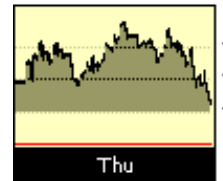


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PROLOGUE

June 1991--Scottsdale, Arizona

Rhoda Silverman eased her 1984 Chevy Suburban out of the driveway, starting her weekly two-mile trip to her elderly mother's condominium. Saturday had been their day for years, a time when they could chat over breakfast at Smitty's or Luby's Cafeteria. Sometimes, on special days, they even splurged for lunch at Red Lobster.

She flipped on the car's air-conditioning. Summer in Scottsdale had arrived early this year, and this Saturday was particularly sweltering. To beat the heat, they probably would spend the day window shopping at Fashion Square Mall, the newly renovated indoor shopping center. Their visits to department stores had become a Saturday favorite in recent years after Rhoda's mother, Fannie Victor, began to lose her sight to a degenerative eye disease. The eighty-year-old woman loved to sample perfumes, touch the different clothing textures, or just sit in her wheelchair by the fountain, listening to the crowds.

Rhoda looked ahead to the McDowell Mountains as she turned onto Mountain View Road, the carefully landscaped street leading directly to her mother's apartment. It was a beautiful drive. But she knew this was one of the last Saturdays she would take it.

Why couldn't I have protected you?

The question almost never left Rhoda's mind. She knew that she and her husband, Bernard, had kept the secret too long, hoping somehow that they would find a solution. But endless tries, sleepless nights, and frequent tears got them nowhere. She was still brooding about it when she reached the parking lot of her mother's retirement community. Maybe, she thought, maybe today would be the day. Maybe, finally, she could tell her mother the truth.

But how do I tell a blind, crippled old woman that she's losing her home?

Rhoda still didn't understand how it happened. Everything had started with such promise. Her mother moved to Arizona in 1985 to be closer to her children. She arrived with about \$100,000 from the sale of the small Brooklyn row house she had lived in for decades. It was the first time in her life that Fannie had some money. After all the years of frugality and hard work, of going without vacations or movies or fancy clothes, Fannie finally could live the rest of her life in comfort. All she needed were safe investments.

That was when Bernard met Steve Ziomeck, a young vice-president with Prudential-Bache Securities, at a Scottsdale businessmen's club. Ziomeck's knowledge of finance impressed Bernard, much to Rhoda's delight. After all, she could think of no place safer for her mother's money than with "the Rock," the name that decades of popular advertising helped bestow upon the Prudential Insurance Company of America, the company that bought the brokerage in 1981.

When Fannie and her family went to the local Prudential-Bache branch for the first time, Ziomeck put them immediately at ease. A good-looking young broker with a baby face and a calming sales style, he stressed the words that mattered to them: Safety. Security. Income. None of them quite understood the investments Ziomeck recommended. Still, since neither Rhoda nor Bernard had much college or knowledge of finance, they figured that they should trust their broker's selections. Besides, the investments seemed well diversified, in a range of businesses like energy, real estate,

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airplane leasing, and horse breeding. Ziomeck told them that Fannie could expect \$792.67 a month from the investments. Combined with Social Security and money from her children, that was enough to let her live in her own apartment.

With the money tucked away, Rhoda found a spot for her mother at a Scottsdale retirement community, the Villages at McCormick Ranch. Fannie fell in love with the apartment, with its Mexican tile, recessed ceiling, and large bedroom. It was poolside and on the ground level, so she easily could come and go in her wheelchair. Even though her vision was already faltering badly from her incurable condition, she still had time to learn her way around the apartment before she lost her sight. This was the place, Fannie decided, where she wanted to live out her last days. With Rhoda's help, she took out a mortgage and bought it.

The problems started almost immediately. Checks from Prudential-Bache did not come monthly, as they had thought, but instead every three months. Even then, the money was far less than what Ziomeck told them they could expect. Eventually, the checks stopped coming entirely. Rhoda and Bernard, who handled Fannie's bills, began covering her mortgage payments with their own money. But they couldn't keep that up long--their own business was struggling as the economy slowed, and they just didn't have the cash.

Finally, in November 1990, Rhoda telephoned Ziomeck's assistant, Kelly, exasperated about the investments' poor performance. Why didn't the breeding company make some money by just selling the damn horses? Rhoda asked sharply.

"Didn't anybody tell you?" Kelly responded. "They went out of business."

Rhoda demanded to speak with Ziomeck, and peppered him with questions. She learned that her mother's financial situation was dire. Her mother didn't own stocks, as Rhoda had thought, but something called limited partnerships, a name she did not remember hearing before. The partnerships were performing terribly but couldn't be sold. Unlike stocks and bonds, no real market to buy and sell them existed. All Rhoda's mother could do was hang on, Ziomeck said, and hope that the partnerships' fortunes improved.

But there was no time to wait. Already, they were months behind on Fannie's mortgage payments. Rhoda explained the troubles to the mortgage company and offered to turn over the deed to the apartment if her mother could stay on as a renter. But the company said foreclosure was the only option. Her mother would have to move out.

Rhoda pulled her car into the space behind her mother's apartment. Maybe now was not the right time to tell, she thought. Maybe let her enjoy today.

She went to the door of the apartment, swinging it open as she knocked. Fannie was ready, waiting at her kitchen table in a flowered sundress. Rhoda hugged and kissed her mother, and sat down beside her at the table. She launched into some idle chit-chat.

Fannie immediately sensed something was wrong. "You're very tense," she said. "You're agitated. What's the matter?"

Rhoda stammered for a moment. Then she blurted it out. "There's a problem," she said, her voice trembling. "I don't know how to go about saying this. I guess the best way is the truth straight out."

For the next few minutes, she rambled about what had happened: the declining income. The partnerships. The mortgage. The failed attempts to find a solution.

Her mother listened quietly. It wasn't sinking in.

Rhoda took a breath. "We've lost the apartment, Mom," she said. "We'll keep trying to

get out of this. Maybe business will pick up. I'll try everything I can. But we have to start looking for another place for you to live."

For an instant, the two sat in silence at the table. And then Rhoda heard a throaty, guttural sound like nothing she had ever heard. It was her mother's moan of horror.

"Why would they want to throw an old lady out into the street?" Fannie sobbed, tears streaming down her face. "I don't want to be homeless. I don't want to leave."

Rhoda sank down off her chair and, on her knees, wrapped her arms around her crying mother.

"This is my home," Fannie cried. "I love it here. Oh, please, I don't want to go."

Rhoda could not find the words to calm her mother. Her own guilt and sense of failure overwhelmed her. Rhoda began crying, apologizing again and again.

It seemed like they sat there forever. Rhoda held her mother close, rocking her, fruitlessly trying to calm her. Finally, her tears exhausted, Fannie looked up at her daughter.

"Rhoda," she said. "Where did all the money go?"

August 1993--San Diego, California

Mike Piscitelli stared down at the stainless-steel .357 magnum revolver in his hand. The silvery metal of the gun was clean and bright, perfectly reflecting the light of his bedroom. Such was his reward for cleaning the gun every time he fired it, and polishing it even if he didn't.

He looked up and saw himself in the bedroom mirror a few feet away. He almost didn't recognize his reflection. Even with his tall, wiry frame, Piscitelli had never seen himself so gaunt. In the last few months, he had lost about two inches from his waist. The dark circles under his eyes from his daily insomnia gave his face a worn, hollowed-out look.

So much had changed. So much had been lost.

Piscitelli watched his reflection as he raised the handgun. Slowly, he slid the tip of the six-inch barrel between his teeth. He paused, staring at his image in the mirror as he held the powerful gun in his mouth.

A few years earlier, he could never have imagined reaching this point. Piscitelli had been a success in life. With only a year of college and a career in the wholesale liquor business, he had become a stockbroker in the early 1980s and worked his way up to being a top salesman with Prudential-Bache, the country's third-largest brokerage firm. He earned almost \$200,000 a year. He married a woman he loved. He counted many of his 125 clients as friends.

And then the lies wrecked everything. The lies the firm told him. The lies he repeated to his customers.

The lies helped bring him to Prudential-Bache in 1986. Lewis Jacobsen, the firm's branch manager in Rancho Bernardo, recruited him from Merrill Lynch that year, telling Piscitelli about Pru-Bache's limited partnerships, which pooled small investors' money to buy expensive assets like apartment buildings, oil wells, or airplanes. Pru-Bache had the best partnerships on Wall Street, Jacobsen had said. They gave clients handsome returns and big tax benefits. And, unlike other firms, Prudential-Bache not only paid brokers large commissions for selling the investments but also gave them a share of the cash the partnerships produced later. By selling partnerships, Bache brokers could create their own personal retirement plan, without ever contributing a penny of their

own.

It took six months, but Jacobsen sold Piscitelli on Prudential-Bache. It was worth the effort--Piscitelli soon became one of the firm's top salesmen. Using computer programs provided by the brokerage, he recommended how his clients should diversify their investments. The computer almost always said that a chunk of the clients' money should go into Prudential-Bache partnerships.

