**Financial Desk; 3**

**Wall Street; Close Ties at a Closed-End Fund**

By Diana B. Henriques

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English



One of the popular Wall Street parlor games these days is buying closed-end funds at a discount. The rules are simple. Check the price of a closed-end fund, a fund whose shares trade publicly like common stock. Check the per-share market value of the fund's portfolio. If the fund's price is a lot lower than its net asset value, consider it a bargain.

One of the popular Wall Street parlor games these days is buying closed-end funds at a discount. The rules are simple. Check the price of a closed-end fund, a fund whose shares trade publicly like common stock. Check the per-share market value of the fund's portfolio. If the fund's price is a lot lower than its net asset value, consider it a bargain. By that wisdom, Engex Inc. looks like a steal. The fund, managed by D. H. Blair Advisors, recently reported that its portfolio of growth stocks was worth $12.20 a share. Its shares are trading at $9.50 each. In fact, its shares have traded at a hefty discount through much of their market life.

Yet, there is something about Engex that just doesn't suggest the word "bargain," even to avid discount shoppers. A review of the fund's financial paperwork suggests several reasons why the rules of the closed-end fund game may not offer much guidance in this case. For one thing, a controlling stake in the fund is held by J. Morton Davis, the man who owns both the advisory firm and its parent, the underwriting firm of D. H. Blair & Company. For another, the chronic chumminess between the fund and the other financial operations Mr. Davis owns has prompted Federal regulators to intervene twice in less than three years.

In the closed-end world, Engex is notable at least for its longevity. Founded as a traditional mutual fund in 1968, it converted itself into a closed-end fund in September 1974. Its professed goal is "capital appreciation," rather than dividend income, and its initial prospectus gave it a broad mandate to pursue growth wherever it could be found.

As those familiar with the advertising slogans of D. H. Blair & Company might guess, Mr. Davis believes the best opportunities for growth are offered by freshly minted stocks from small "emerging" companies - the sort of unseasoned small-capitalization stocks, in fact, that the firm has so frequently brought to market. (Engex was originally named the Emerging Securities Fund.) And in the years between 1977 and 1983, small-cap stocks were booming. At the beginning of that period, Engex had a net asset value of $3.16 a share; by 1983, its net asset value had grown to almost $27 a share, while its shares traded in the low teens. The years between 1983 and September 1987 were less kind to Engex investors. Including cash dividends, they just about broke even. By September 1987, their shares had a net asset value of $17.45, they had collected dividends of $8.59 and Engex was trading at just under $14 a share.

Then came Oct. 19, 1987. The value of the stocks in the fund's portfolio fell 44 percent in the market crash and Engex's own shares crashed, too, falling into the single digits where they have generally remained.

What was abundantly clear to most people in the stock market was that small-cap stocks were not the best place to spend the late years of the decade. Engex was free to flee the small-cap world, of course, and it did take occasional forays into the blue-chip world.

Nevertheless, with the Dow Jones industrials and the broader Standard & Poor's 500 up handsomely since 1987, Engex's ever-changing portfolio - which recently included large positions in AT&E, Enzo Biochemical and Maxxam Inc. - has lagged behind.

Since the fund is managed by an advisory firm owned by its controlling shareholder, this track record is unlikely to result in any grass-roots movement to replace the investment adviser. Since taking on the job in 1986, D. H. Blair Advisors has been paid about $560,000 for calling the shots at Engex.

Virtually all the brokerage commissions paid by Engex - more than $90,000 last year alone - have found their way into D. H. Blair's coffers, too. The fund's directors report that those amounts are routine and compare fairly with what Engex would have paid elsewhere.

But this relationship between the fund and its affiliated brokerage house has not always been routine.

In November 1987, the firm and the fund were directed by the Securities and Exchange Commission to enact an unusual indemnification agreement in which the brokerage firm promised to make up any losses that Engex incurred on four specific D. H. Blair stocks - Eye Care Centers of America, Cistron Biotechnology, Crown Brands and University Science Partners. The fund had purchased those shares from D. H. Blair while the brokerage firm was in the process of underwriting them, a violation of Federal securities laws. The S.E.C. also told the brokerage house to return to the fund the $157,410 in commissions paid on those trades.

David Nachamie, secretary of the fund and a D. H. Blair executive, traced the problem to a mistake by the firm's lawyers and said steps were taken to prevent a recurrence.

But in its report for the fiscal year that ended last September, the fund said the S.E.C. had ordered D. H. Blair to rebate another $75,830 in commissions to Engex, toreimburse it for "losses incurred by the Fund on securities purchased by the Fund from Blair as principal." The problem this time, said Mr. Nachamie, was that the fund's orders were not clearly segregated from customer orders. "If we do a trade for Engex, we can't do a markup," he said, "but if we do it for a customer, we can."

The S.E.C. examiners were concerned that the fund may have been improperly charged a markup, Mr. Nachamie said. "It was cheaper to pay whatever they asked to make the fund whole than to hire lawyers and go through a whole big deal over it. These were both just innocent mistakes."

As for why the Engex shares trade so consistently at a discount, Mr. Nachamie is mystified. "I don't really know," he said. "It's possible that it's just because we're small and we don't promote the fund. As far as I know, it has never traded at a premium. But I don't think that is unusual."

**Financial Desk; D**
**BUSINESS PEOPLE; Ex-Drexel Executive Heads Blair Brokerage**
By DANIEL F. CUFF
418 words
29 January 1991
The New York Times
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5
English


Richard A. Maio has taken a job heading a much smaller operation than he used to. But then his old company, Drexel Burnham Lambert Inc., is no longer in business.

Mr. Maio, 50, has been named president and chief operating officer of D. H. Blair Brokerage, a new position at D. H. Blair & Company, a relatively small investment firm that specializes in bringing small companies public.

At Drexel, Mr. Maio was a senior vice president and national sales manager of the retail sales division. "Those were the most productive and happiest eight years of my life," Mr. Maio said yesterday, contemplating the heady 1980's. "It was a wonderful place."

Drexel, the former powerhouse that popularized "junk bonds" under Michael R. Milken, collapsed last year and sought protection from creditors in bankruptcy proceedings.

D. H. Blair is based at 44 Wall Street and specializes in what Mr. Maio called "public venture capital" -- selling stock in promising companies that might or might not succeed.

"Their desire now is to capitalize on that niche but yet bring the firm into the present market and update its product line to become a mainstream house," Mr. Maio said. That would mean more research and recommendations of listed stocks, more involvement in the fixed-income markets, certificates of deposit, bonds, mutual funds and so forth, he said.

Mr. Maio will report to the president and chief operating officer of D. H. Blair & Company, Kenton E. Wood, who will also hold the new title of chairman and chief executive of D. H. Blair Brokerage. J. Morton Davis is chairman and chief executive of D. H. Blair & Company.

Before he joined Drexel, Mr. Maio spent 19 years at E. F. Hutton, now part of the American Express Company. During that time, he rose from broker to branch manager to national product manager. He developed and marketed several Hutton products, including certificates of deposit, zero-coupon bonds and bankers' acceptances.

Mr. Maio attended Villanova University and is a graduate of the University of Miami. Earlier, he spent four years at La Salle Military Academy, where his roommate for a time was John H. Sununu, now the President's chief of staff.

As for his role at D. H. Blair, he said, "You never want to expand something at the expense of something else." The public-offering niche, he added, "gives us a nice foothold and a nice springboard."

**Highflying Broker: Blair New Issues Defy Gravity -- With Help From J. Morton Davis --- SEC Asks Whether His Firm Boosts Prices and Then Sells Out at Big Profit --- A Case of `Churn and Burn'?**

By Ann Hagedorn and Anne Newman
Staff Reporters of The Wall Street Journal
2365 words
6 May 1991
The Wall Street Journal
PAGE A1
English


How does J. Morton Davis do it?

Mr. Davis's firm, D.H. Blair & Co., underwrites initial public offerings of young companies with little track record -- more than 200 of them since 1980. Though risky, the offerings work for Blair. Again and again, its new issues have risen and even soared, staying up for months or years. Though many later falter, they bring rich profits to Blair and other investors who get in on the ground floor and get out in time.

Mr. Davis is the sole owner of Blair and often takes a stake in its offerings. The son of an immigrant food distributor, "Morty" Davis has amassed a fortune that was estimated some years ago at nearly $250 million. Former Secretary of State Alexander Haig, a Blair adviser and a director of one of Mr. Davis's companies, calls Mr. Davis "the most successful venture capitalist in America."

These should be the best of times for Mr. Davis. The initial-public-offering market is hot again. Investors are snapping up shares in young, development-stage companies and established concerns earlier taken private. Entrepreneurs line up for their chance to go public. Mr. Davis has written an Iacocca-style autobiography, "Secrets of a Wall Street Tycoon."

But now the book's publication, initially scheduled last month, has been put on hold. Blair is under investigation by the Securities and Exchange Commission and the National Association of Securities Dealers. The SEC has questioned at least six former Blair brokers and managers. They have told the agency there is more to Mr. Davis's underwriting and investing success than meets the eye. Neither the SEC nor the NASD will comment about investigations in progress.

Robert McCaw, an attorney who represents Blair and Mr. Davis, says, "The SEC is conducting an informal investigation and Blair is cooperating fully. Any SEC inquiry is to be regarded as serious but Blair is handling this as a matter of routine."

According to people familiar with the inquiry, the SEC has been told that Mr. Davis minimizes the usual high risks of underwriting new issues by propping up prices until he can get out at a profit. They say he distributes the Blair-underwritten shares to his clients' accounts, to groups of Blair brokers who will focus their selling efforts on a single issue and to certain other brokerage firms in which Mr. Davis at times holds significant financial interests and over which he exerts leverage.

These firms, say the former employees, are pressured to take the Blair-underwritten stock, to sell it aggressively to individual investors, and to strongly discourage these customers from selling the stock once they have bought it. Then, with stock prices high, Mr. Davis gets out.

While no rule bars underwriters from holding stakes in firms that distribute their offerings, these activities could be illegal if used to manipulate the stock price. This is what the SEC is investigating, say the people familiar with the investigation. The NASD is looking into Blair's buying and selling practices, they add.

Two years ago, the NASD fined the firm $25,000 for buying stock from customers at prices the NASD said "were not fair and reasonable," faulting it for excessive mark-downs and mark-ups. The complaint listed 130 or so securities transactions involving numerous Blair underwritings.

Mr. Davis declined to comment for this article; a spokesman denied any wrongdoing. Kenton Wood, the president of Blair, says that the SEC's interest was stimulated by jealous rivals and disgruntled former employees. The firm owes its success, Mr. Wood says, to its willingness to handle risky issues and to its good relations with a roster of wealthy investors. Mr. Wood acknowledges that Mr. Davis has stakes in other brokerage firms, but he describes him as a passive investor who exerts no influence over them.

The SEC is exploring these ties between Mr. Davis and several securities firms, including F.N. Wolf & Co., Parliament Hill Capital Corp. and the now-defunct firms of J.T. Moran & Co. and R.H. Damon & Co., as well as a mutual fund called Engex and at least one stock trader at the firm of Nash Weiss & Co.

Former Blair managers and employees who have given depositions to the SEC say Mr. Davis influences these brokers, in part because Blair is the main underwriter of small-company stocks and because he has sometimes helped to back the firm or has a stake in it. They say Mr. Davis made the Wolf firm buy his stake in Lidak Pharmaceuticals after Blair took the company public in May 1990 at $5, even though Frank Wolf, the firm's head, initially resisted. By early August, the securities had soared to $11.875. Mr. Wolf didn't return phone calls about Lidak.

Mr. Davis often sells at a profit before new issues decline. SEC filings show that Blair received warrants to buy 180,000 shares of Xicor, a semiconductor firm, at $7.80 a share when it took the company public in 1980. Blair later exercised its warrants and in March 1983 sold its Xicor stock at $14.25, for a profit of $1.2 million. Today, Xicor trades at about $2.50 a share. Mr. Davis has no shares. Similarly, in TIE Communications, Mr. Davis turned a $101,000 stake into $35.3 million, according to a Blair sales brochure. Blair took the company public in 1979, when Mr. Davis had an 8.2% stake in TIE, and his firm received warrants to buy 50,000 shares, SEC filings show. By 1986, Mr. Davis and Blair had disposed of their stakes. Now, TIE is in bankruptcy proceedings.

Exercising warrants at large profits is common among firms specializing in initial public offerings. But former Blair employees who have talked to the SEC say it is no accident that Blair stocks tend to stay strong for a while, because Mr. Davis discourages brokers from fulfilling sell orders. To get clients out of a stock is "a no-no," one former Blair broker says. If a client threatened to sue, the broker says, he had to "backdoor it" -- discreetly transfer the account to another firm where the client could sell. Other former employees also tell of such pressure, and some clients back the allegation.

One disenchanted Blair client, a retired shipping executive from New York, says that last fall he asked his broker to sell his holdings in a new Blair offering, News Communications Inc. But the Blair broker told him he was under pressure not to sell. A veteran investor in over-the-counter stocks, the retired executive says he profited only in the first of his five years as a Blair client; last year, he says he sustained a loss of about $14,000. He eventually shifted the News Communications position to A.G. Edwards & Sons, and is now transferring his entire account to another firm.

In a 1987 lawsuit against Blair, Mr. Davis, and others, client Sidney Metzner and other plaintiffs claimed that their brokers at Blair repeatedly refused to liquidate their accounts, which were decreasing in value. The suit, filed in Manhattan federal court, claimed that after one broker defied the plaintiffs' sell orders and left the firm, the accounts were passed on to a new broker, Peter Rosen.

Mr. Rosen then opened margin accounts without authorization, according to the complaint, and began buying and selling Blair's new issues on margin. When Mr. Metzner ordered Mr. Rosen to liquidate the accounts no later than July 15, 1986, the broker pleaded with him not to, and then ignored his order. In August, Mr. Metzner sent a certified letter ordering Mr. Rosen to "cease trading, liquidate positions and forward checks." Yet the broker continued making purchases in the account, the complaint said. In November Mr. Metzner hired an attorney who contacted Blair. The firm then liquidated the accounts.

Mr. Rosen's securities brokerage registration was revoked in 1990, according to NASD records. He no longer works at Blair, and couldn't be reached at his last known address in Manhattan.

The plaintiffs claimed losses of over $160,000 in trades involving numerous Blair underwritings. A review of the account statements, the suit alleged, revealed that the defendants used "numerous accounts of numerous customers as a vehicle for generating a false appearance of activity in the respective securities underwritten by them."

The case was eventually settled for $125,000 of which Mr. Rosen paid $30,000 according to NASD records. In denying a pretrial motion by Blair in 1988, Manhattan Federal Judge Kenneth Conboy wrote that "the inference of market manipulation reasonably may be drawn from the facts plaintiffs present."

Mr. Wood, Blair's president, says customers are encouraged to hold stocks because that's the wisest strategy for investing in young companies. Holding the stock is "part of the public venture-capital game," he adds, "but if the client insists on selling, the client must be able to sell."

Three years ago, two Blair clients charged in a lawsuit that a Blair vice president traded in their accounts without permission "to facilitate the distribution of a Blair underwriting" and to create "the impression in the minds of Blair's customers and the general public that there was great demand for the high-risk securities . . . when in fact the demand was artificially created by Blair. . . ." the suit says.

The plaintiffs, Konstantin Velis and his wife, Barbara, made the allegations in a civil racketeering suit filed in Manhattan federal court seeking $3 million in punitive damages and $200,000 in compensatory damages. The case is pending.

In one example, the Velises' Blair broker, Richard Brenner, purchased 9,000 shares of Techdyne for the Velises at the offering price of $6.25 a share in April 1985 at a total cost of $56,250, without their approval, the suit alleges. On Jan. 27, 1987, the stake was liquidated at $1.68 a share, for a loss of about $41,065. Techdyne now sells at about 75 cents a share.

The suit is on hold because the Velises are in bankruptcy proceedings. Blair, Mr. Davis and Mr. Brenner have denied the Velises' allegations. Mr. Brenner also responded in court papers that Blair was Davis's "alter ego" and that if any actions damaged the Velises, they "were controlled and directed by Blair and Davis."

The SEC is also exploring Mr. Davis's and Blair's ownership in a maze of entities that buy Blair-underwritten new offerings, according to the people familiar with the inquiry. Notes in the annual report of a mutual fund, Engex Inc., say that in 1987 and 1989 the SEC questioned Engex about purchases of Blair offerings. Mr. Davis is president of Engex. Although mutual funds are ordinarily barred from participating in initial public offerings brought out by affiliated firms, Mr. Wood says Blair consulted lawyers before letting Engex buy the stocks.

Mr. Davis was the majority shareholder in Broadchild Securities Corp., now defunct, but once a big customer for Blair offerings. Broadchild's first three presidents all left to create their own brokerage firms, which often distributed Blair underwritings. An example is former Broadchild president Franklin Wolf, who registered F.N. Wolf in 1982. Mr. Davis twice lent the firm money and bought a 25% stake in it. Current SEC filings show Mr. Davis's wife owning 3.1% of F.N. Wolf's parent, Blair owning 5.5%, and a foundation Mr. Davis controls owning 8.8%.

Known as a penny-stock broker, Wolf has more than 250 brokers in 12 branches. According to recent SEC filings, the SEC is investigating Wolf's trading practices involving two securities underwritten or co-underwritten by Blair, Communications Group Inc. and Computer Components. Wolf has been a market maker in numerous Blair underwritings.

