PHIL DUFF'S HOLLOW HEDGE FUND

The Morgan Stanley veteran spent $100 million on highly paid staff and plush offices before the financial crisis forced him to shut down—without making any investments.

By ANTHONY EFFINGER **Photographs by DANIEL ACKER/Bloomberg News**

No meeting today: This conference room was part of the millions that Duff spent to dress up the interior of his offices.

Phil Duff had a three-decade hot streak.

He earned degrees from Harvard University and MIT and then skipped through the ranks at investment bank Morgan Stanley, becoming chief financial officer in 1994, when he was 36. Hedge fund phenom Julian Robertson hired him four years later as chief operating officer at Tiger Management LLC.

Duff struck out on his own in 2000, founding hedge fund firm FrontPoint Partners LLC—which Duff, a lifelong outdoorsman, named for a mountain-climbing technique used to scale steep ice faces with crampons. Five years later, he sold the company to Morgan Stanley for $400 million.

He could have stopped there. He didn't, and his legacy today is 43,400 square feet (4,030 square meters) of silent, unoccupied office space in Greenwich, Connecticut, with a custom food court, two jumbo flat-screen televisions and about $6 million of other amenities. The offices were to be the home of Duff Capital Advisors LP, a firm that the superconfident

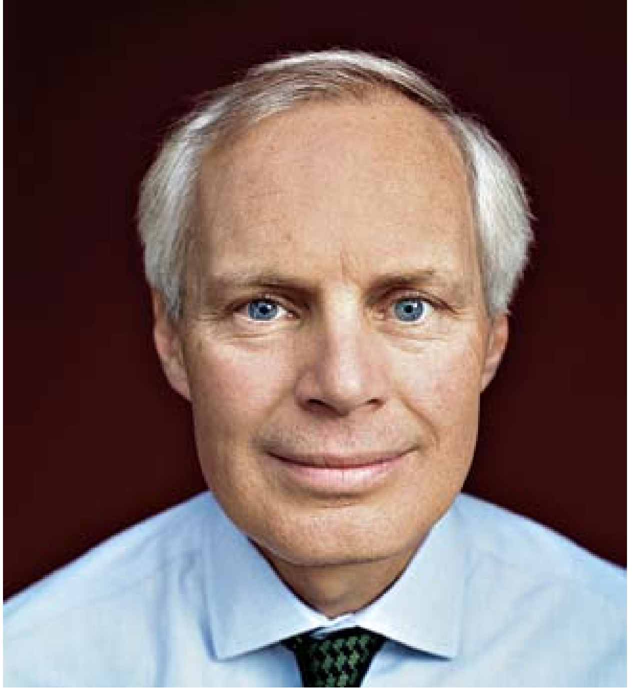
Duff, 52, once predicted would be bigger than Tiger, which at its peak managed $22 billion.

Then the global financial system seized up, and no pension fund had a spare $1 billion to invest with Duff's moneymen. Duff never moved into his new digs. As of late September, his $39,000 desk—a single slab of caramel-colored walnut with bronze legs—still sat in a corner office with views across Long Island Sound. The landlord got the desk, $1.5 million of other furniture and an $11 million penalty when Duff Capital negotiated an end to its 15-year lease, according to a person familiar with the matter.

Duff, who lives in Greenwich and vacations in Sun Valley, Idaho, didn't return phone calls or e-mails.

The past two years have been lethal for hedge funds. A record 1,471 failed in 2008, and another 668 died in the first half of 2009, according to Hedge Fund Research Inc. in Chicago. At first glance, Duff Capital shouldn't have been among them. Phil Duff had survived other crises, and he had more backing than most: $100 million in cash to rent offices and hire managers, courtesy of Lindsay Goldberg LLC, a $10 billion buyout firm in New York. Most of the $100 million is gone, according to a person familiar with the matter.

"It should have been a perfect opportunity," says Josh Green, an independent money manager who joined Duff Capital in October 2008, six weeks before Duff dismissed all of his fund managers.



Duff's reputation at Morgan Stanley and FrontPoint helped him hire top talent for his new firm.

