

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of:)
) File No. OIG-509
)

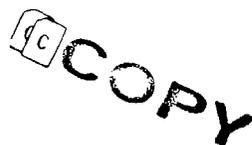
WITNESS: Number 4

PAGES: 1 through 112

PLACE: Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C.

DATE: Friday, February 13, 2009

The above-entitled matter came on for hearing, pursuant to notice, at 10:15 a.m.

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1 APPEARANCES:

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1 C O N T E N T S

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3 WITNESS: EXAMINATION

4 Alex J. Sadowski 7

5

6 EXHIBITS: DESCRIPTION IDENTIFIED

7 1 Draft letter, Easter to

8 Sadowski, 1/24/04 21

9 2 Draft letter, Easter to

10 Sadowski, 1/28/05 21

11 3 Document: "E-mail Search Order

12 Routing Project, 9/10/2004,

13 9:37 a.m." 23

14 4 Two e-mails, McCarthy to Swanson

15 and Nee to McCarthy, multiple cc's,

16 attaching Marhedge article, "Madoff

17 Tops Charts; Skeptics Ask How" by

18 Michael Ocrant, 5/26/05 31

19 5 Article, Barron's, re. B. Madoff,

20 May 2001 36

21 6 E-mail, McCarthy to Swanson,

22 2/28/06 41

23 7 E-mail, Sadowski to Swanson,

24 3/22/05 44

25

1 C O N T E N T S (Continued)

2			
3	EXHIBITS:	DESCRIPTION	IDENTIFIED
4	8	E-mail series, S. Madoff/Swanson,	
5		cc McCarthy, 3/22/05	45
6	9	E-mail, S. Madoff to Swanson,	
7		re. document request, 5/2/03	49
8	10	E-mail series, S. Madoff to	
9		Swanson, 8/12/2004; 5/22/2005;	
10		8/12/2004; 8/15/2004, 8/18/2003	50
11	11	E-mail, McCarthy to Swanson,	
12		3/1/06	54
13	12	E-mail, Sadowski to Swanson,	
14		3/24/06	57
15	13	E-mail, Swanson to Sadowski,	
16		4/24/06	61
17	14	E-mail, McCarthy to Sadowski,	
18		4/6/06	63
19	15	E-mail, Sadowski to Swanson,	
20		4/7/06, 12:17 p.m.	64
21	16	E-mail, Swanson to Sadowski,	
22		4/7/2006	65
23	17	E-mail, Sadowski to Swanson,	
24		4/7/2006, 12:21 p.m.	66
25			

1 C O N T E N T S (Continued)

2			
3	EXHIBITS:	DESCRIPTION	IDENTIFIED
4	18	E-mail series, McCarthy to	
5		Sadowski, 4/7/06, 12:21 p.m.	67
6	19	E-mail, Sadowski to McCarthy,	
7		4/7/2006, 12:23 p.m.	72
8	20	E-mail, Sadowski to McCarthy,	
9		4/7/2006, 12:24 p.m.	72
10	21	E-mail, McCarthy to Sadowski,	
11		4/18/06, and e-mail string,	
12		McCarthy/S. Madoff	74
13	22	E-mail, McCarthy to Sadowski,	
14		4/21/06	76
15	23	E-mail, Sadowski to McCarthy,	
16		4/21/06, 9:12 p.m.	78
17	24	E-mail, McCarthy to multiple	
18		recipients, 4/21/06, 11:40 p.m.	79
19	25	E-mail, Swanson to McCarthy,	
20		4/21/2006, 7:59 p.m.	79
21	26	E-mail, Sadowski to McCarthy,	
22		4/22/2006, 11:42 a.m.	81
23	27	E-mail, Swanson to Sadowski,	
24		4/22/2006, 9:04 a.m.	85
25			

1 C O N T E N T S (Continued)

2			
3	EXHIBITS:	DESCRIPTION	IDENTIFIED
4	28	E-mail, McCarthy to Swanson,	
5		4/27/06, 9:45 a.m.	89
6	29	E-mail, Swanson to McCarthy,	
7		4/27/06, 9:46 a.m.	90
8	30	E-mail, Swanson to McCarthy,	
9		4/27/06, 9:47 a.m.	90
10	31	Invitation, farewell reception	
11		for Swanson, 8/21/06	93
12	32	Document, "Re. RSVP to farewell	
13		reception for Eric Swanson,"	
14		8/21/06	94
15	33	E-mail, Sadowski to McCarthy,	
16		8/21/2006, 3:53 p.m.	95
17	34	E-mail, Song to Sadowski, 9/24/04	105
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1 PROCEEDINGS

2 MR. KOTZ: Okay, we are on the record at 10:15 a.m.
3 on February 13, 2009 at the United States Securities Exchange
4 Commission Office of Inspector General. I am going to give
5 you the oath if that is all right.