Mr. Wolf denies that his firm operates as an outlet for Blair. "Morty Davis . . . didn't help in any way other than being a passive investor," Mr. Wolf says. He declined to comment on the SEC investigations.

Similarly, another former Broadchild president, John T. Moran, formed J.T. Moran & Co. which had nearly 1,000 stockbrokers. Some of them used cold calls and pressure tactics to push low-priced stocks, including Blair underwritings. J.T. Moran collapsed a year ago; it is being investigated by the SEC. Mr. Moran's lawyer, Martin Karlinsky, says that "Blair had a position in Moran but it wasn't much."

F.N. Wolf and J.T. Moran both had connections to First Jersey Securities, another now-defunct firm that is under investigation. First Jersey sold its retail offices to a firm that re-sold 11 to Wolf and five to Moran.

After Broadchild closed in 1986, one of the firm's founders, Josephine Arcano, filed a breach-of-contract suit, alleging Mr. Davis had "imposed a get-rich-quick approach" that caused the firm's demise. Ms. Arcano alleged that Mr. Davis asked a Blair employee to teach Broadchild brokers a tactic "sometimes known in the industry as `churn 'em and burn 'em,'" in which salesmen would encourage customers to buy highly risky securities so insiders like Mr. Davis "could make a handsome profit before the price fell," leaving the customers with the loss. Mr. Davis told Broadchild to "fleece its customers," the suit concluded.

At the trial last summer in White Plains, N.Y., Ms. Arcano testified that Broadchild was distributing the stock for at least 40% of Blair's IPOs. At one point in 1983, the firm was holding in its clients' accounts $22 million worth of stock in companies Blair underwrote. The jury awarded Ms. Arcano $3 million; the case was settled for an undisclosed amount during post-trial proceedings.

A spokesman for Mr. Davis and Blair says "Blair made a strategic decision to close down Broadchild in April 1986" and declined further comment.

**Law**

**FEC Fines D.H. Blair For Allegedly Using Campaign Donor List**

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B4
English


WASHINGTON -- Many big donors to this year's presidential campaigns have been hit up again -- by Wall Street brokers.

The Federal Election Commission fined broker D.H. Blair & Co. $100,000 for allegedly using lists of large contributors to prospect for new customers. Several other brokerage firms were warned to refrain from the practice of using FEC campaign contribution lists. It is illegal to use the data, which the FEC collects for disclosure to the news media and to the public, for commercial purposes.

Among the lists that the brokers were requesting, government documents show, were contributors to the campaigns of President Clinton and Robert Dole. Another popular list was that of House Speaker Newt Gingrich (R., Ga.). But the most enterprising brokers asked the FEC to supply lists of people who contributed $10,000 or more to the Democratic or Republican parties.

Those sorts of requests, however, may have led to the brokers' troubles. FEC officials noticed the unusual, frequent requests and alerted agency investigators. Several Blair brokers then admitted they had used the lists to make "cold calls," as instructed by a Blair manager.

In a letter to the FEC, D.H. Blair General Counsel John McGuire admitted that nine of the firm's brokers had engaged in the practice, but said senior management wasn't aware of what was going on. The FEC referred the matter to the Securities and Exchange Commission, the National Association of Securities Dealers and the New York Stock Exchange.

Four other firms -- Dean Witter Reynolds Inc., Gruntal & Co. and Jansen-Meyers Associates L.P., all of New York, and Vision Investment Group Inc., Melville, N.Y. -- were warned by the FEC not to engage in the practice. Jacqueline Goode, chief financial officer of Jansen-Meyers Associates, said the firm wasn't using FEC data to solicit brokerage business. Officials of Gruntal, Vision Investment and Dean Witter weren't immediately available to comment.

**Wall Street Mob Probe Is Expanded --- Prosecutors Examine 3 Brokerage Concerns**
By Michael Siconolfi
Staff Reporter of The Wall Street Journal
762 words
3 December 1997
The Wall Street Journal
C1
English


Federal prosecutors are expanding a criminal investigation into whether the mob has tried to secure a toehold in some corners of Wall Street.

The U.S. Attorney's office in Manhattan is investigating possible connections among employees of at least three small brokerage firms -- Paramount Capital Management Inc., Toluca Pacific Securities Corp. and D.H. Blair & Co. As part of a broader probe into whether the firms have defrauded investors, the prosecutors are examining, among many other things, whether organized-crime members may have infiltrated the firms and laundered money, according to people familiar with the matter.

The expanding criminal probe suggests that federal authorities are heightening their focus on the mob's potential influence in the securities industry, though prosecutors and investigators stress that any such influence is marginal and concentrated on smaller brokerage-firm players. Indeed, one person familiar with the probe said any organized-crime connections are secondary to discovering if the three brokerage firms defrauded investors.

A spokesman for the U.S. Attorney's office declined to comment, as did a representative for D.H. Blair. A call to Paramount's offices in New York wasn't answered. A woman who answered Toluca Pacific's Burbank, Calif., number said the firm was "no longer in business."

The investigation follows last week's indictment by a Manhattan federal grand jury, alleging that members of the Genovese and Bonanno organized-crime families used bribery and threats to "control" six brokers at New York-based Meyers Pollock Robbins Inc., who were charged with using high-pressure sales tactics and false statements to persuade investors to buy securities.

Prosecutors now also are examining whether there are any ties among employees of Paramount, Toluca and Blair with Meyers Pollock, a person familiar with the matter said. "With Meyers Pollock, the government attempted to cut off one tentacle" of an alleged mob elementincluding relatively new organized-crime members -- among small brokerage firms alleged to have manipulated stocks and abused investors, the person said. "Now, they're attempting to cut off another."

The brokerage firms in the pending investigation have been on regulators' radar screens for some time. Indeed, statesecurities regulators have launched a task force specifically investigating alleged sales-practice abuses by D.H. Blair. In August, the National Association of Securities Dealers announced an accord with D.H. Blair and two of its officials in which they agreed to pay $4.9 million in fines and restitution to settle charges, without admitting or denying guilt, that they excessively marked up prices of 16 newly issued small stocks.

The New York Stock Exchange in March censured and fined D.H. Blair $250,000, alleging that the firm didn't take proper steps to prevent widespread broker misconduct. The firm also settled the charges without admitting or denying guilt. In its complaint, the Big Board alleged that D.H. Blair failed to prevent improper trading practices, faulty recordkeeping and unauthorized trading.

The Securities and Exchange Commission this month accused Paramount Capital Management of defrauding investors by inducing them to invest in a fictitious initial public stock offering. In a civil suit filed in a New York federal court, the SEC alleged that Paramount has been offering and selling securities in a bogus IPO of "Micronet Corp."

In its complaint, the SEC said that when "investors seek information about Micronet, instead of sending them a prospectus, defendants refer them to a Web Site on the Internet for `MicroNet Technology Inc.' -- a company that has not undertaken any initial public securities offering, has no plans to do so, and denies any knowledge of Paramount." The SEC obtained a temporary restraining order against Paramount that freezes its assets until a court hearing, set for today.

Meanwhile, the state of Indiana alleged in a civil action in September that Toluca Pacific and its officials operated in the state for years without being registered to do business there. Indiana also accused Toluca Pacific of unauthorized trading, among other things. The firm failed to respond to the charges, according to state regulators. Last year, the NASD separately fined Toluca Pacific and a broker after accusing them of trading without maintaining the minimum required net capital. Toluca settled the charges without admitting or denying the findings.

Toluca Pacific "is riddled with ties to firms of suspect reputation," contended Bradley Skolnik, Indiana securities commissioner. "They represent the scofflaw mentality that prevails in this segment of the small-cap market," he said.

**New York Probes D.H. Blair's Ties To Defunct Broker**
By Dean Starkman
Staff Reporter of The Wall Street Journal
708 words
16 December 1997
The Wall Street Journal
C1
English


NEW YORK -- State prosecutors are investigating whether employees of D.H. Blair & Co., an underwriter of initial public offerings of small-capitalization stocks, conspired to manipulate stock prices with A.R. Baron & Co., a now-defunct brokerage firm indicted last spring on charges of defrauding investors out of $75 million.

The probe, part of a broader investigation by Manhattan District Attorney Robert M. Morgenthau's office into alleged market manipulation at D.H. Blair, is looking at possible financial ties between officers at the two firms, according to a person familiar with the situation. Prosecutors are also looking at whether D.H. Blair officials had a hand in some of the alleged manipulations at Baron, which was founded by former Blair brokers.

D.H. Blair said that neither the company nor its officers have ever had any involvement with A.R. Baron or its activities. The brokerage firm said it complies with all securities rules and that a recent review by its outside lawyers found it operated at "the highest ethical standards."

The criminal investigation, nevertheless, shines a light on a problem that has long vexed regulators: the informal network of brokers who commit securities violations at one firm, then move to another. And it could also mean more headaches for D.H. Blair, which has a history of regulatory problems and faces scrutiny on other fronts.

Manhattan federal prosecutors are investigating possible links between D.H. Blair employees and organized-crime figures as part of a broader probe into alleged market manipulation. A task force of state securities commissioners last spring began investigating allegations of widespread sales-practice abuses at D.H. Blair. And the Securities and Exchange Commission has also been probing similar allegations.

In August, D.H. Blair and two of its officers paid $4.9 million in fines and restitution, without admitting or denying wrongdoing, to settle allegations by the National Association of Securities Dealers that they excessively marked up prices of 16 newly issued small stocks. And in March, the New York Stock Exchange censured and fined D.H. Blair $250,000, alleging the firm failed to prevent improper trading practices, faulty recordkeeping and unauthorized trading by its brokers. The firm also settled those allegations without admitting or denying wrongdoing.

Mr. Morgenthau's probe grew out of a separate investigation that culminated last May in a sweeping 174-count indictment of Baron and 13 former officers and brokers, most of whom had previously worked at D.H. Blair. The indictment describes Baron as a "criminal enterprise" created solely to defraud investors. Since then, nine of the former Baron officers, including seven former D.H. Blair employees, have pleaded guilty and agreed to cooperate with investigators. The ninth, Baron President Andrew Bressman, pleaded guilty yesterday to one count of "enterprise corruption" and one count of grand larceny and agreed to cooperate.

The trustee, who was appointed by the federal bankruptcy court in Manhattan in 1996 to oversee Baron's liquidation, is negotiating an agreement under which Baron would plead guilty but the court would impose no penalty, according to Daniel S. Lubell, a lawyer for the trustee.

The Baron indictment charges that the frauds began in July 1991, before Baron opened its doors and while many of the indicted brokers still worked at D.H. Blair. Jeffrey Weissman, Baron's former chief executive officer who was seriously injured in a motorcycle accident in 1993 and wasn't indicted, was among those who previously worked at D.H. Blair.

In an administrative complaint last year, the SEC also alleged that a group of brokers manipulated the price of Health Professionals Inc. first at D.H. Blair and later at Baron. One of those named was Mr. Weissman, who agreed to pay $450,000 in fines and restitution to settle the allegations, without admitting or denying wrongdoing.

Mr. Weissman's lawyer, Daniel W. Krasner of New York, says there was "absolutely no connection" between D.H. Blair and Baron. He adds that the fact that Mr. Weissman settled SEC charges of manipulating stocks at both firms doesn't mean the firms were linked.

**Fed Expands Probe on the Mob on Wall Street**
By Roland Jones
245 words
1 January 1998
On Wall Street
English


Federal prosecutors have now turned their attention to three brokerage firms to investigate possible connections between employees and organized crime after the government's recent crackdown on mob ties on Wall Street.

The three firms are Paramount Capital Management Inc., Toluca Pacific Securities Corp. and D.H. Blair & Co. The U.S. Attorney's office in Manhattan declined further comment at this time.

New York's Genovese and Bonanno families have often been accused of controlling the city's main fish market, but news that they had moved into the Nasdaq Stock Market came as a surprise.

A recent indictment, made by a federal grand jury in New York, accuses 19 people of securities fraud and other offenses relating to the manipulation of shares of HealthTech, a health business based in Arizona and listed on the Nasdaq, The Wall Street Journal recently reported. Those accused include Gordon Hall, chairman of HealthTech, and brokers from Wall Street firm Meyers Pollock Robbins who are alleged to have mob ties. The allegations indicate that both brokers and mobsters received shares from the company's managers in return for using threats and bribes to control the price of HealthTech shares. In fact, in May and June of 1987, 80 percent of all shares purchased by retail customer purchases went through Meyers Pollock Robbins' brokers. The SEC has since suspended trading of HealthTech shares on the Nasdaq.

**Riding Shotgun for Wall Street**
Business/Financial Desk; Section D
**Combative Lawyer for Aggressive Brokers Is in Demand**
By PETER TRUELL
2078 words
18 February 1998
The New York Times
Page 1, Column 2
English


When prosecutors delve into the financial and securities markets, Stanley S. Arkin never seems to be far away.

A veteran white-collar defense lawyer renowned for his combative tactics both in and out of the courtroom, Mr. Arkin appears to be almost everywhere these days as Federal and state prosecutors in New York expand their investigations of a number of smaller brokerage firms. Along with a select group of other New York defense lawyers, Mr. Arkin is getting a lot of calls from prospective clients.

"The activity by both Federal and local prosecutors has created more cases on a criminal level than even the 1980's cases involving Michael Milken, Ivan Boesky and others," said Marvin G. Pickholz, a partner at Hoffman, Pollok & Pickholz, who says that his firm is handling more matters involving accusations of securities fraud than ever.

Indeed, the bull market has not only drawn in millions of new and often naive investors, but it has also produced a bumper crop of fast-buck artists eager to prey on them, according to prosecutors, investors and brokers. As stock prices have risen, so, too, has the number of complaints of abuse and fraud. That is one reason prosecutors are focusing more on people accused of harming individual investors than on those involved in the kinds of large-scale operations that drew attention a decade ago.

Mr. Arkin and his colleagues in the white-collar defense bar -- including Stephen E. Kaufman, Robert Morvillo and Charles Stillman -- have benefited from such trends.

What clients get when they hire Mr. Arkin is a 59-year-old graduate of the University of Southern California and the Harvard Law School. They also get something of a legal pit bull.

"He's got courage," said Roy L. Reardon, a partner at Simpson Thacher & Bartlett, which has referred cases to him. "He's prepared to go to war, if necessary, for his client."

In the late 70's, for example, Mr. Arkin took the case of Vincent Chiarella, a financial printer who had traded on information he came across in his work. Mr. Arkin fought all the way to the Supreme Court, and, there, he had Mr. Chiarella's conviction overturned by securing a narrower definition of insider trading.

These days, Mr. Arkin, a dapper but restless man who actually quivers with intensity, has been representing Alfred S. Palagonia, the star salesman at D. H. Blair & Company, a Wall Street firm that has specialized in smaller, more speculative stocks. Blair is now being investigated by prosecutors and securities regulators who want to know what Mr. Palagonia and the firm told prospective investors.

In affidavits prepared for arbitration hearings scheduled to be heard in the coming months before a New York Stock Exchange panel, six private investors maintain that Mr. Palagonia manipulated stock prices for his own and Blair's benefit. These investors are seeking more than $22 million in damages from Mr. Palagonia and the firm.

"Al Palagonia is a very, very persuasive and aggressive salesman," said Mr. Arkin, who urged Mr. Palagonia to take a leave from his job and not to talk to reporters. Still, Mr. Arkin added, "There is no way he ever participated in a manipulation of stock prices."

Mr. Arkin says that in the past, he has advised J. Morton Davis, Blair's owner. As a longtime friend of Mr. Davis and his family, Mr. Arkin might find that he has a conflict in representing Mr. Palagonia, some lawyers say. Not at all, Mr. Arkin replied. Declining to say who is paying Mr. Palagonia's legal fees, Mr. Arkin said he always represented his client to the best of his abilities.

"There have been times I have had to give up one case for another," Mr. Arkin said, "but there is no significant matter where I have been disqualified."

Nonetheless, questions about a possible conflict have been raised by lawyers in regard to Mr. Arkin's current representation of a former Citibank vice president. The executive, Carlos Gomez, is at least tangentially involved in the case of still another of Mr. Arkin's clients, Raul Salinas de Gortari, the elder brother of the former President of Mexico. Mr. Salinas has been in a high-security prison outside Mexico City, as Mexican, Swiss and American prosecutors try to establish the origins of more than $100 million he secreted in Switzerland in the waning days of his brother's presidency in 1994.

The American investigation of Mr. Salinas has focused on Amy G. Elliott, a Citibank vice president who acted as Mr. Salinas's private banker. Mr. Gomez worked alongside Ms. Elliott in the Mexico section of Citibank's private banking department. Ms. Elliott, and her lawyer, Linda Imes, have declined to comment. A Citibank spokesman said yesterday that Ms. Elliott is a vice president in good standing with the bank.

According to colleagues, Mr. Gomez, on one occasion, carried documents from Ms. Elliott to Mr. Salinas and his brother. A Citibank spokesman, while not disputing that one instance, said Mr. Gomez was not involved in handling the affairs of Raul Salinas.

Mr. Gomez, who left his position at Citibank last November, is being sued in New York State court by the bank, which accuses him of theft amounting to $13 million, including interest due.

