Long-Term Capital Partnership May Get $50 Million Fee Despite a Near-Collapse

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WSJ By MITCHELL PACELLE 12/24/98
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Just three months after the near-collapse of **Long-Term Capital Management LP**, the partnership that runs the beleaguered hedge fund stands to collect year-end "performance fees" of as much as $50 million.

The payout will be drawn from the profits made in the fund by the 14 banks and brokerage firms that bailed it out. The exact size of the payout will depend on the fund's value at year end, according to people familiar with the fund. As of the end of November, the $3.625 billion invested by the bailout banks and brokerage firms in late September had increased in value by about $400 million, and the markets in which Long-Term Capital is active have been relatively stable this month.

John Meriwether

The question is whether Long-Term Capital partners like founder John Meriwether and Nobel laureates Myron Scholes and Robert Merton will be allowed to pocket windfall profits so soon after their fund nearly went bankrupt. Such payouts could trigger criticism by those who believe the Greenwich, Conn., fund shouldn't have been rescued in the first place.

The consortium of investment and commercial banks overseeing the fund – which includes **Merrill Lynch** & Co., **Goldman, Sachs** & Co., and the Salomon Smith Barney unit of **Citigroup** – might be reluctant to see huge year-end paychecks going into the pockets of the lead partners themselves. Any payouts to the partners would have to be approved by the consortium and a separate oversight committee composed of five bank representatives.

"All compensation, and especially partnership compensation, has to be approved by the full board of the consortium, upon recommendation of the oversight committee," a Long-Term Capital spokesman said yesterday. He declined to comment on the likely size of the year-end fees or their uses.

The bailout agreement stipulates that the partnership that runs Long-Term Capital is entitled to 15% of all profits on the new money, after the fund generates a return equal to the average London Interbank Offered Rate, or Libor, over the period in question, according to several people familiar with the formula. Although that's lower than the 25% cut of profits the Long-Term Capital partners used to collect, unless the fund falls in value by the end of this month, it will still amount to roughly $50 million under the formula.

So where the fees will go is unclear at this point. Hedge funds typically use such performance fees to pay year-end bonuses to partners and nonpartners alike, and sometimes even to cover the portion of overhead costs not covered by separate management fees.

Long-Term Capital, with about 140 employees spread around the world, is regarded as a costly operation. The separate 1% annual management fee it collects from the consortium, payable in quarterly installments in advance, did not cover its costs this fall, which included substantial restructuring costs, said one person close to the fund.

"I would guess that the partners would get very little extra compensation," says a competing hedge-fund manager who knows several of Long-Term Capital's partners. "The outcry would be enormous."

A spokesman for the bank consortium declined to comment on the size of the payout or what it will be used for.

The sense of crisis that engulfed the hedge fund lingered for more than a month after the 14 banks and brokerage firms

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MARKET CLOSINGS

The stock market closes early today, at 1 p.m. EST, and bonds close at 2 p.m., ahead of Christmas when all financial markets are closed.

After Hedge-Fund Bailout, Profits

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agreed to rescue it on Sept. 23. But in November, the bond markets turned favorable, and the fund began recording profits on the new capital.

Although longtime investors in the fund are still subject to 25% performance fees, they won't be paying such fees this year. That's because their stakes plunged in value by about 90% between the first of the year and the September bailout. And Long-Term Capital's original fee agreement, like those of most hedge funds, contains a "high-water mark." If the fund's managers lose money, they must first recoup those losses before they can begin collecting performance fees once again.

The fact that Mr. Meriwether and his partners, after such a catastrophic year, could collect performance fees on money invested in September illustrates why some other hedge fund managers who lost money during this fall's global turmoil are attempting to raise new money. If a hedge fund, for example, has a 50% loss, it must then gain 100% to get back to the high-water mark and begin collecting a cut of profits. But the high-water mark does not apply retroactively to new money that is raised.

Many hedge funds find that their annual management fees – 1% is typical for the industry – barely cover their costs of doing business. So it is the performance fees that provide fund operators with the bulk of their compensation.

Before its near collapse, Long-Term Capital had some of the highest fees in the industry: a 2% management fee and 25% performance fee. During the first three years of the fund's life, when it generated annual returns of as much as $500 million, partners collected sizable year-end fees.

Hicks Muse Unit Buys Firms

DALLAS – International Outdoor Advertising, a unit of Dallas investment firm **Hicks, Muse Tate & Furst** Inc., said it acquired three Latin American outdoor-advertising companies: **Heres SA**, Chile; **Heres Uruguay**, Uruguay, and **Publibus**, Uruguay.

Terms of the transactions weren't disclosed.

The closely held company said it hopes to become a major provider of outdoor advertising in Latin America.

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