FFH apart is supposed to be published tomorrow. Should be interesting to see how the street reacts."

Heiman, now an analyst at Trawlet & Co. in New York, declined to comment on the e-mails.

Gwynn's Report

Gwynn's published report said Fairfax was short \$5 billion of reserves needed to cover future insurance claims, Fairfax said in its complaint. The company's shares, listed in Toronto, tumbled 28 percent in three trading sessions, to C\$85 (\$67.93), a seven-year low. Its U.S. shares also plunged.

Hedge funds run by the defendants profited because they short sold Fairfax's stock, according to the complaint. In a short sale, an investor sells borrowed shares, hoping to replace them later with cheaper shares, and profiting from the difference.

Two weeks later, in a Jan. 30 report, Gwynn trimmed his shortfall estimate by 40 percent, to \$3 billion. Fairfax shares in Toronto jumped 9.7 percent. Gwynn continued to issue negative reports on Fairfax, according to the complaint.

Short-selling came under attack last year because of the financial crisis. From Sept. 19 to Oct. 8, the U.S. Securities and Exchange Commission banned the shorting of financial companies, including Fairfax, after **Morgan Stanley** Chief Executive Officer **John Mack** and New York Senator **Charles Schumer** blamed the practice for driving companies toward collapse.

Enron's Demise

Chanos, who only shorts stocks, was one of the early predictor's of **Enron Corp.**'s demise. He began betting in late 2000 that Enron's shares would fall after reading an article about accounting irregularities at the power and natural-gas trader. In December 2001, the Houston company filed what was then the U.S.'s largest bankruptcy. Investors sued seeking to recover more than \$40 billion.

"Fairfax is one of our largest shorts," Chanos told a TheStreet.com Inc. columnist in August 2002, according to an e-mail unsealed in the case.

Michael Bowe, a lawyer for Fairfax, said at a Sept. 25 hearing in the case that until receiving the advanced notice of Gwynn's report, Chanos had been covering his short -- buying Fairfax shares to close out his short sale.

#### Covering Positions

"Chanos had been covering his positions up and until the point when he receives the tip that Gwynn is going to issue his report," Bowe said, according to the transcript. "And between that time and the time of the report coming out, he shorts over five million dollars' worth of Fairfax shares, half of which he shorts the day before the report comes out."

Haveles, the Kynikos lawyer, denied that.

"Kynikos continued to reduce its short position in Fairfax after receiving information in mid-December 2002 about the views of Morgan Keegan's analyst," he said. "Kynikos increased its long-standing short position in Fairfax by a modest amount on January 16, 2003, but it did not receive information about the imminent release of the Morgan Keegan report until after the close of trading that day and after Kynikos's trading on that day had occurred."

Kynikos's Fairfax trades are still under seal.

#### Buying, Not Shorting

In an Aug. 8 hearing in the case, SAC Capital lawyer Martin Klotz said that in the period before Gwynn's report was published his client was buying Fairfax shares and didn't short them.

"SAC was not a participant in any conspiracy because we were doing the exact opposite of what they say that we were supposed to be doing," said Klotz, of Willkie Farr & Gallagher in New York.

Another defendant in the case is New York hedge fund Exis Capital Management Inc.

"The way to get this thing down is to get them where they eat, like the credit analysts and holders," Exis's Andrew Heller, also a defendant, told a colleague at another firm five months before Fairfax sued, according to an unsealed e-mail. "We're taking this baby down for the count."

"It's a volatile sucker, but patience will be rewarded," Heller wrote.

#### 'One Little Piece'

The comments don't buttress Fairfax's case, said Eugene Kaplan, a lawyer for Exis and Heller. "In the context of the overall conversation, this is one little piece," Kaplan said. "That's why they were shorting it. They were hoping it's going down."

His clients continue to deny Fairfax's allegations, said Kaplan, of Kaplan Landau LLP in New York. The proof that Exis believed Fairfax "was not what it purported to be" was the hedge fund's "aggressive short position" that ended up losing "several million dollars" when Fairfax's stock kept rising, he said.

The case is Fairfax Financial Holdings Ltd. v. SAC Capital Management LLC, L-2032-06, Superior Court of New Jersey, Morris County (Morristown).

To contact the reporter on this story: Thom Weidlich in New York at [tweidlich@bloomberg.net](mailto:tweidlich@bloomberg.net).

*Last Updated: February 13, 2009 00:01 EST*