DUFF'S DRAMA PLAYED OUT in Greenwich, a town of 62,000 on a tiny panhandle of Connecticut that reaches southwest toward New York City. With its rambling manors and horse farms, Greenwich has become to hedge funds what Detroit was to cars. In 2008, 80 percent of the commercial property in Greenwich was occupied by hedge fund firms, according to real estate broker CB Richard Ellis Group Inc. Thanks to collapses like Duff's, 460,000 square feet of downtown office space, out of the 2.1 million square feet available, is empty.

Duff Capital failed, former employees say, because its founder kept spending money as if the credit crunch weren't happening. Duff agreed to pay $5.5 million a year in rent, according to a person familiar with the matter, and outfitted his top-floor offices with a food court, showers, a boardroom table for 20 and a skylight with panes that filtered bright light to keep traders from squinting at their computer screens.

Duff Capital's demise sent 104 employees into a job market swollen with thousands of refugees from firms such as Merrill Lynch & Co. and bankrupt Lehman Brothers Holdings Inc. Some of Duff's hires, many of whom had left stable jobs months before the crisis, were still unemployed in mid-October.

The Duff debacle may have also hurt tens of thousands of retired workers. Among Lindsay Goldberg's clients are pension funds run by the governments of Florida, Indiana, New Jersey, Pennsylvania, Canada and Denmark.

Whether any retirement funds lost money, or how much, is unknown. Lindsay Goldberg founders Robert Lindsay and Alan Goldberg, who know Duff from the days when they all worked at Morgan Stanley, didn't return calls or e-mails. Spokesmen for the pension funds also declined to comment on the Duff investment.

Duff started his firm with the aim of

DEFUNCT DIGS

Duff spent millions furnishing his Greenwich office—and millions more when he ended the lease.

Desk for Duff	$39,000
Skylight	500,000
Emergency generator	750,000
Information technology	1,000,000
Other furniture	1,500,000
Improvements (kitchen, showers)	6,000,000
Penalty for ending lease	11,000,000

Source: People familiar with Duff Capital's expenditures

EVAN KAFKA

helping cash-strapped pension funds. "Organizations with long-term liabilities are finding it increasingly difficult to close their asset/liability gaps," Duff wrote in a statement announcing the launch of his firm in March 2008. "Next-generation solutions are needed."

As of May, U.S. public pensions had liabilities of $3.6 trillion and assets of just $2.8 trillion, according to the Center for Retirement Research at Boston College. Pension fund managers invest a portion of their assets in hedge funds to try to close the gap.

