

Drug researchers leak secrets to Wall St.

By Luke Timmerman and David Heath Seattle Times staff reporters

Doctors testing new drugs are sworn to keep their research secret until drug companies announce the final results. But elite Wall Street firms – looking to make quick profits – have found a way to harvest these secrets:

They pay doctors to divulge the details early.

A Seattle Times investigation found at least 26 cases in which doctors have leaked confidential and critical details of their ongoing drug research to Wall Street firms.

The practice involves doctors at top research universities from UCLA to the University of Pennsylvania, and powerful financial firms including Citigroup Smith Barney, UBS and Wachovia Securities.

In 24 of the 26 cases, the firms issued reports to select clients with detailed information obtained from doctors involved in confidential studies. The reports advised clients whether to buy or sell a drug stock.

Trading stock based on secret information bought from medical researchers is illegal, say legal experts who were told of The Times' findings.

"That's a good way to go to jail," said lawyer Thomas Newkirk, former associate director of enforcement at the Securities and Exchange Commission (SEC).

Whether they are paid or not, medical researchers who talk with Wall Street about their ongoing research violate confidentiality agreements they sign before drug companies allow the drug testing to begin.

Until now, the selling of drug secrets has been hidden from securities regulators and the public, but biotech and Wall Street insiders said the practice is widespread.

"Everybody does this.... It's now common practice," said the chief executive of California biotech company Valentis, Ben McGraw, a former Wall Street analyst.

Listen to interview excerpts: The practice of selling secrets  
The practice of selling drug secrets, The Times found, is being driven by hedge funds, the largely unregulated investment pools that cater to the super-rich. Hedge funds can make money with aggressive strategies that exploit quick price swings in stocks, and the volatile biotech industry provides many such opportunities.

A single drug's prospects can determine whether a small biotech company's stock soars or plummets, so any inside information provides a potent investing edge.

Such information is so valuable that elite investors pay up to \$1 million a year to firms known as matchmakers, which pair Wall Street

firms with doctors involved in ongoing drug research. Gerson Lehrman Group, the largest matchmaker, claims to have 60,000 doctors available to speak to Wall Street, double the number from three years earlier.

How Wall Street gets the inside scoop on drug testing  
Matchmakers typically pay doctors \$300 to \$500 an hour to talk to elite investors. Some doctors said they can make tens of thousands of dollars a year from such talks.

Drug-company executives say they know about the practice but can't crack down on the doctors they rely upon for conducting patient testing.

Ordinary investors are victimized when inside information is leaked to select investors. Those who know in advance whether a drug is going to succeed or fail can buy stock low or sell it high to those who don't know, making quick fortunes by taking advantage of unwitting investors.

And there is a broader cost to society: Leaking details about ongoing research can introduce bias into drug trials and possibly halt development of potentially life-saving drugs, biotech executives said.

"It appalls me, I must say," said Christopher Henney, a Seattle biotech pioneer who co-founded Immunex, now part of Amgen. "It's absolutely outrageous that they [researchers] would allow themselves to be corrupted in that way."

"The practice is a moral cesspool," said Arthur Caplan, director of the Center for Bioethics at the University of Pennsylvania. "It really just seems to me to be the last straw in the corporatization of American medicine."

Elite investors gained when doctors on a drug trial dropped the word that the drug was failing.

Excitement was building in fall 2002 at Isis Pharmaceuticals, a 300 employee Carlsbad, Calif., company, as it wrapped up a study of Affinitak, an innovative drug to treat lung cancer.

Unknown to the company, however, analysts had started making calls to doctors testing the new drug. Despite confidentiality contracts, the doctors were talking.

By late November, Isis' stock price was plummeting on heavy trading; it lost 20 percent by early December.

A bombshell fell Dec. 6, and suddenly the drop made sense. Andrew Gitkin, an analyst at UBS, a big brokerage firm, issued a research report with a shocking revelation: Doctors on the Affinitak drug trial had talked to UBS and divulged that the drug was not working.

Gitkin's report sent Isis stock spiraling down even further.

Later that day, a news report confirmed that word of Affinitak's failure had "spread across Wall Street's biotech trading floors" for more than a week. Gitkin said in an interview that he believed he "wasn't the only analyst or investor" who had called the doctors.