In an affidavit filed in New York Supreme Court, Thomas M. Lahiff Jr., a vice president in Citibank's legal affairs department, essentially contends that Mr. Gomez embezzled money from the bank by fraudulently inducing Citibank to issue loans to a fictitious borrower. The United States Attorney's office for the Southern District of New York recently brought criminal charges of embezzlement against Mr. Gomez as well.

Mr. Arkin said that he was reviewing the accusations against Mr. Gomez. In response to the suggestion that Mr. Gomez might be able to provide evidence in the Salinas case, Mr. Arkin said: "I very carefully vetted the matter and there is no conflict. Citibank has acknowledged that there is not a link between the cases."

Mr. Arkin, who now heads his own 12-lawyer firm -- Arkin, Schaffer & Kaplan -- spent four years as a partner at the prestigious firm of Chadbourne & Parke in the early 1990's.

"He realized that the culture of a small firm was more suitable for his personality," said Jerome C. Katz, a Chadbourne partner. Chadbourne has continued to work with Mr. Arkin. "Through grit and brains and determination," Mr. Katz said, "he has risen to have as good a litigation practice as anyone in this area."

It is certainly among the busiest. Mr. Arkin, for instance, is also representing Adam Lieberman, the former head of Sterling Foster, a brokerage firm no longer in business that is being investigated by the United States Attorney's office in Manhattan. Mr. Arkin also recently represented Brett Hirsch, a broker from A. R. Baron & Company, who last year pleaded guilty to securities fraud charges in the New York courts.

And Mr. Arkin does not limit himself to New York, or even to the United States. He delights, he says with an impish smile, in "world-class mischief." One recent afternoon, he took evident delight in having Mr. Palagonia in one room and Mr. Gomez in another.

Perhaps his most famous international case was his representation of Edmond Safra, the financier who controls the Republic Bank of New York. Without ever going to court, Mr. Arkin pressed the American Express Company to issue an apology to Mr. Safra in July 1989 and to give millions of dollars to charities of his choice, because it had secretly sponsored a smear campaign against Mr. Safra, then a major rival.

A skillful user of the media and lover of the limelight, Mr. Arkin has strongly criticized the Swiss Government for contending that Mr. Salinas's money is drug tainted while refusing to provide specific evidence.

Mr. Arkin has been handling white-collar cases for more than 30 years. A native of Los Angeles, whose father worked as a marketing executive at 20th Century Fox, he started in the early 1960's as an apprentice to Harris B. Steinberg, a legend of the New York bar.

"Harris Steinberg ground up associates like hamburger, but Stanley lasted," said John Horan, who became Mr. Arkin's partner a few months after Mr. Steinberg's sudden death in 1969. For the two young lawyers, "any case was a good case," Mr. Horan recalled, and Mr. Arkin had a knack for making the best of whatever breaks he got.

Unlike most of his peers, Mr. Arkin was never a Federal or state prosecutor. That, his admirers say, may help to explain why he makes such a zealous advocate, never minding for one moment if he infuriates prosecutors as he makes his client's case.

Besides making his name with the Chiarella case, he won a long-running Arizona dispute involving a land deal that turned into a textbook case for law students. He also cultivated connections with some of the most powerful New York firms, like Shearman & Sterling and Sullivan & Cromwell, often getting assignments from them.

Mr. Arkin's reputation grew enough so that by the 1980's he played a role in several of the biggest securities cases of that era. For example, he defended Richard B. Wigton, a Kidder, Peabody broker accused in 1987 of insider trading, against Federal charges that were later dropped. He also successfully defended D. Ronald Yagoda in the "Yuppie Five" insider-trading case.

Except for his four-year stint at Chadbourne, Mr. Arkin has preferred to plow his own furrow, ruling his own small firm. Adept at attracting high-profile business, Mr. Arkin has regularly broadened his practice by representing departing top executives, like Peter Halmos of Safe Card, who need a forceful negotiator, as well as A-list divorce clients, including Johnny Carson and Ronald O. Perelman. Never short of a name to drop, Mr. Arkin likes to mention his work representing Prince Rainier of Monaco. Some years ago, he even managed the career of Debbie Harry, the rock singer.

Mr. Arkin's often-aggressive tactics draw criticism from some, though. In one big case, Mr. Arkin helped to negotiate an agreement between the Government and his client, Paul Mozer, a Salomon bond trader who had submitted false bids in Treasury auctions. Mr. Mozer's plea resulted in a four-month jail sentence and a $30,000 fine, a much lighter sentence than many had expected. But some who worked at Salomon, dismayed that Mr. Mozer drew a prison sentence at all, questioned Mr. Arkin's approach.

Such mixed reviews are not uncommon, given the widespread view that Mr. Arkin has bountiful talent and an ego to match. Sour grapes may also play a role.

"Some think he's arrogant, too smart for his own good," said Harold Tyler, a partner at Patterson, Belknap, Webb & Tyler. "I think that's partly because of his success."

**19 Charged In $41 Million Stock Fraud Scheme Linked To Mob**
By Colleen DeBaise
680 words
2 March 2000
13:25
Dow Jones News Service
English


NEW YORK -(Dow Jones)- Nineteen defendants have been indicted on charges they ran a $41 million stock fraud scheme linked to four of New York's organized crime families.

Authorities say John Doukas and Walter Durchalter, the principals of New York brokerages White Rock Partners & Co. and State Street Capital Markets Corp., led a "pump-and-dump" scheme involving four highly speculative securities, then enlisted the mob's help to promote the fraud.

The indictment alleges that the firms secretly acquired the stocks and warrants of Country World Casinos Inc. (CWRC), Cable & Co. Worldwide Inc. (CCWW), Holly Products Inc. and U.S. Bridge of New York Inc. between 1993 and 1996. The firms then paid brokers to push the stocks on customers in order to artificially inflate their prices, authorities said.

The firms allegedly sold their holdings at a substantial profit and laundered the money though multiple transfers to off-shore bank accounts. "Once they dumped their shares, the stocks became worthless," said Brooklyn U.S. Attorney Loretta E. Lynch, who announced the indictment Thursday.

Besides the firms' principals, others charged in the case include former brokers at J.W. Barclay & Co. and D.H. Blair & Co.; Holly Products Chief Executive Larry Berman; and several reputed organized-crime figures. Authorities said White Rock and State Street Capital called in the mob to "resolve disputes" and perform other services, but wouldn't elaborate.

Lynch said the case reflects "the continuing influence of organized crime on Wall Street." Several defendants have been charged in other cases filed by federal prosecutors alleging mob attempts to gain influence among small brokerages. Eugene Lombardo, who the government says has ties to the mob's Bonanno family, is already serving an 8-year prison sentence for his admitted role in a 1997 stock-manipulation scheme involving HealthTech International Inc.

Others charged in the most recent case are linked to the mob's Genovese, Colombo and Gambino families.

"We called this 'Operation Street Cleaner,' because it was designed to fight fraud on Wall Street, but it could just as well been titled 'Goodfellas Meet The Boiler Room,' said Howard Safir, commissioner of the New York City Police Department, at a press conference in Brooklyn.

The Federal Bureau of Investigation said it stumbled upon the pump-and-dump scheme during an investigation into Russian organized crime. The defendants netted at least $41 million and possibly as much as $60 million through the pump-and-dump scheme, authorities said.

The 20-count indictment includes stock fraud, money laundering and racketeering charges. If convicted, the defendants face lengthy prison terms and steep fines. Several were scheduled to be arraigned later Thursday in Brooklyn federal court.

In a related action, NASD Regulation filed a complaint charging Doukas and 11 former brokers at State Capital Markets with fraudulent sales practices, supervision deficiencies, and failure to cooperate with an NASD Regulation investigation.

White Rock and State Street Capital went out of business in 1996. At the time of the scheme, the stocks involved traded on either the Nasdaq National Market or the over-the-counter bulletin board, authorities said. Country World Casinos, a casino developer, and Cable & Co., a men's footwear importer, currently trade on the over-the-counter bulletin board.

A Country World Casinos spokesman had no comment on the case. A phone number listed on Cable & Co.'s last filing with the Securities and Exchange Commission in 1998 was disconnected.

-Colleen DeBaise; Dow Jones Newswires; 212-227-2017; colleen.debaise@dowjones.com

The 19 individuals indicted by a federal grand jury are:

Frank Coppa Sr.; Ernest Montevecchi, a.k.a. "Butch;" Daniel Persico; Jack Basile; Rocco Basile; Larry Berman; John Cioffoletti; John Doukas; Walter Durchalter, a.k.a. "Dutch;" Edward Garafola; Daniel Lev; Eugene Lombardo; Edmond Nagel; Alfred Palagonia; Aleks Paul; Jospeh Polito Sr.; Lawrence Ray; Abraham Salaman and Guiseppe Temperino a.k.a. "Joseph Temperino."

-Colleen DeBaise, Dow Jones Newswires, 212-227-2017, colleen.debaise@dowjones.com

**Morty's Legacy Are indictments on the way at D.H. Blair?**
By Jacqueline Doherty
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Over the course of more than three decades, D.H. Blair & Co. foisted hundreds of initial public offerings of small companies on the investing public, marking up stock prices sharply and often leaving public investors high and dry when the stocks subsequently collapsed. Two years ago, the firm shut itself down, not long after paying a $2 million fine to the National Association of Securities Dealers and agreeing to pay $2.3 million in restitution to bilked investors.

As early as this week, another shoe could drop. An indictment of several of the most senior executives of D.H. Blair is expected, thanks to the efforts of Manhattan District Attorney Robert Morgenthau's office, say people close to the situation. The move, these sources add, follows the breakdown of ongoing negotiations between the District Attorney's office and Blair executives.

Though his name is closely identified with D.H. Blair, J. Morton Davis, who joined the firm in 1961 and bought a majority stake seven years later, has technically had no control over the retail business since 1992. That year he gave the retail arm of the company to his family. Davis retained control of the investment banking division, D.H. Blair Investment Banking, which continues to operate today. Davis is not expected to be indicted.

When D.H. Blair ceased brokerage operations, Kenton Wood served as chairman and chief executive, and Kalman Renov and Alan Stahler were vice chairmen. Renov and Stahler are Morton Davis' sons-in-law.

If the indictment -- for stock manipulation -- occurs and the charges are proven in court, executives could face jail time, say those close to the investigation. In addition, the Manhattan D.A. is said to be pushing for a restitution fund that people peg anywhere from $30 million to $110 million. Attorneys for Davis, Wood, Renov, Stahler and D.H. Blair's retail operations declined to comment, as did the Manhattan D.A.'s office.

"It's been a long investigation, and people familiar with the way Blair operated think it's about time it ended with indictments and conviction," says Max Folkenflik, of Folkenflik & McGerity, which has a number of cases involving former Blair retail clients pending against the firm. "Many investors lost millions of dollars while the Blair insiders got rich."

The case against D.H. Blair may have gained momentum as a number of the firm's former brokers landed in hot water in recent years. Perhaps the most high profile case involved Andrew Bressman, a top-producing broker at D.H. Blair before he and a group of former Blair brokers helped launch A.R. Baron in 1992. Baron filed for bankruptcy in 1996. The following year Bressman pled guilty to one count of enterprise corruption and one count of grand larceny as part of the case brought against Baron and its executives by the Manhattan District Attorney's office. Bressman also agreed to cooperate with the D.A., and four years later he has yet to be sentenced.

Alfred Palagonia was also a star broker at Blair until early 1998. He was one of 19 people indicted this past March by the U.S. Attorney in Brooklyn, who claims he and others took part in a stock fraud scheme, linked to organized crime, involving the manipulation of stocks between 1993 and 1996. The 20-count indictment includes charges of stock fraud, money laundering and racketeering. If proven, those involved face potential prison terms and steep fines. Palagonia's attorney declined comment.

A number of other junior brokers at Blair have also been snared by the Manhattan D.A.'s office of late. Vincent Poliseno in February pled guilty to securities fraud and attempted enterprise corruption in a case that was also brought by Morgenthau's office. Poliseno admitted that in order to keep prices of initial public offerings at artificially high levels, he and other brokers used a variety of fraudulent sales techniques.

Similarly, Patrick Falco, another D.H. Blair broker, pled guilty in April to attempted enterprise corruption and securities fraud for fraudulently selling securities. And Jeffrey Berns, also a former Blair stockbroker, was charged by the Manhattan D.A. in May 1999 with fraud, taking bribes and falsifying records and lying to SEC investigators.

In his 1998 book, From Hard Knocks to Hot Stocks: How I Made a Fortune Through Smart Investing and How You Can Too, Davis retailed his rags-to-riches story and counseled investors to take great care in selecting a stock broker. "I am constantly amazed at how few people check the credentials of brokers," he wrote, with no apparent irony. Perhaps he should have heeded his own advice, as these D.H. Blair alums are presumably providing evidence against a legion of wrongdoers -- the top folks at Blair included -- to save their own skins.

Many trips to the woodshed

If the indictment occurs and the D.A. can prove its case, it will be just one more in a series of run-ins with the authorities for D.H. Blair. In 1997, the New York Stock Exchange censured the company and fined it $250,000, alleging it didn't take proper steps to prevent widespread broker misconduct. Then came censure from the NASD and $4.3 million in fines and restitution for allegedly charging excessive markups to retail investors. At the same time, the NASD fined CEO Wood and head trader Vito Capotorto a combined $525,000. Neither admitted nor denied wrongdoing. And in 1998, Blair settled charges of abusive sales practices with state regulators and set up a $2.25 million restitution fund.

Yet despite the various settlements and allegations over the past five years, Morty Davis, a prominent fundraiser for religious charities, and his family continue to actively conduct business. D.H. Blair Investment Banking now arranges mergers and private placements, in which family members often are large investors.

Consider that in July 1999 D.H. Blair Investment Banking arranged a $7.59 million private placement of five million shares of Worldwide Web Networx. As a fee, the firm received $1 million and warrants. Among the 60 investors listed as participating in the private placement are Kalman Renov, his wife and children, and Esther Stahler, wife of Alan, as custodian for their children. The firm subsequently did two more private placements for the company. The shares have gone from 3 5/8 a year ago to 8 1/8 in January to 3/8 today -- not an uncommon arc for a Blair stock.

Then there's the merger between Margo Caribe and iTract. As of June 1, Morty Davis, D.H. Blair Holdings and D.H. Blair Investment Banking held 9.8% of the shares of Margo, a Puerto Rican plant distributor. SEC filings report that in December 1999 the chairman and chief executive of Margo was approached by Alan Stahler about the possibility of Margo merging with an early-stage Internet company. A deal was subsequently put together. The stock has run from 2 1/2 in January to 35 5/8 when the merger was announced on February 9 to a recent 8 1/8.

So, while the Davis clan may no longer be running a retail operation, they're definitely not sitting on their hands as the bull market for stocks rolls on and on.

**Fifteen at Blair Brokerage Firm Indicted In Probe Stemming From Baron Collapse**
By Colleen DeBaise
Dow Jones Newswires
505 words
28 July 2000
The Wall Street Journal
C20
English


NEW YORK -- D.H. Blair & Co.'s retail-brokerage company and 15 of its officers and employees have been indicted on stock-fraud charges, two years after the unit ceased operations.

The 173-count indictment, announced yesterday by the Manhattan district attorney's office, outlines a method in which D.H. Blair brokers allegedly used high-pressure sales tactics to generate commissions and manipulated stock prices for "massive" illegal profits.

Among those charged were Kenton Wood, the former chairman of Blair's retail firm; Alan Stahler and Kalman Renov, the firm's vice chairmen; Vito Capotorto, head trader at the firm; and Alfred Palagonia, its top-producing broker. The 15 individuals were taken into custody and were to be arraigned later in New York State Supreme Court.

Charles Stillman, a lawyer for Alan Stahler, says Mr. Stahler is "well known in the community as an honest and hardworking family man. He denies each and every one of the charges made against him." None of the other individuals involved could be reached for comment.

Manhattan District Attorney Robert M. Morgenthau said at a news conference that the inquiry into Blair was an "outgrowth" of the investigation into A.R. Baron, a small brokerage firm formed by former Blair brokers that collapsed in 1996 amid allegations it cheated investors out of $75 million. The district attorney said the Blair probe began in late 1997 and is continuing.

Mr. Morgenthau was unwilling to put a figure on possible investor losses in the latest case, but said Blair manipulated at least 10 initial public offerings during a 12-year period of criminal conduct. He estimated that 50,000 people invested money with Blair before its ceased retail operations in 1998.

In recent months, three former Blair brokers have pleaded guilty to securities fraud that cost investors tens of thousands of dollars. In August 1997, the firm agreed to pay $2.3 million of restitution to retail customers for alleged excessive markups in connection with several public offerings after a regulatory probe led to a censure and fines of $2 million.

Besides the top officials, 10 Blair brokers have been charged in the case. All of the defendants have been charged with enterprise corruption, which is punishable by as many as 25 years in prison. Blair and its former employees are charged with manipulating stock prices -- including securities offered in IPOs -- for the benefit of the firm, certain favored customers, brokers and others associated with Blair.

Blair's retail-brokerage unit and investment-banking operations separated in 1992. The investment-banking unit, which continues to operate under the name D.H. Blair Investment Banking Corp., isn't being investigated, authorities said. In a statement, D.H. Blair Investment Banking said it is "in no way involved in the action brought by the DA" and stressed it has been "an entirely separate company" from D.H. Blair & Co. for eight years.