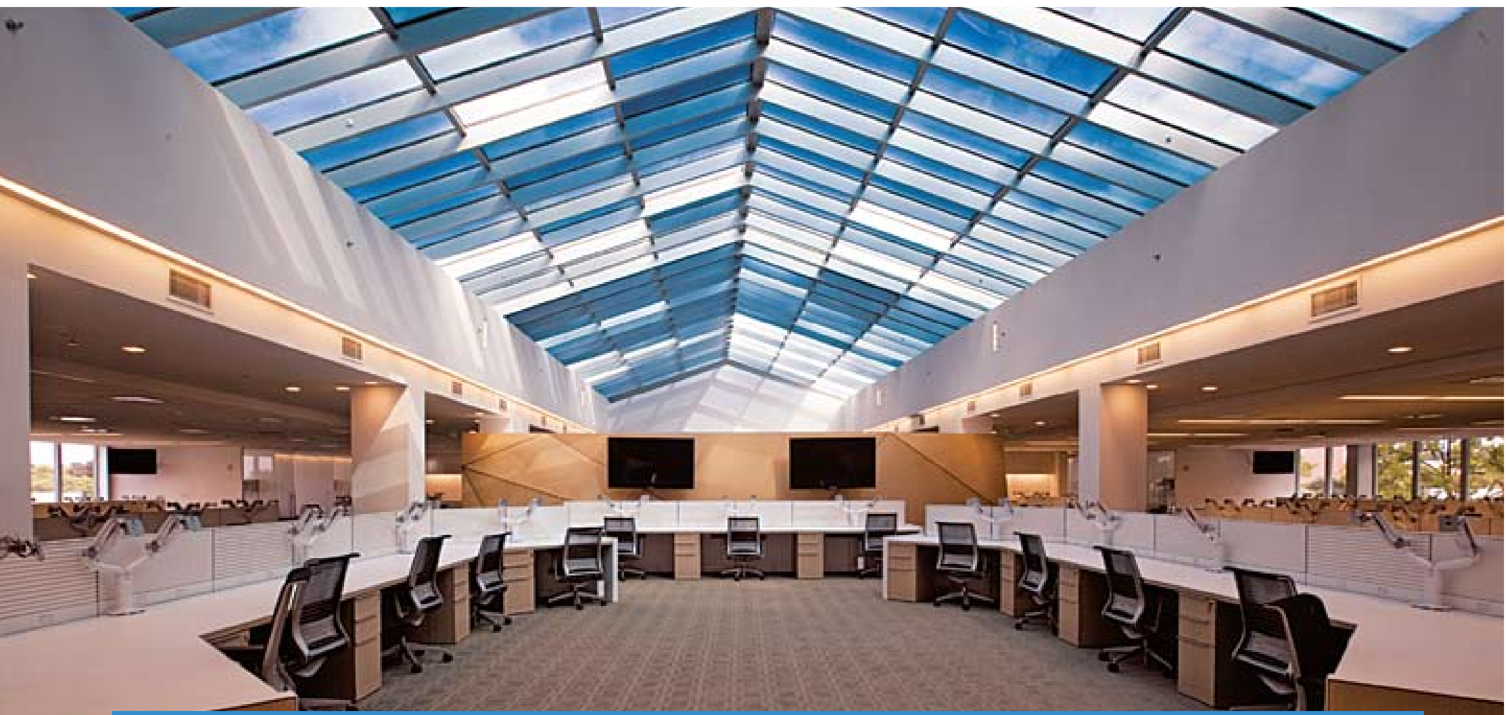
LINDSAY GOLDBERG'S INVESTMENT was working capital for Duff Capital itself; it wasn't intended as seed money for any funds Duff created. The $100 million was the buyout firm's only direct investment in a finance company, according to the portfolio on its Web site. Lindsay Goldberg usually invests in closely held companies such as Keystone Foods Holdings LLC, the largest supplier of chicken and beef to McDonald's Corp. in the U.S., and Crane & Co., a maker of stationery and greeting cards.

Former employees say Duff had a great idea: a hedge fund that was a one-stop shop for pension managers looking to boost returns. Duff would offer a carefully vetted, diverse group of investment strategies under one roof, rather than bet on one type of investment, as many hedge funds do. Pension managers could choose. The funds would be uncorrelated—meaning when one lost value, another might gain—and Duff Capital would do all of the risk management in-house, making the operation palatable to the most staid pension manager.

Had Duff been able to weather the panic that hit markets in September 2008 and attract investors, his money managers could have bought securities at clearance prices. As of Oct. 12, the Standard & Poor's 500 Index was up 19.2 percent from January—the month when, according to former employees, Lindsay Goldberg forced Duff out of his own firm.

Former employees would speak only on the condition that they not be named. One reason is that Lindsay Goldberg made departing staff sign confidentiality agreements in exchange for severance, they say. "I'm going to talk about nothing," says Robin Roger, former general counsel at Duff, citing the agreement she

Duff paid $500,000 for a **light-filtering skylight**.



EMPTY PROMISES

Phil Duff opened his firm during the global financial meltdown, which eventually forced him to shut down.

March 5, 2008:	**March 16:**	**Aug. 7:**	**Sept. 12:**	**Sept. 15:**	**Oct. 20:**	**Nov. 5:**	**Jan. 16, 2009:**	**May 27:**
Duff launches Duff Capital Advisors with $100 million from private equity firm Lindsay Goldberg.	JPMorgan Chase announces deal to take over struggling Bear Stearns.	Duff hires Pequot Capital Management and Tribeca Global Management investment teams.	Lindsay Goldberg complains to Duff that he's spending too much.	Lehman Brothers fails in the biggest bankruptcy in U.S. history.	Duff Capital cuts 60 of its 104 employees.	Duff hands control to Lindsay Goldberg.	Lindsay Goldberg forces out Duff, changes name to Investment Risk Management Holdings.	Lindsay Goldberg closes firm, keeps four people to sell assets, settle claims.