6 MR. SADOWSKI: Sure.

7 Whereupon,

8 ALEX JOSEPH SADOWSKI

9 was called as a witness and, having been first duly sworn,
10 was examined and testified as follows:

11 EXAMINATION

12 BY MR. KOTZ:

13 Q Could you state and spell your full name for the
14 record?

15 A My name is Alex Joseph Sadowski, A-l-e-x,
16 J-o-s-e-p-h, S-a-d-o-w-s-k-i.

17 Q My name is David Kotz. I am the Inspector General
18 of the United States Securities and Exchange Commission.
19 This matter is being conducted pursuant to an investigation
20 by the Office of Inspector General, Case Number OIG-509.

21 I am going to ask you certain questions and you
22 will provide answers under oath. The court reporter will
23 record and later transcribe everything that is said. Please
24 provide verbal answers to the questions. A nod of the head
25 or another non-verbal response won't be able to be picked up

1 of did a front-running exam of Madoff, of kind of Madoff
2 Securities, which I think is here but not so much, again, I
3 think it was more front-running using the market maker,
4 right, because John did mention this me that he had a
5 conversation with Madoff but he wasn't sure about the time,
6 right, the exact time of when he had it, right.

7 BY MR. KOTZ:

8 Q He mentioned this to you recently?

9 A Yes, right.

10 Q But at the time you weren't aware of this?

11 A No, no, no. I mean because you have got to think
12 about this obviously when the story breaks, everyone talks
13 about it and then we run through what exams did we do. I
14 remember -- because we even said was he part of the pre-open
15 exams that we did, that is what we called the ones that we
16 were just referring to. And then John had mentioned, he was
17 like, "Yes, I think I talked to him one time."

18 Q When you say "him," do you mean Bernie Madoff?

19 A Yes, I think so. Yes, yes, he said Bernie and then
20 but he said there was no mention of I guess the investment
21 advisor, and I think that is what prompted this
22 "front-running exam," and it was done in like '05. What is
23 the date here? Yes, this is '05, that makes sense. So then
24 that exam, that finding there was basically no front-running,
25 so now it makes more sense because John Nee, I think he is

1 in -- they are in the New York office, right, so then they
2 shipped it up to the New York office.

3 Q Do you know how much involvement John McCarthy had
4 before it was shipped up?

5 A Probably not much. He was associate director, so
6 the day to day involvement, and as you can imagine people
7 talked to John in getting tips and things like that if that
8 is what this is considered, right.

9 Q What about Eric Swanson, do you know what
10 involvement he had in that front-running exam?

11 A I don't because I wasn't that involved. I wasn't
12 involved at all in that exam.

13 Q Do you know these guys: John Nee, William Ostrow,
14 Peter Lamore, Bob Sollazzo?

15 A I know Bob Sollazzo and I know John Nee. I don't
16 know them well but I have talked to them and dealt with them
17 on a variety, the other two I do not.

18 Q And Sollazzo and Nee are good examiners?

19 A Yes, Bob has been, he has kind of run the New York
20 office exam program forever. As you can imagine, there is a
21 lot of -- you try to coordinate as much as possible, and I
22 think that is why obviously there was this e-mail from John
23 Nee to John McCarthy, right. John did mention that this
24 conversation he had with Nee about this.

