Insurer Fairfax Financial says some of the world's richest hedge funds hired a freelance analyst named Spyro Contogouris to shoot down its stock.

THE CASE OF THE HEDGE FUND HIT MAN

By Anthony Effinger

One morning in 2005, an unusual letter arrived for Rev. Barry Parker at St. Paul's Anglican church in Toronto. The news: A member of his flock was out to swindle the parish.

"Dear Father," the note begins. "The attached documents are being sent to you out of my concern for the Church's finances." The letter goes on to say that the allegedly wayward parishioner, an insurance executive named Prem Watsa, was bilking shareholders of Toronto-based Fairfax Financial Holdings Ltd.

"I am perplexed by the mystifying, spectacular rise of this insurance medusa," the typed letter reads. "Be aware, Father, be skeptical and ask Mr. Watsa to make a full confession." The note was signed *P. Fate*. The return address was that of St. Patrick's Cathedral in New York.

Stranger still is what Fairfax says is the source of the letter: a cabal of hedge fund managers—among them James Chanos, Steven Cohen, Daniel Loeb, David Rocker and Adam Sender—hoping to profit from a slump in Fairfax stock. Fairfax, which has a history of accounting lapses, sued eight hedge fund firms for racketeering in July 2006, demanding $6 billion in damages. The insurer says the letter to Parker, excerpts of which were included in its complaint, was just one of many dirty tricks the fund managers used to smear the company, which has 8,000 employees and $26.8 billion of assets. The hedge funds have denied wrongdoing.

At the heart of this story is a freelance research analyst named Spyro Contogouris, whose previous—and often contentious—dealings have ranged from Houston real estate to Nigerian natural gas. Until recently, Contogouris, 46, ran a firm that had a more cloak-and-dagger than stocks-and-bonds sound to it: MI4 Reconnaissance LLC, based in New Orleans.

Fairfax says the hedge fund firms paid Contogouris and MI4 employee Max Bernstein to send out slanderous reports about the insurer and to harass its executives. Contogouris, like the hedge funds, has said the insurer's allegations are false. The skirmish took a strange turn last November, when Contogouris was arrested on unrelated embezzlement charges. He has pleaded not guilty in that case. Contogouris and the hedge funds have said they would argue on Sept. 5 to have the Fairfax complaint dismissed. Contogouris didn't respond to telephone messages left at his New Orleans home.

The Fairfax fight is one of several bitter battles taking place between companies and independent research firms. Internet retailer Overstock.com Inc. has sued Rocker and researcher Gradient Analytics Inc., claiming Rocker paid Gradient and helped analysts there write negative reports on Overstock.com. Drugmaker Biovail Corp. has sued Cohen's SAC Capital Advisors LLC and Gradient, alleging a plot to drive down its shares. The firms say the claims are false.

The cases raise questions about the integrity of securities research four years after several Wall Street firms

Accused: Fairfax says analyst **Spyro Contogouris** used dirty tricks to smear its CEO.

PHOTOGRAPH BY LOUIS LANZANO/BLOOMBERG NEWS settled claims that their analysts issued biased reports to win investment banking business. The 2003 settlement helped boost business for analysts who aren't affiliated with big investment banks. Independent researchers had helped regulators uncover financial fraud at Enron Corp., Tyco International Ltd. and WorldCom Inc.

Now, some unaffiliated analysts are allegedly being corrupted by deep-pocketed hedge funds, which often bet against stocks. In its complaint, filed in the New Jersey Superior Court in Morris County, Fairfax alleges hedge funds hired Contogouris to beat up its stock. "The complaint tells a story of people playing by a whole different set of rules," says Michael Bowe, a lawyer at New York–based Kasowitz, Benson, Torres & Friedman LLP, which represents Fairfax.

The hedge fund firms say Fairfax sued to quiet critics. "This case involves a spurious attempt by Fairfax, a publicly traded Canadian company, to use New Jersey's anti-racketeering statute to silence all stock market analysts critical of Fairfax and to deter investors from 'shorting' its stock," wrote lawyers for Sender in a memorandum supporting the motion to dismiss.

Fairfax has been a tempting target for short sellers. The company headed by Watsa, a former door-to-door air conditioner salesman who built his property-casualty insurer through acquisitions, has been plagued by erratic earnings and accounting errors. In June 2005, Fairfax disclosed that the U.S. Securities and Exchange Commission had requested information on Fairfax's use of reinsurance products. The company said the investigation was ongoing as of early August.