Source: Bloomberg

signed with Lindsay Goldberg. "It's behind me." Roger now works at New York–based hedge fund firm Harbinger Capital Partners LLC.

Duff offered to sell Class A shares—the same class of shares owned by Lindsay Goldberg—to everyone in the firm. He projected that in five years he could raise $35 billion for his handpicked managers to invest, according to a document describing how another class of stock granted to employees as an incentive would grow in value as Duff Capital added assets. The $35 billion is about seven times what FrontPoint had raised in the same period.

THE GOAL WAS pure Duff, people who know him say. Like many successful hedge fund operators, Duff is doggedly competitive, they say. A longtime skier, Duff still occasionally hits the slopes in a New England master's league.

Duff has always been ready with ideas for running a financial firm, says Paul Ghaffari, who, like Duff, was one of the three co-founders of FrontPoint. "He thinks out on the horizon constantly," says Ghaffari, founder of Capitoline LLC, a money management company in New York.

Founding and then selling a money management firm was a good way to make a fortune before the Great Recession of 2008. Duff's 2006 sale of FrontPoint was an example. An earlier case was Highbridge Capital Management LLC, whose founders in 2004 sold 55 percent of their then-12-year-old New York–based company to JPMorgan Chase & Co. for $1.3 billion. Vikram Pandit sold his hedge fund, Old Lane Partners LP, to Citigroup Inc. for $800 million in 2007. He eventually became chief executive officer of the acquirer.

Founding and then selling a money management firm was a **common path to riches before the Great Recession**. Duff sold FrontPoint to Morgan Stanley for $400 million. Vikram Pandit sold hedge fund firm Old Lane to Citigroup for $800 million.

Lindsay Goldberg committed to investing as much as $500 million in Duff Capital, according to a March 2008 Duff press release. The $100 million it put in to start bought the firm 100,000 Class A shares, according to a March 2008 document describing the shares. That gave them an 80 percent stake in the firm, before employees also invested.

Duff had his own skin in the game. He paid $10 million for 10,000 A shares. Duff Capital fronted him another 10,000 shares in exchange for a note from him promising to pay $10 million for them at a later date.

The A shares divided the management team at Duff, according to people who worked there. Twenty-one managers were required to pay cash for them. Six were given A shares in return for promissory notes, the people say, even though another March 2008 document describing the shares said, "A Units are owned by investors who contributed capital."

The biggest individual cash investor after Duff was FrontPoint veteran John Zimmermann, head of the new firm's client acquisition group. Zimmermann, 51, put up $4.2 million, according to a complaint he filed, together with head trader Michael McCarty, in New York State Supreme Court—a trial-level court—on July 29. McCarty, 40, invested $2.1 million.

The recipient of the biggest loan was Eileen Murray, the firm's president and a colleague of Duff's at Morgan Stanley. She was fronted shares worth $5 million, according to people who worked at the firm. Murray, now at hedge fund firm Bridgewater Associates Inc., didn't reply to calls and a faxed message seeking comment.

Phil Duff was born in Red Wing, Minnesota, a town of 16,000 people about 60 miles (97 kilometers) southeast of Minneapolis on the Mississippi River. His father owned the local newspaper, the *Red Wing Republican Eagle*. He graduated from Harvard in 1979 and worked as a grain trader at commodity merchant Louis Dreyfus Corp. In 1982, he enrolled at Massachusetts Institute of Technology's Sloan School of Management, where he wrote a master's thesis on how anti-takeover tactics affect shareholder wealth. One of his conclusions: A target company shouldn't go to court because that stops the bid dead, hurting its stock.

Duff worked at Morgan Stanley during the summer he attended Sloan and took a full-time job in the firm's mergers and acquisitions division after graduation. He eventually became head of the group advising banks and brokerages. In 1994, he was named CFO under President John Mack.