25 Q This is John you are talking about?

1 A Yes, yes, he is like, "I remember talking with Nee
2 about it, that they were doing an examination of Madoff," and
3 he was like that, "We talked to him" because it is funny
4 because he said that at first that Madoff didn't even admit
5 or something because when he says here, "When he finally
6 admitted to executing trades for billions of dollars in
7 customers," he kind of said that -- John McCarthy told me
8 that, "I thought that was a red flag" in talking about it
9 kind of now in the sense of why wouldn't Madoff admit,
10 because apparently it took him -- when John Nee spoke to him,
11 it took him a long time to kind of I guess admit that he was
12 executing trades for hedge funds.

13 Q So in this conversation you were having with John
14 McCarthy about this thing that hit with Madoff and you were
15 talking about the front-running exam, did McCarthy ever say,
16 "Wow, how did those guys miss that" or "I wonder what
17 happened"?

18 A Well, again, revisionist history, we kind of said,
19 like we looked at the Markopolos memo and say, "Wow, if I
20 would have had this memo, it would have been a field day"
21 because, again, you have to put these things in context when
22 you talk about if you would have went in front of the
23 Commission in 2005 and said, "I want to do an enforcement
24 action potentially, I don't have any evidence of anything but
25 Bernard Madoff, I need to do an enforcement action because I

1 doing these around that time.

2 Q And at the time did he make any comments about her,
3 favorable comments?

4 A No, no, he was.

5 Q Did he like her at the time?

6 A No, he was actually -- she was I think dating
7 someone. He was actually up until the end of '05, he was
8 actually engaged to be married to someone else. Kind of fate
9 stepped in if you will. He was supposed to get married in
10 Florida and then there was a hurricane in the place where
11 they were supposed to get married and it didn't happen. And
12 then --

13 Q Who was that that he was supposed to marry?

14 A I can't remember her name.

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And from kind of the way I view

21 things, I think then, a couple of months later, I think that

22 is when he started dating Shana

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And, again, as I

1 be asked to speak at those events?

2 A "Prestigious" is probably a little strong of a
3 word. John McCarthy basically ran the exam program for
4 broker-dealers and Eric Swanson was kind of the number two,
5 so to listen -- so those are the natural people you are going
6 to have come and talk at those events just as you would have
7 Steve Luperello who kind of ran the exam program for NASD or
8 Tom Gero or Rick Ketchum, right.

9 Q Why were they motivated to spend their time doing
10 this?

11 A Oh, because you want to -- as a regulator, you want
12 to be perceived certainly as trying to help broker-dealers be
13 more compliant. It is an outreach type program in an effort
14 to facilitate compliance within the industry and to think
15 about issues. It is just like when a chairman or someone
16 goes to the Securities Trader's Association and gives a
17 speech or something like that. It is designed to talk about
18 things that are going on internally, here are the issues that
19 we care about, here is what we are going to look at when we
20 come in to do an examination. Make sure your AML policies
21 and procedures are updated if there are new rules, things
22 like that. So they were certainly designed to try to educate
23 and for them to ask questions related to obviously issues.

24 BY MR. KOTZ:

25 Q Was Shana effective at getting speakers?

1 don't know.

2 Q You didn't hear anything about a tip that was
3 received about Madoff that Steve Cutler gave to Laurie
4 Richards?

5 A No, never, never.

6 Q Okay, when did you understand that Shana and Eric
7 became romantically involved?

8 A I would say, it was probably, I remember I think it
9 was around this time.

10 Q Meaning March of 2006?

11 A Yes, like SEC Speaks was around that time because I
12 remember a bunch of people were out, and I think I remember
13 them two spending a lot of time talking to each other because
14 I remember even talking to him about it, I said, "What is
15 going on, you spent a lot of time talking to Shana?" And
16 that is when I think he kind of mentioned, yes, he is an easy
17 person to talk to, she was telling me about Personal Privacy, and
18 I was telling her about all my craziness and that is when you
19 got the sense that okay maybe something is going to happen
20 here.

21 Q So you think that occurred around March of 2006?

22 A I would say March or April. I don't know when they
23 kind of officially made it official dating but I would
24 probably put it, that is from what my observation, if it was
25 six months before that, I didn't know about it.

1 Q Okay, so can I show you a couple of documents?

2 A Sure.

3 Q A 3/24/06 e-mail at 10:00 a.m. Okay, we will mark
4 this as Exhibit 11, this is an e-mail from you to Eric
5 Swanson, 3/24/06 10:50 a.m. I'm sorry, Exhibit 12. If you
6 could look at that all the way down to the bottom.

