Gordon Investigated for $43 Million Theft at Merrill (Update3)

(Updates Merrill's share price in 18th paragraph.)

Aug. 11 (Bloomberg) -- Daniel Gordon, former chief energy trader for Merrill Lynch & Co., is being investigated for embezzling $43 million from the world's largest securities firm in 2000 by disguising the theft as an energy trade, according to a letter written by a U.S. Justice Department prosecutor and interviews with Canadian law-enforcement officials.

Merrill Lynch, based in New York, hasn't disclosed the loss in public filings. Gordon sent the money in 2000 to a Caribbean-incorporated shell company he controlled, according to the Justice Department letter. Merrill, the largest securities firm by capital, said in a civil-court filing on July 14 that it recognized the possibility of ``the alleged fraud.''

The embezzlement would be the largest employee theft from a financial institution in modern times, said John Coffee, Adolf A. Berle professor of law at Columbia Law School in New York, where he directs the Center on Corporate Governance. Frank Partnoy, a securities-law professor at the University of San Diego School of Law, said the case suggests Merrill's oversight and control of its executives was inadequate.

``We're alleging Dan Gordon defrauded Merrill Lynch of $43 million'' and laundered the money with the help of a Canadian offshore-banking consultant, said Gregg Lepp, a Canadian prosecutor in Edmonton, Alberta, in a telephone interview. Gordon, also under investigation by federal prosecutors in New York, hasn't been formally charged with any wrongdoing.

``The usual credit-check and due-diligence procedures in place at Merrill Lynch were not followed with respect to'' Gordon's transactions, Assistant U.S. Attorney Jane Levine in New York wrote in a letter to Canadian law-enforcement officials, citing interviews with witnesses in Merrill's credit department and written internal communications.

Potentially Wider Problem

Partnoy, the San Diego law professor and author of ``Infectious Greed,'' said the episode should concern the company's investors.

``This is highly material information about how Merrill Lynch is run and how their controls and credit checks are able to detect theft or fraud,'' Partnoy said. ``It's evidence of a potentially wider control problem. In my opinion, because of the nature of the transactions, the $43 million loss should have been disclosed.''

Merrill reported $1.02 billion net income in the quarter ended June 30. ``The $43 million is a drop in the bucket for Merrill,'' Partnoy said. ``That's not the issue of primary concern. It's the breakdown in controls.''

Gordon, now chairman of Daticon Inc., a legal-document-storage company in Norwich, Connecticut, didn't return three phone messages to Daticon and his mobile phone requesting an interview.

Merrill Cooperating

Gordon's attorney, Alan Levine, managing partner of Kronish Lieb Weiner & Hellman LLP in New York, declined to comment. Levine also didn't respond to two faxes detailing the allegations against Gordon.

Merrill Lynch was unaware of the alleged theft until last October, two years after Gordon allegedly took the money, said Merrill spokesman Bill Halldin. He said that in all the time Gordon was at Merrill, the firm was unaware of any wrongdoing by Gordon. ``We're cooperating fully with the appropriate law enforcement officials on this matter,'' he said.

Gordon's energy-trading unit was under the supervision of Kelly Martin, senior vice president and head of global debt markets at Merrill, Halldin said. Martin resigned last December and is now chief executive of Elan Corp., Ireland's largest drug maker.

Martin reported to Thomas Davis, then head of Merrill's investment banking and capital markets business, Halldin said. Davis was fired in September for refusing to testify to the Securities and Exchange Commission and U.S. Justice Department about Merrill's transactions with Enron Corp. in 1999, Halldin said.

`Constantly Improving'

Asked what Merrill Chairman and Chief Executive Stanley O'Neal has done to tighten internal controls, Halldin said, ``We're continually improving our internal controls and compliance procedures.''

The breakdown in internal controls is the third incident reported in the past year in which Merrill has failed to adequately supervise its employees.

Merrill agreed to pay $80 million in March to settle SEC charges that it helped Enron Corp. commit accounting fraud. In April, Merrill agreed to pay $200 million to settle accusations by state and federal regulators that the firm allowed conflicts of interest by its research analysts.

Merrill neither admitted nor denied wrongdoing in either case.