Piscitelli never reviewed the dense, legalistic documents each partnership filed with the Securities and Exchange Commission--he had neither the time nor the desire. That was not his job. Instead, like most stockbrokers, he examined the sales material provided to him by the firm. That was supposed to summarize, in simple English, what the filings said. Then he passed that information on to his clients: The partnerships were safe investments, some as secure as certificates of deposit in the bank. Still, they paid a huge yield, often as much as 13 percent to 19 percent, with some of that money tax-free. Investors could scarcely resist that pitch. By 1988, Piscitelli had sold more than \$9 million worth of the partnerships to his clients and friends. The sales material was so convincing that he even bought some for his own portfolio.

But by the late 1980s, something terrible started to happen. The Prudential-Bache partnerships began to fall apart, starting with one of the biggest, VMS Mortgage Investment Fund. A real estate partnership, VMS Mortgage had guaranteed high income for three years and then return of the original investment. But instead it simply collapsed. The once guaranteed income vanished, and most of the principal was lost. Suddenly, some of Piscitelli's friends were forced to take out second mortgages on their homes to continue their retirement. Piscitelli called Prudential-Bache executives in New York demanding to know what was happening. His was one of hundreds of telephone calls from brokers around the country. Eventually, New York stopped answering questions.

Piscitelli's chest pains started soon afterward, followed by the intense headaches. He took eight aspirin a day, but the headaches just grew worse. As other partnerships came undone, he spent his days dealing with angry clients while desperately trying to hold his own life together.

Friends filed lawsuits against the firm and Piscitelli. His constant anxiety destroyed his marriage. His annual income dropped to \$20,000. A few anonymous telephone callers threatened to kill him. Fearful for his safety, Piscitelli purchased a .25-caliber pistol and a .357 magnum. He loaded them with hollow-point bullets and carried one of the guns at all times, ready to defend himself against his former friends.

By 1993, Piscitelli could no longer function in his job. He couldn't concentrate. He was always irritable. He frequently wept. That May, he went on disability leave. A doctor for Prudential would later diagnose Piscitelli as suffering a major depression caused by anxiety related to the partnership troubles. The broker could not overcome his sense of having betrayed his friends and of having been betrayed by his employer.

Piscitelli looked into the mirror. He saw tears streaming down his face and onto the gun in his mouth. He was crying uncontrollably again. He took the barrel out from between his lips and wiped away the tears. He turned to put the weapon back into his closet.

He had put the gun in his mouth before. He was sure he would do it again.

Maybe, someday, the time would be right.

But not today. Not today.

Slowly, almost imperceptibly, the truth settled in as the 1990s began. One at a time, until they numbered in the hundreds, then the thousands, then the hundreds of thousands, people in every state and around the world awoke to realize that they had been victims of the most destructive fraud ever perpetrated on investors by Wall Street.

While the magnitude of the crime was unparalleled, it was not engineered by the shady penny-stock promoters or crooked savings and loan operators who exist on the underbelly of the financial world. Rather, the scheme emerged full-blown from the New York headquarters of one of the brokerage industry's brightest lights, an investment firm with a name that conveyed the essence of reliability and trust: Prudential-Bache Securities.

The cost of the fraud, in financial and human terms, was so large it surpasses imagination. More than \$8 billion worth of risky partnerships packaged by Prudential-Bache collapsed after they had been falsely sold as safe and secure. Even after the partnerships lost most of their value, the investors had no idea what had happened. Every month, on millions of account statements, Prudential-Bache lied about the true worth of the partnership portfolios, showing them as never having lost a penny in value. And so the damage spread unchecked for more than a decade, like a low-grade fever building slowly toward a fatal disease.

In the end, no single brokerage firm, banker, or trader destroyed the financial security of more people than Prudential-Bache. The losses from the celebrated insider-trading and junk-bond scandals of the 1980s add up to only a small fraction of the damage suffered by investors from the betrayals at Prudential-Bache. And yet the hue and outcry that swept the country over the harm inflicted on powerful corporations and institutions by those scandals went unheard for years in the partnership debacle; for too long, the financially unsophisticated victims of Prudential-Bache's crimes did not have powerful lawyers fighting for them or the financial firepower to make their voices heard in Washington. They suffered alone, their scars unseen or ignored for years.

The crime was finally visible when, by the thousands, the firm's clients faced the prospect of losing their homes, their retirements, or their children's education. Some investors who carefully pinched pennies for decades wound up in bankruptcy. Scores of Prudential-Bache brokers saw their careers, their health, and their lives fall apart, often because they unwittingly repeated the firm's lies about the investments. Still other brokers, caught up in the greedy revelry of the firm, violated securities laws and common sense by concentrating the portfolios of elderly retirees in the high-commission investments.

The fraud, beginning in the early 1980s, brought in more than a billion dollars in profits to the firm, through the fees and commissions paid by the partnership sales. At the center of the scandal was the Direct Investment Group, the little-known department that propelled Prudential-Bache to the forefront of the partnership business. For executives at the senior reaches of the firm, the flow of cash from the department's business became personal piggy banks, financing profligate corporate spending, regal lifestyles, and even sexual conquest. Limousines, wild parties, and expensive overseas junkets became the order of the day, paid for out of clients' investment dollars.

Overseeing this money machine was a small group of executives who cut corners or ignored problems as they promoted the firm and built personal empires. Alone, none of these men could have created the disaster that emerged from Prudential-Bache; together, their weaknesses and desires combined to push the firm inexorably toward scandal. At the head of the partnership department was James J. Darr, a hard-charging executive who took it over in 1979 after his scrupulous predecessor was fired for refusing to sell deals of questionable quality. Darr transformed the department into an organization overwhelmed by charges of corruption.

But the executives who were supposed to watch Darr and rein in rulebreakers simply celebrated the department's financial success, with little attention to how the business was being done. At the top were George L. Ball, a celebrated wunderkind of Wall Street who, as president of E. F. Hutton & Co., oversaw a separate and fatal scandal for that firm before abandoning it to take over as chairman of Prudential-Bache; Loren Schechter, the firm's general counsel and chief law enforcer, who for years failed to notice the evidence of wrongdoing in his midst; and Robert Sherman, the head of retail at the firm, whose taste for liquor, eye for women, and desire for power became ingredients in decisions he made as Darr's supervisor.

The inside story of this massive fraud begins in the dawn of the 1980s at Bache & Company, a struggling third-tier brokerage already mired in scandal. In 1981, the firm was reborn and elevated to a newfound public esteem when it was purchased by Prudential, the respected insurance company. But while Bache's image improved, many of its shoddy practices worsened. By the end, the firm experienced a chain of scandals with connections like an archipelago, visible only beneath the surface. It is only in hindsight that each of those scandals can be seen as warnings--tragically missed, though sounded repeatedly over more than fourteen years--about the terrible secrets at Prudential-Bache Securities.

At its base, this is a cautionary tale about an abuse of the investor faith that is an essential building block of the American economy. That faith has created great industries, from the dawn of the railroad to the age of computers, by allowing huge pools of money to be channeled from individual investors to growing businesses. It has touched almost every American home, helping working people achieve financial independence or reach goals only dreamed of by their parents. At its essence, it is what allows billions of dollars of securities to trade each day based on nothing more than a voice on the telephone. By taking advantage of that faith, Prudential-Bache cracked the foundation of the marketplace. It robbed us of our ability to believe. It betrayed us all.

CHAPTER SEVEN

Clifton Harrison bounded off the elevator into the offices of the Prudential-Bache Direct Investment Group. He bantered for a moment with a receptionist, who allowed him to walk past without checking to see if he was expected. He headed briskly toward Darr's office. "Good morning, Vawn," Harrison drawled as he reached a desk outside the executive suite. "How are you this fine day?"

Darr's secretary, Vawn Major-Hazell, looked up at Harrison and smiled. By late 1982, Harrison was a frequent visitor to the department, using its offices as almost his personal New York headquarters. With his polish, expensive clothes, and unflagging good manners, Harrison charmed many of the women in the department. He came off as a friendly--if hyperactive--senior executive. And with good reason. With Darr as his chief backer, Harrison had been catapulted from being just a convicted felon hustling for attention on Wall Street to the premier role as a top sponsor of partnerships sold by Prudential-Bache.

As Major-Hazell and Harrison chatted, Darr emerged from his office, beaming. He and Harrison had grown especially close; Harrison was one of the few general partners Darr would meet alone, behind closed doors. Harrison, who loved to tell tales about his playboy exploits, bragged about escorting Darr to swank parties hosted by Manhattan's jet set, including Steve Rubell, the flamboyant cofounder of Studio 54, and Roy Cohn, the feared Manhattan lawyer and former sidekick to Senator Joseph McCarthy. Darr seemed giddy with excitement anytime Harrison planned to take him out for a night on the town.

On this day, Harrison wanted to take one of his victory laps around the department to thank the people who worked on his most recent deal. Shortly after he arrived, he and Darr headed toward the cramped cubicles in the due diligence area. Harrison popped his head into each and thanked everyone. Finally, he arrived at the cubicle of David Levine, who handled much of the work on Harrison's deals.

