

# BusinessWeek

JULY 13, 1998 / THE MCGRAW-HILL COMPANIES

\$3.95

## The Global 1000

The world's  
most valuable  
companies

## The GM Strike

A chance  
to reshape  
the auto giant?



## Hewlett- Packard

Why Lew  
Platt is  
angry



## Basketball

Can David Stern  
reinvent  
the NBA?



# SPIELBERG

How Hollywood's most successful  
director runs his creative empire

PAGE 96







INVESTIGATIONS

# DUBIOUS DEALINGS BEFORE DREYFUS

The murky past of a fund manager now under FBI scrutiny

**O**n Dec. 12, 1994, the financial news wires reported that Leon G. Cooperman, manager of the prestigious Omega Advisors Inc. hedge fund, had bought a 6.5% stake in a penny stock called Home Theater Products International Inc. To Wall Streeters familiar with Cooperman's high-rolling investment style, Omega's 615,000-share stake in this fly-speck company was a shocker. It wasn't just the size of the company. Skeptics believed that Home Theater was a fraud—an old-fashioned, widely promoted stock scam. And sure enough, three of its top execs later pleaded guilty to securities fraud and insider trading.

Word of the stock's cruddy quality reached Cooperman after the item hit the wires. When the Omega partner who bought the stock was questioned by Cooperman, according to a source familiar with the incident, it was obvious that he hadn't done even elementary research on the company. Cooperman swiftly dumped the shares—overruling his partner, who subsequently left the firm. His name: Michael L. Schonberg. After leaving Omega, he surfaced at

an equally tony firm—Dreyfus Corp.

This incident would have long been forgotten were it not for the controversy that has swirled around Schonberg and Dreyfus in recent weeks. The Mellon Bank Corp. subsidiary has been beset by questions concerning Schonberg's personal holdings in two other microcap stocks he bought for his two Dreyfus funds—the Aggressive Growth and Premier Aggressive Growth funds. According to a senior law enforcement official, Schonberg's activities at Dreyfus are under investigation by the FBI, as well as by the Securities and Exchange Commission and the New York State Attorney General's Office, which has just sent a wave of subpoenas.

The New York probe could be particularly thorny for Dreyfus. The state regulators, who have both civil and criminal jurisdiction, are conducting a wide-ranging probe that began in December, 1996, as an investigation into Dreyfus' advertising of the two funds. According to a source close to the probe, the investigation subsequently broadened to an examination of the funds' stock purchas-

Schonberg's involvement in penny-stock



es—which have included a host of thinly traded penny stocks—and later to encompass the allegations of conflict of interest. Dreyfus declined to comment on the investigations. Andrew Kandel, head of the Attorney General's office of investor protection, commented on the general issue by noting pointedly that mutual funds that "choose to dabble in these highly speculative and manipulation-prone securities and market them to Main Street investors must make specific public disclosure and employ the most thorough supervision of fund managers and fund activities."

For Dreyfus, the incident at Omega raises an intriguing question: When it hired Schonberg in August, 1995, did Dreyfus know that he had left his last employer in the aftermath of the Home Theater fiasco? Dreyfus did not respond to questions on this subject, saying only that it would not be "appropriate" to comment on Schonberg's former employment. And the list of questions is likely to grow for Schonberg, Dreyfus, and the \$23 billion money-management firm where Schonberg worked from 1988 to 1994, just before his brief stint at Omega—UBS Asset Management Inc.

**BIG STAKE.** According to SEC filings compiled by Technometrics Inc., a New York firm that tracks institutional holdings, Schonberg bought for UBS a large stake in a company called American Medical Technologies. And that could be troublesome, because he obtained 20,000 unregistered warrants in that company for his personal account while loading up on the stock for UBS in 1992. A 250,000-share stake in the company was disclosed in UBS's Sept. 30, 1992, filing. That made UBS the largest institutional owner of the stock. UBS's stake in the stock swiftly doubled and grew again during 1993, peaking at yearend at 785,000. Schonberg was chief investment officer of the firm, but despite his lofty position, UBS Managing Director George Jamgochian confirmed, Schonberg ordered the purchase of this tiny stock. And a UBS spokeswoman said "there is no indication in our records whether or not" UBS was informed of the warrants.