Read the UBS report [PDF] That would explain why investors were selling Isis shares, driving the price down. Investors who knew the trial results in advance could have shorted Isis stock – a way to make money when its price falls – and made a quick 30 percent profit.

Isis chief executive Stanley Crooke, an M.D. with a Ph.D. in pharmacology, was furious.

"We were very shocked that somebody would try to do an analysis like that, shocked that any investigators would talk to an analyst and give him impressions and lead him to specific conclusions," Crooke would say later.

Crooke complained to UBS. He also questioned the doctors testing his new drug, trying – without success – to find the leak, he said.

Three months later, Isis released its Affinitak results and Gitkin's information was proved correct – the drug was a dud.

Gitkin said he did nothing wrong. "I don't know who does and who doesn't sign confidentiality agreements. ... I would assume that if they signed a confidentiality agreement they wouldn't talk to me."

Sometimes, hedge funds and brokerage firms pay one well-informed doctor to be quizzed by investment managers in a conference call. But other times, their approach to gathering valuable secrets about drug trials is more sophisticated and wide-ranging.

Analysts foretell Eyetech's fall

Recently, Citigroup Smith Barney penetrated a major study to see how an experimental drug fared against a just-approved drug for treating macular degeneration, an incurable eye disease and the leading cause of blindness in the elderly.

The brokerage talked to 26 eye doctors, but they weren't just any doctors. Twenty of the 26 had researched the experimental drug; 23 of the 26 had researched the other one, meaning that more than half had worked on both. The doctors were able to give Smith Barney valuable comparative information.

Nearly all agreed that the drug still being studied, a product called Lucentis from biotech powerhouse Genentech, would prove vastly superior to the drug that recently had gone on the market, Macugen, made by Eyetech, a smaller company.

But the doctors were more explicit than that. Based on its survey, Smith Barney predicted remarkable results: 97 percent of patients on Lucentis would have stable or improved vision, as measured by how many lines of an eye chart they could read. Smith Barney summarized those findings in a report to select customers May 5.

As it turned out, the numbers were almost exactly on the money. On May 23, not long after Smith Barney's report, Genentech announced results from its Lucentis study: 95 percent of patients had stable or improved vision – just as predicted by the doctors Smith Barney talked to.

The announcement battered Eyetech's stock, which lost nearly half of its value in a day. Any hedge fund or other investor who had acted on Smith Barney's research by betting against Eyetech would have made better than a 40 percent return in just three weeks.

Dr. Scott Pendergast, a lead researcher in the Macugen study who said he doesn't speak to investors, was shocked when told of the Smith Barney report.

"That's definitely inappropriate," Pendergast said. "They're getting information that was not publicly available."

The Seattle Times interviewed 15 of the lead doctors on the Macugen and Lucentis research, many of whom acknowledged accepting money to talk to Wall Street firms. None specifically recalled talking to Smith Barney, but they said they had talked to many investors during the time Eyetech's stock price was in a steep decline.

All 15 doctors insisted they didn't reveal confidential or valuable details.

"People will call and ask 'Do you think this drug is working?' I'm just being asked to give my gut feeling," said Dr. David Boyer, a Los Angeles ophthalmologist.

"They'll ask what I can't answer," said Dr. Richard Rosen in New York City, who said he talked on the phone or face to face with investment firms about twice a day for \$300 to \$500 an hour.

"They're looking for results of trials that aren't out yet," Rosen said. "I can't answer that. I can just answer from my personal experience in how patients seem to respond to certain therapies."

Even so, Rosen acknowledged his experience can be valuable. "If you treat 20 patients you can get some sense of where a trial is going," he said.

Some medical researchers say they refuse to talk to hedge funds or stock analysts because they know the aim is to get confidential information.

Dr. Steven Nissen, a cardiologist at the Cleveland Clinic involved in half a dozen ongoing research studies and chairman of a federal Food and Drug Administration (FDA) advisory panel making recommendations on new drugs, said he gets "zillions" of calls from investors who say they simply want to talk about a certain disease.

"As soon as I hear the pitch I know what's going on," Nissen said. "The impressions of somebody on the trial are relevant to whether the trial is likely to succeed."