Review & Preview Follow-Up

**A Return Visit to Earlier Stories -- Tarnished Legacy: Blair accused of stock fraud**

By Jacqueline Doherty

206 words
31 July 2000
Barron's
14
English


The legacy of J. Morton Davis received a black eye last week, when a Manhattan grand jury indicted D.H. Blair & Co., the now-defunct brokerage firm, and 15 of its ex-employees on securities-fraud and enterprise-corruption charges punishable by up to 25 years in prison.

Davis, who wasn't indicted, headed a predecessor firm's retail brokerage and investment banking operations for more than 20 years, until 1992. Then the business split into a retail brokerage arm, D.H. Blair & Co., which was given to his family, and D.H. Blair Investment Banking, over which he kept control.

Davis' sons-in-law, Kalman Renov and Alan Stahler, however, are defendants in the case brought by Manhattan District Attorney Robert Morgenthau's office, as we expected ("Morty's Legacy," July 17). Renov and Stahler, vice chairmen of the retail shop when it closed in 1998, are now brokers at Laidlaw Global Securities.

D.H. Blair Investment Banking isn't involved in the legal action. A statement from D.H. Blair & Co. maintained that it and its former employees are innocent.

**Soldiering On: William Blair & Co., securities-industry survivor, sticks with growth companies**
By Harlan S. Byrne
1211 words
28 April 2003
Barron's
26
English


"We're still standing," Edgar D. "Ned" Jannotta says more than once during an interview. That's the way that Jannotta, only half jokingly, describes the status in today's tough times of the independent, privately owned securities firm, William Blair & Co., where he has for many years been a key figure and currently is chairman.

Chicago-based William Blair & Co. has long stood out from the pack, not least because of an illustrious history. It was founded in 1935, during the Great Depression, by William McCormick Blair, scion of one of the well-to-do McCormick clans in Chicago, with help from friends after an earlier venture didn't succeed. Active until his death at age 97 in 1982, Blair built a firm that stressed integrity, conservative finances and service to companies with solid growth prospects.

Now, having weathered the ups and downs of nearly 70 years -- including the tumultuous past three -- Blair is indeed one of the last independent securities firms still standing. Most, like Alex.Brown, Robertson Stephens and Wheat First, have fallen by the wayside or been absorbed by big banks or insurance companies. But Blair (no relation to the once-controversial, now-defunct, penny-stock underwriter D.H. Blair) is still doing what it has always done: catering to affluent clients and growing businesses. And by all appearances, it is doing it quite well.

Some of the companies Blair has taken public over the past year have emerged as true stars. Dick's Sporting Goods, a fast-growing retailer that went public at $12 a share last October, with Blair as a co-manager, has climbed more than 125%, to 27.15. The prestigious Chicago Mercantile Exchange, which Blair helped bring public in December at 35, is now trading at 52.42, for a gain of 50%. And Portfolio Recovery Associates, active in the burgeoning field of delinquent consumer loans, has seen its shares climb about 105% since an IPO last November, to 26.58. Blair was the lead manager on that deal.

To be sure, some of Blair's deals have been clunkers. Shares of Cosi, the restaurant chain, have fallen like a stone since the company's IPO last November -- from 7 to 1.28 now. By and large, however, offerings handled by Blair have been considered to be stocks well worth watching.

Blair, which also offers brokerage and asset management, actively combs the market at large for promising growth stocks. Among its top picks right now: Bed Bath & Beyond, the housewares giant, and DeVry, the education concern.

The company has emerged relatively unscathed from the problems of the past few years -- the corporate scandals, Wall Street's run-ins with regulators, even the dot-com bubble. Although it traded Internet stocks for a time, it exited the market quite early, executives say.

Though Blair doesn't disclose profit and revenue figures, it says its earnings surged more than 20% last year -- while profits of the securities industry slumped more than 35%.

That's not to say the bear market has been easy. Blair says its revenues last year slipped by 6%, with many aspects of its business taking hits. As a result, it was forced to make cutbacks, trimming its work force to 800 from the 977 peak in 2000.

With morale sagging, some employees simply defected, including a group of one-time partners who formed their own firm.

Despite the setbacks, Blair was involved in nine of the 76 IPOs by U.S. firms during the past year, a strikingly high number for an independent outfit. Blair only led on two of those, a disappointment to the company but hardly shabby in light of the poor showing of many of its peers. One notable score was Blair's lead managing of a large, $623 million debt issue for a new hospital in Cook County, Ill.

Blair is owned by 167 principals, who were partners before the company took its current form as a limited liability corporation. While William McCormick Blair at one time owned about 40% of the firm, none of the current principals own more than 1%.

Although the principals could at some point decide to sell out and join the consolidation wave, no such plans appear to be in the works. And Blair executives maintain that the firm's capital -- about $120 million and no long-term debt -- is more than sufficient for staying independent. E. David Coolidge III, vice chairman and CEO (and a descendant of President Calvin Coolidge), tells Barron's that the financial cushion is especially large given the industry's downturn.

Coolidge says one of the company's biggest strengths is that it avoided the kind of asset expansion that so many other securities pursued in recent years. "Thus we don't have writedown problems" he says. Blair also takes pride in having recently expanded client assets under management by $2 billion, to $19 billion.

Managing client assets, of course, takes many forms. In addition to handling the portfolios of wealthy individuals and families, the firm has guided many companies through IPOs and other money-raising moves. Among those clients: Household Finance, which recently sold out to banking giant HSBC, and Concord EFS, which is being acquired by First Data Corp.

Blair took OshKosh B'Gosh public in 1985 and subsequently assumed management of the assets of chairman Doug Hyde. Blair reports doing six deals over the years for J. M. Smucker, including a recent complex transaction linking Smucker with the Jif and Crisco brands of Procter & Gamble.

Blair has also built highly profitable, but less visible, relationships with such Chicago-area companies as Illinois Tool Works, Molex, AAR, AON and CDW Computer Centers.

Blair, meanwhile, claims to have thousands of individual clients, both in the U.S. and Europe, through an office in London. Many of the individual clients, like OshKosh B'Gosh's Hyde, are managers or owners of corporations Blair has served. The clients get to rub shoulders with each other once a year at Blair's increasingly popular growth-stock conference; attendance hit 1,600 last year, with 150 companies making presentations.

Increasingly the spotlight may move to John Ettelson, recently named president and chief operating officer. In a talk with Barron's, Ettelson, 44, said better times could be ahead with the end of the Iraq war, which had driven many clients to the sidelines. Some already are getting more venturesome in their investing, he says. A number of Blair's businesses are doing quite well so far this year, including money management and investment banking, excluding IPOs.

Ettelson, previously the firm's chief financial officer, seems a clear candidate to eventually take the top spot at Blair, as chairman or CEO. Coolidge is now 60 and Jannotta is 72.

These days, trying to predict any securities firm's future is rather tricky. But if William Blair & Co. sticks to its approach, Ned Jannotta's words -- "We're still standing" -- could hold true for some time to come.

ENFORCEMENT PROCEEDINGS

**IN THE MATTER OF ALFRED PALAGONIA, ALEX DEWAR, DARREN ORLANDO, STEVEN FRANTZ AND ANDREW SCHANDLER - SEC BARS FIVE FORMER D.H. BLAIR BROKERS FROM THE SECURITIES INDUSTRY**

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SEC News Digest
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English


Today, the Commission issued an order barring five former stockbrokers at now-defunct broker-dealer D.H. Blair & Co., from associating with any broker or dealer. The five individuals-Alfred Palagonia, Alex Dewar, Darren Orlando, Steven Frantz and Andrew Schandler-consented to the issuance of the order, which was based on criminal convictions obtained by the Manhattan District Attorney's Office after an investigation by that office and the Commission staff. Each pleaded guilty to and was convicted of at least one count of violating the Martin Act-the New York state general business law-for market manipulation and fraudulent sales practices. People of New York v. D.H. Blair, et al., Ind. No. 3282/00.

In connection with their pleas, the five brokers were sentenced to prison or probation and paid a total of $435,000 in restitution to defrauded investors. Specifically, Palagonia paid $400,000 and was sentenced to two to six years in prison. Orlando paid $35,000 and was sentenced to probation. Dewar, Frantz and Schandler were sentenced to probation and were not required to pay restitution. In addition, all but Palagonia were required to perform between 1,200 and 1,500 hours of community service.

Since 2000, the Commission has revoked D.H. Blair's broker-dealer registration and barred four former officers and twelve former brokers from associating with any broker or dealer based on their prior criminal convictions. See Rels. 34-47070, 34-47071, 34-47072, 34-47073, and 34- 47074 and 34-47797. (Rel. 34-49174; File No. 3-11389)

Business
**PENNY DREADFUL - HEDGE FUND MANIPULATION OF PINK SHEETS OVERLOOKED**
Christopher Byron
1264 words
19 June 2006
New York Post
31
English


TOMORROW, all 18 members of the Senate Judiciary Committee were scheduled to gather in a second floor chamber of the Dirksen Office Building for a familiar Washington ritual, an afternoon's worth of senatorial speechifying disguised as the questioning of witnesses at a hearing.

The hearing was set to deal with a subject discussed more than once in this column in recent months: The imaginary menace of alleged market-rigging collusion between stock analysts and hedge funds.

There are plenty of things hedge funds could properly be taken to task for by regulators and their congressional overseers, such as the possibility that hedge fund managers have begun spicing up their performance numbers by trading in the shares of easily manipulated penny stocks.

That is exactly the sort of scary hedge fund practice Congress ought to be investigating, particularly now that the overall stock market is weakening while trading in penny stocks is shooting off the charts. Two recent studies show trading volume in these trash securities have nearly quintupled since January, and there can be little doubt that a lot of that action is coming from hedge funds.

Yet Washington has let itself become beguiled instead by the fanciful notions of a relentlessly whining CEO named Patrick Byrne, who founded and heads a Utah-based Internet retailer called Overstock.com Inc. Byrne would have liked nothing better than to see his ravings immortalized in a Senate committee hearing carried live on C-Span.

In Byrne's view of the world, Overstock.com's troubles, which basically boil down to hemorrhaging losses and a tumbling stock price, aren't his fault at all. According to Byrne, the true villains are a gang of hedge funds and research analysts who have cooked up a scheme to destroy the company by smearing it in the press.

Byrne is a campaign contributor to Sen. Orrin Hatch, a Republican from Utah who is a member of the Judiciary Committee. And that in turn may or may not explain why the committee agreed to take up Byrne's cause even though the Judiciary Committee has no apparent oversight authority for Wall Street and the capital markets.

Late last week, the committee fortunately decided to postpone - perhaps even scrap - its misbegotten hearing, apparently after staffers failed to round up a credible list of witnesses willing to testify that plots such as the one alleged by Byrne even exist, let alone that they represent a blight on the market.

YET it would be a shame indeed if Congress were to wave away the broader concerns of hedge fund oversight in the process. These private mutual funds for the wealthy are a ticking time bomb at the heart of capitalism, and every day the ticking grows louder and more ominous.

Efforts by former SEC Chairman William Donaldson to defuse the bomb by registering and regulating the hedge fund industry under the Investment Company Act of 1940 wound up costing him his job.

And though his successor, Christopher Cox, has talked a good game about pressing ahead with Donaldson's initiatives, his efforts to date have led to little but the filing of reams of useless information by the funds. Does the SEC really need to know a fund's "normal business hours" of operation, or whether it has a Web site? The registration process requires answers to those and dozens of similar questions.

Funds are also required to prepare and submit highly detailed "compliance program" manuals outlining the procedures that management intends to follow to make sure the employees don't lie, cheat and steal from their clients or anyone else.

Such questions have spawned a cottage industry of outsourcing shops that handle the entire registration process, paying special attention to such SEC "hot button" documents as a fully elaborated "code of ethics" for the firm. Cost: $30,000 to $50,000 for a typical small-scale fund with maybe four employees and $30 million of assets under management.

Both Cox and Donaldson claimed the registration process will help the SEC to get a handle on how hedge funds operate, and to spot problems before they explode into market-rattling crises.

Yet oversight of the industry is not likely to accomplish anything of the sort. Though the SEC now has a huge new Rolodex of phone numbers and contact names to riffle through for snap audits on unsuspecting funds, the audits themselves are nothing but fishing expeditions in which the examiners don't even know what type of fish they're trying to catch.

To head off problems before they develop, the SEC really needs to know the one thing it isn't asking the funds to disclose: the actual and specific assets into which they are plowing their investors' money.

Separate SEC regulations do require hedge funds with more than $100 million of assets under management to file quarterly reports (on a so-called Form 13F) that list all portfolio holdings of Nasdaq and NYSE-listed stocks. But the rules don't require funds to include any holdings the funds may have in OTC Bulletin Board and so-called "pink sheet" penny stocks, which thus don't get reported at all.

Yet SEC officials have time and again singled out the penny stock arena as the most volatile, risky and crime-infested back alley of Wall Street, leaving investors to search tediously through the SEC's public records database, EDGAR, for evidence that a large and presumably well-managed fund may actually be secretly mired in penny stocks.

Some big hedge fund managers have been dabblers in penny stocks for years. A review of 13F filings by the $7 billion SAC Capital hedge fund empire of Steven A. Cohen of Greenwich, Conn., shows that in 1996, a Mafia-linked penny stock brokerage firm called D.H. Blair & Co. underwrote a penny stock company called Laminating Technologies Inc., which went through two name changes before landing in the portfolio of Cohen's hedge fund under the name Speedcom Wireless Corp. in early 2001.

Within two years, Cohen's fund held enough warrants to make him the largest single investor in the company, with a controlling 24.4 percent of its stock. Cohen bought into the company even though it had never made a dime of profit and had been delisted from Nasdaq and was trading on the OTC Bulletin Board.

SAC Capital is still listed in SEC filings as the largest owner of Speedcom, which is now known as SP Holding Corp. It is trading on the OTC Bulletin Board at $3.25 per share, though it hasn't reported any revenues in years and shows a checking account balance of $15,000.

ONE can find similar random examples scattered through Cohen's other portfolios, as well as various other hedge funds. But they are not comprehensive, and may or may not represent more than isolated examples.

And don't count on the SEC taking up the subject in any case. Why should it be otherwise when even the commission's own overlords in Congress seem more interested in the imagined victimization of a sore-loser CEO than in heading off a real crisis that could be lurking just around the corner.

Junk food: The SEC is giving its stamp of approval to hedge funds that often dabble in risky penny stocks, when they should be warning that what's inside the funds is often bad for investors' financial health. [Photos: UPI; 20th Century Fox; N.Y. Post photo composite]

**Paying the PIPER at SulphCo**
By Bill Alpert
3535 words
5 February 2007
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English


The collapse of Sulphco stock in the past year shouldn't merit much attention. After all, lots of hyped tech stocks bomb out. But this little Reno gamble shows the risks of betting on unorthodox science claims -- especially when Wall Street's smart-money investors have gotten there first in private placements.

SulphCo was just a money-losing stock promotion that claimed it could turn sulfurous crude into higher-priced, clean-burning oil. About a year ago, those claims helped boost its shares to $19.70, giving the company a stock-market value of $1 billion. But with just a bit of research, anyone could have figured out that SulphCo's founder, Rudolf W. Gunnerman, had faked his academic background and that his previous tech ventures had cost investors millions of dollars (as Barron's reported in "A Crank Case?" Jan. 23, 2006). Some who'd worked closely with the 78-year-old German emigre say that he'd even claimed to have invented the laser and talked of being "the bastard son of Hitler."

SulphCo (ticker: SUF) now trades at $3.91 after recently falling as low as $2.25, and Gunnerman is in a nasty court fight for control of the company. SulphCo's directors fired him as chief executive at a tumultuous Jan. 12 meeting in which he tried to have the police arrest one of them for trespassing. He's battling the board in a Nevada state court case, where the directors allege that Gunnerman traded on insider information and lied in a recent Internet podcast by saying that SulphCo would become profitable this month.

Small investors eager for alternative-energy plays might have been fooled by Gunnerman's illusionist feints -- like his flaunting "honorary" Ph.D.s from overseas diploma mills when he actually never finished college. Yet it's hard to understand how he might have fooled the savvy hedge funds and sophisticated investors who bet big in SulphCo's private placements of its stock. Unless, that is, they assumed Gunnerman could find them greater fools to buy their shares.

Among the most sophisticated SulphCo investors is the family of Zev W. Wolfson, a New York City real-estate magnate renowned for charity and for active investing in hedge funds. For years, the 77-year-old Wolfson and his sons Abraham and Aaron, and stepson Morris, have invested quietly from their family office in a 29th-floor aerie of their skyscraper at the foot of Manhattan. Just last March, the Wolfsons added to their $17 million investment in SulphCo by putting $2.5 million into a private placement.

The Wolfsons invest widely, but eschew publicity. No wonder. For more than a decade, they've been important financiers of public disasters like SulphCo and of the unsavory brokers who promote such stocks -- underwriting the financial muggings of little old ladies from their glass tower.

Through their lawyer, the Wolfsons declined to discuss with Barron's their involvement with SulphCo or any other investment. The Wolfsons expressed doubts about Barron's journalistic integrity, says Eli Levitin, general counsel and managing director of their investment and real-estate ventures. The Wolfsons are not mere penny-stock investors, says Levitin. "They are really a very substantial family office."

Given their picaresque history on Wall Street's wild side, the Wolfsons might well be concerned about the attentions of a journalist. And that history might make public investors wonder if they want to put their savings into any stock like SulphCo, where private-placement investors like the Wolfsons have shown up first.