Shares of Merrill were down 41 cents to $51.35 at 4:01 p.m. New York time on trading at the New York Stock Exchange.

Sold to Allegheny

Merrill sold its energy-trading unit to Allegheny Energy Inc., a Maryland-based utility, in January 2001, and Gordon became Allegheny's chief energy trader. The utility fired Gordon in September for violating company conflict-of-interest rules, spokeswoman Cynthia Shoop said. She declined to say what the conflicts were.

Merrill's decision to sell the unit was made by Merrill's then-Chief Executive David Komansky, saying the division wasn't part of Merrill's core business, Halldin said.

Two months ago, in a lawsuit that began last year in federal court in New York City, Allegheny accused Merrill of concealing knowledge of Gordon's wrongdoing at the time of the sale. Merrill denied the accusation. ``The only party that suffered damages was Merrill Lynch,'' Merrill wrote in a July 14 legal response filed in U.S District Court in New York City.

Gordon's Age

Another issue in dispute is Gordon's age. Allegheny said in court documents that ``Gordon was several years younger than had been represented to Allegheny.'' Assistant U.S. Attorney Levine wrote in her letter dated Nov. 21, 2002, that Gordon was 26.

The allegations against Gordon are contained in a 76-page sworn statement filed by Sergeant Joseph Mamela of the Royal Canadian Mounted Police in the Provincial Court of Alberta in Edmonton, and in a 12-page letter written to Alberta's attorney general by Assistant U.S. Attorney Levine.

Mamela filed the statement with the Alberta court in December to establish probable cause to obtain a search warrant. The court granted the warrant to search Newport Pacific Financial Group SA, an Edmonton company Gordon had hired to establish two offshore companies, according to Canadian prosecutor Lepp.

Levine's letter, sent from the U.S. Attorney's New York office and titled ``Request for Assistance in the Investigation of Daniel L. Gordon,'' sought help in tracking Gordon's use of offshore bank accounts.

Shell Company

``This office has developed evidence that Daniel L. Gordon was involved in the embezzlement and laundering of approximately $43 million,'' Levine wrote. She wrote that Gordon directed Merrill to send the $43 million to Falcon Energy Holdings SA, a shell company incorporated in Anguilla, a Caribbean island, as payment for a ``fraudulent contract.''

Merrill wired the money to Falcon on or about Aug. 30, 2000, ``to a bank account held in the name of Newport Pacific Financial Group at AIG Private Bank Ltd. in Zurich, Switzerland, for further credit to Falcon,'' she wrote.

Levine declined to comment, citing Justice Department policy.

Merrill had accepted Gordon's word that Falcon was ``an international energy firm with investments in power plants, oilfields and gas reserves,'' Levine wrote.

Levine's letter sought assistance from Canadian officials already investigating Newport as part of a money-laundering probe. Newport charges $18,000 to establish an offshore corporation, trust and bank account, each in a different nation to ensure privacy, said Michael Ritter, its chief executive.

Trust in Belize

Ritter helped Gordon form the offshore companies, controlled by a trust in the Central American nation of Belize, and opened the accounts with AIG Bank in 2000, Ritter said in a telephone interview. Gordon said they were for two Merrill clients, Ritter said.

``When money comes from a bona fide like Merrill Lynch, you don't question its pedigree,'' Ritter said.

Newport Pacific Trust Co. of Belize, an affiliate of Newport Pacific, froze the money in 2000 after $32.5 million of the $43 million was wired out of the offshore companies' accounts soon after they were opened, because Ritter suspected something was amiss, he said.

Ritter said he contacted Merrill lawyers shortly after Merrill sold its Global Energy Markets Unit, known as GEM, to Allegheny Energy, alerting them to his suspicions the account was used for money laundering. ``They didn't seem concerned,'' Ritter said. ``They seemed relieved it wasn't their problem.''

`No Information'

``Merrill Lynch received no information about Falcon or suggestions of impropriety affecting Merrill Lynch,'' Merrill spokesman Halldin said.

Ritter said Newport now holds the remaining $10.5 million in long-term investments, and that he's not spoken to Gordon for more than two years. ``I'd love to hear from him,'' Ritter said. ``It's a bizarre situation.''