Contogouris says in court documents that he did work for six different hedge fund firms. In a sworn affidavit in an unrelated civil complaint against him, he names several firms that Fairfax later sued, including Exis Capital Management Inc., which is run by Sender.

Exis did indeed buy research from MI4 and shorted Fairfax stock in 2005, based in part on Contogouris's analysis, according to Sender's lawyer, David Zensky, of Akin Gump Strauss Hauer & Feld LLP in New York. "Exis vigorously denies the charges of wrongdoing in the complaint," Zensky says.

In a flurry of reports issued in 2005 and '06, MI4 said Fairfax used a web of European subsidiaries to conceal a cash crunch. Contogouris likened the insurer to Enron and postulated that a "Friends of Fairfax" club made up of analysts and investors conspired to drive up its stock.

"What draws them to each other, and indeed binds them together, is a feeling of belonging to a 'Group Think,'"

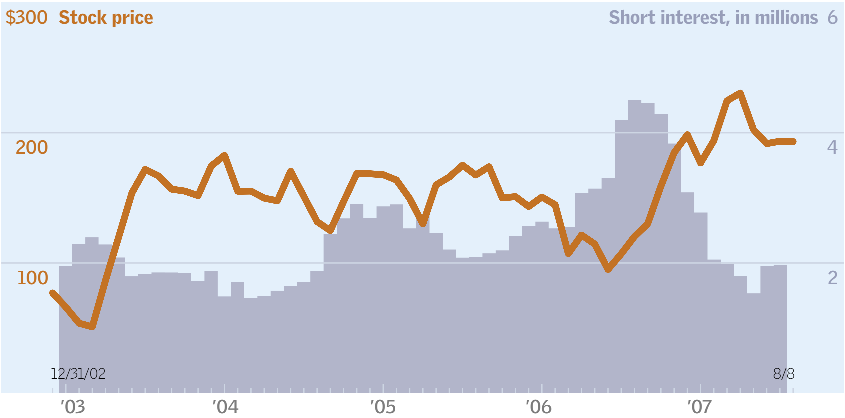
Exis Capital Management founder **Adam Sender**, a protege of hedge fund titan Steven Cohen, bought research from Contogouris's firm, MI4 Reconnaissance.

CHRIS GOODNEY/BLOOMBERG NEWS

Bears attack

Fairfax stock has withstood several bouts of heavy short selling.

FAIRFAX FINANCIAL HOLDINGS



Source: Bloomberg

Contogouris wrote in a report dated June 23, 2006. "It's herd behavior, it's Orwellian in its management and, in the case of Fairfax and the members of the FoF Club, it's true."

Among the club members, according to Contogouris: Mason Hawkins, chief executive officer of Memphis, Tennessee–based Southeastern Asset Management Inc. Southeastern is Fairfax's largest shareholder, with 22 percent of the stock as of June. Lee Harper, a spokeswoman for Southeastern, didn't return telephone calls seeking comment.

Contogouris's war with Fairfax took an odd turn on Nov. 13, 2006, when he was arrested on federal charges of embezzling money from an unnamed former employer. News of the arrest sent Fairfax soaring 10 percent in a day. Contogouris pleaded not guilty to a four-count indictment filed in Manhattan federal court in New York. His lawyer, James Felix, declined to comment.

Most critics of Fairfax have gone quiet since the company filed its racketeering complaint. In all, Fairfax sued eight hedge fund companies: Red Bank, New Jersey–based Copper River Management LLC, the successor to Rocker Partners LP that was formerly run by Rocker; Sender's Exis; Chanos's Kynikos Associates Ltd.; and Loeb's Third Point LLC, all based in New York. Two others are in Greenwich, Connecticut: Lone Pine Capital LLC and SAC Capital. Another, Trinity Capital of Jacksonville Inc., is based in Jacksonville, Florida. The last, Sigma Capital Management LLC, is a New York–based division of SAC.

Several of the managers are named personally, including Chanos, Cohen, Loeb, Rocker and Sender. In addition, Fairfax sued Morgan Keegan & Co. analyst John Gwynn; Christopher Brett Lawless, a former analyst at Fitch Group Inc. in New York; Bernstein; and Contogouris. Fairfax says Gwynn and Lawless conspired with the hedge fund firms.

Most of the defendants remain mum. Copper River, Kynikos, Lone Pine and SAC declined to comment. Third Point and Trinity didn't return calls. Messages left at a New Jersey listing for Lawless weren't returned.

