

Paying the Piper at SulphCO

By BILL ALPERT

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

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

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

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

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

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

Through their lawyer, the Wolfsons declined to discuss with *Barron's* their involvement with SulphCo or any other investment. The Wolfsons expressed doubts about *Barron's*

journalistic integrity, says Eli Levitin, general counsel and managing director of their investment and real-estate ventures. The Wolfsons are not mere penny-stock investors, says Levitin. "They are really a very substantial family office."

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

Since the early 1990s, the Wolfsons have put tens of millions of dollars into small-cap companies through bridge loans and PIPEs -- private investments in public equities -- a sometimes controversial form of investment that is being scrutinized by the Securities and Exchange Commission. (See [Why Hedge Funds Love Pipes.](#))

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

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

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

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

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

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

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

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



A Family's Highs and Lows: Zev Wolfson's family had built its fortune and reputation on Manhattan real estate, charitable donations and hedge-fund investments. But the family or its employees have also been deeply involved with boiler-rooms like A.R. Baron, funded iffy promotions like SulphCo and teamed with alleged naked short-sellers like Pond Equities. Why? The Wolfsons aren't talking. **From left to right: 1969** -- One State Street Plaza launches Zev Wolfson's real-estate empire. He becomes an avid investor in hedge funds and buyout firms. **March 1995** -- Three people killed in collapse of Harlem tenements owned by Wolfson's stepson Morris. No criminal charges were filed. **June 2004 - March 2006** -- Dubious petroleum technology of "Dr." Rudolf Gunnerman financed by Wolfson's sons and associates. **July 2004** -- *Grand Theft Auto* game distributor, which faked sales, is acquired by company advised by Wolfson's general counsel. **April 2006** -- Naked short-selling allegations filed by SEC against broker associate of Wolfson's general counsel.

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

Executives of both Kensington Wells and Patterson Travis were ultimately convicted of running stock-fraud conspiracies to pump up the prices of, and then dump, stocks like

VideoLan Technologies, a Kensington Wells underwriting financed by Abraham and Aaron Wolfson and Morris Wolfson's wife, Arielle.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As noted, the Wolfson Group's managing director, Eli Levitin, says the family won't discuss its investing. As it turns out, Levitin himself has followed the Wolfsons in patronizing dubious brokers and their stocks. Back in 1997, he received warrants for

15,000 shares of a D.H. Blair-sponsored company that marketed discounted chiropractic care. The warrants were Levitin's compensation for performing investor-relations services, said the SEC filings of the now-vanished company.

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

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

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

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

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

Lifshitz and his partners say in their statement that "virtually all" the cases involving Birnbaum or Levitin's wife were started before the lawyers or their charities invested with Levitin or Birnbaum. After TheStreet.com raised questions last year, the lawyers divested

themselves of the Birnbaum-managed partnerships that are class-action plaintiffs. They also asked a legal-ethics professor at Hofstra, Roy Simon, to examine the lawyers' investments with Birnbaum. He pronounced them ethical.

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

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

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

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

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

Why Hedge Funds Love PIPEs

THE HISTORIES OF WALL STREET'S scuzzy companies frequently feature PIPEs, or "private investments in public equities." In these financings, a public company sells stock via a discounted private placement to investors—typically hedge funds or investment vehicles controlled by wealthy investors like the Wolfsons of New York. Public investors in PIPE-issuing companies don't make out very well, say researchers like Clemens Sialm, an assistant professor of finance at the University of Michigan's Ross School of Business. Sialm and his colleagues studied more than 5,000 PIPE deals done

from 1995 through 2002 and recorded in a database compiled by Sagient Research of San Diego.

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

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

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

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

-- B.A.