Since the early 1990s, the Wolfsons have put tens of millions of dollars into small-cap companies through bridge loans and PIPEs -- private investments in public equities -- a sometimes controversial form of investment that is being scrutinized by the Securities and Exchange Commission.

The typical PIPE deal works out badly for a company's public shareholders, according to most studies. But the deals can produce good returns for the hedge funds and wealthy investors who buy shares in private placements from a public company at a discount that's typically 10% or more from the public market price. That can allow the private PIPE investors to quickly profit through short sales as well as price appreciation. Wolfson family members have been private-placement investors in dozens of companies, including one that federal prosecutors alleged was linked to organized crime.

The Wolfsons may well have been true-believers in stocks like SulphCo, where the promoters hide the truth. Former SulphCo employees tell Barron's that the company secretly doctored crude-oil samples to make its processing seem successful. Through a lawyer, Rudolf Gunnerman denies that his company faked tests or that he ever talked of inventing the laser or being Hitler's son.

For whatever reason, the Wolfsons have repeatedly supplied large amounts of capital to dubious stock promoters. In fact, securities and court filings show that they financed promotions by some of the most notorious boiler-rooms of Wall Street's rapacious 1990s, such as D.H. Blair and A.R. Baron, both brokers that went out of business as the Manhattan district attorney sent their key personnel to prison.

A probe by a federal bankruptcy trustee into the 1996 collapse of A.R. Baron concluded that the Wolfsons were in on the schemes of that brokerage firm, 13 of whose employees ultimately were convicted of defrauding investors.

According to the trustee's 1998 suit in Manhattan's bankruptcy court, the Wolfsons funded A.R. Baron and supplied trading accounts used in the firm's pump-and-dump manipulations, in exchange for a promised share of the illicit spoils. The Wolfsons ended up settling the trustee's proceeding, without admitting to the allegations. They have never been charged with wrongdoing by government regulators. "The action by A.R. Baron's bankruptcy trustee was settled years ago," says Wolfson attorney Levitin, "with a mutual agreement by both parties to dismiss their claims against each other."

After 10 years of patiently piecing together parcels of property at the southern tip of Manhattan, Zev Wolfson launched his realty empire in 1969 when his real-estate partnership built One State Street Plaza, a 32-story building with unequalled views of the Statue of Liberty.

With his real-estate cash, Wolfson became an early investor in the hedge-fund and private-equity industries. In the 1980s, he was a limited partner of money managers like Carl C. Icahn, Saul Steinberg and John A. Mulheren Jr., a controversial trader convicted in 1990 of stock manipulation. That conviction was later reversed, but not before police stopped Mulheren from confronting prosecution witness Ivan Boesky with a rifle.

Wolfson also has a reputation for sharing his profits with charitable beneficiaries, supporting overseas religious and educational groups in a low-profile manner.

In the 1990s, Zev Wolfson's sons began appearing as investors in their own right. While Abraham, Morris and Aaron Wolfson may well have made blue-chip investments that don't fill the public record, numerous SEC registration statements show one or another of them as substantial participants in private placements by a rogues' gallery of bad-news brokers. In addition to D.H. Blair and A.R. Baron, those brokers included Kensington Wells, William Scott & Co. and Patterson Travis. These firms stole hundreds of millions of dollars from the investing public, by the estimate of government regulators.

Executives of both Kensington Wells and Patterson Travis were ultimately convicted of running stock-fraud conspiracies to pump up the prices of, and then dump, stocks like VideoLan Technologies, a Kensington Wells underwriting financed by Abraham and Aaron Wolfson and Morris Wolfson's wife, Arielle.

Morris also invested directly in a boxing promoter underwritten by William Scott & Co., a firm whose brokers were busted in the June 2000 "Mob on Wall Street" dragnet -- when Brooklyn's federal prosecutors and the SEC broke up a ring of boiler-rooms that they said were controlled by New York's organized-crime families.

D.H. Blair was the infamous brokerage firm that hyped many millions of dollars worth of flimsy stocks through the 1980s and '90s, -- until its rip-offs were halted with a wave of regulatory censures and fines in 1998. Prosecutors eventually secured convictions of 12 Blair brokers and four officers for defrauding retail investors.

Zev Wolfson's sons and their investment entities made bridge loans to D.H. Blair's investment-banking clients prior to public offerings. The Wolfsons put more money into PIPE financings once the D.H. Blair stocks came public -- receiving huge piles of stock and warrants that would be ruinously dilutive to public investors once the privately placed securities were registered and eligible for sale.

Patrons like the Wolfsons were essential to D.H. Blair's hustles. Brokers say that the Wolfsons were important enough to rate personal visits from Blair's wealthy owner, J. Morton Davis. A financial analysis of SEC filings shows why.

The Wolfson brothers, in-laws, employees and various investment entities registered shares worth more than $100 million from the private placements of Blair and similar firms.

To be sure, the lists of such boiler-rooms' private patrons were long, and the Wolfsons weren't the only wealthy New Yorkers helping to bankroll dubious stock promotions. Investing alongside them, for example, in Beachport Entertainment -- one of the allegedly mobbed-up stocks targeted in the June 2000 federal prosecutions in Brooklyn -- was Martin Hodas, who ran many of the peep shows around Times Square before it was Disneyfied.

In 1998, the federal bankruptcy trustee for the boiler-room A.R. Baron presented the court with embarrassing details of the Wolfsons' relations with A.R. Baron chief executive, Andrew Bressman. According to the trustee's complaint filed in Manhattan bankruptcy court, Abraham, Morris and Aaron invested $400,000 in the brokerage firm after a July 1994 meeting in which Bressman offered to cut them in on his firm's rigged stock offerings. "This was a game," the complaint says Bressman told them, And "in order to make money at the game, you had to be an insider."

According to the complaint, Bressman told the trustee that in 1994 he became close to the Wolfson brothers -- particularly Morris -- visiting with them several times a week and often praying with them. To renovate A.R. Baron's offices, the trustee alleged, Bressman hired a construction company controlled by Morris.

That company, Adonis Construction, got Morris unwanted media attention in 1995 when a tenement it owned in Harlem collapsed and killed three people.

The trustee further alleged that Bressman asked the Wolfsons to let him trade their accounts to help manipulate the price of the "house stocks" that A.R. Baron controlled, and to create the appearance of active trading. How did the Wolfsons get the Baron stocks? Through PIPE deals, of course.

The Wolfsons' accounts "were among the largest and most actively traded at A.R. Baron," said the trustee in a pleading. "The purpose of the trading," the trustee continued, "was to facilitate the A.R. Baron criminal enterprise by creating the false appearance of the firm's liquidity. Unlike other A.R. Baron customers, the firm allowed [the Wolfsons] to move funds in and out of their accounts freely." The small investors snared by the broker's cold callers, in contrast, were never allowed to sell out of A.R. Baron's stocks.

The trustee found that the Wolfson accounts realized over $83 million in cash proceeds from trading A.R. Baron house stocks. Attached to the trustee's complaint were exhibits showing "crossed trades" between various Wolfson family accounts -- trades that the trustee said had "no conceivable investment rationale."

The Wolfsons' spree with A.R. Baron ended after the SEC subpoenaed Morris in the summer of 1995 to testify in its investigation of the boiler-room. The family transferred its shares of A.R. Baron house stocks to Bear Stearns. After A.R. Baron collapsed in June 1996, Bressman pleaded guilty to state charges of grand larceny and racketeering, for schemes that cost investors at least $75 million.

The Wolfsons denied the bankruptcy trustee's allegations that they had been part of the A.R. Baron scam. They objected when the trustee rejected the Wolfsons' claims for more than $1 million from a restitution fund. Eventually, the Wolfsons settled by paying the trustee $90,000.

As strange as the Wolfsons' involvement with a Wall Street low-life like Bressman might seem , even stranger was their use of their charities as investment vehicles in the A.R. Baron machinations.

Among the Wolfson accounts used for A.R. Baron's trading schemes, said the trustee's filings, were those of United Congregations Mesora -- a not-for-profit Jewish organization controlled by Zev Wolfson and his son Abraham -- and the Chana Sasha Foundation, controlled by Morris and Arielle Wolfson. In its tax returns, the Chana Sasha Foundation said it makes educational grants and helps needy families. In SEC filings, it showed a predilection for millions of dollars' worth of the house stocks of A.R. Baron and other boiler-rooms.

As noted, the Wolfson Group's managing director, Eli Levitin, says the family won't discuss its investing. As it turns out, Levitin himself has followed the Wolfsons in patronizing dubious brokers and their stocks. Back in 1997, he received warrants for 15,000 shares of a D.H. Blair-sponsored company that marketed discounted chiropractic care. The warrants were Levitin's compensation for performing investor-relations services, said the SEC filings of the now-vanished company.

In 2004, another failed company in which Levitin was an investor and adviser merged with a videogame-distribution business called Alliance Distributors Holding. The next year an SEC suit alleged that Alliance had been one of several distributors involved in a sales fraud scheme by executives at Take-Two Interactive Software (TTWO), publisher of the very violent, very popular gangster game Grand Theft Auto. Without making admissions, Take-Two executives settled the SEC suit, which had contended that in 2000 and 2001, Alliance's predecessor business Corner Distributors had let the Grand Theft publisher park $10 million worth of games. Corner then returned them all after Take Two had falsely reported them as having been sold. (It might amuse Grand Theft Auto devotees to learn that Corner Distributors was involved in a real East Harlem numbers racket that produced a 1998 guilty plea by a patriarch of Corner's family owners.)

Levitin has owned several investment ventures with Mel E. Lifshitz -- a class-action lawyer with the New York firm Bernstein, Liebhard and Lifshitz-and Ezra Y. Birnbaum, a Maserati-driving broker whom the SEC sued in Brooklyn's U.S. district court last year, alleging that Birnbaum allowed his employees at the Brooklyn brokerage firm Pond Equities to engage in "naked" short selling. Birnbaum's brokers allegedly drove down a company's shares by selling them short without borrowing and delivering stock to make the short sales legit.

Neither Birnbaum, nor his attorney, responded to Barron's' inquiries. In a statement to Barron's, Lifshitz said that he and his law partner, Sandy Liebhard, have known Levitin and Birnbaum for more than 30 years. The circle of friends has donated substantial sums to each others' charitable trusts, according to the trusts' tax returns. Those returns also show some of the trusts investing in many of the same crummy stocks as the Wolfsons, through trust accounts at Birnbaum's Pond Equities.

As reported last year by TheStreet.com Website, the Bernstein, Liebhard & Lifshitz lawyers' financial ties to Birnbaum and Levitin raise ethical questions. That's because the lead plaintiffs in many of the law firm's class actions were Levitin's wife, Raizy, as well as Ezra Birnbaum and Birnbaum investment ventures -- including some ventures in which the lawyers themselves were investors.

Class-action law requires an arms-length relationship between plaintiffs and the class attorneys, notes Columbia University law school professor John C. Coffee, to help ensure that the attorneys don't shortchange the class members. "Courts have held that you can't be both the plaintiff and the attorney," says Coffee, speaking generally, "because we want the plaintiff to monitor the attorney, and you can't do that if you're the same person."

Lifshitz and his partners say in their statement that "virtually all" the cases involving Birnbaum or Levitin's wife were started before the lawyers or their charities invested with Levitin or Birnbaum. After TheStreet.com raised questions last year, the lawyers divested themselves of the Birnbaum-managed partnerships that are class-action plaintiffs. They also asked a legal-ethics professor at Hofstra, Roy Simon, to examine the lawyers' investments with Birnbaum. He pronounced them ethical.

The charitable foundation of Lifshitz's law firm continues to invest with Levitin, through a venture called BL Cubed. Within weeks of the Lifshitz firm's sharing in a $3.5 million class-action fee award from suing a company called Irvine Sensors on behalf of Ezra Birnbaum, in June 2004, the BL Cubed venture invested in a PIPE deal in Irvine Sensors (a struggling chipmaker whose shares had fallen 99.7% from their year 2000 high). Then, BL Cubed invested in a SulphCo PIPE deal alongside the Wolfsons. It's strange to see class-action attorneys investing in the sort of companies such attorneys typically sue.

Levitin says that none of his investment activities "relate in any way to, or affect, the Wolfson family, nor do they relate to my position as general counsel of Acta Realty or any other Wolfson family entities."

He says that the Wolfsons' SulphCo position is a long-term investment. It had better be. A few weeks ago, SulphCo's board fired founder Rudolf Gunnerman and filed their Nevada state court allegations that Gunnerman had made many SulphCo stock purchases in violation of the company's insider-trading policy. Former SulphCo employees tell Barron's that Gunnerman frenetically traded the company's stock. Gunnerman remains a SulphCo director and shareholder. He issued a press release calling the board's allegations vicious and false.

Last Monday, SulphCo held a conference call featuring Gunnerman's replacement as CEO -- Larry Ryan, a former General Electric executive. Ryan promised a valid commercial test of the company's oil-processing technique as soon as he could get the SulphCo ultrasound device to function reliably. After the call, SulphCo shares rose 18% to end the week at 3.91.

If Gunnerman's technology does indeed work, SulphCo investors can thank the Wolfsons for financing Gunnerman through PIPE deals. If not, perhaps they can apply for help from the Wolfsons' charities.

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Why Hedge Funds Love PIPEs

The histories of wall street's scuzzy companies frequent- ly feature PIPEs, or "private investments in public equities." In these financings, a public company sells stock via a discounted private placement to investors -- typically hedge funds or investment vehicles controlled by wealthy investors like the Wolfsons of New York.

Public investors in PIPE-issuing companies don't make out very well, say researchers like Clemens Sialm, an assistant professor of finance at the University of Michigan's Ross School of Business. Sialm and his colleagues studied more than 5,000 PIPE deals done from 1995 through 2002 and recorded in a database compiled by Sagient Research of San Diego.

They found that shares of PIPE issuers underperformed those of similar companies by about 30% in the two years after a PIPE deal, if the private-placement investors were mostly hedge funds. A third of the issuers were delisted within two years of their PIPE offerings.

The private-placement investors seem to do well, however. Hedge funds got their PIPE shares at an average discount of 14% to the stock's public- market price, often also receiving warrants convertible into additional stock. Sialm estimates that those warrants boosted the deals' value to the private-placement investors by another 15%. By matching his PIPE database with information in the Lipper TASS hedge-fund database, Sialm figures that hedge funds enjoyed returns of 2% in the month of their PIPE purchases.

Remorseful PIPE issuers have complained that the hedge funds' profits and public's losses in PIPEs result from the private-placement investors exploiting the discount they receive, by shorting the issuers' stocks. Sialm's study found that PIPE issuers' short interest did indeed rise. But he doesn't blame PIPE "privates" for the stocks' declines. "These are companies in poor financial health," he says, that would have gone out of business with or without the PIPE deals. As financings of last resort, the PIPEs forestall bankruptcy.

In the past year, the staff of the Securities and Exchange Commission has sought to get better disclosure in registration statements filed for certain securities that are often sold as PIPEs, says David Lynn, the chief counsel for the commission's corporation finance division, primarily when the deal would significantly dilute the interests of public investors.

-- B.A

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**Sleazy doings on Wall Street.(clearing firm owned by Bear, Stearns & Co. involved in failure of bucket shop stock brokerage A.R. Baron & Co.)(Cover Story)**

Gretchen Morgenson
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AN OBSCURE New York City brokerage firm, A.R. Baron & Co., slipped into bankruptcy last July. Brokerage is not the right word. It was a bucket shop. Baron was in trouble with regulators from the moment it opened its doors four years earlier. When it closed, its customers were on the hook for roughly $22 million. Its owner, a 31-year-old egomaniacal fellow named Andrew Bressman, has filed for bankruptcy. The N.Y. County district attorney's office has convened a grand jury on the A.R.Baron affair.

Just another boiler-room blowup? These outfits come and go, and not much has changed since the days when Robert Brennan and Denver-based Meyer Blinder ravaged and raped small investors. But this debacle was different. In failing, Baron laid bare a corner of the securities industry that is rarely seen but is hugely profitable: processing trades for other firms.

This involves clearing customer trades, processing securities transactions and other paperwork, and providing capital necessary for smaller broker/dealers to conduct their business. A major player in the clearing business is the prestigious, publicly traded brokerage giant Bear, Stearns &Co. Inc. Guess who cleared for Baron? Bear, Stearns Securities Corp., its clearing subsidiary. And guess who figures prominently in the story? Randolph Pace, a notorious bucket-shop operator of the past, who has been the subject of numerous regulatory actions during his short career in the securities business. Pace co-owned Rooney, Pace Inc. in the 1980s.

Processing of securities transactions was little noticed until 1968, when, amid growing trading, stock exchanges began closing down on Wednesdays so clerks could sort out the mountains of tickets representing customer orders. Volume had simply grown too fast for the then-primitive systems to handle. A number of famous old firms went under-Goodbody & Co., among others. Computers and vast infusions of capital eventually solved the problem.

Because expensive computer systems are required, the clearing business has become concentrated in fewer hands. Most large brokerage firms and banks, such as Merrill Lynch,Smith Barney, Chase and J.P. Morgan, still clear their own customers' trades, but many others do not. Since 1983 the number of clearing firms has declined-from 1,200 to 780-while the number of broker/dealers (also called introducing brokers) has risen from 3,500 to 5,000. Big names in clearing are Pershing, a division of Donaldson, Lufkin & Jenrette; Correspondent Services Corp., a subsidiary of PaineWebber Inc.; and Prudential Securities.