7 (Exhibit No. 12 was marked for
8 identification.)

9 THE WITNESS: Yes, I remember this e-mail.

10 BY MR. KOTZ:

11 Q Okay. What do you remember about the e-mail?

12 A We were out late, and that was the night -- that
13 was the night that he was talking to Shana, and that was a
14 joke, I was like, "Shana made off the evening" because I was
15 insinuating that they spent the night together.

16 Q So where were you out, or what was the event?

17 A It was SEC Speaks.

18 BY MS. STEIBER:

19 Q In D.C.?

20 A In D.C. and there were like hundreds of people.

21 They went to a bar.

22 Q What was going on that night that made you think
23 that they were --

24 Were they flirting?

25 A Like I said, they spent the whole night talking to

1 BY MS. STEIBER:

2 Q Did she work at the SEC?

3 A I don't think so, no.

4 Q Did you learn who she was?

5 A It was someone that he knew, I think, for a long
6 time, so I can't remember her name.

7 BY MR. KOTZ:

8 Q And this thing about McCarthy saying, "You're
9 keeping secrets from me," did you find out about this
10 relationship before John did?

11 A I think I did, yes. Again, context matters right?
12 John and Eric I think were, they were -- they had a very good
13 working relationship, and I think at this point Eric was
14 getting ready to leave the Commission, John was getting ready
15 to leave the Commission, and I think the relationship in one
16 sense was I don't want to say strained because that is
17 probably a strong word but it was you know, and I think this
18 is going on with Shana, and I was basically kind of put in
19 the middle. I kind of talked with both of them.

20 Q You were closer with Eric than John was?

21 A No, I wouldn't say that. I wouldn't say that at
22 all. I just think at that time, again going through the
23 things that I was going through, the things that Eric was
24 going through, it was just but, like I said, six months
25 before Eric was going to be married.

1 (Exhibit No. 33 was marked for
2 identification.)

3 THE WITNESS: Probably joking with Eric because
4 again the way that the -- at that time that we were going
5 through those e-mails before, there was significant tension.

6 BY MR. KOTZ:

7 Q Right.

8 A Now, we are past the tension.

9 Q But doesn't it seem to indicate that there is at
10 least some lingering tension even in August?

11 A Well, it is more of you know, yes, it is more, it
12 more in lightheartedness. I think it is an acknowledgment
13 that, hey, we went through a difficult time where there was
14 some tension, right. And I say, "Couldn't leave well enough
15 alone," like basically we are past this, let's move on with
16 our lives and going to be happily married. We all went
17 to -- John went to the wedding, I went to the wedding, so
18 this wasn't a tension in the sense of -- it was in the grand
19 scheme of things, it was --

20 Q Right.

21 A -- relatively --

22 Q You said that you spoke to Eric after there was
23 information in the press about Bernie Madoff?

24 A Sure.

25 Q And what was his reaction at that time? Was he

1 A Yes, I had three, I had people come in and I
2 interviewed them and they are always a little quirky, you can
3 tell they are smart but they are disgruntled typically in
4 some way. It was, "I left this job because they were
5 engaging in fraud," when maybe that wasn't -- there was
6 always an ax to grind it seemed like.

7 Q And you didn't see that in the Markopolos'
8 complaint?

9 A When you listen to his testimony, again I think he
10 has a little bit of quirkiness about him but he seemed to
11 become obsessed with this not because of he lost money or got
12 fired from a job, he seemed to become obsessed with this
13 because he basically pretty convincingly proved that this was
14 a fraud, and he wanted to help bring it down.

15 BY MS. STEIBER:

16 Q You said something that made it a credible
17 complaint were the names that he gave, the contacts. Was
18 there anything else about the complaint, the information in
19 the complaint?

20 A Just that it was detailed -- sorry. It was
21 detailed. It was very -- in my judgment, very methodical.
22 It just gave you a road map. It just gave you so many ways
23 to -- because that is what you need as an examiner, you need
24 to say all right, I now have this so I can go ask this person
25 for this piece of information. And it is, it is a connecting

1 of the dots. That is what these types of things are and that
2 was certainly something that led you to at least start
3 connecting. But, again, I don't want to overstate this
4 because I'm viewing it in hindsight like everyone else and it
5 is easy to say.