More analyst reports

Dr. Ron Garren, who runs a small hedge fund in Carmel, Calif., and works part time as a cancer doctor, knows this. He admits he pays doctors in an effort to get confidential details about ongoing drug research.

"They really aren't supposed to talk because of confidentiality," Garren said. "But a lot of times it's a slip of a word here and there. You can generally tell from body language if a person running a trial likes the drug or doesn't. You can generally ferret out, if you're good, the safety issues."

One experienced research analyst at a major brokerage firm said he's studied "elicitation techniques" taught to FBI and CIA interrogators.

"We get them to talk about the weather, or the Mariners, then you pop in your one innocent question you want to know about," said the analyst, who spoke on the condition that his name not be used. "Then you switch back to whatever it was you were talking about before. When the doctor hangs up, he thinks he's had a nice conversation about the weather or the Mariners."

Hedge funds explode

A rapidly growing form of investment ramps up the pressure to gain inside information on drug research.

Powerful economic forces are driving the trend to pay for secret information. Years of a raging bull market were good to mutual funds. But when the good times on Wall Street ended in 2000, money began pouring into hedge funds in search of better returns.

Though barely a blip on Wall Street 15 years ago when they collectively managed less than \$40 billion, hedge funds now manage close to \$1 trillion – doubling in size in just the past five years, according to Chicago-based Hedge Fund Research.

Unlike mutual funds, hedge funds aren't regulated and can take big risks, such as buying a stock with borrowed money or shorting a stock, a way to profit when its price falls. Hedge funds aren't satisfied keeping pace with an up-and-down market. They expect to make profits even in bad times and have a powerful incentive to do so: Fund managers get to pocket 20 percent of their funds' profits.

With such big payoffs for fund managers, the number of new funds has exploded, intensifying competition.

"As soon as money gets involved, it attracts people, and people go to greater and greater lengths to get an edge on their competition," said Joe Edelman, portfolio manager of Perceptive Life Sciences Master Fund, a \$600 million biotech hedge fund in New York.

The way to get an edge on Wall Street is with better information, Edelman said.

"If everybody has the same scoop, it's not a scoop," he said. "People will go to great lengths and throw a lot of money around to outdo the next person."

The need for scoops has driven Wall Street firms to pay medical researchers to divulge secrets, said David Miller, who digs up

information for his Seattle-based newsletter Biotech Monthly, but refuses to pay doctors.

"It's becoming standard practice" for hedge funds and brokerage firms to pay doctors, Miller said. "A couple years ago, this is something you would have seen as unusual. Today it's not."

Miller said the practice taints the biotech industry, allowing some with inside information to get rich at the expense of individual investors.

"What this has to do with is people who are so greedy in the market that they are willing to break all the rules to make money," Miller said.

Hedge funds have become some of the most active traders on Wall Street, accounting for as much as half of the trading volume in the New York Stock Exchange, according to Credit Suisse First Boston. Brokerage houses now scramble to woo hedge funds and their massive trading business. Not only do these funds buy and sell enormous amounts of stock, they do more complicated trades that are lucrative for brokerages, such as shorting stock.

One way brokerage houses attract the trading business of hedge funds is by offering them valuable research they can't get elsewhere, said Paul Latta, research director for the brokerage firm McAdams Wright Ragen in Seattle.

Even the best research analysts at brokerage houses agree it's difficult to keep up with the information that hedge funds are able to collect. Many hedge-fund managers are doctors themselves, some from the same elite medical schools as the doctors they are calling.

Quynh Pham, with Delafield Hambrecht in Seattle, was ranked by Forbes magazine this May as one of the top 10 research analysts in the country. Yet Pham, a microbiologist with an MBA, said when it comes to gathering information, "I really can't hold a candle to the hedge funds. They're able to do things that are unethical."

Delafield Hambrecht makes it a policy not to pay doctors for information, Pham said. But she talks to hedge-fund managers who do it all the time, she said, citing a recent example involving Seattle-based Cell Therapeutics.

Research on Cell Therapeutics' experimental lung-cancer drug was nearing completion early this year. Dr. Corey Langer, an oncologist at Fox Chase Cancer Center in Philadelphia, was in charge of testing, which included many patients in Eastern Europe. In the months leading up to the results being released, Langer was "hounded" by calls from the Wall Street firms seeking information, he said.

