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Bayou Fund, Founder Face Lawsuits Over $4.5 Mln in Unpaid Debts

By Andrew Dunn and Katherine Burton - Aug 31, 2005

Aug. 31 (Bloomberg) -- Bayou Management LLC, the Connecticut-based hedge-fund company under investigation for fraud, and founder Samuel Israel III face two lawsuits claiming at least $4.5 million in unpaid debts.

South Cherry Street LLC, a Denver-based investor, claims in an Aug. 26 complaint that Bayou didn't return its $1.5 million in the Bayou Accredited Fund LLC as promised in letters in July and August. Separately, Steven Starker claims Israel failed to repay a $3 million promissory note that came due July 15. Israel had borrowed the money a month earlier, according to the suit Starker filed Aug. 19.

``Defendant has failed and has acknowledged his inability to pay the obligations due under the note,'' according to Starker's complaint. His suit and South Cherry Street's were filed in state court in New York.

Israel, 46, wrote investors July 27 that he was shutting the four funds run by his Stamford-based company and returning their money. Investors have yet to be reimbursed, triggering probes by the Federal Bureau of Investigation, the U.S. Securities and Exchange Commission and the Connecticut Department of Banking into what happened to the $440 million Bayou had under management.

Bayou is the biggest hedge fund to come under scrutiny for missing funds since 2000, when money manager Michael Berger was accused of hiding $400 million of losses over four years. Hedge funds -- lightly regulated investment portfolios designed for wealthy investors and institutions -- will have to register with the SEC beginning in February, opening them to random audits for the first time. There are about 8,000 hedge funds with about $1 trillion under management.

Breach of Duty

South Cherry Street is seeking the return of its money, plus damages, as well as a restraining order barring the removal of any investor funds from Bayou's accounts. South Cherry Street claims that Bayou breached its fiduciary duty to investors and alleges conversion, the unlawful appropriation of property.

Eva Ciko, the lawyer who filed the complaint, didn't return calls seeking comment. Howard Schiffman, an attorney at Dickstein Shapiro Morin & Oshinsky, the law firm that filed Starker's suit, declined to comment.

South Cherry Street claims that it received the July 27 letter from Israel, plus subsequent letters saying that Bayou was performing an audit before liquidating the fund and that investors would soon receive 90 percent of their money.

``In fact, plaintiff has not received any distribution from the purported liquidation of the fund,'' the South Cherry Street suit claims.

Calls yesterday to Israel's home and to Steven Oppenheim, a lawyer at New York-based Faust, Rabbach & Oppenheim, who's representing Bayou, weren't returned. Phones at Bayou's offices in Stamford weren't answered and voice mailboxes were full.

Arizona Seizes Funds

Yesterday, Arizona officials said they had seized $101 million in a Wachovia account that may have come from Bayou. The state is asking for Bayou investors to come forward.

``Our group of investors is relieved to know that at least some of the money has been secured,'' said Ross Intelisano, a New York lawyer representing five Bayou clients. ``There's still a long way to go to obtain complete recovery.'' Intelisano's clients have about $10 million invested in Bayou.

The Arizona attorney general took the money May 19 from a Wachovia account held by Majestic Capital Management. Officials acted after learning the funds had been moved in rapid transfers from Germany to London, Hong Kong and the U.S., Cameron Holmes, assistant attorney general, said in an interview. They were told that the $100 million was proceeds of a loan secured by a goldmine in Pinal County, Arizona, valued at $152 billion.

``Bayou's filings with the court indicate that it's their money -- the state is pursuing proof of that,'' Holmes said. The hedge fund submitted a letter from Karl Johnson, named as the principal of Majestic Capital, saying the funds came from Bayou.

Short-Term Trader

Arizona has asked that a receiver trace the funds and assure they are returned to the rightful owners. Bayou has filed a competing motion to have the money returned to the Majestic Capital account. A hearing is scheduled for Sept. 1. Contact information for Johnson or Majestic Capital couldn't be obtained.

Intelisano said his clients believe that Israel ran the funds legitimately at first, and later lost money and tried unsuccessfully to trade his way out of the losses.

Israel, who founded Bayou in 1996 after working for Leon Cooperman's Omega Advisors, pitched himself as a short-term stock trader, according to a presentation given to potential investors in 2002. About half his portfolio was long, a bet that stocks would rise, and half was short, a bet that prices would fall, the presentation said.

Bayou used marketers and consultants, including Hennessee Group LLC, and its own brokers to attract investors.

``I've spoken with investors who said they were put into the fund by Hennessee,'' Intelisano said. Hennessee advises institutions and wealthy investors on hedge funds. Intelisano also said three of his clients were recruited by brokers at Bayou Securities LLC, the brokerage firm owned by Israel. South Cherry Street said in its court documents it invested in the fund through Hennessee.

Lee Hennessee, who founded New York-based Hennessee Group in 1997, didn't return phone calls seeking comment. The SEC declined to comment on whether Hennessee or other third parties are included in the investigation.

The cases are Starker v. Israel, No. 05602998, and South Cherry Street LLC v. Bayou management Co. LLC, No. 05603078, both filed in New York State Supreme Court, New York County.

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