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Funds Slam WaMu Trading Investigation

By Peg Brickley

Washington Mutual equity investors have an "ample basis" to push ahead with allegations that major hedge funds engaged in improper trading during one of the largest bankruptcies in U.S. history, an attorney for WaMu shareholders said Wednesday.

Bloomberg News

Appaloosa Management, Centerbridge Partners, Owl Creek Asset Management and Aurelius Capital Management have denied what a lawyer for Aurelius called "deadly serious and dangerous allegations" of wrongdoing in WaMu's Chapter 11 case.

Shareholders have no proof of wrongdoing, the hedge funds told a bankruptcy judge Wednesday, in spite of conducting a detailed probe into suspicions that the four turned confidential information picked up at the Chapter 11 plan bargaining table into profits.

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Kenneth Eckstein, an Aurelius attorney with Kramer Levin Naftalis & Frankel, said the hedge fund and its lawyer chief Mark Brodsky have been essentially "accused of crime" in Washington Mutual's bankruptcy case.

"A public accusation of insider trading is the equivalent of a moral crime," Eckstein said at a hearing in the U.S. Bankruptcy Court in Wilmington, Del. Aurelius is determined to clear its name and says all the evidence turned up in the investigation proves only its "meticulous" adherence to the law.

The test will come in July, when Washington Mutual renews its push to emerge from bankruptcy with a Chapter 11 plan that means a $7 billion payday for the hedge funds and other creditors, but nothing for shareholders.

Shareholders have been raking through documents and questioning witnesses about the insider trading suspicions in preparation for a confirmation fight. Wednesday, their attorney denied shareholders were simply angling for delay in hopes of wrangling a settlement.

"Obviously we're proceeding in good faith, we have an ample basis for what we're doing," shareholder attorney Edgar Sargent, of Susman Godfrey LLP, said at Wednesday's hearing before Judge Mary Walrath.

In court papers, the hedge funds said they adhered strictly to agreements that required them to keep confidential Chapter 11 information out of their trading decisions at critical points in the case. Sargent said the funds did maintain ethical walls during two crucial 60-day periods, but that didn't end the inquiry.

Shareholders may argue that the big hedge funds played such a crucial role in negotiating WaMu's Chapter 11 plan that they took on the duties of company "insiders," including a fiduciary duty not to profit from inside information, Sargent said.

Hedge-fund attorneys said they had complied with court orders requiring them to hand over information to the shareholders.

Sargent said shareholders are struggling against "literally a Siberia of redaction" shielding all but the most innocuous information in what the hedge funds turned over.

Walrath rejected WaMu's bankruptcy plan earlier this year and said accusations of insider trading aimed at investors that own $2.5 billion worth of securities in the case deserved a closer look.

That touched off an investigation that has rankled some of the biggest investors in bankruptcy, firms that regularly buy and sell debt of distressed firms. Washington Mutual's bankruptcy means whopping profits for many, as debt that sold for pennies is being promised payment in full, with years of interest at the contract rate.

(Dow Jones Daily Bankruptcy Review covers news about distressed companies and those under bankruptcy protection.)