To beat the hedge funds, Fairfax has enlisted public relations maestro Michael Sitrick and überlitigator Marc Kasowitz, whose New York–based law firm Kasowitz, Benson, Torres & Friedman has battled class action asbestos claims and helped cigarette maker Liggett Group Inc. avoid penalties imposed on Big Tobacco.

Only one Fairfax detractor is still talking: William Gahan, a trader at Institutional Credit Partners LLC, a New York–based fixed-income manager. Gahan, 41, correctly predicted the 2003 collapse of scandal-plagued Italian dairy company Parmalat Finanziaria SpA. Now, he says he has accountants and tax lawyers delving into Fairfax.

Gahan says Fairfax used transactions with a Cayman Islands–based subsidiary of Bank of America Corp. to dodge U.S. taxes. Fairfax says the deals were proper.

After Gahan began asking questions about Fairfax, the insurer included him and his firm in its racketeering suit. "Anyone who questions the company gets sued," he says.

Gahan fueled Fairfax's allegations of a conspiracy in November when he and Bernstein posted a $200,000 bond to guarantee that Contogouris would appear in court on the separate embezzlement charges. Gahan says he did it because he thinks Contogouris is innocent. He says he's skeptical about all the dirty deeds that Fairfax alleges, too. "You can put anything in a lawsuit," Gahan says.

Lawyers for Contogouris and Bernstein say their clients are protected by the First Amendment to the U.S. Constitution, which guarantees the right to free speech. On those grounds, they say, the complaint should be dismissed.

"Without the application of those protections at this phase of the litigation, the MI4 defendants will be permanently harmed, and their First Amendment rights, and indeed their livelihoods, will be permanently impaired," attorney Stephen Rosenberg says in court papers.

It's been a wild ride for Contogouris, a controversial character who took up stock research after working in real estate and on energy investments. No one involved in the Fairfax case seems to know much about what Contogouris did before 1993. After that point, some of his business dealings are detailed in court documents.

For a time, he lived large in Hollywood. In 2000, he bought a house just

Fairfax says a cabal of powerful hedge fund managers plotted to drive down its stock. The Toronto-based insurer has sued the managers for racketeering, demanding $6 billion in damages.

Under CEO **Prem Watsa,** who built Fairfax through acquisitions, the Toronto-based insurer has been plagued by erratic earnings and accounting lapses.

above Sunset Boulevard, according to property records. He and his brother Chris, an executive producer on Eminem's *8 Mile* soundtrack, bought a Los Angeles music club called the Mint. Chris lunched with Paris Hilton and sang at the club with Guns N' Roses frontman Axl Rose. Spyro rubbed elbows with Renée Zellweger and Lionel Richie as a board member of the Bony Pony Ranch, a camp for low-income kids near Los Angeles.

Contogouris made his first big mark in real estate in 1993, when a Greek shipping magnate named Dimitri Manios hired him to renovate a 1906 brownstone in Manhattan. Manios died suddenly, and his brother, Vassilios, later asked Contogouris to refurbish and sell two buildings in Houston, according to a civil fraud complaint that Manios filed in April 2005 against Contogouris in Harris County, Texas. As of mid-August, that case hadn't been resolved.

Then the trouble started. According to Manios's complaint, Contogouris withheld more than half of the $39.5 million he got for the Houston properties. Manios fired him in April 2002. In his complaint, Manios says he belatedly discovered that Contogouris had been siphoning money for years through a network of more than 130 bank accounts.

The criminal embezzlement complaint against Contogouris doesn't name a victim, but the details match Manios's civil action against Contogouris, down to the numbers on checks that Contogouris allegedly used to steal money.

Even before Manios fired him, Contogouris was prowling for a new moneymaker, this time in energy. In 2000, he agreed to invest $3.75 million in a partnership established by Houston-based Hanover Compressor Co. to build a natural gas compression plant on barges in Nigeria.

The Hanover project turned out to be a fiasco. Hanover investors later filed a class action suit against the Houston company, alleging that the deal was a ploy to artificially inflate Hanover's sales.

The deal appears to have been a good one for Contogouris. The complaint, filed by Pirelli Armstrong Tire Corp. Retiree Medical Benefits Trust, says Hanover guaranteed a refund of Contogouris's investment and paid him a $1 million commission for entering into the contract.