"David," Harrison said as he shook Levine's hand, "I want to thank you. You've done a marvelous job." Harrison prattled a bit about his next deal, saying how it would be the best one yet. Then he said good-bye.

As Levine watched Harrison stroll away with Darr, his polite smile dissolved into a scowl. Why the hell are we doing business with this guy? he thought.

No one in due diligence was happy about Harrison's prominence in the small camp of general partners that Darr was forming for the Direct Investment Group. His criminal

record--and the decision to keep it secret from both brokers and investors--was only part of the problem. Even D'Elisa, the man who found Harrison, had decided that the man was little more than a fake.

"I am very uncomfortable with this guy," D'Elisa had told Levine while reviewing a Harrison deal. "He's got no expertise. He brings nothing to the table. And he's a felon."

D'Elisa knew that the success of a partnership often hinged on the integrity, knowledge, and experience of the deal's sponsor. Harrison came up deficient on all counts. His financial condition was far riskier than D'Elisa might have imagined when they first met; his debts left him with a negative net worth.

Worse, Harrison never lost the heavy spending habits he picked up in his days as an embezzler. He spent tens of thousands of dollars a month on dinners at fancy restaurants, nights at elegant hotels, limousines, furs, expensive wines, and flowers for his wife and girlfriends. The spending was so reckless that in 1981 Diners Club had threatened to cancel his account for failing to pay his balance of \$14,597.43. Months later, he cracked the spending ceiling on his MasterCard. The man held up by

Prudential-Bache as a top financial professional could not even manage his own credit cards.

Making matters more troublesome for the due diligence team, Harrison's knowledge about real estate had ended up being painfully sparse. He rarely could answer their detailed questions about his deals. Instead, Harrison often just dismissed his questioners with a wave of his hand and a claim that he only dealt with the finest properties. But in truth, the deals Harrison championed were never his own real estate developments. Instead, Harrison used his reputation as having an "in" at Prudential-Bache to persuade other developers to allow him to raise money for the projects with a tax shelter. If the developer agreed, Prudential-Bache sold the shelter to its retail investors. The developer would then receive money to help finish construction. For his part, Harrison would be named the shelter's general partner, allowing him to charge investors huge annual management fees. Harrison, the developer, and Prudential-Bache all made money from the arrangement.

As far as D'Elisa was concerned, all Harrison deserved for that sort of effort was a one-time finder's fee, not the right to manage the properties. But Darr not only insisted that Harrison be named general partner, he also helped make sure those deals received only light due diligence. If D'Elisa or Levine asked too many questions, Harrison went over their heads to Darr. If due diligence did not want the deal approved, Darr simply took it to the department's investment committee, which rarely ignored his opinion. If there were five votes on the committee, the joke went, then Darr had four of them. After all, he played the largest role in deciding how everyone on the committee was paid. It was in no one's self-interest to cross him.

Making Darr's embrace of the Harrison deals all the more inexplicable was that the department didn't need the business. Scores of reputable corporations, developers, and syndicators were knocking at the firm's door with partnerships to sell. The list of potential general partners included a number of high-profile, high-quality groups, like Lincoln Properties, a large real estate company in Chicago. While the firm did business with such groups, the volume never equaled that of the Harrison deals.

It all seemed very suspicious. From D'Elisa, the real estate due diligence team knew that Darr took money at Josephthal and that Harrison had been imprisoned for embezzlement. Put two people like that together, the reasoning went, and sparks had to fly. It became an article of faith among much of the department--despite a lack of evidence--that Harrison was paying Darr to sell his shelters. When Harrison's huge fees were calculated, executives would joke about what percentage would line Darr's pockets. Even a trip Darr and Harrison took to Europe was fodder for black humor.

"They've got to go check out their Swiss bank accounts sometime," Levine said when he heard about the trip.

Even with all their scorn, the due diligence team knew that Harrison could market the hell out of himself and his deals. Largely, that was because Harrison had no qualms about putting the deals together in a way that ensured the highest tax breaks possible for investors--either by pouring tax deductible debt onto the building project or by relentlessly pushing up the appraisals of the properties. Of course, that aggressiveness also raised the risk that the partnerships might anger the Internal Revenue Service, but few brokers or investors seemed to worry about that.

There was so much focus on the tax benefits of the deals that few investors noticed the many fees that had been lathered on by Harrison and the Direct Investment Group. The charges were so thick that the chances of obtaining a capital gain on the investments were virtually obliterated. Through the endless assortment of fees, more than 20 cents out of every dollar invested by clients immediately went into the pockets of Harrison and Prudential-Bache.

To bring more fees into Prudential-Bache, Darr set up a complex web of corporations with names like Bache Properties and Bache-Harrison Associates. Though the arrangement was not disclosed to investors, those corporations allowed Darr and other executives he chose to share in some of the cash flow from the partnerships.

Darr often played hardball in negotiations on how much money those corporations would receive--once going so far as refusing to hand over investor cash that had already been raised unless Harrison agreed to pay higher fees to the firm and to Bache Properties. By directing the fees to the shell companies, Darr sidestepped the restrictions imposed by the National Association of Securities Dealers on the amount a brokerage firm could charge in selling a security. The Bache subsidiaries were not selling securities--they were monitoring, consulting, and advising.

"It was ridiculous. If we could have figured out a way to charge a fee for breathing, we would have done it," one member of the department said years later.

By 1982, the money was rolling in from the huge fees tacked onto the Harrison partnerships. But, unknown to Darr, Harrison had planted a time bomb--in one of their very first deals. That partnership, called Bessemer/Key West L.P., raised about \$4.4 million. The partnership was designed to tap into Harrison's European contacts. It raised the money exclusively from investors in West Germany, where Bache had a strong presence. But the partnership was a tough sell--it invested in two shopping centers based in Bessemer, Alabama, and Key West, Florida, hardly the places where a German investor would be inclined to put his money.

So Harrison made his investors a promise. On May 20, 1981, he wrote letters to all of the potential foreign investors and guaranteed that the deal would be a success. If, by 1986, they were dissatisfied with the investment, Harrison said he would repurchase their partnership stake for 150 percent of the original cost--putting himself on the hook for \$6.6 million. To the investors, the promise was even more attractive because it came on the letterhead of Bache-Harrison, the corporation set up as a device for charging fees. With a commitment for guaranteed profits, apparently backed by a large American brokerage firm, the foreign investors snapped up the deal.

Harrison didn't tell any senior Pru-Bache executive in New York about his guarantee, including Darr. Worse, he didn't have anything close to the money he needed to live up to his promise. At the time he sent out the letters, Harrison's net worth was in the deficit column, at a total of negative \$350,000. If he ever had to make good on his commitment, he would be wiped out. It was the kind of fact that under federal securities laws had to be disclosed to investors in every subsequent Harrison deal. But since Harrison didn't tell Bache, the firm raised millions of dollars for him over the next few years without ever revealing his financial guarantee in the deal for the German investors.

The first big Harrison deal in the United States came that same year with a partnership called Barbizon New York Ltd. The partnership invested in the Barbizon, a twenty-four-story hotel in the heart of Manhattan. With Harrison as the general partner, the deal

raised \$6 million for refurbishing the hotel. Investors expected tax deductions and hoped to enjoy the cash flow the hotel received from guests.

The deal was immensely profitable to Bache and Harrison. Harrison was paid \$100,000 a year in the first year--and \$150,000 each year afterward--as a "servicing fee." Metro-Housing, a Harrison affiliate set up for the Barbizon deal, tacked on an "incentive management fee" of at least 4 percent of the deal's cash flow.

Still, Harrison was more than generous to Bache with his investors' money. The firm was paid \$540,000 in commissions and expenses. In other words, 9 percent of the money contributed by the investors immediately went into the firm's pockets. Bache-Harrison, the jointly owned corporation, slapped on another \$78,000 in fees for finding a loan. Then, Bache International, another affiliate, received \$25,000 for arranging the same loan. And although the arrangement was not disclosed to investors, Bache Properties would also receive 20 percent of certain money received by Metro-Housing. In the end, at least 17 percent of the money invested in the deal went into the pockets of the brokerage, its executives, and Harrison.

While the firm didn't tell any of the investors in the deal that Harrison was a convicted felon, it became a point of great importance almost immediately after the deal closed. Every luxury hotel needs to be able to sell alcohol in its restaurants and through room service. But that requires a liquor license from the state. In 1982, Harrison decided to apply for a license and picked up all the necessary forms from the New York State Liquor Authority. He went down the application, answering "no" to each question on such matters as whether he had been known by another name or had ever filed for bankruptcy.

He turned to the second page. There, in the middle of the document, was the question: "Have you ever been convicted of any felony or of any other crime?" Harrison scribbled the answer "yes, misappropriation of bank funds." Then he studied the other requirements: He would have to submit his fingerprints to the government, and his filing would become a matter of public record. Harrison tossed aside the form. He refused to complete it, even when bankers who lent money to the deal begged him. Harrison would not create a new public document that would disclose his criminal record.