While at Morgan Stanley, he got to know fellow Harvard grad Lindsay and Goldberg, a Yeshiva University–trained lawyer. Both helped start Morgan Stanley's private equity division. Dean Witter, Discover & Co. bought Morgan Stanley for $11 billion in June 1997. In the ensuing management shuffle, Duff was named CEO of the conglomerate's fund company, then called Van Kampen American Capital Inc., based in Oakbrook Terrace, Illinois.

Duff had once been on track to succeed Mack, and he protested that he'd been shunted aside, according to a person who was at Morgan Stanley at the time.

In 1998, Duff left to become COO of Tiger Management, which ran one of the best-performing hedge funds of all time, with an average annual return of 25 percent in the two decades ended in 2000. Duff's timing couldn't have been worse. During his second week on the job, Tiger lost $2 billion in one day on a wrong-way bet that the yen would fall against the dollar. In 2000, Robertson stopped managing any money except his own. "This is a performance business, and we don't deserve to have anyone's money if we don't perform," Duff said in an interview with Bloomberg News just before Tiger closed its doors.

Duff rebounded. He and Tiger's head trader, Gil Caffray, partnered with Ghaffari, a money manager for billionaire George Soros, to start FrontPoint in November 2000. FrontPoint developed an investment system that would become a model for Duff Capital. The firm recruited a group of fund managers with different areas of experience and then raised money and parsed it out to them. Investors could choose from a list of investment strategies, while FrontPoint's auditing, compliance and risk management personnel kept watch, aiming to attract conservative pension fund investors.

The plan worked. FrontPoint had pulled in $4.3 billion by the end of 2004 and $5.5 billion by the end of 2006. The cash pile got the attention of Mack, who had just returned to Morgan Stanley as CEO in 2005 after being co-CEO of Credit Suisse Group and chairman of hedge fund firm Pequot Capital Management Inc. In October 2006, Morgan Stanley announced a deal to buy FrontPoint. The price, not disclosed at the time, was $400 million.

Morgan Stanley named Caffray vice chairman of its investment management division and head of the FrontPoint funds. Duff was passed over in part because he had angered his portfolio managers by scuttling an earlier offer by Morgan Stanley at a higher price, according to a person familiar with the matter. He worked as a consultant to Mack. Then, in March 2008, he launched Duff Capital, with offices on Park Avenue in New York and in Greenwich.

Posh address: Duff agreed to pay $5.5 million a year for his Greenwich office, with an option to buy.

The woods north of downtown Greenwich, where property records show Duff lives, are littered with estates owned by hedge fund managers. Steven Cohen, founder of SAC Capital Advisors LLC, bought a place there for $14.8 million in 1998 and expanded it to include an ice rink that he maintains with his own Zamboni. Some Greenwich offices are as plush as the residences. Amaranth Advisors LLC, a hedge fund firm that lost $6.6 billion trading natural gas in 2006, had a soundproofed music room with a drum kit and a mixing board. There were also a gym and a billiards room with a machine that sucked away cigar smoke, according to a person who visited the office.

U.S. stocks had been falling for four months when Duff Capital debuted. Eleven days after Duff announced the formation of his company, the Federal Reserve agreed to guarantee $30 billion of securities owned by Bear Stearns Cos. as part of a deal in which JPMorgan Chase took over the investment bank for just $240 million. The crisis had come.

Eight days after that, Antares Investment Partners, a Greenwich-based landlord, announced it had leased every square inch of its newly renovated building at 100 W. Putnam Ave. Duff Capital helped Antares do it. The firm signed a 15-year lease with annual rent of $5.5 million for the first five years, with an option to buy, according to a person familiar with the contract.

Even after the Bear Stearns scare, Duff was hiring like it was 2007. He announced new fund managers and executives by the batch in press releases. They came from American International Group Inc., Tribeca Global Management LLC, UBS AG, JPMorgan, Lehman Brothers and Pequot. People joined the startup because it was headed by Phil Duff, the man behind FrontPoint.

THE ONE THING Duff didn't do was find a big investor. In his initial press release, he said that he was in discussions with "several" institutions to raise as much as $1.5 billion. Months passed, and he never inked a deal. Payroll and improvements to the Greenwich office were costing money in the meantime. By July, Duff Capital was burning through $5 million of Lindsay Goldberg's cash per month, according to a person familiar with the matter.