The Pirelli complaint doesn't allege any wrongdoing by Contogouris. Mark Roberts, president of Cambridge, Massachusetts–based independent research firm Off Wall Street Consulting Group Inc., says Contogouris was an unwitting accomplice in the scheme. Roberts says he had been digging into Hanover's accounting and had recommended shorting the stock. Then Contogouris came to him with information, Roberts says.

Hanover settled the class action suit in 2003, without admitting or denying wrongdoing. "Spyro is a very honest person," Roberts says. "I could be wrong, but I don't think I am."

Working on the Hanover project, Contogouris met fund managers who'd wagered against it, Roberts says. Contogouris liked the work and had a list of potential clients. He decided to become a stock analyst, Roberts says. MI4 was born.

Contogouris met Sender through a friend of a friend or a relative, Sender's lawyer Zensky says. Sender, 38, left SAC in 1998 to establish Exis. Like his mentor Cohen, Sender is a collector of contemporary art. In a March interview with Bloomberg News, Sender valued his private collection at $100 million.

Morgan Keegan's Gwynn says he met Contogouris at Sender's office. "As far as I know, he was an employee of Exis," Gwynn said in a telephone interview.

Contogouris's dealings have ranged from Houston real estate to Nigerian natural gas. Until recently, he ran a research firm that had a more cloak-and-dagger than stocks-and-bonds sound to it: MI4 Reconnaissance.

KAZ EHARA/THE NATIONAL POST

"He was never an employee of Exis," Zensky says of Contogouris. "Like others, we bought research from him. He had a very impressive work ethic and lots of good ideas and insight concerning a variety of companies."

Sender lost his 2005 bet against Fairfax. The shares rose, forcing him to cover his losses by buying more expensive stock.

Before its battle with short sellers, Fairfax was a press-shy insurance company. Watsa, the founder, was born in Hyderabad, India. He graduated in 1972 from the Indian Institutes of Technology with a degree in chemical engineering and moved to Canada. He sold air conditioners to put himself through the University of Western Ontario, earning an MBA in 1974. He did a stint as an investment analyst at an insurer, then established his own money management firm, Hamblin Watsa Investment Counsel, in 1984. A year later, he bought his first insurance company, Markel Financial Holdings, a struggling trucking insurer. He renamed it Fairfax, short for *fair, friendly acquisitions.*

Fairfax thrived until the late 1990s, when it bought two U.S. insurers: Crum & Forster Holdings Inc., for $565 million, and TIG Holdings Inc., for $847 million. Both got swamped by unexpected liabilities, including claims tied to the terrorist attacks of Sept. 11, 2001.

The 9/11 attacks cost Fairfax $85 million after taxes and contributed to a loss of $298 million for the three months ended on Sept. 30, 2001—20 times the loss from a year earlier, according to company financial statements. Watsa shut most of TIG in December 2002. With more of its operations now in the U.S., Fairfax listed shares on the New York Stock Exchange in the same month.

The bears pounced, selling 2 million shares short by January 2003. The Fairfax Project—a name the band of hedge funds used, according to the company—had begun.

Fairfax says the hedge fund firms worked with analysts to hammer the stock. One of the first analysts to take aim was Gwynn at Morgan Keegan, who issued a report on Jan. 16, 2003, saying Fairfax was short $5 billion of reserves needed to cover future claims. Fairfax shares listed in Toronto tumbled 28 percent during the next four days, to 85 Canadian dollars, a seven-year low. The U.S. shares followed suit.

Two weeks later, on Jan. 30, Gwynn backpedaled and issued a new report that put the shortfall at $3 billion. Fairfax shares in Toronto rebounded 9.7 percent.

Contogouris started following Fairfax in early to mid-2005. He lays out his side of the story in a complaint he filed against various Fairfax executives and subsidiaries in U.S. District Court in Louisiana in November 2006.

Contogouris zeroed in on Fairfax's European subsidiaries. He said Watsa was

using them to inflate assets. In a report dated Nov. 13, 2005, he said Watsa had shuffled money from a unit in Hungary to another in Gibraltar and then to a third in Luxembourg so Fairfax could count the money twice and use it to get loans. He later pegged the amount at $1 billion.

Bowe says that's nonsense. "As detailed in Fairfax's lawsuit, the alleged undisclosed off-balance-sheet entities and alleged undisclosed pledge agreements upon which Contogouris's claims are based never existed," he says.