Clifton Harrison, whose felony conviction wasn't viewed by Darr as sufficient reason to prevent him from raising millions from retail clients, could not legally sell any of those same people a glass of wine.

Peter Archbold, the manager of Pru-Bache's Dallas branch, leaned back in his chair as he listened to one of his fellow branch managers on the telephone. The manager had just called Archbold with a question: Why hadn't the Dallas branch done more sales in a Clifton Harrison deal involving a Texas property?

Archbold had figured someone would ask him that at some point. The Dallas office was one of the firm's jewels and was a huge seller of the firm's deals. Archbold had earned the reputation as a team player from the time he was an assistant manager in Binghamton, New York, in 1972. By 1982 Dallas had one of the best collections of prospective clients for tax shelters--booming oil in Houston and rising real estate prices in Dallas produced a surplus of wealthy investors with no idea what to do with their money. Since Harrison was a Texan, it seemed likely that the branch would sell out the deal all by itself. But the Dallas brokers knew something the rest of the firm hadn't been told.

"Well, Harrison is pretty well known here," Archbold said. "He's a convicted felon."

"You're kidding."

"No, I'm not," Archbold said.

The two managers talked for a bit, and then hung up. A few minutes later, Archbold's

telephone rang again. It was Bob Sherman, the head of retail, and Jim Darr. Both men sounded absolutely livid. The other branch manager had just called New York in a rage, wanting to know why he had never been told that the firm was doing business with a felon.

"What are you doing putting down our deals?" Sherman demanded.

Archbold was taken aback. He hadn't done anything except tell another manager the truth. Obviously, this was a touchy point in New York. So before he got into any more trouble, he agreed that he wouldn't say anything again that would put down the deal.

A few days later, Archbold received a telephone call from another branch manager, again asking why the Dallas office wasn't selling the Harrison deals. Did the brokers in Dallas know something that other people in the firm should know?

"No comment," Archbold replied.

The other manager tried again to finagle an answer, but Archbold refused to budge. He wouldn't tell his colleague anything. The frustrating call came to an end. Within a few minutes, his telephone rang. It was Darr and Sherman on the line again.

"What the hell are you doing saying _no comment'?" Sherman asked. "Well, what do you want me to say?" Archbold replied. "You don't want me to answer their questions. Tell me what I should say and I'll say it." Darr and Sherman mumbled a response. They told Archbold to be more careful but never told him what to say. Archbold hung up the telephone with an uncomfortable feeling. New York was trying too hard to keep Harrison's background a secret.

Tom Huzella, the biggest-selling partnership broker in Pittsburgh, was flattered to hear that Clifton Harrison was on the phone. "Tommy, thank you for selling the Barbizon," Harrison said, drawling Huzella's name out so it sounded like "Tah-may."

"You are one of my key people," Harrison said. "Now, you help me with my next deal, and I'll send you and that lovely Carol of yours to Monte Carlo."

The ego stroking had its intended effect. Huzella, along with a number of other top brokers, became a huge fan of the Texas developer. It wasn't just that his deals had enormous tax breaks, or that Harrison knew how to flatter brokers. Probably the biggest selling point was Darr. Whenever he spoke to the brokers, he made it clear that the full resources of his department were behind Harrison.

Huzella had been impressed by that when Darr first introduced Harrison to him in late 1980. While Huzella was visiting New York on other business, Darr called him into his office, where he saw an impeccably dressed man with long, flowing hair.

"Tom, this is Clifton Harrison," Darr said. "He's a world-renowned real estate investment banker. He's been very successful in the Dallas real estate market and knows the New York market. We're going to be doing a lot of things with him." He was someone with almost a Midas touch, Darr said.

As Darr spoke, Harrison reached into his pocket and produced an oversized business card that carried a European address. He offered it to Huzella. As they spoke, Huzella noticed that Harrison could not maintain eye contact. Instead, Harrison was always looking around the room, as if he feared missing something. It struck Huzella as odd. But, if Darr recommended Harrison so strongly, Huzella figured he must be a first-class general partner. So, when Harrison's deals started coming out, Huzella eagerly told his clients about them.

"We have this wonderful investment with a New York City property called the Barbizon," he told prospective clients. "It's being put together by Bache with Harrison Freedman Associates, an internationally known real estate developer."

Eventually in his pitch, Huzella, like every broker in the system, assured potential clients of the investment's safety.

"This has the full blessing of the firm," he said. "We spend a lot of money on due diligence to make sure everything is done right."

D'Elisa stormed into his office in Smithtown, New York, and called in his secretary for some dictation. He had finally had it with Clifton Harrison. The man refused to cooperate with any of the requests from the due diligence department. If Levine or D'Elisa asked for financial records to back something up, Harrison would just refuse, or instead would go over their heads to Darr. Harrison failed to show up for appointments to review his deals. Even when he did come, he never had his homework done--he couldn't answer some of the simplest questions. On this day in 1982, D'Elisa decided to throw down the gauntlet. If he couldn't get Harrison under control, maybe some memos in the file might make Darr do it.

After his secretary sat down, D'Elisa dictated a memo to Harrison. "I fail to understand why we have so many problems in the deals we do with you," D'Elisa said. "We require adherence to procedures that we have gone over again and again with you in Dallas and New York. These continued problems may require us to reevaluate future programs with you."

Then, D'Elisa told his secretary to take another memo, this time to Darr. "Clifton seems to feel that he has leverage in dealing with me through his close relationship with you. I am sure you will agree that he, like any other sponsor, including some of our proprietary sponsors, must follow strict offering and submission procedures." He added bluntly, "I refuse to have myself or my staff antagonized by someone who is not part of this organization."

Once his secretary finished typing the memos, D'Elisa reviewed them and shipped copies to Darr, Proscia, and Peter Fass, the outside lawyer who worked on Harrison deals. That, D'Elisa thought, might shake things up a little. The head of real estate due diligence had put a memo in the file saying that a sponsor was using his influence over the head of the department to avoid following standard procedures. It was the kind of document that might cripple any defense if the firm was sued over a Harrison partnership. The memos had the intended effect--for a short time. Darr called to assure D'Elisa that Harrison would start cooperating. And he did, for about three weeks. But then Harrison again started refusing to cooperate with the due diligence department.

If D'Elisa expected that his protests would slow down Darr's appetite for Harrison deals, he was disappointed. The department soon started marketing one of the biggest real estate deals in its history, called the Archives New York Limited Partnership. The deal, with Harrison as the general partner, was a \$16.5 million offering--an astonishing sum at the time.

Proscia handled the marketing out of New York. In consultation with Darr and Harrison, he developed an aggressive strategy: Branch offices were canvassed to find brokers who would want to sell the product; regional marketers for the tax shelter department were telephoned and ordered to include discussions of Harrison in any future meetings; and plans were drawn up for training brokers about the tax shelter deals. On Harrison's tab, ten of the firm's top brokers were flown to Manhattan for a dinner hosted by Darr and Harrison at the expensive 21 Club.

Amidst all the hoopla, no one noticed the deal's fatal flaws. It needed at least \$40 million in financing but had access to only \$30 million in loans at any one time. In other words, from the first day the partnership was formed, the Archives deal was already short \$10 million in cash. Even the loans it had were dicey--they were conditioned on the completion of a construction budget. The offering documents implied a budget existed; in fact, there was none.

The biggest, most public deal in the history of the department was doomed from the

start.

The sounds of a raucous party spilled out from a private room on the second floor of Smith & Wollensky. Prudential-Bache's entire partnership department--from Darr to the regional marketers to the secretaries--was at the Manhattan steakhouse celebrating the successful completion of the Archives deal. The deal was so large that it would mean big bonuses for the department's professionals. So, on this night in the fall of 1982, Harrison hosted the dinner at Smith & Wollensky, one of Darr's favorite restaurants. It was becoming a tradition that general partners would buy the department an expensive dinner at Smith & Wollensky once every three months.

The dinners had all the subtlety of a Roman orgy. They were nothing like the staid, civilized, and professional closing dinners that sometimes accompany the completion of a successful deal on Wall Street. "The Smith & Wollensky dinners were epic in their grossness and expense," one department executive who worked at a number of Wall Street firms said years later. "To this day, I've never seen anything else like it. And the fact that we were making somebody outside the department pay for it was disgusting."

In the days leading up to the Harrison dinner, Darr wandered about the department, speaking to female employees.

"What are you going to be wearing at Smith & Wollensky?" he asked. "Are you going to wear a nice dress?"

By the night of the dinner, the excitement was overflowing. Some members of the department purchased new clothes just for the occasion. At the appointed time, everyone ambled into the room and found a seat around the long tables arranged in a C shape.

Then the heavy drinking started. As master of ceremonies, Darr wandered about the room with a knife in his hand, cutting off the tie of any executive who didn't turn away fast enough. Later, he stood up and gave a speech, hurling insults at Harrison, the host, as well as at members of the department.

