Dueling lawsuits put top hedge fund in spotlight

Rob Varnon, Staff Writer

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Will it be another big win for the top-rated hedge fund of 2010? Or will the fund's former trading star take sweet -- and expensive -- revenge?

Don Brownstein's Structured Portfolio Management has sued former managing director and top trader Jeffrey Kong for $10 million, alleging Kong violated a no-compete clause when he took a job with a rival firm. But Kong's counterclaim could cost SPM more than $74 million and raises questions about who is most responsible for the $2 billion Stamford fund's success.

In December, SPM sued after Kong took a job with Passport Capital LLC., a San Francisco-based firm with $4.1 billion under management. Kong had an employment contract with SPM that included a no-compete clause. SPM says it wants Kong to return a $5 million bonus from last year and a $5.8 million disbursement from the fund's first-quarter profits of last year.

But one of Kong's attorneys, Jonathan Sack of New York-based Sack & Sack, said Kong was not properly compensated for all he did and is owed $74 million for his performance.

Sack also said the employment contract is too broad because it prevents Kong from "working globally." He said Kong would have to leave the planet to earn a living if that contract is upheld.

SPM's attorneys wrote in their complaint that the court needs to hold Kong to the agreement, not only because it could harm SPM's business, but also because there are many other firms with similar agreements and allowing Kong to break it could be precedent-setting.

But the dimensions of the case go beyond the legal arguments. The case could provide a glimpse into how one of the world's most successful funds operates and how Brownstein manages.

Bloomberg named SPM the top hedge fund for 2010, citing its returns of 50 percent. The fund has made millions in recent years on mortgage-backed securities. Interviews with Brownstein over the last few years indicate the firm made money by betting people would not be able to refinance mortgages during the downturn in the housing market.

Brownstein, a former philosophy professor, is most often described as brilliant for his ability to spot trends in the market and create strategies to act on those trends. But now the darling of the industry is facing off against a former top trader.

"There's an old saying, `never fire your bookkeeper, he knows too much,'" said attorney Richard Slavin, head of Cohen and Wolf Plc.'s securities practice. "Well, the trader knows everything."

Slavin, who is not involved in this case, said he's handled suits like this and they sometimes can turn into embarrassing tell-alls in which the traders reveal what happens inside the offices of these firms beyond what strategies are used. And that's what the firms try to keep out of the record.

In this case, that's already happened, and lawyers from both sides squared off twice last week in Stamford Superior Court before Judge Douglas C. Mintz, arguing over a motion to seal Kong's counterclaim. Mintz initially ruled to seal the document but is requiring a public version with some redactions.

SPM's attorneys said in their motion to seal that the counterclaim revealed "highly confidential and proprietary information belonging to Plaintiffs into the public record, including ... confidential trading and investment strategies, methodologies, and information related to Plaintiffs' management, clients and business of Plaintiffs." The motion specifically said Kong revealed fee rates and specific profit contributions attributable to specific funds, how it manages private funds portfolios and risk, and the management styles of Brownstein and Kenneth Cron, SPM Group's president.

On Thursday, the sides squared off again briefly in open court with Kong's attorney Eric Grayson, of Greenwich-based Grayson & Associates, arguing the whole document didn't divulge any trade secrets and should be made public. The lawyers for Kong said no specific algorithms are mentioned and much of what's in there has been divulged by Brownstein in interviews.

SPM's attorney, Thomas Goldberg, of Stamford-based Day Pitney, objected, saying Kong's attorneys were revealing the sealed information in open court and pointed out a reporter was present. Mintz noted it was the reporter's right to be there and acknowledged a wave from the journalist.

Mintz ordered the two sides to try to hammer out an agreement over what paragraphs should be redacted.

This sent the lawyers and Kong -- Brownstein was not at the hearing -- into three conference rooms where a routine reminiscent of a Marx Brothers movie unfolded. Lawyers would come in and out of the rooms, doors opening and closing. One lawyer would go into a room then quickly turn around, go back to the room he came from and re-emerge with a binder and presumably some point to be made.

At one point Sack, Kong's attorney, told the pack of SPM lawyers outside the conference rooms, "Just because it's embarrassing doesn't make it a trade secret."

There was some argument back and forth before the sides moved into one of the conference rooms and closed the door. Finally after more than two hours of this, the lawyers met in judge's chambers, while Kong sat on a bench in the hall outside the courtroom.

Kong sat calmly and occasionally tapped at his smart phone. He talked about his family and how he got into the business, though not the case. At 51, he's the son of an independent Long Island businessman, who has lived in Connecticut for 25 years. He has a finance and management degree, but taught himself computer programming.

He confided he has enjoyed the second half of 2010 after he left SPM because he got to stay home and spend it with his family, but added that now he has to go back to work.

That Kong is not a household name doesn't mean he was not vital to the success of the fund. One trader said each fund is different. In some, the traders are rock stars, and in fact, many hedge funds are run by traders who still actively trade. There are some, such as SPM, where the founder and leader is more of a big-picture guy who sets the strategy that the traders act on. But as several people noted, Kong had to be pretty good to last 10 years at SPM, which has averaged nearly 28 percent returns since its founding.

Brownstein and his firm did not return requests for interviews. His attorney, Goldberg, declined to comment on the case.

When all the attorneys emerged from their meeting with Mintz, the counterclaim remained sealed, but SPM's attorneys were instructed to file a version with the redacted paragraphs by Tuesday.

Grayson, who vehemently argued for keeping the counterclaim open, said the reality behind this case is that Brownstein "screwed up. He fired his top trader and he knows it."

While there's already been some fireworks, Slavin at Cohen and Wolf said typically the real nitty-gritty info on cases like these comes out during the hearing to impose a temporary injunction.

That's scheduled for Feb. 28.

While that is a sort of day of reckoning for Brownstein and Kong, their conflict on Thursday was interrupted with a another day of reckoning for a couple who represent the fallout of the very crash in the housing market that Kong and Brownstein cashed in on.

Mintz delayed hearing SPM's case a few minutes on Thursday to sign a stipulation in another case that allowed Yvonne and Jianhua Tsoi to pay a few thousand dollars to Patriot National Bank so they could stay in their home a little longer, at least through February, before giving up the keys and walking away.

Reporter Rob Varnon can be reached at rvarnon@ctpost.com
Reporter Dan Tepfer contributed to this story.