The circumstances in which Schonberg

obtained the warrants are far from clear. Officials of American Medical (since renamed Tidel Technologies Inc.) say the shares were transferred to Schonberg by an investment banker at Laidlaw Equities Inc. They declined to name the banker, who they say obtained the shares for free in connection with the spin-off of an American Medical subsidiary. The banker's relationship with Schonberg, if any, was unclear.

According to traders and brokers intimately involved in such stocks, unregistered penny-stock warrants are rarely sold because there is no public market for them. And when they are sold among traders, they sell at a steep discount, often for just a few cents. But according to a letter to BUSINESS WEEK from Christo-

the New York investigators but not from Dreyfus—which appears to contradict Dreyfus' repeated assertions that it is conducting a "thorough investigation" of allegations regarding Schonberg's personal holdings. Dreyfus did not respond to a request for comment.

Schonberg's purchases of American Medical at UBS may well have enhanced the value of the stock, and thus his warrants. After joining Dreyfus, he loaded up on the shares for the Aggressive Growth fund in early 1996. According to Condrion, the fund has since sold out its shares at a profit. Condrion says Schonberg exercised the warrants in March, 1997, but has never sold the shares.

The other stock in which Schonberg had a personal stake, while buying the shares for Dreyfus, was Chromatics Color Sciences International Inc. (BW—June 22). And there, too, is a previously undisclosed UBS connection. According to Technometrics, UBS acquired a 220,000-share stake in Chromatics in the last three months of 1993, making UBS the biggest institutional holder of the stock. Jamgochian confirmed that Schonberg ordered that purchase as well. UBS sold out its position after

a few months, at about the time Schonberg left for Omega. In December, 1994, Schonberg obtained cut-rate shares in Chromatics in a private placement.

Was there any connection between Schonberg buying Chromatics stock for UBS and later getting cut-rate shares for himself? Schonberg won't comment. Meanwhile, Dreyfus, while publicly supporting Schonberg, has quietly removed him as a portfolio manager of the two funds but is keeping him on as an "analyst." Dreyfus spokeswoman Patrice M. Kozlowski says that the move was in the works for a while and is unrelated to the controversy over his personal holdings. But in April, Dreyfus had said that while Schonberg was no longer the lead manager, he would stay on as a portfolio manager. Kozlowski declined repeated requests to explain the contradiction. And that's understandable. With all those investigators putting Schonberg and his employer under a microscope, Dreyfus has a lot more serious issues to explain.

By Gary Weiss in New York



## THE SCHONBERG AFFAIR: SOME UNANSWERED QUESTIONS

**1. THE OMEGA DEPARTURE** Did Dreyfus know that Schonberg had left Omega Advisors after Omega repudiated his purchase of a questionable penny stock?

**2. THE AMERICAN MEDICAL WARRANTS** Was Schonberg's purchase of the stock for UBS Asset Management, and later for Dreyfus, influenced by his position in illiquid warrants?

**3. THE CHROMATICS TRADE** Was Schonberg's purchase of Chromatics for UBS in any way related to his obtaining cut-rate Chromatics shares several months later?

DATA: BUSINESS WEEK

pher M. Condrion, Dreyfus' chief executive, Schonberg purchased the warrants late in 1992 at a price of \$1.50 per share and the exercise price was \$1.25.

It was unclear why Schonberg, or any savvy investor, would pay such an apparently steep price for unregistered warrants that another investor had obtained for nothing. The warrants could not be exercised until American Medical registered them. Leonard L. Carr Jr., the company's senior vice-president, says American didn't know when that would be until yearend 1996, shortly before they were registered. Once registered, the warrants could only be exercised for 60 days after the registration date. In effect, then, they were a wager that shares of this penny stock would climb to \$2.75 or higher at some unspecified point in the future. Tidel's chief executive, James T. Rash, says that the company handled the transfer of the warrants to Schonberg but has no evidence of the purchase price. According to Rash, the company has received an inquiry from

transactions goes back to his days at Omega and UBS