With the cost on someone else's tab, executives, secretaries, and other staff members ordered enough food for several meals. Giant five- and six-pound lobsters were delivered to the table in front of a single person, along with huge steaks and side dishes. At the end of dinner, they loaded the extra food into doggy bags and took it home. Everyone knew that after a Smith & Wollensky party, they could expect free dinners at home for days.

Even the due diligence executives were ordering with abandon, although not for the free food. Instead, the evening at Smith & Wollensky was their one opportunity to get back at Harrison. If they couldn't stop his deals, at least they could run up his tab. During the meal, a secretary leaned over to David Levine. She showed him the wine list and asked if it would be all right to order a particularly expensive bottle of wine. Levine looked at the list and saw the bottle cost close to \$150.

"Oh, yeah," he said. "A \$150 bottle of wine? No problem."

The drinking and revelry went on for hours. The marketing executives started a competition of trying to drink more of the expensive wine than anyone else. Darr, who told everyone he was something of a wine buff, always had his own favorite brand and year--even if it was not on the wine list--brought in special in a crystal decanter. Pittman also liked wine and begged Darr for a taste of the good stuff. But Darr just refused.

During the meal, two executives, who by then were completely drunk, slid under the table and began crawling around the room, looking up the women's dresses. One marketer picked up an extremely expensive brand of champagne and downed it straight out of the bottle. When he finished, he hurled the bottle across the room. It whizzed past Freddie Kotek, a member of the due diligence department, barely missing his head before hitting the wall.

Following the after-dinner drinks, the drunken and sated ordered cigars all around. Executives stood, stumbling out of the room, with their cigars in hand. A waiter walked into the room carrying a leather case with the bill. He stepped around the table and placed it in front of Harrison.

Kotek and other members of the department were walking past Harrison as he opened the case and looked at the bill. Harrison looked positively stunned. "I don't believe it," Harrison muttered to no one in particular. "Six thousand dollars for a dinner, and I didn't get no pussy."

The due diligence executives looked at each other and rolled their eyes. Boy, this is a class act we're working with, Kotek thought.

They strolled out of the room as Harrison put down his American Express card to pay the bill. They felt satisfied that they had at least been able to stick it a little bit to Darr's friend.

But in truth, the dinner didn't cost Harrison a penny. Like all of the Smith & Wollensky dinners, held four times a year for much of the rest of the decade, the general partner simply submitted the bill to the partnership he ran. It was, after all, a legitimate business expense. So the cost of the dinners didn't come out of the pocket of Harrison, or Darr, or any of the people who gorged themselves on those nights.

Instead, the bills for the department's drunken revelry were paid out of the savings that small retail clients had entrusted to Prudential-Bache.

Later that same year, on a sultry Texas Sunday in October 1982, the relationship between Harrison and Darr reached a high point, in front of about 150 spectators.

They gathered at St. Michael and All Angels Episcopal Church, a place so well known for its wealthy parishioners that Dallas wags call it "St. Mink's and All Cadillacs." Amid the church's elaborate decor, Harrison waited that day to marry his fourth wife, Alexandra, less than a year after divorcing his third wife.

Harrison arrived at the church, dressed elegantly in an expensive tuxedo. Joining him in the front of the church as one of his two best men was Darr, who had flown down from New York especially for the service. Executives in the department marveled that, over so short a period of time, Darr had apparently become Harrison's best friend.

Harrison liked to brag that this time he was marrying into money: His new wife's family, he told friends, controlled a major international company. Wealth showed in the apparent cost of the wedding--between the service at St. Michael and the reception at the tony Northwood Country Club, some guests estimated that the price tag for the day must have reached as high as \$60,000.

A few weeks later, Harrison returned from his honeymoon and immediately headed to the Direct Investment Group. He was roaming about the department when he stopped at the desk of Kathy Eastwick, the former compliance administrator who now worked as a product manager. Eastwick congratulated Harrison on his new bride. After thanking her, he cracked a smile.

"You won't believe what Mr. Darr did to me," Harrison said.

"What did he do to you now?" Eastwick asked.

"Well, you know I've told you he never spends a penny," Harrison said. "But do you believe that man made me pay for his airline tickets for him to come to my wedding?"

D'Elisa set his portfolio briefcase on the kitchen table, opened its flap, and carefully slid

a tape recorder inside. He plugged a microphone wire into the recorder and slowly laid the wire up the inside of the briefcase and over its opening at the top. Then, he tore off a piece of electrical tape and attached the tiny, sensitive microphone to the outside of the briefcase. He closed the flap over the microphone; it was hidden, but pointed toward an opening between the flap and the briefcase. D'Elisa turned on the recorder and checked it out. It picked up his voice perfectly.

He stood back and examined his handiwork one more time. No one would be able to see the microphone was there. Finally, he was ready to go tell Darr he was quitting. Whatever tricks Darr decided to play in response would be captured on tape. It was the only way D'Elisa could think of to protect himself from Darr's manipulative tactics.

By May 1983, Darr was one of the most powerful people at Prudential-Bache. Despite the initial promise when Ball took over, the firm was still struggling with heavy losses. The Direct Investment Group was one of the rare divisions in the firm that was actually making money. And Ball believed in feeding success. Whatever resources Darr wanted had been given to the department. In speeches to brokers, Ball had almost always thrown in a line of support for the partnership effort. Darr had frequently been invited by Ball to make presentations to senior executives. No one could have missed Ball's seal of approval for Darr and the Direct Investment Group.

That particularly delighted Bob Sherman, the head of retail and Darr's boss. To him, Darr's partnerships appeared the way to almost limitless revenues--and fat bonuses for all of the executives involved.

"Darr's producing a lot of money," Sherman told a group of senior retail executives at the time. "He's going to be making a big contribution to retail." To some executives, Sherman also said that Darr had secretly confided that he had once worked with the Central Intelligence Agency. That, Sherman said, was particularly exciting.

Even with the support that the department was receiving from the firm, D'Elisa did not think he could work there anymore. He thought the department was doing bad business. He had watched all the quality people either get forced out or simply abandon the firm in disgust. From the Futon Five, only he and Dennis Marron still survived. Too many of the executives who remained were concerned about the wrong things. In D'Elisa's mind, Darr had corrupted people with the easy money that his department was bringing in. Too many of them had seemed to forget that this business wasn't about living the highest life.

Despite his frustration, D'Elisa had tolerated staying with the firm because he worked out on Long Island, some forty miles away from Darr. But weeks earlier, Darr had called to say that D'Elisa would have to start working in Manhattan. D'Elisa immediately had started looking for another job and had found one at Bear Stearns & Company. He didn't want to work alongside Darr. D'Elisa didn't want to risk being corrupted, too.

After setting up his tape recorder, D'Elisa traveled to Prudential-Bache headquarters and went to Darr's office. Before walking in, he turned on the recorder.

"Relax, John," Darr said as D'Elisa sat down. "I know why you're here. I know you've got a job offer from another firm and I know you're seriously considering it."

There it is again, D'Elisa thought. Ever since the Futon Five fiasco, Darr delighted in telling members of the department that he knew everything they did and said. Dennis Marron theorized that Darr somehow was listening in on their telephone calls. Others thought it more likely that there were spies in the department.

"So, what would it take to make you happy here?" Darr asked. For you to leave, D'Elisa thought. He said the Bear Stearns offer was too good to pass up. It was making him a partner, which Prudential-Bache couldn't do, since it was not a partnership. Plus, he said, Bear Stearns was paying him a lot more money.

"Look," Darr replied. "I can't make you a partner, but this is what I can do. I'll make you

a senior VP. I'll give you a \$50,000 raise. And I'll vest you immediately."

The offer was unbelievable. The raise was enormous. But the vesting offer was more important: That would guarantee D'Elisa a share in the fees and cash flow pouring into the corporations, like Bache Properties, that Darr set up for the partnerships. Each day, he was establishing new corporations, with names like Prudential-Bache Energy and Prudential-Bache Minerals, and they were bringing in millions of dollars a year. Darr's offer could easily have been worth \$2 million. Still, it wasn't good enough.

"Jim, I don't want to commute into the city every day."

A look of anger flashed across Darr's face. "You're willing to commute into the city every day for Bear Stearns, aren't you?" he asked. "Why aren't you willing to commute into the city for me?"

"Well, I just would prefer not to."

Finally, Darr caved. D'Elisa could stay on Long Island, as long as he shipped one of his staff members to Manhattan. Then Darr would live up to all the other financial promises. The offer was too sweet to simply reject out of hand.

"All right, Jim, I'll consider doing the deal," he said.

"Come back to me tomorrow, and I'll talk with the necessary people," Darr replied. "But it's a done deal."

The next afternoon, D'Elisa couldn't bring himself to make the final commitment. He needed more time to think about it. Even with all that Darr had put on the table, he still was not convinced that it was worth it. He felt as if he were selling his soul.

Finally, after a night in bed with his head spinning, D'Elisa decided to take the deal. He went into Manhattan the next morning and walked into Darr's office.

"All right, Jim, if we're going to do this, I want it in writing," he said. "I want a contract."