6 BY MR. KOTZ:

7 Q You mentioned the possibility of incompetence. Did
8 you know of OCIE examiners or folks in OCIE that were
9 incompetent that might have missed this?

10 A Yes.

11 Q Yes?

12 A It is difficult, you don't want to disparage former
13 co-workers but the SEC is a large organization.

14 Q Right.

15 A Typically when people come in, it is difficult if
16 they are really not up to par to get rid of them. And there
17 is a mentality sometimes, it is very, okay, we have this
18 checklist, right, so we need to go by this checklist and if
19 everything happens on this checklist, it is okay. There was
20 not a lot of outside the box thinking. I think that is one
21 of the things that John was very good at because with the
22 specialists investigation, it was something that taken to a
23 level that wouldn't have been if he didn't do it because it
24 was also about a mentality, right. The analogy that we use
25 is that a typical SEC examiner walks into a room where there

1 are a bunch of dead bodies lying around and they notice that
2 the clocks are 10 minutes fast. And it really is. And,
3 again, it is not meaning to be disparaging but it becomes
4 difficult but you also have to factor in the restraints that
5 you have.

6 Q Now was that sort of the reputation of the New York
7 office of examiners?

8 A I think they, like other offices, I think they had
9 some very talented examiners but they also had their share of
10 people that probably weren't very strong.

11 Q What about the Enforcement lawyers, was there a
12 good relationship between OCIE and Enforcement in terms of
13 working together in a collaborative fashion?

14 A At times. As you probably have heard, there are
15 always those issues of turf battles. We obviously as
16 examiners we don't have enforcement authority, but if we find
17 something, we want to be involved in it, right, because we
18 were there. And there were times when things would go to
19 Enforcement and they would say, "Well, thanks for all your
20 hard work, we got it now. We will take it from here." And
21 then obviously if they needed stuff, they would come back.
22 There were times that there were some tension there, which
23 was typical.

24 Q Okay. Let me ask you another question, let's say
25 you did an examination and you didn't find anything or you

1 found some suspicious things but in the end you couldn't
2 prove it so you just concluded that there was nothing
3 significant there. And then Enforcement is starting to look
4 at, this same case, would you try to work with Enforcement to
5 give information?

6 A Sure.

7 Q Would you follow up?

8 A Sure. I was fortunate, I had several cases that I
9 worked on. I testified in a trial on behalf of the
10 Enforcement Division. Most of my work throughout my career
11 was cases that led to enforcement where I worked closely with
12 them.

13 Q But do you think that it is possible that there
14 might have been examiners who were working on an examination,
15 had suspicions but didn't find anything and then Enforcement
16 is picking something up and so they were potentially worried
17 that Enforcement would find something that would make them
18 look back?

19 A I think that is a very valid theory in the sense
20 that, and I think that potentially is one of the cultural
21 problems with the SEC is that there is the culture or fear
22 that I don't want to -- you see these people, this is the
23 worst case scenario for certain people, right. People's
24 pictures are in the New York Post. And there is some of that
25 culture I think of --

1 Q The culture being?

2 A Of I don't want to be proven to be incompetent and
3 so we are going to kind of -- not slide this under the rug
4 but it is just if I have already looked at something and it
5 is not there, it is not there because I am competent and you
6 don't need to go and look and question my judgment.

7 Q Right, so you might want to convince Enforcement
8 that there isn't something there to prove that you were right
9 in the first place?

10 A I could certainly see people doing that because it
11 is obviously poor but people worry about reputations, and I
12 think that is probably one of the -- again, from a cultural
13 standpoint of the agency, that is probably a weakness in my
14 judgment.

15 Q I am going to show you another document, this goes
16 back to what we were talking about early on, maybe this will
17 refresh your recollection about that initial matter you were
18 involved in regarding Madoff, so why don't we mark this as
19 Exhibit 34. This is an e-mail from Personal Privacy to you,
20 9/24/2004.

21 (Exhibit No. 34 was marked for
22 identification.)

23 THE WITNESS: Okay.

24 BY MR. KOTZ:

25 Q Can you see were it says, "Question: Why does this