That month, Duff merged with North Sound Capital LLC, a Greenwich-based hedge fund with $900 million of assets. The deal was contingent on Duff raising $500 million more for North Sound's managers, which Duff never did, and North Sound left Duff in December, according to people familiar with the matter.

Lindsay and Goldberg tolerated the costs until mid-September, when they paid a visit to the firm's offices on Park Avenue and demanded to know why Duff was spending so much money—and not earning any, according to people familiar with the meeting. On Sept. 15, Lehman went bankrupt.

Goldberg, who took the lead on the Duff investment, pushed Duff to fire people. In October, two months after announcing a batch of hires, Duff dismissed 60 of his 104 employees, according to people who worked at the firm.

The next month, Goldberg pushed Duff to give him control of the firm, which had been a limited partnership controlled by Duff. The incorporation was changed to a limited liability company overseen by an eight-member board. Four of the directors were employed by Lindsay Goldberg.

To save money, Goldberg asked employees to take new A shares in lieu of cash bonuses, according to people familiar with the situation. That diluted the value of shares owned by cash investors like McCarty and Zimmermann, the people say.

The ax fell on Duff in mid-January, people familiar with the matter say, when Lindsay Goldberg pushed him out. Duff Capital was rechristened Investment Risk Management Holdings LLC, which would develop risk analysis tools, Lindsay Goldberg said on its Web site.

Goldberg kept the company going through May 21, the day the private equity firm finished raising money for its newest fund: Lindsay Goldberg III LP. If investors knew about the Duff Capital collapse, it didn't stop Lindsay Goldberg from raising $4.7 billion.

At the end of May, Lindsay Goldberg fired all but a skeleton crew of four people whose job was to settle claims and sell assets. Among those cut were McCarty and Zimmermann. As usual, Goldberg asked the pair to waive legal rights accompanying their shares. McCarty and Zimmermann balked, according to the complaint the pair filed in August. They claimed that their equity investment had nothing to do with their 2009 employment contracts, under which Zimmermann was owed $791,666.67 and McCarty was owed $645,833.33. "Duff Capital's conduct in holding hostage plaintiffs' guaranteed compensation, or wage, is in bad faith, arbitrary, unreasonable, malicious and willful," they charged in the suit.

Lindsay Goldberg settled with McCarty and Zimmermann in September. None of the people involved would discuss the terms.

Duff's Greenwich office will have a new tenant soon. Hedge fund firm Shumway Capital Partners LLC leased the space in October, according to a person familiar with the matter. Like Duff, founder Chris Shumway worked at Tiger with Julian Robertson. What Shumway is paying is not known, though Antares had been asking $115 a square foot, an 18 percent discount to Duff's rent. The price includes the $39,000 desk. **B**

Brackets await computers that never arrived in the Duff Capital **trading room**.

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Duff Complaint

You can use the Bloomberg Law Search (BBLS) function to find the complaint filed in July by former Duff Capital executives Jack Zimmermann and Mike McCarty against the firm, now known as Investment Risk Management.

Type BBLS <Go> and click on United States and then on All United States so that the search criterion appears under Selected Sources at the bottom of the screen. Tab in to the field under Enter Search Terms and enter *DUFF CAPITAL*, as shown at right, and press <Go>. Type 1 <Go> to run your search.

To view the complaint, which was settled in September by Lindsay Goldberg for undisclosed terms, click on the item that begins *McCarty Michael v. Investment Risk Management LP, Docket No. 602336/2009*. Then click on Manually-Collected Complaint under Docket Text.

You can access hedge fund filings, rankings, performance and news by typing HFND <Go> for the Bloomberg Hedge Fund Home Page.

Type WWCC <Go> for a menu of functions and news related to the fallout in housing, government, the debt markets and the economy from the global financial crisis. Type WDCI <Go> to compare writedowns and credit losses with capital raised by banks and financial firms worldwide.

Type NSE PHIL DUFF <Go> for news stories that mention Phil Duff.

BETH WILLIAMS