"OK, I'll give you a contract," Darr replied. "But forget about the Long Island office. You could have had it yesterday. But you're a day late. You can't have it today."

D'Elisa stood up and shook Darr's hand. "Thanks a lot," he said, and he turned to walk out of the office. That was the end. He quit his job.

If Darr had been so quick to back out on the Long Island commitment, D'Elisa knew that everything else would vanish, too. He was tired of playing Darr's games. He just wanted out.

D'Elisa headed down the elevator and walked across the lobby. He pushed through the revolving door and began walking briskly down the street. With each step he took, he felt an enormous weight lifting off his shoulders. It was over. After the years of battling and intrigue, it finally had come to an end.

He didn't even want to guess how long the people he left behind would survive.

Clifton Harrison grabbed a chair in a conference room at Prudential-Bache and threw it against the wall.

"Goddamn it, you asshole!" he screamed at David Levine as the chair clattered to the floor. "What's the matter with you? This is a great deal!"

Levine stood his ground. He wasn't going to pass on the latest partnership that

Harrison brought into the firm in June 1983. By then, Levine was far along on the due diligence learning curve. He knew that Darr and Harrison were pushing bad deals through the department. This latest one, called Exchange Center Limited Partnership, was the worst. Levine decided that, this time, he was going to stick with his analysis, regardless of the pressure.

The \$32 million Exchange Center deal made little sense to anyone on the due diligence team. It was an awful transaction for investors. The deal would build a thirty-nine-story red-granite office tower on South LaSalle Street in the heart of Chicago's financial district. The fees and expenses were so heavy that Levine did not see how it was possible for any investor to make a penny on the deal. All told, Harrison, Prudential-Bache, and the Direct Investment Group would pocket more than 20 percent of the money that was raised.

When the Chicago deal first came in the door, Levine decided to pass it to Jeff Talbert, a new, young member of the due diligence group. He wanted to see how Talbert would react. After all, Talbert knew nothing about Harrison's criminal background or the troubles that his other deals had experienced. It was the best way to get an honest response. Levine dropped the documents on Talbert's desk without telling him any of the details.

"Let me know what you think of this one," Levine said.

Talbert started reviewing the documents, and after just a few minutes, decided that Levine must be kidding. The deal was ridiculous: It assumed it could charge rent of \$32 a square foot by 1985, when the best estimates for the rental costs in that year averaged around \$27. Nobody would pay the extra \$5. With such unrealistically positive assumptions, the deal had to flop. Talbert stood up and carried the documents back over to Levine's cubicle. Freddie Kotek and some other members of the department were there talking with him.

"I've gone over this, and I was surprised," Talbert said. "There are lots of problems. I can't even figure out why we're looking at this deal."

"It's a Clifty deal," Levine replied.

Talbert looked perplexed. "Who's Clifty?"

Kotek spoke up. "Clifty, Clifton Harrison," he said. "Clifty's a guy we do deals with, a friend of Darr's."

Talbert could see the disgust in his colleagues' faces. "Well, what's wrong with the Clifty deals?" he asked.

"They're all like that one," one of his coworkers replied. "They suck."

"And he's a convicted felon," Levine added.

The four talked about what should be done with the Chicago deal. Talbert said that if these Harrison deals were as bad as everyone said, he was worried about them. What would happen when they blew up? Brokers would get mad, and then the department wouldn't be able to sell anything. It seemed like an incredibly risky way to run the business.

Then it came up that there was one other Harrison deal in the pipeline, called Fountain Square Limited Partnership, which would raise a little more than \$6 million for a building in downtown Cincinnati. Maybe, someone joked, they should appease Darr by letting the Cincinnati deal through while killing the \$32 million Chicago deal. At least that way, less money would be on the line.

Levine looked back at the documents, steaming. D'Elisa was not there anymore to fight

for them. But, Levine thought, if the newest person in the department could throw aside the Chicago deal that quickly, he was not going to let it through. This one he was going to take to the mat. He rejected the deal out of hand.

But Darr refused to accept Levine's opinion. He and Harrison called Levine into a meeting in a conference room and double-teamed him. Levine refused to change his decision.

Later, Darr told Levine that since there was such a split opinion, the matter would be taken to the department's investment committee for a decision. Levine knew what that meant: Unless he could think of something, the deal would go through. Darr completely controlled those investment committee meetings.

Levine walked back to his desk with a new resolve. If Darr wanted to present the deal to the committee, fine. But Levine was going to make sure they knew, in a written memo, about the deal's problems. Word spread that Levine was going to the mat in his effort to kill the deal.

The investment committee met soon after. On that day, Joseph Quinn, a former official with Chase Manhattan Bank, took over D'Elisa's job as the new head of due diligence. Shortly before the meeting, Levine spoke with Quinn and told him about what was happening with the Chicago deal.

The meeting started later that morning in the department's boardroom. Senior executives, including Darr, gathered around the conference table as Levine distributed copies of his two-page memorandum on the Exchange Place deal. For the next half hour, Levine went through his memo, point by point: The deal was one-sided, in favor of the general partners over the investors; the rents were above market; the real estate market was soft. He supplied a stream of data to support his position.

Finally, Levine finished his presentation. With such a massive criticism on paper, he figured the meeting was over. He couldn't see how it would be possible for even Darr to push this deal through. Levine started gathering his things.

"Now, wait a minute," Darr said. "We have an interesting problem. We've had two people who did the due diligence here, and they don't agree."

Levine looked up, stunned. "What?" he asked. He couldn't understand what Darr was talking about. He ran due diligence for real estate private placements. And everyone in his department agreed with his analysis.

Darr motioned toward someone sitting at the table. "Ralph, why don't you tell us what you found," he said.

One of the department's appraisers stood up and began passing out copies of a second memo. Levine couldn't believe it. Appraisers figured out fair values of purchase prices for buildings. They never on their own had reviewed deals for their investment quality. They didn't have the background to do it.

This is a total setup, Levine thought.

For the next few minutes, the appraiser described the benefits of the Exchange Place deal. He trembled as he spoke, obviously very nervous and uncomfortable. In Levine's mind, the report made no sense. But Darr had managed to take back control. The appraiser finished his report and sat back down.

"Well, thank you very much, Ralph," Darr said. "Obviously, David, you need to go back and take another look at this." The investment committee gave the go-ahead for the department to proceed with the deal.

Levine and Quinn headed out of the meeting room to Quinn's office. Levine slumped into a chair. He looked pale and wiped out. The stress from trying to do his job properly was just overwhelming.

"I'm living in the Soviet Union, trying to fight the KGB," Levine muttered. Quinn looked nervous. "This is a nightmare," he said. "I don't want to do this deal."

Finally, Quinn came up with a suggestion: They would proceed with the deal. But they would question it to death. Darr couldn't stop them from demanding more information from the developer and general partner. So they would just keep demanding more and more financial records until the developer Harrison had found walked away out of frustration. Levine agreed.

As the due diligence team learned of what had happened in the conference room, most of them began to say the same thing: Darr was creating a monster. He didn't have any interest in their judgment about deal quality--he just wanted to keep the products coming. There was only so much Quinn, Levine, and everyone else could do to hold him off. Someday, the deals he pushed through would start falling apart. When that happened, there would be hell to pay. A lot of careers were going to be ruined, potentially even their own.

Dennis Marron closed a bound report filled with financial data from NRM Energy Company. He looked out of his office window at a view of the Brooklyn Bridge and sighed. Marron knew he had to block Prudential-Bache from doing its next big oil partnership with NRM. Nothing was particularly terrible about NRM--Pru-Bache had already sold a number of the oil company's partnerships. But Darr seemed very close to the NRM executives, talked about them frequently, even traveled to their Dallas headquarters a few times to visit. That was enough to make Marron suspicious. He saw the havoc that Darr's friendships were causing for the due diligence team in real estate. Marron wasn't going to allow another Clifton Harrison problem to develop with the oil and gas partnerships.

Marron was frustrated--handling due diligence for Darr had an Alice-in-Wonderland quality about it. The numbers, the experts, the market all said one thing. But each morning, the due diligence team stepped through the looking glass into the Direct Investment Group, and everything turned on its head. The old standards didn't matter. If Darr wanted to do a particular deal, it was almost impossible to stop him.

This time, the deal was too important. For months, Marron and Douglas Holbrook, a specialist on energy financing who had been recently hired out of the firm's corporate finance division, had been trying to put together a unique energy deal with Prudential Insurance. It would be an energy income deal, in which investors' money is used to purchase oil reserves that had already been discovered and proven. Then, if the partnership is well managed, it makes money for investors by pumping the oil out of the ground and selling it at a profit.

The idea was attracting attention at the highest levels. Ball himself was involved in discussing some of the terms of the deal. He had explored selling a similar partnership at Hutton, and it interested him. Since this would be the first major product involving Prudential Insurance, Ball wanted to make sure everything was handled just right.