Read the pitch

Through the firm Gerson Lehrman, Langer began charging \$500 an hour to answer their questions. "I decided I'd rather get paid for giving my time," he said.

When he talked to elite investors, Langer said, he told them he couldn't divulge results of the study before the company announced them in March because he had signed a confidentiality agreement.

But he did share one critical insight with the investors who paid. Earlier, Cell Therapeutics had announced promising news that patients on the study were living longer. But during calls, Langer said, he cautioned investors that this early result might not be due to the drug, but rather to patients in Eastern Europe not being as sick as originally thought.

Word spread quickly. In Seattle, Pham at Delafield Hambrecht got calls from hedge-fund managers to see if she had dug up anything on the Cell Therapeutics study. One hedge-fund manager told her he already had called 20 medical centers in Eastern Europe, Pham said.

In the end, Langer's warning was right. On March 7, Cell Therapeutics announced its drug failed to prolong lives. Its stock plunged 48 percent that day. Any hedge fund shorting the stock after talking to Langer would have scored big.

Langer said he didn't know what his Wall Street contacts did with his information. "They don't tell me, and frankly I don't want to know," he said.

Enter the middleman

A new industry rounds up influential doctors who'll talk to investors – for a fee.

Hedge funds and mutual funds don't have to track down doctors on their own. There is now an industry built around paying influential doctors – referred to as "thought leaders" – to talk to them.

The pioneer in this field is Mark Gerson, who co-founded Gerson Lehrman Group in 1998 when he was 29 and attending Yale Law School. By then, he had already written a book on neoconservatism and was the subject of a flattering George Will column about Gerson's brief experience teaching at an inner-city Catholic high school.

Gerson used his networking skills to start Gerson Lehrman's "Council of Advisors" and now says its numbers have climbed to 60,000 physicians. Advisers agree to talk to hedge funds and mutual funds for an hourly fee, usually around \$300 to \$500 an hour.

Some doctors charge more. Dr. Celestia Higano, an oncologist at the University of Washington, said she raised her fee to \$1,000 an hour to discourage investors from calling. After that, Gerson Lehrman sent her assistant an e-mail, urging that she lower her rate.

"At this rate Dr. Higano would become a reserved advisor, and therefore would be used more sparingly since her rate is above \$500/hr," the e-mail said.

Gerson told The Times he charges investors a basic rate of \$60,000 for six months of access to the firm's doctors. But hedge funds pay Gerson Lehrman up to \$1 million a year for its most premium service, he said.

Brokerage firms also serve as matchmakers for their best clients by setting up conference calls with medical researchers. Typically, brokerage firms invite 10 to 40 hedge-fund or mutual-fund clients to participate in these calls, said Fariba Ghodsian, an analyst at a hedge fund in Los Angeles. Small investors don't have access.

In an interview, Gerson said his firm reminds doctors to honor their confidentiality contracts. He said he has never heard of doctors leaking confidential information through his service. Gerson said he does not believe they would do so because the doctors and his clients want to protect their reputations.

"Nobody that we've ever met wants to succeed financially in a way that would not honor their reputation," he said.

Tactics defended

Some involved say they're doing nothing wrong and are, in fact, performing a useful service to advance "promising therapies."

Defenders of the practice contend that most conversations with medical researchers are not efforts to ferret out secrets about clinical trials. Hedge funds and other investors said they often are collecting information on how doctors will use drugs in the market.

Albert Sebag, CEO of Clinical Advisors in New York, another firm that hooks up doctors and Wall Street firms, said physicians don't have any inside information from the companies.

"They just put patients on the study. They don't know what the patients are necessarily getting. The data is typically analyzed by a third party," Sebag said.

Many studies are "blinded," meaning that patients and in some cases doctors don't know who is getting the experimental drugs or something else, such as a placebo.

But hedge-fund managers said it often is possible to find out from doctors how a study is progressing, even when it is "blinded." That's because drugs can have obvious side effects that patients receiving a placebo won't get.

ImClone's Erbitux for colon cancer, for example, causes rashes. During ongoing studies, said Garren, the hedge-fund manager, he took advantage of that, calling cancer physicians who had experience with the drug.

