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Mutual Funds

Exclusive N.Y. AG Investigating L'Affaire Schonberg

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The **New York State Attorney General's Office** is investigating **Michael Schonberg's** handling of two **Dreyfus** mutual funds, and the **Securities and Exchange Commission** is also involved, according to a person familiar with the situation.

Dreyfus will convene a special meeting tomorrow at its offices to discuss the Schonberg affair, according to four directors on the boards of the [Dreyfus Premier Aggressive Growth](#) and [Aggressive Growth](#) funds he used to lead manage.

"I can tell you I'm going to a meeting on Wednesday. That's all I can say," says Robert Glauber, a director of the Premier Aggressive Growth fund. Schonberg, who was replaced as lead manager on the funds in April after having managed them since the middle of 1995, handled his funds in a manner sharply divergent from other aggressive growth funds. Schonberg regularly took big positions in illiquid micro-cap stocks that were closely associated with penny-stock brokerages and had substantial short interest.

Questions have been raised about Schonberg's personal ownership of some of these positions that were also in his fund.

In examining Schonberg's performance, an April *TSC* [story](#) also raised questions about the correlation between Schonberg's funds' holdings and those of the small firm of **Janssen-Meyers Associates L.P.**, run by two former **D.H. Blair** employees who have been subject to **National Association of Securities Dealers** fines.

In recent months **Dennis Vacco**, the New York attorney general, has sought to increase his office's power to crack down on fraud schemes by penny-stock brokerages, and the AG's inquiry likely stems from that work. The attorney general's office said it could neither confirm nor deny the existence of an investigation.

In addition, the Securities and Exchange Commission is looking into the manager's activities. According to a person familiar with the situation, at issue is whether Schonberg favored one fund over the other in managing the funds' assets. A call to the SEC wasn't returned.

The regular board meeting for the two funds was held in early June and the Schonberg affair was discussed -- though not in depth, according to one of the fund directors. Every mutual fund has a board that, like a corporate board, is charged with governance and oversight. Most fund boards meet quarterly.

Dreyfus spokeswoman Patrice Kozlowski would not comment on any aspect of the Schonberg affair, citing Dreyfus policy.

Michael Schonberg ran the two Dreyfus funds from mid-1995 until early April, when he was demoted to deputy manager. Paul LaRocco, who works for the Denver mutual fund company **Founders**, replaced Schonberg as lead manager of the two funds. **Mellon Bank** ([MEL:NYSE](#)) owns both Dreyfus and Founders. In the two years until March of this year, the performance of Schonberg's two funds was breathtakingly awful: The Premier Aggressive Growth fund lost 18% in that period, while the Aggressive Growth fund dropped 30%. The **S&P 500** in that time? Up 77%.

Besides the links to Janssen-Meyers, Schonberg's funds also invested in companies that **Kinder Investments L.P.** -- a fund set up by J. Morton Davis, the chairman of D.H. Blair -- invested in, such as **Cytoclonal Pharmaceuticals** ([CYPH:Nasdaq](#)) and, in a private placement, **Chromatics Color Sciences** ([CCSI:Nasdaq](#)).

In addition, Kinder held 4.7% of **Macrochem** ([MCHM:Nasdaq](#)) as of April 9, according to SEC filings. Peter Janssen of Janssen-Meyers held more than 1.5 million shares, or about 7%, of the Lexington, Mass., drug-delivery company, according to SEC filings. Schonberg's Dreyfus funds owned more than 1.3 million Macrochem shares, or about 6%, as of the end of March.

Companies Schonberg invested in have had investment banking and underwriting relationships with other firms that have run afoul of the regulators, including **Investor Associates**, which led Chromatics Color Sciences' initial public offering, and D.H. Blair itself.

Manuel Asensio, a noted shortseller, in a barrage of [press releases](#) and postings on his [Web site](#), has alleged Schonberg was involved in questionable transactions while running his funds.

SEC filings show that Schonberg was personally an investor in two companies in which he subsequently had his funds invest. Schonberg owned shares in Chromatics Color Sciences, in which Dreyfus had a 2 million-share (split-adjusted), or about 13.5%, stake as of September. Dreyfus has since been reducing its stake, according to **Technometrics** data. *Business Week*, in its current issue, reports that Schonberg received warrants of **American Medical Technologies**, which has since changed its name to **Tidel Technologies** ([ATMS:Nasdaq](#)). The Dreyfus Aggressive Growth fund later established a 350,000-share position in American Medical. *Business Week* raised the issue of whether Schonberg violated securities laws under these circumstances.

Dreyfus has said that Schonberg complied with its personal trading regulations. Schonberg, reached by phone, said: "I can only direct you to talk to Patrice [Kozlowski]," referring to the Dreyfus spokeswoman.

Senior Writer [Dagen McDowell](#) contributed to this story.