Bear, Stearns' clearing subsidiary is a big player, with 2,100 customers, up from 725 in 1987. It is so big in this business that it claims to handle 12% of the New York Stock Exchange's volume. Its clearing customers generate more than 100,000 trades every day. A decade ago its daily trades averaged 33,000. Most of Bear's clearing clients are small OTC marketmaker firms, hedge funds and money managers-good customers, solvent and well respected. But then there was Baron. As it turns out, Bear, Stearns clears for other outfits like Baron.

Officials at Bear, Stearns declined to be interviewed for this story. Company spokesperson Hannah Burns says: "Clearing is a very, very proprietary business for us, and we don't want the public knowing about it."

A strange comment. Doesn't the public have a right to know how its trades are handled? Clearing is much more than a routine process of matching the seller of a security with the corresponding buyer. A clearing firm also ponies up significant capital to each of its introducing brokers, allowing them to do business on a relatively small deposit, usually a minimum of $250,000. However, if a customer fails to pay, it is the introducing broker who gets stuck, not the clearing firm. Nor is the clearing firm on the hook if brokers at one of the introducing firms engage in unauthorized trading or other securities' laws violations. In short, the clearing firm shares in the profits but takes none of the regulatory heat.

A clearing firm's chief vulnerability is if one of its broker/dealers fails and winds up owed more by customers than what it has in cash. In most cases that risk is modest if the clearing firm keeps a watchful eye on its customers' dealings.

One veteran of the clearing business says:"A clearing firm looks at its customers' numbers every day. The first time trouble shows its head, you stop it immediately." Clearing firms can terminate their agreements with customers at any time, but they usually give the firm a grace period of a month or two to find a new home.

The risk of a firm's failing is, how-ever, far outweighed by the financial rewards of the clearing business. First there's the introducing broker's deposit paid to the clearing firm, which can use the money interest-free. Then there are the fees a clearing firm levies on every transaction an introducing firm makes-called a "ticket charge"-of anywhere from $10 to $30 per trade. The clearing firm also charges interest-typically 1% a month-of customer debit balances carried on the clearing firm's books. The interest meter starts ticking the day a trade is done. This is where the real money in clearing is made. Clearing firms like Bear,Stearns also have free use of customers' credit balances.

Last but not least, clearing firms such as Bear demand that an introducing broker's listed equity business-trades in NYSE and Amex stocks-all be funneled to its trading desks. Other firms would pay 2 cents or 3 cents a share for this order flow; Bear gets it for free.

The man running this gold mine at Bear, Stearns is Richard Harriton, 61, an imposing and imperious man who came to the firm in 1979. Reportedly the son of a Brooklyn bakery- supply salesman, Harriton has become a wealthy man as a Bear, Stearns senior managing director. He sits on the firm's Management and Compensation Committee, which decides how many millions of dollars will be parceled out to the company's executives in bonuses each year.

Bear is known for its largesse to top employees. Last year, for example, Bear, Stearns President and Chief Executive James Cayne made $20.4 million in compensation; Chairman Alan (Ace) Greenberg got $18.9 million; Executive Vice President Warren Spector received $19.5 million. Harriton's compensation was unspecified in the proxy and the annual report, but it was no doubt hefty.

Bear, Stearns' financials don't specify how much its clearing business brings in.

With reason:Why let outsiders in on how lucrative its clearing is? In 1996 Bear produced revenues of $5 billion, on which it earned $496 million. Clearing almost certainly contributed to Bear's extraordinary results-up 68% in its most recent quarter, ended December. The firm's stock surged to an alltime high of $31.75.

All Wall Street firms have personalities; Bear's is scrappy and entrepreneurial. Bear executives are encouraged to behave as aggressive and enterprising sole proprietors.If they do so successfully, they will get their reward in the form of a bigger bonus.

Running one of Bear's biggest profit centers makes Harriton a towering figure there. His contributions to the firm's bottom line make it likely that he is autonomous, left alone to manage his fiefdom. He reportedly has introduced himself to prospective clearing customers by saying: "I run the most profitable division of Bear, Stearns and I'm the most powerful man on Wall Street in clearing." It is widely assumed that he runs his show without much input from the top boss, Alan Greenberg.

What is so special about Bear, Stearns' clearing work? Harriton knows that what he is selling is not just his firm's back-office processing: All clearing firms have sophisticated systems and most charge less to perform these services than Bear. What Harriton is selling-especially to the small and dubious firms-is respectability. If Bear's famous name appears on the trade confirmation or monthly statement as the clearing firm, who can doubt that his money is in safe hands?

Even before the Baron debacle, some of the biggest Wall Street flameouts had been clearing customers of Bear, Stearns Securities Corp.

One of Bear, Stearns' first clearing customers was Rooney, Pace Inc., a notorious stock manipulator firm shuttered by regulators in 1987. Former co-owner, Randolph Pace, is a close friend of Harriton and regularly brings new clearing customers to Bear.

Another clearing customer in Bear, Stearns' recent past was D. Blech &Co., the investment firm run by David Blech that specialized in biotechnology stock underwritings. D. Blech's failure in 1994 reportedly left $200 million in investor losses and clearing firm Bear on the hook for $10 million.

Bear,Stearns also cleared for Stratton Oakmont from 1990 until early 1994, when Bear bounced the firm amid bad press about its boiler-room tactics. Stratton was effectively shut down by regulators last month.

Right now Bear, Stearns is the clearing firm for at least 15 brokerages that are, if not full-fledged bucket shops, close to it. (See chart, p. 118.) These include Sterling Foster, charged last September in a $53 million fraud complaint by the NASD for manipulating stock prices of newly issued stocks; Lew Lieberbaum & Co., of Garden City, N.Y.; Josephthal Lyon & Ross Inc. of New York City.

Does having Bear as a clearing firm give cachet to smaller firms? Just ask Ian Barry, investment manager of Fiduciary Management Services, developers of Grand Bahama Island. In July 1995, Barry learned that the broker handling his client's $2 million account was moving its back-office business from Denver-based Hanifen, Imhoff to industry giant Bear, Stearns. "I felt we were in excellent hands," says Barry, from his office in Bermuda. "Bear, Stearns was a household name."

A global reputation was important to Barry because Fiduciary Management's broker, Richard Simone, had recently left Alex Brown & Sons for a brokerage firm Barry did not know-A.R. Baron &Co. Although Barry trusted Simone, he also says he felt comfortable with Simone's shift to Baron because of the Bear, Stearns connection.

Barry didn't rest easy for long. Immediately after Baron announced its new clearing arrangement with Bear, Stearns, Barry began receiving confirmations of trades in Fiduciary's account that he had never authorized Simone to do, stocks that bore no relation to the conservative securities Barry generally dealt in.

Unable to get these $2 million trades reversed by Simone, or A.R.Baron's owner, Andrew Bressman, Barry went to Bear, Stearns for help in canceling the unauthorized trades. Even though Barry notified Bear of the unauthorized trading within ten days, as required by New York State law, Bear, Stearns moved not one inch to rescind the trades. Bear advised Barry to take it up with Baron, claiming to be "just the clearing firm."

Barry never got satisfaction from Baron. As it turned out, Barry was one of many Baron customers victimized by the unauthorized trading. According to the Securities &Exchange Commission, since its very first days A.R. Baron had engaged in egregious sales practice abuses, including rampant unauthorized trading in customer accounts, and abusive sales practices involving stocks that it underwrote.

In industry parlance, Baron was a firm that employed a "no net sales" policy. That meant Baron's brokers would allow their clients to sell a position in one of their so-called house stocks only if another of the firm's clients placed orders to buy the shares. In short, a Baron stock couldn't drop because the broker wouldn't permit trades at lower prices. This had the effect of propping up Baron's special stocks, for a while at least.

As Barry discovered, Fiduciary's $2 million was used to buy shares in a Baron house stock-Cypros Pharmaceutical-that somebody else was likely selling. When the firm went bankrupt months later, Fiduciary Management was left with around $2.6 million in losses.

Fiduciary Management, in suing Bear, is represented by Lewis Lowenfels, a highly respected securities lawyer in New York City whose writings have been cited by the U.S. Supreme Court. Says Lowenfels: "The Fiduciary Management case goes to the heart of the legal responsibilities of clearing firms in relation to introducing brokers." In other words, in keeping Baron alive for almost a year, Bear, Stearns enabled the firm to harm investors with its fraudulent sales practices. As a result, Bear was perhaps more than just a clearing firm.

Bear, Stearns disavows responsibility for Fiduciary's losses, even though the firm was notified of the unauthorized trades almost immediately after they were placed.

Bear itself lost money in the Baron mess; it is identified in Baron filings as a creditor of the firm in the amount of $2.3 million. Oddly, Bear has not filed a claim with the bankruptcy court, perhaps trying to minimize its link to the disaster.

Why would Bear, Stearns risk its reputation by dealing for a firm like Baron? On July 17, 1995, for example, A.R. Baron settled a case with the NASD, agreeing to pay the regulator $1.5 million in fines and restitution; Baron's principal, Bressman, paid $35,000 to settle charges that he and the firm executed trades for customers at unfair and unreasonable prices. Three days after this public shaming, Bear, Stearns agreed to begin clearing for Baron.

Until the firm finally failed in July 1996, Baron's capital position several times fell below the minimum required by regulators. This means Baron could not conduct business until it put up more capital. On several occasions Baron simply closed its doors. But Bressman & Company would always manage to rustle up the necessary capital somewhere. At a crucial point in the fall of 1995, Bear put up $1.1 million of its own capital to float Baron back up to minimum levels.

All the while, Bear was receiving customer complaints from folks like Ian Barry. Bear continued to clear for Baron as SEC and NASD regulators were at Baron auditing and investigating continually throughout 1995. Finally, Baron was bleeding money: During the month of October 1995, for example, Baron had $5 million in losses and unpaid-for trades. Bear continued to clear.

The question of why Bear was involved with Baron gets even more curious when you discover that Bear had cleared for Baron once before, in 1992. Bear ended its clearing relationship with Baron that summer during an underwriting that Baron had in the works-Cypros Pharmaceutical. Harriton told Baron to look around for another clearing firm because Bear was afraid the Cypros deal would unwind and end up with a stock trading below the offering price. In short, Bear was worried Baron could not support the shares in the aftermarket. Baron found another clearing firm, Adler Coleman.

Unfortunately for Baron, Adler Coleman went bankrupt in 1995, so once again Baron needed a clearing firm. It landed at Hanifen, Imhoff for roughly three months, but was kicked out.

Why did Bear now open its doors to Baron?The question is especially compelling when you realize that because of the nature of Baron's business, Bear wasn't really making all that much money on its clearing business.

Remember the variety of ways a clearing firm makes money.The most profitable is charging interest on the firm's customer debits-typically a result of stocks bought on margin. But Baron had no customer debits-it was a firm, as many bucket shops are, that specialized in stocks that are not marginable. Baron's customers had no margin positions.

Neither did Baron's clients typically have credits in their accounts-cash resulting from a liquidated stock position.

Another interesting fact: Harriton's number-two man on the operations side at Bear, Stearns Securities Corp., Peter Murphy, wanted to throw Baron out. Murphy was overruled by Harriton.

Why would Harriton deal with a clearly disreputable bucket shop?

Was it as a favor to Morris and Abraham Wolfson, sons of New York real estate magnate Zev Wolfson-developer of One State Street Plaza? Morris Wolfson has sizable accounts at Bear, Stearns. He was also a big player in Baron's house stocks. And Wolfson Investment had bought $400,000 worth of A.R. Baron's privately issued convertible preferred stock. As a special client of Baron he would be entitled to allotments of hot issues before the suckers were invited in.

Bressman told people that the Wolfsons asked Harriton to take on Baron as a clearing firm again. Bressman told people that Harriton asked the Wolfsons if the family would guarantee the firm. The family declined, but Harriton took Baron back anyway.

Morris Wolfson, 38, is infamous as co-owner of a Harlem apartment building that collapsed in 1994, killing three people. Wolfson was not found liable for the deaths.

But Wolfson was not Harriton's only tie to the Baron firm. After taking Baron back into the Bear, Stearns fold, Harriton introduced Bressman to Harriton's pal, barred manipulator Randolph Pace. Bear, recall, cleared for Rooney, Pace before it went out of business in 1987. Pace didn't return a reporter's phone call seeking comment.

Harriton apparently isn't discriminating when it comes to picking friends. Baron's president, Andrew Bressman, has also been chummy with Harriton. Bressman has dined often with the Bear managing director, taking him to New York Knicks basketball games, where Bressman's front row seats let him and his guests rub shoulders with celebrities like film director Spike Lee.

A person intimately familiar with the clearing business at Bear, Stearns tells FORBES that more than favors were involved. The source insisted on strict anonymity but is clearly knowledgeable about the situation.

Here, according to the source, is what happens: A bucket shop that clears through Bear has a hot underwriting in the works. On the day the stock begins trading, as many units or shares as are needed to generate a $100,000 profit are placed in a so-called nominee account at another brokerage firm. A nominee account is an account that carries a fictitious name. Our source charges that Harriton was the beneficiary of trades of this sort.

A. R. Baron was not the only sleazy outfit to clear through Bear, Stearns. Another Bear, Stearns clearing customer is Sterling Foster, the penny-stock outfit that the NASD sued for $53 million in a fraud case last fall. A company that Sterling Foster brought public last year, called Embryo Development Corp., lists Matthew L. Harriton, 31, as its chief financial officer. He is said to be

Richard's son.

The last hot stock underwriting sponsored by A.R. Baron came on Aug. 9, 1995: 1.8 million shares at $5 in a company called PaperClip Imaging Software, Inc. Like most hot Baron issues, PaperClip rose on its first day of trading, to almost $8. Those in on the offering who sold before the close of trading reaped handsome gains.

Normally, with this kind of offering, the first allotments go to favored customers and insiders. But with PaperClip, large numbers of the shares were assigned not to the clients who had been promised them, but to overseas entities-suspected to be nominee accounts.

The presumption is that Baron insiders and their friends were the real owners. An obvious manipulation, PaperClip is now trading at less than 50 cents.

FORBES gave Bear, Stearns plenty of time to respond to our allegations. Bear, Stearns' only comment was: "Pending litigation prevents us from commenting."

The whole situation stinks.

**The Big Uneasy --- A Cloud Over A Gaming Company's New Orleans Bid**
By Eric J. Savitz
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THERE'S something about gamblers and boxing: Whenever one shows up, the other seems sure to follow. For years, some of the biggest fights were sponsored by Caesar's Palace and other Las Vegas casinos. When Atlantic City's gaming halls opened their doors in the late 'Seventies and early 'Eighties, much of the boxing business picked up stakes and headed East. More recently, the fight game has opened up a Southern branch, holding bouts in Biloxi, Miss., the home of a growing fleet of riverboat casinos.

So in some ways it made perfect sense when Triple Threat Enterprises, the one and only publicly traded boxing management company, decided to sell off its money-losing boxing operations and get into the red-hot gambling business.

It's been a quick transformation. One year after Triple Threat completed its departure from the boxing ring, the company has new managers, a new name, Capital Gaming International, and a new business-casino gambling.

Capital Gaming has adopted a two-pronged strategy. It pursues gaming-management contracts for Indian reservations, and it seeks riverboat casino licenses. Earlier this year, the company agreed to pay $2.5 million for British-American Bingo, a Phoenix-based subsidiary of Bass PLC that operates high-stakes bingo and other non-casino gaming operations for Indian tribes in five states. British-American also has contracts to develop and manage casinos for both the Narragansett tribe, in Charlestown, R.I., and the Muckleshoot tribe, in Auburn, Wash.

Meanwhile, Capital Gaming's 72%-owned Crescent City Capital Development subsidiary recently received tentative approval from the Louisiana Riverboat Gaming Commission for the proposed Crescent City Queen -- a yet-to-be-built sternwheeler with 30,000 square feet of gaming space, to be berthed on the Mississippi River in New Orleans. At the same time, the company is scouting future gaming opportunities in a variety of other jurisdictions. It has acquired an option on a tract of land along the Delaware River in Philadelphia, where talk of gambling is growing, despite the opposition of Pennsylvania's governor.

Investors have responded warmly to the early efforts in casino gaming. Since the start of the year, Capital Gaming's shares have soared to around 8 from 1 3/8 -- as recently as late June the stock traded as high as 12 5/8. Last week there were signs that holders were getting restless -- the stock slumped nearly three points. And the truth is, there are reasons to be wary.

For one thing, Capital Gaming's ambitions seem to exceed its resources.

By the company's own estimates, developing its planned casinos in Louisiana, Rhode Island and Washington will require at least $86 million -- $40 million each for the New Orleans and Narragansett projects, $6 million for the more modest Muckleshoot facility, on which construction is scheduled to start within a few days.

As of March 31, however, Capital Gaming had just $5.4 million in the bank. The company recently called its outstanding warrants, which should raise another $2 million, but that's hardly the solution.

Nor can the company count on much help from the ongoing British-American Bingo operations: The company estimates that Indian gaming-management fees will fall to $2.9 million for the September 1993 fiscal year from $3.9 million last year and $5.1 million in fiscal '91.