The two offshore companies were Falcon and Ostrich Capital Partners, which was incorporated in the Marshall Islands, according to Assistant U.S. Attorney Levine.

Gordon used the companies to move the $43 million through Newport's accounts in the AIG Swiss bank, Levine wrote. American International Group Inc., the world's largest insurer by market value, owns the bank.

AIG spokesman Andrew Silver declined to comment.

`Fraudulent Contract'

``Falcon was not a legitimate company, but rather an offshore shell corporation controlled by Gordon and used as a vehicle to receive and launder the $43 million Merrill Lynch wired to Falcon under the terms of the fraudulent contract,'' Levine wrote.

Allegheny Energy purchased GEM for $490 million and a 2 percent stake in Allegheny's power-generating and wholesaling operations.

Merrill and Allegheny began their legal battle in the U.S. District Court in New York last September. Allegheny said it was defrauded by Merrill, and wanted the purchase rescinded. In court filings, Merrill has denied wrongdoing, and said it's still owed $115 million, in addition to $490 million it already received.

``Rather than terminate Gordon, Merrill Lynch instead swept its knowledge concerning the Falcon transaction under the rug and sold GEM to Allegheny,'' the power company said in a counterclaim against Merrill filed with the court on June 13.

Merrill Denies Allegations

``Merrill Lynch, knowing of the problems with GEM and its personnel, particularly Gordon, recognized an opportunity to solve its problems -- and profit handsomely -- by selling them to Allegheny,'' Allegheny said in the document. When it bought GEM, Allegheny said it ``had no reason to doubt Gordon's integrity or qualifications.''

Merrill said in its court-filed response that it remained unaware of Gordon's alleged theft for more than 18 months after the sale.

Gordon transferred $30 million from Falcon to Ostrich and wired the money to a New York bank account for Kings Holdings LLC, also owned by Gordon, in October 2000, according to Lepp and Levine. Gordon transferred an additional $2.5 million to another account, Lepp said.

The next month, Kings acquired a 70 percent interest in Daticon, Levine wrote. Kings then wired $25.5 million to an unidentified Connecticut law firm, which ``appears to be for the Daticon acquisition,'' according to the Levine letter.

Glenn Gordon, Daniel's father, who is now chief executive of Daticon, declined to comment.

Daticon stores more than 100 million pages of data in an Internet-based document repository for law firms, according to its Web site.

Merrill Lynch is a minority, passive investor in Bloomberg LP, the parent of Bloomberg News.

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Merrill Former Energy Trader Probed Over Payment From Allegheny

Aug. 14 (Bloomberg) -- Daniel Gordon, the former energy trader under investigation for embezzling $43 million from Merrill Lynch & Co. in 2000, is also being probed for allegedly defrauding $2.5 million from Allegheny Energy Inc., the company he joined after leaving Merrill, according to a letter written by a U.S. Justice Department prosecutor.

Gordon's career as an energy executive ended last September when Allegheny fired him as chief trader for violating unspecified conflict-of-interest rules, said Allegheny spokeswoman Cynthia Shoop. Gordon, 27, appointed chief energy trader at Merrill Lynch in 1999, moved into the same position at Allegheny in 2001 after it bought Merrill's energy trading unit.

An investigation by Allegheny, a Maryland-based utility, found that Gordon arranged a payment of $2.5 million of company funds in 2002 to an unidentified real estate company he controlled, in order to end a contract he had negotiated with himself, wrote Assistant U.S. Attorney Jane Levine.

``It turns out that the leased facility was not fully constructed, that Gordon was in fact the principal owner of the land on which the building was to be constructed, as well as the owner of the real estate company with whom Allegheny signed the lease and to whom it paid the $2.5 million termination fee,'' Levine wrote.

In July 2002, Allegheny said it would fire 10 percent of its 6,000 employees and reduce capital spending by $700 million over the next few years. Allegheny decided to end the project Gordon started, and thus pay out the $2.5 million, in order to reduce further spending, Levine wrote.

Allegheny's Shoop had no comment on the investigation.

Gordon, now chairman of Daticon Inc., a legal-document-storage company in Norwich, Connecticut, didn't return phone messages to Daticon and his mobile phone requesting an interview. His lawyer, Alan Levine, managing partner of Kronish Lieb Weiner & Hellman LLP in New York, declined to comment.

