

# Hedge fund manager can't be sued for failure to disclose dispute

By Eric T. Berkman

An investor who lost \$7 million investing in a hedge fund could not sue the fund's operator under the Uniform Securities Act for failing to disclose in the fund's prospectus that he had been previously involved in a residential landlord-tenant dispute, a Superior Court judge has ruled.

The defendant fund operator argued that the omitted information was so unimportant to a reasonable investor that his failure to disclose it could not be considered a material omission.

Judge Christine M. Roach agreed.

"Personal allegations in an unadjudicated civil court action, not involving the subject investment or linked to the business experience of the fund or its manager, have been viewed [by various federal appeals courts] as immaterial to a reasonable investor," wrote Roach, granting summary judgment to the defendant. "Having surveyed the spectrum of available authority on this question, I find no reasonable investor in [the plaintiff's] position would have viewed the brief housing dispute against [the defendant] as material to the decision whether to purchase interests in [the hedge fund]."

The 14-page decision is *Welch v. Barach*, et al., *Lawyers Weekly* No. 12-090-12. The full text of the ruling can be ordered at [www.masslawyersweekly.com](http://www.masslawyersweekly.com).

## One-man operation

Kevin J. O'Connor of Hinckley Allen & Snyder in Boston, who represented the defendant, said that the plaintiff was trying to establish that because the hedge fund was a one-man operation, the court should view materiality more broadly than it otherwise would.

"But the court basically adhered to an established line that the factors it should consider are those that relate to the business rather than looking more broadly at character concerns or things of that nature," he said.

O'Connor added that if the decision had gone the other way, it could have opened a "Pandora's box" for operations like hedge funds and hi-tech startups that rely heavily on one individual while also selling securities.

David B. Mack, a business litigator with O'Connor, Carnathan & Mack in Burlington, said the decision confirms that not every omission will result in liability under the Uniform Securities Act, "especially where the omission is remote in substance to the investment."

Mack, who was not involved in the case, said the decision is useful because case law on this point is scant in Massachusetts.

"While not binding, it should help practitioners advise their clients in this arena," he said. "The integrity of a fund manager is important in every case, but it appears in my view that the nature and timing of the prior litigation involving this defendant was properly deemed immaterial as a matter of law."

Plaintiff's counsel Jeffrey S. Robbins of Mintz, Levin, Cohn, Ferris, Glovsky & Popeo in Boston, said it was "undisputed" that the defendant had lied to his client and numerous other investors by representing that he'd never been sued when he knew that he had.

"We regard the court's ruling that no reasonable investor would have regarded [the



Kevin J. O'Connor  
Hinckley Allen

defendant's] lie as capable of significantly affecting the mix of factors pertinent to a decision to invest with [the defendant] as perplexing," said Robbins, whose client has filed a notice of appeal. "We regard the court's decision as flying in the face of the Supreme Judicial Court's precedent in [its 2004 *Marram v. Kobrick Offshore Fund, Ltd.* decision], as well as the well-established purpose and scope of the state securities statute."

Robbins said that if this decision stands, it will "almost inevitably encourage certain individuals to conclude that they can employ false or misleading statements in seeking to induce the purchase of securities and avoid the consequences of doing so."

## Failed investment

In June 2003, plaintiff Jack F. Welch Jr., former CEO of General Electric, decided to make an initial \$2 million investment in MLT Capital, a hedge fund operated by defendant Daniel J. Barach, a former classmate of Welch's at Harvard Business School.

As the fund's principal and sole employee, Barach was entirely responsible for its management, investment decisions and solicitation of investors. Welch apparently became interested in the fund during a social evening with Barach, where he was impressed with Barach's presentation and attracted by the fund's relatively low fees.

Before making an investment, Welch reviewed the fund's private placement memorandum (essentially a prospectus for shares in

a private company), which was dated Nov. 24, 1997 and which stated that there were no prior or current administrative, civil or criminal actions against Barach.

Based on the fund's strong performance following his initial investment, Welch ultimately purchased additional interests twice the following year, bringing his total investment to \$7 million.

But by 2007, the fund was no longer performing as well. At the end of 2008, after suffering severe losses, Barach advised Welch and other limited partners that the fund was shutting down.

Six months later, Welch sued Barach and MLT Capital in Superior Court, alleging misrepresentation under the state Uniform Securities Law and the Consumer Protection Act.

Specifically, Welch claimed that Barach made a material omission by failing to update the PPM in 1999 after his residential landlord sued him.

The 1999 dispute arose from the landlord's refusal to extend Barach's lease for a few weeks until he and his wife could close on a new home. The landlord's allegations apparently portrayed Barach as difficult and vindictive, but there was never a contested hearing in the case. Barach denied the landlord's allegations and the case settled out of court on terms favorable to Barach and his wife within weeks.

Welch claimed that if he had known of the 1999 dispute at the time of his investments in

Barach's fund, he would not have made the investments.

#### Immaterial omission

Roach rejected Welch's argument that Barach's failure to disclose the 1999 landlord-tenant dispute in an updated PPM amounted to a material omission.

As the judge pointed out, both the 2nd and 11th U.S. Circuit Court of Appeals have previously found that personal allegations in a civil action that was never adjudicated in

wife was long concluded by the time Welch considered investing in MLT Capital," said Roach. "The parties to the undisclosed litigation had only a personal, landlord-tenant relationship. The case did not involve [either the fund or Barach in his capacity as its general partner]. And the action was settled quickly by the parties themselves."

The judge did agree with Welch that because MLT Capital was a one-man investment operation, Barach's personal character was of "paramount importance."

Nonetheless, she continued, the cases Welch relied on to support such an argument involved nondisclosure of litigation that had a direct bearing on either the value of the investment or the value of the business.

"As already noted, Barach's litigation did not arise in connection with his responsibility for the fund's operations and activities, and in no way affected the value of investments in MLT Capital," said Roach.

"And, nothing in the record suggests that the decline of MLT Capital was in any way related to Barach's integrity or character."

Accordingly, the judge concluded, Barach's motion for summary judgment should be granted.

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**CASE:** *Welch v. Barach, et al.*, Lawyers Weekly No. 12-090-12

**COURT:** Superior Court

**ISSUE:** Could an investor who lost \$7 million investing in a hedge fund sue the fund's operator under the Uniform Securities Act for failing to disclose in the fund's prospectus that he had been previously involved in a residential landlord-tenant dispute?

**DECISION:** No, because the omission was immaterial to a reasonable investor's decision to invest in the fund.

court and that involved neither the subject investment nor the business experience of the manager are deemed immaterial to a reasonable investor.

Applying that reasoning to the situation in this case, the judge said it was clear that the landlord's 1999 civil action was immaterial to Welch's investment decisions.

"The 1999 action against Barach and his



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