To address its financing needs, the company plans to sell at least $50 million of junk bonds. But that may require the cooperation of some risk-taking investors, for Capital Gaming faces a host of political and regulatory hurdles.

The planned Rhode Island casino, for instance, faces opposition from almost every major politician in the state. The issue is tied up in court, but ultimately could be decided by Congress, which is considering modifying the Indian gaming laws to give more control to the states. In Louisiana, the system for awarding licenses has been roundly criticized in the local press for being highly politicized. President Riverboat Casinos, which was denied a license, is challenging the process in state court.

Not least, the company faces major regulatory hurdles. Before it can operate its proposed New Orleans riverboat, it requires a license from the gaming division of the Louisiana State Police, which will first conduct a detailed background investigation. The BritishAmerican bingo acquisition, meanwhile, requires an okay from the National Indian Gaming Commission, which is conducting an inquiry of its own. And a little poking around in the closets of some of the principal players in the Capital Gaming cast yields a crowd of skeletons.

Capital Gaming, a/k/a Triple Threat Enterprises, came public in November 1990. In an offering underwritten by **D.H. Blair**, the company sold one million units -- each consisting of four shares and four warrants -- for $5 each. After the exercise of all of the warrants -- the company called them for redemption in early July -- Capital Gaming will have 13.6 million shares outstanding.

At the time of the initial offering, the company's primary business was managing the careers of three boxers: Charles "The Natural" Murray, a welterweight; Alfred "Ice" Cole, a cruiserweight; and "Merciless" Ray Mercer, a heavyweight.

None of the three remind anyone of Frazier or Ali; Murray and Cole are probably familiar only to hard-core fight fans. Mercer's exploits in the ring may be more familiar: The Manhattan District Attorney's office recently charged that during a February fight in which he unexpectedly found himself losing, Merciless Ray repeatedly offered fellow heavyweight Jesse Ferguson a $100,000 bribe to take a dive. Ferguson declined and won the encounter, depriving Mercer of a chance at a title bout. Mercer pleaded innocent to the bribery charge. There's talk of a rematch.

Months earlier, Triple Threat saw the writing on the wall. Reliant on its floundering fighters for cash flow -- its primary source of revenue was a 22 1/2% interest in their earnings-Triple Threat found itself on the ropes.

So in February 1992, Triple Threat began exiting the fight game, selling a share of its boxing interests to Great American Recreation, operator of a ski resort and other recreational properties in northern New Jersey. Last July, Great American agreed to acquire the rest of the boxing business. And in September, less than two years after its IPO, Triple Threat changed its name to Gaming Devices Funding Inc., to reflect its new business: providing "financial support to video lottery and electronic gaming machine manufacturers."

An interesting idea in theory, but apparently not very profitable in practice. For in January 1993, the company set the stage for a second change of direction, hiring two former Atlantic City casino executives to run the company.

I.G. "Jack" Davis, who spent nearly three decades as president of Resorts International before becoming president of Donald Trump's Taj Mahal Casino, was named CEO, and one month later added the title of chairman. Edward Tracy, former president of Trump's three Atlantic City casinos, became president and chief operating officer. At the time they were hired, Davis and Tracy had been partners in a gaming consulting firm, and Davis says the company hired Tracy at his suggestion. Two months after Davis and Tracy joined up, Gaming Devices Funding became Capital Gaming International.

The appointments of Tracy and Davis, both with long track records in the casino business, gave the company some muchneeded credibility. Davis contends the process of winning gaming licenses should be aided considerably by the fact that both men are already licensed by New Jersey's Casino Control Commission, and he's little fazed by the political and legal roadblocks that stand in the way of the company's Louisiana and Rhode Island projects. The obstacles are, nonetheless, considerable.

Davis contends the proposed Narragansett casino will be a boon not only to the company, which would collect 30% of the facility's operating profits, and to the tribe, but also to Rhode Island, which would get 2,500 new jobs. Nonetheless, casino gambling is opposed by almost every major Rhode Island officeholder, on the grounds that a casino would encourage crime and create more economic ills than it would cure. Democratic Gov. Bruce Sundlun, who has led the opposition, has vowed that "there'll never be a casino as long as I'm governor." Also opposing the project: Attorney General Jeffrey Pine; U.S. Sens. Claiborne Pell and John Chafee, and U.S. Reps. Ron Machtley and Jack Reed.

When the tribe declared its intention to build the casino last year, Rhode Island filed suit in federal court in an attempt to stop it. The state lost but has since appealed, and a hearing is expected sometime this fall.

Simultaneously, the casino's opponents are trying to change the rules of the game: Rep. Machtley has drafted federal legislation designed to limit the scope of Indian gaming, to give the states greater control.

In challenging Louisiana's casino-selection process, President Riverboat Casinos contends that the Riverboat Gaming Commission didn't follow the procedures laid out by the state legislature. Gordon Grant, a New Orleans lawyer representing President, contends that part of the problem is that the process has become "highly politicized."

As noted, both of Capital Gaming's major projects face regulatory review; a negative finding by either body could be devastating for the company. So it's significant that the personal histories of some people associated with the company could invite close scrutiny. And while Capital Gaming expresses confidence in its ability to successfully navigate the regulatory waters, there are signs that the company is aware of some obstacles below the surface.

Specifically, late last month it announced the resignation of John E. Dell, its largest shareholder, as vice chairman and a director, and said Dell had formed a trust to liquidate his entire position in Capital Gaming stock. A founder of the company who at one point served as chairman, president and chief executive, Dell owns 3,455,000 shares -- about a quarter of the 13.6 million shares outstanding after the warrant conversion.

Two million of Dell's shares are subject to options previously granted to members of management. Davis has the right to acquire 500,000 of Dell's shares at $5 apiece, and one million more at $10. Frank Gelb, a Ventnor, N.J., boxing promoter who serves on the company's board, can acquire the other 500,000 shares for $5 each. According to the company, Dell intends to liquidate the remaining 1,455,000 shares at the rate of 5,000 shares a day -- except under certain conditions, which it didn't spell out and which Davis says aren't specifically defined.

Davis, who serves as trustee for the trust holding Dell's shares, says he could accelerate the divestiture if he concludes that additional sales won't upset the market in the stock.

At 5,000 shares a day, it would take 291 trading days -- well over a year -- to unload the rest of Dell's position, assuming Davis and Gelb exercise their options. At one point, Dell had an even larger stake-but in late May he sold 1,025,000 shares in the open market at an average price of $9.14 a share.

In explaining the resignation, Capital Gaming said Dell "has not previously held or applied for a casino operator's license," and noted that over the past 10 years, he "has been involved in a number of complex business transactions which he felt might unnecessarily delay the Indian Gaming Commission's normal due-diligence process with regard to Capital Gaming's acquisition of British-American Bingo."

Davis says Dell was the only member of the company's management without a New Jersey casino license. "All the other managers and principals have current licenses," he says. "In other jurisdictions, we will rely heavily on the fact that New Jersey has done all this investigation over the years. Dell would have caused us considerable delay in passing the entire company."

Dell will remain a consultant to the company on matters unrelated to Indian gaming, and, according to Davis, Dell will continue to be paid $240,000 a year in consulting fees.

Despite the company's protestations to the contrary, it seems possible that gaming regulators may be less concerned about the complexity of his business affairs than with the types of activities in which he has been involved.

Many of Dell's business ventures have links to the pennystock firms First Jersey Securities and F.N. Wolf & Co. Since 1988, for instance, Dell has served as a consultant to F.N. Wolf. While Dell isn't an officer of the firm, he's clearly a valued member of the team-in fiscal 1992, the brokerage paid him compensation of more than $3 million. F.N. Wolf's namesake, Franklin N. Wolf, was a director at Triple Threat until resigning in July 1991.

In January of this year, the SEC filed suit in federal court in Manhattan against F.N. Wolf and another brokerage firm specializing in small stocks, Hibbard Brown & Co. The government alleges a variety of securities-law violations stemming from the sale of stock in Treats International, a company that the government contends was at one time almost entirely controlled by First Jersey Securities founder Robert Brennan. While Dell was not personally a target of the suit, the activities addressed in the charges took place while Dell was drawing millions in compensation from F.N. Wolf.

For the 10 years prior to his association with F.N. Wolf, Dell was an officer at First Jersey, and in 1985 he succeeded Robert Brennan as the notorious firm's president (regulators eventually drove First Jersey out of the brokerage business). Over the years Dell and Brennan have repeatedly crossed paths. Brennan, for instance, owns a 13.3% stake in Great American Recreation, the company that bought Triple Threat's boxing operations. Percival Leach, who resigned as a Capital Gaming director in April of this year, is now working with Great American on the possible development of an Indian gaming facility in northern New Jersey. Despite Capital Gaming's sale of its boxing business to Great American, Dell personally serves as boxer Ray Mercer's manager; Hank Johnson, Mercer's trainer and a former Triple Threat director, is now on the Great American board.

The regulators may also be interested in the past activities of Frank Gelb. Besides sitting on the company's board and holding an option to buy 500,000 of Dell's Capital Gaming shares -- an option now worth well over $1 million -- Gelb is a well-known boxing promoter long associated with casinos in Atlantic City and elsewhere.

Gelb says his primary role at Capital Gaming is to work on development of casino gambling in his native state of Pennsylvania; for his troubles, the company pays him $120,000 a year. Among his current boxing projects: promoting an Aug. 12 fight at a casino in Bay St. Louis, Miss., pitting Ray Mercer -- yes, that Ray Mercer -- against heavyweight Tony Willis.

In 1985, Gelb's name appeared prominently in a report prepared by New Jersey's Commission of Investigation on the influence of organized crime on boxing in the state. The report devoted more than 20 pages to discussion of Gelb's relationships with several reputed members of Philadelphia's Scarfo-Bruno organized-crime family.

Among other things, the report noted that Gelb, who then had an office in Center City Philadelphia, received repeated visits from Frank "Blinky" Palermo, a former boxing promoter now in his eighties who at one time was convicted of a wide range of crimes, including extortion, racketeering and aggravated assault and battery. According to the report, Palermo introduced Gelb to Frank "Frankie Flowers" D'Alfonso, a reputed mobster whose shooting death on a Philadelphia street in July 1985 led to life sentences for mob boss Nicodemo "Little Nicky" Scarfo and seven of his associates.

In the report, the commission said it had received information from the New Jersey State Police indicating that D'Alfonso and Palermo "were involved in closed-circuit boxing with New Jersey licensed promoters Gelb and Joe Hand." According to the report, D'Alfonso invested $50,000 of mob funds in a closed-circuit telecast co-promoted by Gelb and Hand in 1980.

Gelb was never charged with any crime related to the activities described in the report-he says he never did anything wrong, and "never even had a traffic ticket." As evidence of his clean record, he points to the fact that he remains licensed to do business with the Atlantic City casinos.

Davis says he wasn't aware of Gelb's mention in the report, but adds that he doesn't think it matters. "If you're licensed in New Jersey," he says, "you're doing pretty darn good. That completes my due diligence." Still, it seems likely that the report was familiar to Capital Gaming's executive vice president for compliance, Clinton L. Pagano. From 1975 to 1990, Pagano served as superintendent of the New Jersey State Police, a stretch that includes the period in which the state police were providing the Commission on Investigation with information about Gelb's relationship with reputed mobsters.

The 28% of Crescent City Capital Development not owned by Capital Gaming is held by Republic Corporate Services, a Shreveport, La., distributor of video lottery terminals. Republic, owned by Sammy Mijalis, employs as a contractor the wellconnected Louisiana businessman Gus Mijalis, Sammy's uncle.

Both Gus Mijalis and the company go out of their way to point out that he's neither an officer nor a shareholder of Crescent City or Republic. But it's clear that Gus Mijalis continues to play a central role in Crescent City's bid to open a Louisiana casino: Call Republic asking to speak to someone about Crescent City, and you're immediately referred to Gus Mijalis. And one day after Barron's spoke to Capital Gaming Chairman Davis, Mijalis boasted in an interview that Davis had held the previous day's discussion from Mijalis's Shreveport office.

Although Mijalis denies that politics had anything to do with Capital Gaming's selection by the Riverboat Gaming Commission, it's undeniable that Mijalis long has had a close relationship with Louisiana Gov. Edwin Edwards, who nominates the members of the commission. Edwards has appointed Mijalis to several other state posts, including seats on the state's racing commission and the Board of Regents; Mijalis has provided and helped raise campaign funds for the governor.

In 1985, Mijalis, Edwards and several others were indicted on racketeering and conspiracy charges relating to the issuance of hospital and nursing-home certificates of need. All defendants were acquitted; Mijalis contends the allegations were politically inspired. "I have a piece of paper that says we're totally innocent," Mijalis says.

In 1986, the Bank of Commerce, a Shreveport institution Mijalis controlled, was declared insolvent by federal regulators. The Federal Deposit Insurance Corp. filed suit against Mijalis and several other bank officers, alleging breach of fiduciary duty and negligence in their administration of the bank. A jury returned a $29 million verdict against Mijalis and four associates, finding gross negligence. The case remains tied up in court as the FDIC attempts to collect the award from the insurers who provided the bank with officers' and directors' liability coverage.

(At the time the Bank of Commerce was closed down, Louisiana's commissioner of financial institutions was Kenneth Pickering, who now serves as chairman of the Riverboat Gaming Commission. Pickering was one of only two members of the seven-member panel to oppose Capital Gaming's riverboat application; he declines to discuss the reason for his vote. "It didn't go the way I wanted it to go," Pickering says. "That's just the way it is.")

In Washington, the House Oversight and Investigations Subcommittee held a hearing in May on insurance fraud. The hearing featured the testimony of Carlos Miro, a convicted swindler cooperating with federal authorities while awaiting sentencing on 16 counts of mail fraud related to his role in the 1988 collapse of Anglo-American Insurance of Louisiana. In describing Anglo-American's activities, Miro testified that he and an associate were at one point told by Mijalis that he could arrange a Louisiana license for Anglo-American for $50,000.

Mijalis has never been charged with any crimes in connection with the collapse of Anglo-American, and he denies any wrongdoing. But he concedes that he once acted as consultant to the failed insurer; according to news reports, Anglo-American paid Mijalis $25,000 in consulting fees in 1988, and in 1986 had listed Mijalis as a contact on its insurance application with the state.

Miro also told the subcommittee that he, Gov. Edwards and Mijalis planned unsuccessfully to generate millions of dollars for themselves by gaining control of Louisiana's workers' compensation system. Edwards has denied the allegations, branding Miro a "self-confessed liar and thief."

In early 1985, Mijalis bounced three checks he'd written on accounts at the Bank of Commerce that were intended to pay gambling debts incurred at Harrah's Club casino in Lake Tahoe in October 1984. Seeking payment, Harrah's sued Mijalis, first in Nevada and later in Louisiana, in a case that dragged on for years. Mijalis says the debt was cleared -- but only after Mijalis filed for bankruptcy. Mijalis says his bankruptcy proceedings were wrapped up several months ago.

Despite all this, Mijalis says there's nothing in his past that should slow the licensing of Crescent City Development's riverboat. "They've looked at me every way in the world," he says. "If there was anything in my background, someone would have found it a long time ago."

He gets no argument from Tracy or Davis. "As far as the company is concerned, he hasn't done anything illegal or anything wrong," Tracy says. "He's never been convicted of a crime."

On the subject of Mijalis's friendship with the governor, Davis observes that "everybody here says or is said to be close to the governor. I've met a lot of people down here who have similarly close relationships."

For his part, Mijalis says his relationship with the governor wasn't a factor in Capital Gaming's success before the Riverboat Gaming Commission. "The governor had nothing to do with this," he says. "We made a good presentation."

The company agrees. "We think it's always astute to have a local partner," Tracy says. "Republic Corporate Services is already licensed in the state to distribute video gaming machines," potentially speeding the process of getting them approved for a casino license.

At least, that's what they're betting on.

**INCOMPETENCE, INC. (ROONEY, PACE GROUP BROKERS; INCLUDES RELATED ARTICLE ON UNFRIENDLY TAKEOVER OF NORLIN CORP.)**

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English


Incompetence, Inc.

THIS IS A STORY THAT is hard to tell with a straight face. It has had its comic aspects, but what isn't funny is that lots of people lost lots of money through the machinations of Pat Rooney, Randy Pace and their Rooney, Pace Group.

Let's go back to the late summer of 1984. Patrick Rooney, the cochairman of the publicly traded brokerage house of Rooney, Pace, was entertaining hundreds of employees and spouses at his Southampton, N.Y. summer home. Under a big circusstriped tent on the tennis courts, guests sipped champagne and ate hors d'oeuvres before sitting down to a catered dinner.

Amid the festivities, the flamboyant hosts, Rooney, and Randolph Pace, made a grand announcement: Two registered representatives among the guests that night--Richard Nager and James Cohen--were being rewarded with the titles of managing director. Well, not right away. When they returned officially to work. The pair was taking what was referred to around the firm as "an SEC vacation.' They had been suspended by the Securities & Exchange Commission from working at Rooney, Pace for 30 days after the signed consent decrees to charges of stock manipulation involving a company called Sequential Information Systems.

Among the guests was Harry Henzel, a slight, graying 39-year-old broker who'd been hired from Bear, Stearns the previous spring to manage Rooney, Pace's new Atlanta office. Henzel was carried away with the festivities and the euphoria about his new job, but it did strike him as peculiar that the firm should reward a couple of types who had just been censured by the SEC. Today he wishes he had been more alert to the implications about a corporate culture that took securities violations so lightly.