If Prudential Insurance agreed to invest, the deal would be enormously appealing to retail investors. What client wouldn't want to invest money alongside one of the world's largest companies? Making it even better, Holbrook was insisting that some of the money paid to general partners up front--known as the promote--be held back until clients received their original investment back from partnership distributions. That would help put more investor cash to work and improve the chances for success.

The partnership would also have big benefits for Prudential-Bache. One of the Direct Investment Group's subsidiary corporations, called Prudential-Bache Energy Production, would serve as a co-general partner in the energy income deals. Then it could charge management fees and snap up a piece of the cash flow. It could be

enormously lucrative for the firm, and also for select members of the Direct Investment Group, such as Darr, who would share in the money flowing into the subsidiary company.

Darr liked the idea as soon as he heard it, and he immediately told Marron that he wanted NRM brought into it as the managing general partner. "They're the best guys for this," he said.

Marron objected. As far as he knew, NRM had little involvement with institutional investors like Prudential Insurance. Other companies had stronger financial positions. He did not mention his most serious concern about Darr's relationship with NRM.

"Go see NRM," Darr commanded.

A short time later, Marron and Holbrook were on the plane to Dallas to meet with NRM executives. After about an hour of speaking with them, neither Marron nor Holbrook was much impressed. They struck Holbrook as having more knowledge about partnership sales than they did about the oil and gas business.

As the last stop on their due diligence trip, Marron and Holbrook visited the bank that was financing much of NRM's operations. The banker in charge of the account praised NRM as a fast-growing company with strong finances.

"Would you lend NRM more money if they needed it?" Marron asked.

"Oh, absolutely," the banker replied.

Wait a minute, Holbrook thought. We're leaving something out of this equation. "If Prudential-Bache stopped raising capital for NRM, would you still lend them money?" he asked.

The banker looked shocked by the question. "Well," he said. "No, we wouldn't."

The conclusion was obvious: NRM was getting bigger because Prudential-Bache was raising money for it. If the firm stopped, the growth could stop as well. Marron and Holbrook were trying to judge the wave height in the ocean by examining the wake from their own boat.

"Man," Holbrook said after they left the bank. "We've got to figure out a way to get these guys out of this deal."

On the three-hour flight home from Dallas, Marron and Holbrook plotted how to ditch NRM. If they found another oil company that Prudential Insurance liked, Darr could never stop it. But unless they stumbled on a solid company soon, they knew, no matter what their objections, that NRM was going to do the deal. They needed to move fast. Holbrook was sure he was having lunch with executives from Crawford Energy. That was what he remembered hearing from Ed Devereaux, the partnership marketer in the New York region. He barely knew Crawford but figured there would be no harm in meeting them. Even if he didn't strike up any business, at least he would get a free meal.

So in early 1983 Holbrook and Devereaux went to the City Midday Club at 140 Broadway, just a short walk from Wall Street. As they got off the elevator, Holbrook recognized Rich Gilman, a former insurance company executive he had met over some deals years before. Holbrook had immense respect for Gilman and strode quickly toward him to say hello.

Holbrook was surprised to find out that Gilman was one of the two people he was meeting. Gilman introduced the other man as Anton Rice III, known to everyone as Tony. Holbrook took almost an immediate dislike to Rice. A tall man with graying temples, blow-dried hair, and French cuffs, Rice struck Holbrook as striving too hard to

hit some Wall Street image. He had a little too much of a salesman's smell to him, all polish and gentility.

As the four men followed the maître d' to a table, Holbrook thought fast. Gilman had introduced Rice as the chief financial officer of Graham Resources, not Crawford Energy. Gilman apparently worked with Graham, too. Holbrook had heard of that company before. Headquartered in Metairie, Louisiana, Graham had been founded in 1975 by Ford Graham, a sharp and crusty oilman who started in the business in 1938, and his son, John, a Princeton graduate and lawyer.

Holbrook remembered that he had seen a tombstone advertisement in the Wall Street Journal in 1980 announcing that the St. Paul Fire and Marine Insurance Company had committed to investing close to \$90 million with Graham in an energy property acquisition deal. If Graham was good enough to attract St. Paul, he thought, and employed quality people like Gilman, maybe it would be the right choice for the energy income deal.

As the men dined over fresh salmon and beef tenderloin, Rice laid out the purpose for the meeting: Graham had been raising money for drilling partnerships with Merrill Lynch but now wanted to do business with Pru-Bache. Rice mentioned that he once worked for Merrill and knew Darr from there. He left out that Darr had tried to get a job at Graham while still working at Josephthal. It didn't strike Rice as important.

Holbrook listened politely, then shook his head.

"We're not interested in a drilling deal," he said. "We're looking at doing an income fund. Maybe if you're interested in something like that we might be able to talk."

The conversation was all very sketchy, without any hard proposals. After more than an hour, the meal came to an end, and everyone stood up from the table. "Well, it was great seeing you, Rich," Holbrook said. "Let's not lose track of each other. Maybe we have something we can work on here."

Holbrook and Devereaux said good-bye to their hosts and hustled back to the firm. Holbrook scrambled immediately into Marron's office.

"I may have found an option to NRM," he said.

Marron listened as Holbrook excitedly described his meeting. He spoke highly of Gilman, adding that if Graham had sent only Rice, he never would have thought about doing business with them. Graham had done transactions and was a company of real substance. As he finished up, Marron liked what he had heard. He told Holbrook to call Prudential Insurance and see what they thought. Maybe, he thought, they had found a way to beat Darr at his own game.

Darr stopped Marron in the hallway as he was about to walk past.

"Dennis, I want you to get control of Holbrook," Darr said. "He's yours. Control him." Then he walked away.

Marron knew that Darr was angry at his team. Holbrook had no qualms about speaking his mind on a deal and never seemed afraid to tell Darr when he disagreed with him. Marron knew that alone would be enough to infuriate Darr. But now, he and Holbrook had displaced NRM with Graham in the energy income deals. Darr could never reverse the decision even if he wanted to--it had the full backing of Prudential Insurance. The company had agreed to invest in the Graham deals.

Still, Darr made Marron's job as difficult as possible. Even though the Direct Investment Group had already started putting together more than \$100 million worth of Graham partnerships, Darr refused to meet with executives from Graham Resources, saying he was too busy. So Marron and Holbrook handled the negotiations almost by themselves,

frequently flying down to the company's headquarters in the unfashionable outskirts of New Orleans. It was there, during one negotiating session with John Graham, that the story of Darr's past came up yet again.

"I've heard some information about Jim Darr," Graham said. "As I understand it, he's not totally aboveboard, and I'm concerned about that. Is that something I have to worry about?"

Marron couldn't believe it. Everyone seemed to know Darr's reputation. "Well, I have to admit that I've heard some things about him, too," Marron said. "But the transaction we're doing here is a good one. We've got Prudential Insurance in it. Jim Darr, whatever his problems are, shouldn't affect it at all."

Graham pursed his lips for a moment. "All right, fine," he said.

The Prudential-Bache Energy Income Fund was ready to go in June 1983.

Both Holbrook and Marron were immensely proud of what they had accomplished. They had conceived of the idea, brought it to the table, and found the managing general partner. Because of their work, Prudential-Bache was in one of its first huge ventures with Prudential Insurance, its new parent. Holbrook figured that with his and Marron's success, they would soon have more authority to pursue other quality deals.

Holbrook forgot that the coin of the realm in the Prudential-Bache Direct Investment Group was not success in deals. It was loyalty to Jim Darr. By that standard, both he and Marron were penniless.

In the summer of 1983, Holbrook sat at his desk, feeling almost numb from shock. Rumors had been circulating for weeks that Darr wanted someone new in charge of due diligence for energy deals. Marron and Holbrook would soon have a new boss. But Holbrook could not believe that even Darr would select the person whose name was in the rumor mill: Bill Pittman, the volatile product manager who, not much earlier, was handling the department's paperwork.

Holbrook shook his head in disbelief. Pittman had absolutely no qualifications for the job. He knew nothing about oil and gas and hadn't been to business school. He was Darr's yes-man. Holbrook scrambled down to Marron's office as soon as he heard the news.

"I just heard that Pittman got promoted over you," he said. "You're not going to take this, are you?"

Marron seemed resigned, almost tired of the battles. "Well, what can I do about it?" he said. He wanted to move out to Denver and work out of an office there, and at least Darr had given him permission for that.

"But, Dennis, my God! Bill Pittman?"

Marron shrugged. There was no undoing Darr's decision. Marron went to Denver. A few weeks after Pittman started in his job, he walked into Holbrook's office and told him they were not going to be able to work together. Holbrook left and accepted a standing offer he had with A. G. Becker, a competing firm. The people Darr could not control were out of Prudential-Bache's energy due diligence team. After his one defeat over NRM, he had reasserted his power.

A few months later, members of the department attended a meeting of the Direct Investment Group. Darr stood before members of his staff, as well as Matthew Chanin, an energy expert from Prudential Insurance who was deeply involved in the Graham deals. Darr described some recent successes and took special note of the work his department performed in finding and assembling the Prudential-Bache Energy Income Fund.