Fairfax, in its complaint, says the hedge funds' dirty tricks started in late 2005, with the November letter to St. Paul's, where Watsa served as chairman of the investment committee. In that letter, the writer identified only as P. Fate tells Parker that Watsa bears a striking physical resemblance to Martin Frankel, who in 2004 was sentenced to 17 years in prison for stealing more than $200 million from U.S. insurers. Fate goes on to tell Parker that Frankel also stole a fortune from the Catholic Church.

Contogouris and the hedge fund firms deny wrongdoing and say Fairfax is trying to silence its critics. The fight is one of several battles taking place between companies and independent research firms.

"While these coincidences are surprising, they do not compare to the similarities between the massive money-laundering schemes perpetrated by Marty Frankel and the massively convoluted paper shuffle created by Mr. Watsa," Fate says. Attached was a 26-page article detailing Frankel's fraud, his flight from U.S. authorities and his supposed interest in sadomasochistic orgies. Parker didn't return calls seeking comment.

Watsa got the same package via e-mail, Fairfax says in its complaint. Computer code at the bottom of the document shows P. Fate is in fact Bernstein, Fairfax says in its complaint.

The same day Watsa got the e-mail, someone phoned Fairfax and left a message. "Tell Watsa that when he goes to jail next year we will visit him and bring him some treats," the caller said, according to Fairfax. The originating phone number was listed to Exis, the insurer says.

The harassment was relentless, says Paul Rivett, Fairfax's chief legal officer. For months, he says he had to turn off his home phone periodically because of crank calls in which people read excerpts from J.K. Rowling's Harry Potter books or claimed to be drug dealers looking for money. "It felt as if they were trying to wage a psychological warfare campaign," Rivett says.

Fed up, Rivett says he convinced

William Gahan, a trader at Institutional Credit Partners, says Fairfax used transactions with a Cayman Islands company to dodge U.S. taxes. Fairfax says the deals were proper.

Watsa to hire a law firm to investigate. Kasowitz Benson's Bowe had useful experience. In February, his firm had sued SAC Capital and several other hedge fund firms and analysts, alleging a plot to drive down shares of Biovail. Like Fairfax, Biovail was under investigation by the SEC in August.

The attack on Fairfax intensified. In May 2006, Contogouris arrived at the London offices of a Fairfax unit, according to the insurer. He got past the building's security personnel by saying he was a reporter, the complaint says. Inside, he tried to get executives to talk by saying that Watsa had sold the subsidiary. *Special Situations Research Consultant, MI4 Reconnaissance,* read the card he later left behind. The phone number on the card rang through to Exis, Fairfax says.

Short interest in Fairfax's U.S. shares surged to 4.2 million shares in July 2006 from 3.3 million that June. On July 26, seven months after the letter arrived for Parker, Fairfax sued the hedge fund firms, Bernstein, Contogouris and the others, alleging a vast conspiracy.

Then came a twist: Two days later, Fairfax said it would restate earnings to correct five years of errors. That August, Fairfax quantified the restatement, lopping off $235.3 million of shareholders' equity. The hedge funds say in court documents that Fairfax sued to blunt criticism of its accounting. Bowe calls that claim "silly."

After Fairfax filed its suit, many Fairfax critics shut up. At Morgan Keegan, Gwynn stopped covering the company in January. Only Gahan is pounding the table now. He says a friend—not one of the people named in Fairfax's complaint—suggested in 2006 that he look into Fairfax. He talked to Contogouris, dug through Fairfax's earnings restatements and at one point blanketed the 25-foot (7.6-meter) length of a conference table at his firm with SEC filings.

After more than a year of forensic accounting, Gahan says Contogouris was right: Something was rotten at Fairfax. Gahan says Fairfax improperly lowered its U.S. tax bill in 2003 when it consolidated a reinsurance unit called Odyssey Re Holdings Corp. into its U.S. tax group. Sitrick, Fairfax's spokesman, says that claim is false.

In early 2003, Fairfax owned 74 percent of Odyssey. Owning more than 80 percent would give Fairfax the right to consolidate Odyssey for tax purposes. Fairfax had net operating losses that would cancel out Odyssey's profit, letting Fairfax keep $140 million that Odyssey would have otherwise sent to the U.S. Internal Revenue Service for 2003, Gahan says.