Rooney and Pace themselves made an interesting pair. Pat Rooney, 46, the son of an Ontario postman, as a kid hustled newspapers in remote Thunder Bay, Ont. Rooney worked his way through the University of Minnesota and, after graduation, labored first as an accountant at Price Waterhouse, then as chief financial officer for a small financial firm. Bored and restless, he drifted from one brokerage house to another as an analyst and institutional salesman, finally landing at Baird Patrick & Co., where he met Randy Pace. The two then left together to work at Ross Stebbins, a now defunct New York broker.

Randolph Pace, now 41, is the son of a Brooklyn doctor and attended Long Island's Adelphi University. He left law school after three months, and in 1971 went to work for his uncle's brokerage firm, William Norton & Co., until it closed in 1973 under a cloud. Norton pleaded guilty to violating securities and tax laws. Pace was indicted in 1976 for tax fraud, based on information that came out during the investigation, but he was granted immunity in return for giving testimony in the Norton case.

Both now schooled in pushing stocks, Rooney and Pace boosted Ross Stebbins' revenues way up, and then, denied a controlling interest, left to form Rooney, Pace in 1978. Pat was the dealmaker, Mr. Outside, while Pace pretty much ran the firm. Specializing in initial public offerings of small, risky companies, Rooney, Pace was positioned to do spectacularly well in the new-issue booms of 1980-81 and 1982-83. Some of its merchandise was dicey--unproven companies that more respectable brokers wouldn't touch--but the profits were sensational: For the fiscal year ending May 1983, the partners netted $23.4 million before taxes on revenues of $56.9 million. Pretax margins of better than 40%--if only all the companies they dealt in had done so well.

But easy profits proved their undoing. Hubris set in. If they could make that kind of money peddling relative junk, why not move into the big time and make hundreds of millions?

Pat Rooney, the more ambitious of the two, followed the example of Sanford Weill, the man who built a tiny brokerage firm into what is now American Express' Shearson Lehman Brothers. Rooney deeply admired people like Sandy Weill. He admired financial success in any form, going so far as to name his son Victor --for Victor Posner.

Rooney wanted to do what Weill did: expand during poor markets by acquiring weak brokerage firms for virtually nothing, and wait for the good markets and spectacular profits.

Rooney forgot that Sandy Weill had built his company with a close eye on costs. So far as costs were concerned, Pat Rooney threw caution to the winds. They figured they were loaded. Pat and Randy, for example, took Rooney, Pace public in October 1983, raising $16 million at $8 a share, keeping 54% of the stock for themselves. They went on a spending spree, raiding big-producing registered reps from mainline firms, luring hotshots with bonuses for signing that routinely hit $150,000 and more. The firm expanded to 23 offices and 600 employees.

The result: Rooney, Pace almost went broke during the biggest bull market in history. By the spring of 1985, the firm was out of cash, having lost virtually all of the partners' original capital, the proceeds from its stock offering and $25 million raised in a junk bond deal in 1984.

Remember the old joke: "We lose money on every item we sell but make it up on the volume'? That seems to have been the Rooney, Pace strategy. The company was paying its brokers 50% of the commissions they brought in vs. 35% to 40% for the industry in general. On top of that, forgivable loans, credited to some salesmen by boosting their commissions another 10%, raised some reps' take to 60% on each sale. Rooney, Pace, also paid the brokerage firm of Bear, Stearns another sizable cut to do all its back-office work. Analysts, too, got in on the largesse. Analysts got a percentage of the commissions that came in for the stocks they recommended. Some Rooney, Pace analysts who had base salaries of $60,000 were earning $500,000 with commissions. Analyst Jane Gilday, one of the stars, reportedly made $800,000 to $1 million one year.

Add it all up and Rooney, Pace was frequently paying out more in overhead and commissions to its employees than it was earning from customers. Costs were out of control: The company's offices were too numerous and too expensive, and its support staff was bloated. It's easy to see how the profits disappeared.

So here was a firm that went public on the basis of 1983 pretax earnings of some $23 million, but by the end of fiscal 1984 earnings were down to $1.2 million on revenues of $50.6 million --and, judging from the sloppy bookkeeping, these earnings were probably overstated. By the end of fiscal 1985, pretax losses were $43.8 million on revenues of $48.7 million. Expenses were 70% greater than revenues. Rooney, Pace's capital base was melting away, and the regulators would soon be asking nasty questions, but not enough, as it turns out.

What makes this true story seem incredible--why it would never fly as fiction--is that all the while it was losing money by the bagful, Rooney, Pace was milking customers and flouting rules supposedly in place to protect the public. Example:

In 1985 Rooney, Pace was a marketmaker and owned 1.1 million shares of a stock called Syncom (a hodgepodge of small companies selling dried flowers and ladies stockings, among other things). By August 1985, when Rooney, Pace's net capital situation was so bad the NYSE could have shut the doors, Syncom stock had moved up to 1 1/4 bid and 1 5/16 asked. Rooney, Pace began pressing its corps of retail brokers to move the stock from inventory to customers at its market high. So anxious was Rooney, Pace to unload the shares that it gave the brokers a 25-cent-per-share sales credit. And it worked. The firm picked up an extra $1 million or so for its depleted capital account. And the customers? Within three months the stock's value collapsed to 47 cents, or 64%. The most recent quote: between 3 and 10 cents.

Back now to Harry Henzel, the Atlanta branch manager. On Friday, Mar. 15, 1985 Henzel had a personal portfolio of stocks worth over $1 million, representing a net worth that had taken him 18 years to build. The following Monday it was gone.

The firm owned 189,000 shares of the Computer Stores Inc. and made a market in the stock. Henzel and his Atlanta salesmen had been big buyers of the stock for themselves and their customers. Pace wrote an order ticket, totally unauthorized and illegal under SEC regulations, selling the stock to Henzel at $3.50 a share, $1.50 above the then existing market price. But there was more. When the market opened on Monday with the stock still at 2, Henzel's account, facing a margin call and unable to cover the bogus "buy' at $3.50, was ultimately wiped out.

Why did the New York office foist the stock on Henzel? He says Rooney, Pace needed the money. The firm's net capital was reported on Feb. 22 as only $1.2 million, and by May 31, as $739,486. Moreover, a cash flow report submitted as part of Henzel's case showed that Rooney, Pace was in so much trouble the day it moved the stock to Henzel that there was only $800,000 in the bank to cover $1.8 million in checks written.

A year later, after 52 hearing sessions, a New York Stock Exchange arbitration panel awarded the $1.1 million back to Henzel--although legal fees ate up half the award. Rooney's defense during the arbitration hearings was an eye-opener, showing how close to the wind the firm was sailing. FORBES has obtained copies of the arbitration hearings transcripts, which run to almost 5,000 pages. The main charge by Henzel, of course, was that Pace sold stock to him that he hadn't ordered. But even Rooney, Pace's defense itself can be read, without much trouble, as admitting to numerous violations of SEC, NYSE and NASD regulations--a pattern that shows up in other cases involving the brokerage.

Theodore Rosen, a former managing director of Rooney, Pace, says the firm did the same thing to him, dumping into his account stock in Regent Air, a first-class airline, now in bankruptcy, that was brought public by Rooney, Pace. Rosen lost about $50,000 but, unlike Henzel, swallowed the stock.

A similar story can be found in American Educational Computer, a stock manipulation case out of Rooney, Pace's Oklahoma office. State securities officials characterize this as "the worst securities fraud case in Oklahoma's history.' But this time an investor, Floyd Bergen, was involved. In a lawsuit, Bergen charges that he lost $1.4 million because American Educational Computer stock had been placed--"parked'--in his account in January 1985 without his authorization (a potential SEC violation), allegedly to keep the stock from tanking by showing there was a buyer when there was none. While Rooney, Pace in a suit against its Oklahoma brokers blames the brokers, Bergen charges it was a combination of actions among the local brokers and the home office in New York.

More irregularities: Pace, himself, admits that some of his analysts, brokers and top executives bought stock before the firm published its recommendations. On Wall Street they call this "frontrunning,' and it is illegal under SEC regulations. But brokers were thus able to buy stock for themselves before recommendations got to the clients, and then sell as clients bought at a higher price. This at a time when the firm was attempting to build an institutional client base. "By the time the reports got to the institutions, the stock was already up,' says one disgusted ex-employee. "Maybe retail investors won't notice, but institutions aren't that dumb.'

It wasn't that Rooney, Pace did doubtful, even possibly illegal, things only when it got into trouble. It was simply acting true to character. In 1981--two years before Rooney, Pace went public--there was Sequential Information Systems Inc. The SEC recently ruled that Randy Pace and two of his brokers, in attempting to do a public offering for the company, parked shares of Sequential Information in customer accounts to make it look as if the offering had been sold. Apparently, even naive customers couldn't be talked into buying stock in a company whose prospectus said it could go bankrupt if it couldn't do the offering. Sequential needed money to pay withholding taxes to the government.

At this point, a name familiar to FORBES readers enters the picture. Remember Robert E. Brennan, the flashy and crafty founder of First Jersey Securities? Brennan's family and associates owned 20% of Sequential's stock.

This was not the only involvement of Rooney, Pace with Robert Brennan. In 1981 Rooney, Pace brought International Thoroughbred Breeders public. ITB breeds horses, races them and spent tens of millions to reopen the Garden State Race Track in southern New Jersey-- which gives Brennan his credentials in the horse racing world.

Brennan's moneymaking acumen, unfortunately, did not rub off on Rooney, Pace. Acquisitions engineered by Pat Rooney and occasionally by Randy Pace usually proved disastrous. In 1981 they acquired salesmen and offices of John Muir & Co., a new-issue house that was closed down in violation of net capital minimums. Seemingly oblivious to that public relations blunder, Rooney, Pace plowed on with an acquisition of brokerage offices of J. David & Co., the remnants of the empire of Ponzi-builder J. David Dominelli. The brokers left, but the leases on ten offices stayed.

There was the acquisition of Hanover Square Securities to get Rooney, Pace into the lucrative stock-loan business that makes short-selling possible. Unfortunately, Hanover's stock business was riddled with fraud. And even though Hanover Square had a strong floor trading operation, business disappeared. End of Hanover Square-- again except for some very expensive leases. There also was the $1 million acquisition of Securities Counsel Inc., a Michigan-based firm that managed institutional money. But institutions were reluctant to do business with Rooney, Pace. So Securities Counsel was unloaded for $250,000.

Did the partners know how bad things were getting? Good question. One source says there were periods when the top executives at the firm did not know how much money they were losing and how quickly. Partly true, probably, but partly ingenuous. Sketchy bookkeeping confused the regulators--the New York Stock Exchange, in particular. The NYSE, which regularly inspects its members, in 1984 discovered many bookkeeping problems that tended to exaggerate Rooney, Pace's net capital position. When it looked again in the summer of 1985, many of the irregular ways of computing net capital had not been corrected. When they were, the corrections completely wiped out the firm's capital. Rooney, Pace notes in its 1986 10K that, because of additional charges imposed by the NYSE, it was in violation of net capital for certain periods of 1985 and into 1986.

Shortcomings, according to former Rooney insiders, included carrying some stocks on their books at inflated prices. In addition, large bills went unpaid and even unrecorded on the books, a way of overstating the brokerages' capital position until after the monthly net capital reports were turned in to the regulators.

Perhaps Rooney, Pace's worst acquisition--it cost the firm some $12.3 million --was the unfriendly takeover of Norlin Corp., which among other things owned Charles P. Young & Co., specializing in the printing of Wall Street documents. Would Wall Street trust Rooney, Pace with its most classified secrets? Naturally not, but the thought never seems to have crossed either Rooney's mind or Pace's. It was perhaps the clearest case of Rooney's ego overcoming good business sense, says a former associate. Norlin also proved to be the wedge that drove the two partners apart. Pat Rooney left to run Norlin in May 1985. Rooney and Pace privately made $103,000 apiece by selling Norlin stock they had acquired to Rooney, Pace (see box).

In the summer of 1984, months after the Norlin acquisition, Rooney, Pace was in such straits that to raise $25 million Pat tapped the junk bond market at an interest rate of nearly 18%. Capital was draining away fast--millions went to meet a margin call on Norlin stock and to pay off a $5.3 million contract settlement to Rooney, Pace former vice chairman Lawrence Williams.

By July 1985, while Wall Street in general was enjoying one of the biggest bull markets in history, Rooney, Pace announced it could not meet the second interest payment on the bonds-- indeed, if forced to, might have to declare bankruptcy. Having little choice, most bondholders agreed to swap the bonds for a combination of preferred and common stock and notes.

Reading this tale of incompetence and corruption, the reader may well ask: Where were the regulators? Why didn't the New York Stock Exchange shut down Rooney, Pace? The answer sheds little credit on the Big Board. As a member firm Rooney, Pace had been admitted to the club. Unlike the NYSE, the National Association of Securities Dealers regularly closes down firms that violate net capital requirements. Witness OTC Net and John Muir & Co. Howard Sirota, a former NASD enforcement attorney, now a lawyer in private practice, takes a cynical view of the Big Board's tolerance of Rooney, Pace's shortcomings: "Being a member of the New York Stock Exchange means never having to say you're sorry.'

And where was the SEC? Attorney Ira Lee Sorkin, who headed the SEC New York regional office until he resigned in September, blames the stock exchange. "We turned over whatever we had to them.'

What does the exchange say? "When one of our firms gets into financial difficulty, we try to work with them until they can get a capital infusion or we can arrange a merger,' explains John Phelan, chairman of the NYSE. "We did pay a lot of regulatory attention to Rooney, Pace,' says Henry Poole, NYSE general counsel.

At any rate, the matter is now academic. Rooney, Pace is no longer an exchange member, having resigned in June of this year.

This tragicomedy is not yet ended. It has an epilogue--which may bring more of the same. Rooney, Pace, down to only five offices and 200 employees, still functions. Its shares are languishing at around $1 a share on the American Stock Exchange.

But Rooney, Pace is not moribund. Though Pat Rooney said he is "too busy' to talk to FORBES, a contrite Randy Pace, now running the firm without his old partner, was not. Pace says it was really Pat who drove them too far too fast, though he blames himself for riding along. And for front-running stocks? "I took care of the problem by firing the brokers and analysts,' he says. To try to avoid future bookkeeping irregularities, Pace says he has hired a new chief financial officer. Yet, even at this late date, Randy Pace says he does not understand why he's taken so much heat from the SEC and New York Stock Exchange. "The lesson I've learned,' he says, "is to stick to the basic brokerage business.'

Among those who believe he will is brokerage industry analyst Perrin Long of Lipper Analytical Distributors. Long says Pace has cut costs and recently reported net capital of over $5 million and a profit of $844,000 for the first 1987 quarter, ending August. Best of all, says Long, Pace is going back to his roots--the thing he knows best--small initial public offerings and over-the-counter market trading.

Another believer, apparently, is a group of partners led by a Chicago venture capital firm called Walnut

Capital. After an earlier affiliation deal with a Wall Street outfit fell though, the Walnut people agreed to take half the seats on the board and bring Rooney, Pace's capital up to about $10 million. Oh, yes. There will be a new Rooney, Pace stock offering to raise more capital.

How much has really changed? One of the proposed Rooney, Pace investors is former Las Vegas casino operator Clifford Perlman. The state of New Jersey in 1980 denied Perlman a casino license. One reason may have been his alleged mob connections. Ah, yes, Cliff Perlman. Rooney, Pace lost a lot of money when it took Regent Airlines public in 1983 because the federal government wouldn't grant Regent a license. Why? Because it may not have liked the association between Regent and Perlman, who was Regent's chairman.

Never mind. The new stockholders say they want to clean Rooney, Pace's image and may change the name to help do so. It looks as if they will have to change much more than the name and image. Just this July the "new' Rooney, Pace took public CCC Franchising Corp., a security guard company. Guess who owns 40% of CCC's stock? Robert Brennan's International Thoroughbred Breeders.

Another straw in the wind: Donald Erenberg joined Rooney, Pace as president in January 1985, from **D.H. Blair** via **Ladenburg, Thalmann & Co.** To bring in badly needed revenues, Erenberg hired Blair's Stuart Travis, (FORBES, Apr. 22, 1985) one of the most controversial, high-producing brokers in the business. He brought with him a bunch of high-pressure telephone salesmen. The group is known to some as "Stu and his baby gorillas.'

The term "gorilla' is apt. The scene does have its comic aspects, but the fact remains it's a jungle out there.

Table: Sorry results

Rooney, Pace's pretax earnings (top) turned red in the midst of a roaring bull market, while the competition cleaned up. Its stock, at the same time, dropped to an alltime low as its rivals prospered.

Photo: The founders: Randolph Pace and Patrick Rooney

Easy profits proved the undoing of Mr. Inside and Mr. Outside.

Photo: Former Rooney, Pace broker Harry Henzel

On Friday he had a net worth of over $1 million, on Monday it was gone.

Photo: Former New York SEC bead Ira Sorkin

"We turned over whatever we had to the NYSE.'

Photo: NYSE Chairman John Phelan

"When one of our firms gets into financial difficulty, we work with them.'

ILLUSTRATION: graph CAPTION: Rooney, Pace; NYSE members; pretax earnings and stock value, -1980-86.

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