Bankruptcy Trustee Says Fletcher Investments Inflated Through Fraud

Hedge Funds Run by Alphonse Fletcher Were Likely Insolvent Years Ago, Report Says

By
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Updated Nov. 27, 2013 1:14 p.m. ET

In a prospectus to investors, hedge-fund manager Alphonse Fletcher Jr. said he planned to achieve returns by doing deals "immediately, quantifiably worth more to the buyer than the seller."

But a court-appointed bankruptcy trustee said in a report this week that the values Mr. Fletcher placed on investments were inflated through fraud, and that his firm's funds were likely insolvent as far back as December 2008.

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The Massachusetts Bay Transportation Authority fund invested $25 million in 2007 in a Fletcher fund and hasn't been able to redeem it. Boston Globe via Getty Images

In the report, the trustee, Richard J. Davis, said that a network of related Fletcher hedge funds had not made a profitable investment after August 2007. Instead, working with a consultant, Mr. Fletcher, chairman and owner of Fletcher Asset Management, created "wildly inflated valuations" to generate more than $30 million in fraudulent fees and attract new investors, the report said.

Mr. Davis's report said that the Fletcher firm also generated "cashless notes" between its own funds that led to extra fees and improperly increased calculations of assets under management, just before funds were evaluated by a key hedge-fund industry index.

"In many ways, the fraud here has many of the characteristics of a Ponzi scheme where, absent new investor money coming in, the overall structure would collapse," Mr. Davis said in a nearly 300 page report.

Mr. Fletcher didn't respond to requests for comment. In the past, he has said the firm relied on a consultant and mathematical models to estimate the value of hard-to-value investments. He said the valuations were carefully checked and reviewed by others.

The valuation of the Fletcher firm's investments and its use of investor funds are also under investigation by the Securities and Exchange Commission, the report said. The Justice Department has also issued a subpoena for Fletcher documents, the report said. Representatives of the SEC and Justice Department declined to comment.

Mr. Fletcher, now in his 40s, achieved a measure of fame on Wall Street when he was still in his 20s and 30s as a Harvard-educated investor securing impressive returns. At one point, a Fletcher fund told of going 11 years without a single losing month.

Mr. Fletcher's main investment fund, Fletcher International Ltd., filed for federal bankruptcy protection in Manhattan in June 2012. The filing was made to block court-appointed liquidators in the Cayman Islands from taking over the fund at the behest of unhappy investors, Louisiana pension funds that had unsuccessfully sought their cash back

Mr. Davis, appointed by the court last year, tracked 10 investments that were immediately marked up by Mr. Fletcher at a weighted average of 2.7 times what he paid for them, the report said. Although valued at as much as $454 million, they were worth only $60 million when they were sold or transferred out of the funds, it said.

The investments were mainly private investments in public companies, known as PIPES, in which investors often receive hard-to-value warrants or rights.

Mr. Davis said the valuation consultant that the Fletcher firm used, Quantal International, inappropriately applied mathematical models with faulty inputs, and didn't check them against the market value of similar warrants to realistically gauge value. He said Mr. Fletcher was

Quantal's only significant valuation client. In a statement, Quantal said it "believes the allegations in the report about it are unfounded and untrue."

Three Louisiana public pension funds invested a total of $100 million with a Fletcher fund in 2008, based an offer of a minimum annual return of 12%, backed by the shares of another investor. None of that money was put to work in new public investments, the report said.

Rather, investor funds were used among other things to make an unsecured $27 million loan to Mr. Fletcher for another investment, and to pay $8 million to produce a movie, Violet & Daisy, directed by Mr. Fletcher's brother, Geoffrey Fletcher, the report said.

It also identified another investor as the Massachusetts Bay Transportation Authority Retirement Fund, which invested $25 million in 2007 in a Fletcher fund and hasn't been able to redeem it, the report said.

A spokesman for the MBTA fund confirmed that it was working with the trustee to recover its funds. He said that the fund had first invested $10 million with Fletcher in 2004 which resulted in a "successful return."

In his report, the trustee laid out a plan to work with other court-appointed liquidators as well as the MBTA retirement fund to file suit against the Fletcher firm and related individuals as well as Quantal and Fletcher's administrators and accounting firms. He said there was almost nothing else left of value in the hedge funds.

The three Louisiana funds—the Firefighters' Retirement System of Louisiana, the Municipal Employees' Retirement System, and the New Orleans Firefighters' Pension and Relief Fund—filed a separate lawsuit earlier this year against Fletcher Asset Management and others in state court in Louisiana, alleging violations of the state's securities law in offering the investment, negligent misrepresentation and unjust enrichment. Parties are arguing over where the case should be heard.

Phillip W. Preis, a lawyer representing the three funds, said the trustee's findings showed that problems at the Fletcher firm were worse than the pension funds thought when they filed the suit.

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