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## CORRECTED: MergerTalk: Hedge funds muscle in on bankruptcies

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(Deletes reference to Coleman seeing evidence of insider trading after paragraph 15)

By Dane Hamilton

NEW YORK (Reuters) - The contentious Northwest Airlines Corp. NWACQ.PK bankruptcy case is a new battleground in a larger war between hedge funds and distressed companies that will only widen, experts say.

The No. 5 U.S. airline wants to cancel existing stock and issue new equity to creditors as part of plan to exit Chapter 11 bankruptcy this spring, less than two years after it filed.

But a group of 13 hedge funds, which collectively hold 19 million shares, or about 30 percent, are fighting the plan, contending Northwest's equity has value despite the company's assertions to the contrary.

The funds include such powerhouses as Citadel Investment Corp., Marathon Asset Management, Sandell Asset Management and Owl Creek Asset Management, the lead fund, according to court documents.

Bankruptcy courts have always been contentious arenas, where competing groups of creditors vie for a bigger slice of a reorganized company. But in recent years, hedge funds have entered the scene en masse and changed the landscape in most major bankruptcies.

"The dynamics of Chapter 11 cases have changed radically from just a few years ago," said Jonathan Henes, bankruptcy attorney with Kirkland & Ellis.

Advisers to bankrupt companies say the new investor class has made it much more difficult to build a consensus among competing groups of creditors to exit bankruptcy, further pushing up costs and extending the length of restructurings.

Since hedge funds can hold multiple, undisclosed and sometimes competing classes of securities in a bankrupt company, it opens the door for untenable demands in bankruptcy court, as well as insider trading and other misdeeds, these advisers argue.

### SLUGGISH PROCESS

"It is sometimes hard to know who are these creditors and what their interests are," said Harvey Miller, a prominent bankruptcy lawyer and Greenhill & Co. (GHL.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) vice chairman. "They are creditors with multiple personalities. They use rights in one position to benefit their holdings in another."

But hedge funds argue that they are only asserting legal ownership rights in a sluggish process that is often weighted in favor of the bankrupt company. They also say they provide much-needed liquidity for investors less willing to assert these rights.

"It was easier to reach an agreement ten to 15 years ago," said bankruptcy lawyer John Ashmead of Seward & Kissel, who has represented hedge funds

in cases including Federal-Mogul Corp. FDMLQ.OB, Mirant Corp. (MIR.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)), Refco Inc. RFXCQ.PK and others.

"A dramatic explosion of hedge funds ... has unquestionably added to a level of additional work and complications," said Ashmead, but "I don't necessarily think it is worse or has led to a bad result."

Others say hedge funds are increasingly demanding the formation of "official" creditor committees, as they have in the Northwest case, which forces the bankrupt company to pick up what can be millions of dollars in legal and administrative costs.

Yet, because hedge funds mostly aren't required to disclose their holdings, such demands can amount to a court maneuver to garner more proceeds for their asset class, said Tim Coleman, senior managing director for Blackstone Group, which advises on restructurings for major companies such as Delta Air Lines

DALRQ.PK.

"It is a big deal," Coleman told a restructuring conference at Cardozo School of Law this week. "We are very often inundated with people saying we are a big powerful group and we want our lawyers to be paid."

#### COMING TO A HEAD

The disclosure issue in Northwest's bankruptcy could come to a head this week, when presiding U.S. Bankruptcy Court Judge Allan Gropper says he'll decide whether the hedge fund group needs to disclose not only their holdings in the airline, but at what prices they bought the securities.

The funds argue that this information is a trade secret and irrelevant to the case. But some see a larger plan by debtors and those that advise them.

"They are trying to chill the activism of the hedge funds," said Seward & Kissel's Ashmead, who isn't representing the hedge funds in this case. The debtor move is "a tool to create a stumbling block to decrease the involvement of hedge funds in activism. I don't think it adds much."

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