Instead of using precious cash, Fairfax got 4.3 million Odyssey shares—enough to get more than 80 percent—by handing over $78 million of notes to a unit of Bank of America called NMS Services (Cayman) Inc., based in the Cayman Islands. NMS, in turn, went out and borrowed Odyssey shares from investors and transferred them to Fairfax. NMS kept the right to get the shares back 21 months later.

Fairfax said it made the purchase for tax reasons and as an investment. Deals done solely for tax reasons rankle the IRS, and it has disallowed transactions when companies can't prove another purpose. Gahan says Fairfax couldn't make any money because of the way its deal was

'Anyone who questions the company gets sued,' ICP's Gahan says of Fairfax. He says he's skeptical about all of the dirty deeds that the Canadian company alleges. 'You can put anything in a lawsuit,' he says.

STEVE PYKE

structured, which meant there was no investment purpose.

For example, in 2006 Fairfax gave Bank of America $23.5 million in cash to cancel notes it had used to pay for 1 million shares of Odyssey, Gahan says. That meant Bank of America gave up rights to them and needed to buy 1 million shares to return to investors, he says. Fairfax agreed to pay Bank of America for the cost, Gahan says, based on his reading of Odyssey SEC filings. The reimbursement slashed any profit Fairfax would have made from owning the shares for three years, Gahan says.

"Fairfax never had a real investment in the stock," says Bryan Skarlatos, a tax attorney at Kostelanetz & Fink LLP in New York who Gahan hired to examine the transaction.

Fairfax says Gahan and Skarlatos are wrong. "The statement that Odyssey was not properly consolidated with Fairfax in 2003 is simply untrue," Sitrick, the outside spokesman, said in a statement. "The 2003 transaction being discussed, and the resulting tax consolidation, complied precisely with the IRS regulation and all relevant laws governing consolidation. The individuals raising these issues are defendants in Fairfax's racketeering litigation who still hold an economic interest in a decline of Fairfax stock and have admitted their association with co-defendant Contogouris. Their theories about consolidation ignore the actual terms of the governing tax provisions, contradict the relevant tax authorities and are otherwise based on false factual premises that simply do not exist."

Robert Willens, a managing director and tax-accounting analyst at Lehman Brothers Holdings Inc., says Gahan's best shot is that the IRS examines the transaction to see if it had any purpose other than tax avoidance. The IRS hasn't scrutinized a case like this in a long time, but there's a chance it could, he says. "These cases are on the books," Willens says.

Gahan has put money on being right. ICP has bought credit derivatives that will rise in value if, as Gahan predicts, publicly traded Odyssey Re gets hit with a big tax bill, weakening its financial condition. His boss, ICP founder Thomas Priore, says the fight is about more than money. "When they sued us, it became personal," Priore says.

As for Contogouris, his days as an analyst are over, for now. MI4 has stopped doing research, for fear of getting sued again, his lawyers said in court documents. As of mid-August, his separate trial on embezzlement charges had yet to be scheduled.

None of his former clients would step forward to help when he was arrested, either. "No one would take his call," Gahan says. It seems Contogouris, one-time head of MI4, has been disavowed by the hedge fund firms that now stand accused of paying him to do their dirty work.

ANTHONY EFFINGER is a senior writer at Bloomberg News in New York.
aeffinger@bloomberg.net

BLOOMBERG TOOLS

Finding Contogouris's Cases

You can use the Bloomberg Law Search (BBLS) function to access documents from court cases involving Spyro Contogouris. Type BBLS <Go>, tab in to the ENTER SEARCH TERMS field and enter *CONTOGOURIS*. Type <Go> 1 <Go> to search. As of Aug. 8, the search returned 57 documents, as shown below.

To see details of a class action, or group lawsuit, filed in February on behalf of shareholders of Fairfax Financial Holdings against Contogouris, hedge fund managers and analysts, click on the case named Holomon v. S.A.C. Capital Management, LLC et al, Docket No. 2:07-cv-00640. The docket is the court's official record of filings in the case. To see the complaint, scroll down to the Docket Proceedings section of the screen, click on 1 under Req# and then click on the attachment named Part_1.pdf.

You can use the Short Interest (SI) function to graph the total number of shares of Fairfax that were reported sold short and not yet repurchased by a set monthly settlement date. Type FFH CN <Equity> SI <Go>. The short interest ratio, which is denoted SIR on the axis on the left side of the screen, shows the number of days of average trading volume it would take to cover the outstanding short positions.

Type HFND <Go> for the main menu of hedge fund functions and data.

THOMAS JASTRZAB