"I'd like to congratulate the person who really carried the ball on energy income, and is largely responsible for its success," Darr said. "And that's Bill Pittman."

Pittman, who played absolutely no role in originally putting the deal together, raised his arm from the audience to accept Darr's praise.

The meeting broke up, and Chanin wandered over toward Marron. He looked a little disturbed and stopped Marron to talk with him.

"Boy, Dennis," he said. "You just got screwed."

Three executives from Graham Resources walked into a cocktail party at a hotel near Fort Lauderdale, Florida. They were scheduled to meet a group of thirty Prudential-Bache brokers and managers who were attending a sales conference in the late summer of 1983. It was Graham Resources' first opportunity to size up the types of people who would be selling the new Energy Income Fund.

The Graham executives--Rich Gilman, Paul Grattarola, and Rusty Renaudin--fanned out in the massive marble room. They walked among the Prudential-Bache brokers and managers, who were busily munching on shrimp hors d'oeuvres and downing free drinks. Waiters in white gloves walked through the crowd, silently whisking away the empty plates and glasses that the brokers scattered haphazardly about the room.

James Parker, the Direct Investment Group's chief marketer for Florida, introduced the Graham executives to as many brokers as he could. After about half an hour, the crowd moved to a conference room. There, the Graham executives were scheduled to make a presentation describing the new energy income partnership.

Before leaving Louisiana, the three executives had plotted how to handle this group from Prudential-Bache. This, they decided, would be the best opportunity to get some intelligence on the firm's brokers and managers. Graham had done business with Merrill Lynch in the past and knew the high level of training that those brokers received. Renaudin and Grattarola, both regional marketers for Graham, were former Merrill Lynch stockbrokers and felt they understood the salesman's mentality.

The best pitch, the group had decided, was to treat the Prudential-Bache brokers as if they were from Merrill Lynch. That meant making a sophisticated marketing presentation about the way the Energy Income Fund worked and how it might perform. This would not be like hocking shoes; instead, Graham would provide an educational lecture that would help the brokers understand the product and see where it might fit with their clients' investing needs. If the presentation went over the heads of the crowd, then Graham, in coordination with Prudential's marketing team, could dumb it down a little the next time.

The task of making the presentation at the Florida meeting was given to Gilman. As all the brokers and managers found their places, Gilman sat down at the head table, reviewing his notes. Finally, he was introduced and stood up before the assembled group.

"I'm here today to introduce you to an exciting new product that will provide your clients with a unique way to participate in the oil and gas industry," Gilman began. "It is called the Prudential-Bache Energy Income Fund."

As planned, Gilman launched into a sophisticated description of how the partnerships worked. While the presentation was technical, it was not financially complex. He described how the partnerships would use investor money to buy oil in the ground, then pump it and sell it. The cash from sales--minus expenses--would be returned to the investors in distributions. Included in each distribution was the original cash used to buy oil plus the profit from its sale. It was like investing in a car for \$1,000, souping it up, and selling it for \$1,500--the money received included \$500 in profit and \$1,000 in

original investment.

Finally, Gilman explained that determining the value of the oil in the ground was somewhat complex. While a reserve was purchased all at once, it would be pumped out over decades, with the price of oil always changing. He described how values are assigned to the reserves. He used the parlance of the industry, mentioning the "present value" of the reserves and the "internal rate of return" of the partnership.

Gilman paused and looked up. A sea of blank, uncomprehending eyes looked at him. The brokers and managers had absolutely no idea what he was talking about. Nor did anyone look like they much cared.

A hand went up, and Gilman pointed toward the man. "Do you have a question?" he said.

Yeah," the Prudential-Bache broker said. "What are you guys going to pay in commissions?"

As complex as the Energy Income Fund was to understand, the first thing that the brokers cared about was how much money was in it for them.

For the next few minutes, Gilman fielded question after question about the commission structure of the partnerships, from how much would be paid overall to how much would end up in the brokers' pockets.

Grattarola sat back in disgust. Great, he thought. We've got a bunch of guys here interested in just three things: commissions, commissions, and commissions.

Eventually, the brokers started asking some questions about the oil business. But the queries were either pointless or so idiotic that Gilman seemed to have trouble keeping a straight face.

"Is oil going to \$100 a barrel?" The Graham executives did not know. "Well, how long do you think it would take for it to go that high?" Again, they said they did not know if it ever would.

Near the end, they called on a broker who was eagerly waving his hand.

"Yes," the broker said. "Is it true that the oil is in huge underground lakes?" Grattarola took that question. After pausing for a minute to catch his breath, he answered. No, it was not true.

The meeting drew to a close, and a number of branch managers walked to the front of the room. Several of them looked extremely mad. One short, overweight manager pushed himself into the Graham executives' faces.

"What the hell were you people talking about?" the manager demanded angrily. "Present values? Internal rates of return? We don't want to hear any of this fancy stuff. You just talk about yield. How much money would somebody who put \$10,000 in an oil partnership get each year?"

The Graham executives could not believe what they were hearing. Yield was the return on investment--for most retail clients, it usually referred to the amount of fixed interest they were paid on a bond. Even in the sloppy parlance of Wall Street, telling investors that the partnership's cash distributions were a yield would not only be misleading, it would be fraudulent. Perhaps part of the money--the difference between the costs of purchasing and selling the oil--might be referred to loosely as "yield." But as Gilman had just explained, the distributions also included a return of the original capital that was used to buy the oil in the first place. Describing the distributions as "yield" would be like telling bank customers that all cash withdrawals from their own accounts were interest payments. It was simply false.

"Calling this 'yield' does not tell the whole story," Gilman answered. "It would be very misleading."

"Well, then it's too damn complicated," the manager replied. "If you guys can't break this down and make it simple, then nobody at this firm is going to sell it. Let me tell you, if your sales pitch is longer than three minutes, then I don't want you talking to my brokers. They've got better things to do."

After a few more tense minutes, the meeting broke up. The three Graham executives hustled out of the room. They were supposed to drive a rental car to the airport, where they were scheduled to fly to another meeting of Prudential-Bache brokers. But they decided to take a limousine. They needed the driving time to start preparing a much slower, less sophisticated presentation. They hired a car and piled into the back.

"Well," Gilman said. "What do you think?"

"I think we're in deep shit, guys," Grattarola said. "These are the dumbest bastards I've ever run into. We've got managers who don't understand, and are a bunch of hustlers. We've got brokers who are stupid, and not well trained."

Renaudin agreed. "These guys don't know their ass from a hole in the ground," he said.

The three discussed whether it was possible that the ignorance they were seeing was just in Florida, or if it was throughout the firm.

"I'll tell you, we don't need sales material for this bunch," Grattarola said. "We're going to need educational material. We've got to keep it real simple for these guys, and go back to the very, very basic stuff."

Some questions were raised about whether educational material alone would help the brokers sell the partnerships. But Grattarola was insistent.

"These guys don't understand investments," he said. "They don't understand the terminology of the Street. And they sure as hell don't understand oil and gas. We could end up with some serious compliance problems."

All of them knew what Grattarola was saying. These brokers could easily fall out of compliance with the securities laws requiring them to accurately describe investments to their clients. How could they be accurate if they didn't understand what they were selling?

Getting the brokers educated was the top priority. Otherwise, they might start breaking the law.

* * *

"Today, I want to tell you about an investment opportunity with potential high cash flow, a superior structure, a unique sharing arrangement, and low risk."

By the late summer of 1983, hundreds of Prudential-Bache brokers across the country heard those words in the opening seconds of the first marketing video for the Energy Income Fund. The video, put together by the Direct Investment Group, began with a shot of Ron Gwozdz, the department's first product manager for the energy partnerships. As he recited the opening line, he walked to an office door and grabbed a hard hat. He threw open the door, and the scene dissolved to an oil field setting. For the next few minutes, Gwozdz talked about the experience of Prudential Insurance and Graham Resources in the oil business. He introduced John Graham, who discussed how low oil prices made the timing for the investment perfect.

"Ron, I've never seen a better time to buy products in the ground at distressed prices," Graham said.

Graham dismissed the idea that there might be a long-term glut of oil and natural gas. "That's somewhat misleading," he said. "This should not be the case."

When Grattarola saw the video, he thought it was a disaster. It didn't explain the partnerships--if anything, it oversimplified them. It made them seem safer than they actually were. It didn't discuss the risks. It didn't raise any of the important compliance issues. It offered none of the education that was so critically needed. But few people in the senior ranks of Graham or the Direct Investment Group seemed to care. The video was simple. It would get the partnerships sold.

The video ended with Gwozdz walking in an oil field, praising the partnership. "Prudential-Bache Energy Income Fund 1 is a limited partnership that is projected to give you high cash flow, appreciation, and low risk," he said. He added that the partnership "has a projected return on investment of from 16 percent to 19 percent."

By the fall of 1983, those marketing lines had been used to raise \$26.7 million from 2,328 investors for the first Graham energy income partnership sold by Prudential-Bache. The investors all heard about the high returns and the low risks.

The largest criminal fraud to come out of the Direct Investment Group was under way.