Garren said he paid many of the physicians to talk and asked the same question: How many patients with rashes had their tumors shrink?

After talking to doctors at a few medical centers that enrolled the most patients in the study, he came away believing the drug would be a hit. However, Garren said he didn't act on the information until after the Erbitux results were publicly known.



Sometimes the Wall Street firms can hit the jackpot, getting details from a doctor who is not "blinded" at all and has access to complete safety data.

That happened in February, when clients of the brokerage firm Fulcrum Global Partners were invited on a conference call with two doctors involved in research for Encysive Pharmaceuticals, a small Houston biotech.

#### Timeline

Investors get an early scoop on Encysive

One of the doctors, Harold Palevsky of the University of Pennsylvania, sat on the study's data-safety-monitoring board, a group meant to protect patients. Board members aren't "blinded" and get complete safety data while a study is in progress, because their job is to shut down a study if patients start to suffer from dangerous side effects.

Members of data-safety-monitoring boards are sworn to secrecy to protect the integrity of the research. Yet, according to notes of the call later released by a Fulcrum analyst, Palevsky offered investors new and valuable information.

Encysive was testing a drug called Thelin for pulmonary hypertension, a rare and potentially fatal disorder of the blood vessels in the lungs. Earlier studies raised concerns that Thelin might be linked to serious bleeding or that it could damage the liver.

But, according to the analyst's notes, Palevsky assured investors that "the overall incidence of major bleeding events is rather low" across several Thelin trials.

Five days later, Feb. 14, Encysive announced the study had succeeded. Patients on the drug had no serious bleeding episodes.

That day, Encysive's stock surged 13 percent on the busiest trading volume in its history. Fulcrum analyst Patrick Flanigan boasted in a report that the results "are consistent with statements expressed by our physician consultants on a conference call we hosted last week."

Uzi Roshia, compliance director at Fulcrum, said the firm did nothing wrong.

"It was the doctors who had agreements with the company," he said. "It was their responsibility to make sure the conference call didn't contradict their confidentiality agreement."

Palevsky said he didn't reveal anything confidential, even though Fulcrum's report said Palevsky talked about information that had not yet been published.

"I am not responsible for what they say," Palevsky said "I spoke about data which had previously been published. Period."

Critics say drug-safety monitors such as Palevsky, with access to patient results, shouldn't talk to anyone, let alone Wall Street, about the research.

Palevsky defended his decision to talk to Fulcrum: "Why should I have not?"

Because talking about what you know as a safety monitor, said Penn bioethicist Caplan, is "about as big a no-no as you're going to get."

Breaking the law?

Courts have ruled that analysts can't coax someone to divulge company secrets.

Wall Street analysts argue they're doing nothing wrong. The U.S. Supreme Court ruled in 1983 that because analysts don't owe allegiance to the companies they research, they are free to gather valuable information and pass it on to their customers. Analysts also are free to collect tidbits of data that, when pieced together, may amount to valuable information not available to the public.

However, the court also has ruled that analysts can't coax someone to divulge company secrets, which it called "misappropriating" nonpublic information.

John Coffee, an insider-trading expert and law professor at Columbia University, said that it is clearly illegal to trade stock based on information obtained by paying doctors to leak confidential material about research they are doing for drug companies. Paying 20 doctors to answer the same question about the same drug trial is not the same as collecting tidbits of data, Coffee said.

Misappropriating company secrets violates federal securities laws. And the practice of selling secrets is illegal for all parties involved, including doctors, hedge funds and research analysts, legal experts say.

The Securities and Exchange Commission, told of The Times' findings, said it had no comment.

Newkirk, who left his post as the SEC's associate enforcement director for a private law practice late last year, said he had not known about medical researchers selling confidential information to investors until The Seattle Times told him about it.

He knew of no SEC investigation of the practice. However, he said the examples uncovered by The Times were the kind of insider-trading cases he would have pursued at the SEC and the kind of cases the agency would pursue now if it knew about them.

Newkirk said the SEC should investigate the practice of selling drug secrets for a simple reason:

"Because people ought to know better. People in the securities industry ought to know better than to do things like that. Doctors who've accepted confidentiality agreements — they are the kind of educated people who ought to keep their word."