Gordon-Owned Company

The Assistant U.S. Attorney wrote that after Gordon joined Allegheny, he also improperly arranged for Allegheny to sell fuel to Eastern Energy Group, a home-heating-oil company he owned in Connecticut. A year ago, Allegheny discovered this arrangement, Levine wrote.

``It appears that he had used Allegheny's credit to secure a supply contract for his personal business, without disclosing his self-interest to any of the parties,'' the U.S. prosecutor wrote. Such heating-oil contracts were unusual for Allegheny, which doesn't buy and sell wholesale home heating fuel, she wrote.

``When confronted with this information, Gordon first denied, but then ultimately admitted his ownership of Eastern Energy,'' Levine wrote.

Merrill Lynch Case

In the Merrill Lynch case, Gordon had the firm send $43 million in 2000 to a Caribbean-incorporated shell company he controlled, according to the Justice Department letter. Merrill, the largest securities firm by capital, said in a civil-court filing on July 14 that it recognized the possibility of ``the alleged fraud.''

Gordon disguised the transaction as an energy trade, according to Assistant U.S. Attorney Levine's letter. The letter was written Nov. 21, 2002, from the New York office of the U.S. Justice Department, and sent to the attorney general of Alberta, Canada, seeking assistance in the U.S. investigation.

Gordon laundered the $43 million with help from a Canadian offshore-banking consultant, said Gregg Lepp, a Canadian prosecutor in Alberta, Canada.

``The usual credit-check and due-diligence procedures in place at Merrill Lynch were not followed with respect to'' Gordon's transactions, Levine wrote, citing interviews with witnesses in Merrill's credit department and written internal communications.

Merrill Was Unaware

Merrill Lynch was unaware of the alleged theft until last October, two years after Gordon allegedly took the money, said Merrill spokesman Bill Halldin. He said that in all the time Gordon was at Merrill, the firm was unaware of any wrongdoing by Gordon.

``If the allegations are true, then Merrill Lynch was victimized by this individual,'' Halldin said. ``We are working with law enforcement authorities who are investigating this former employee's activities. We've taken steps to strengthen our controls as a result of our review of this matter.''

Merrill Lynch is a minority, passive investor in Bloomberg LP, the parent of Bloomberg News.

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Merrill Received Fraud Warning About Gordon in 2001 (Update2)

(Updates share price in last paragraph.)

Aug. 25 (Bloomberg) -- Two weeks before Merrill Lynch & Co. underwrote a $667 million public stock offering for Allegheny Energy Inc. in April 2001, it received a letter from a law firm saying Allegheny's chief energy trader, Daniel Gordon, could be involved in a criminal fraud. Merrill made no public disclosure of the allegation before selling the stock.

The law firm of Davis, Hatley, Haffeman & Tighe PC in Great Falls, Montana, representing K2 Energy Corp., wrote the letter, dated April 13, 2001, to Merrill and Allegheny. A month earlier, Allegheny had purchased Merrill's energy-trading unit, and hired Gordon to run it. The U.S. Justice Department is now investigating Gordon, 27, for embezzling $43 million from Merrill, according to federal documents.

``I wrote a very pointed letter to Merrill and Allegheny warning of possible criminal conduct by Dan Gordon,'' said attorney Max Davis, whose client K2, is a Calgary-based natural-gas exploration company that had sought a $7 million investment from Merrill's energy-trading unit. ``Merrill and Allegheny were on notice that something stinky was going on with this guy.''

In the letter, a copy of which was obtained by Bloomberg News, Davis expressed concern about possible fraud by Gordon in arranging that investment. He said K2 had learned that ``certain actions'' taken in pursuit of that transaction ``are being referred to the appropriate authorities (on an international basis) for investigation of possible criminal charges.''

Merrill, the largest securities firm by capital, had an obligation to investigate Davis's allegations against Gordon before selling the stock to the public, said Constance Bagley, a securities lawyer and associate professor at Harvard Business School.

`Independent Investigation'

``The main problem here is Merrill did the underwriting for Allegheny and had reason to believe a key employee of Allegheny was a crook,'' said Bagley, author of three books advising executives how to deal with legal issues. ``The underwriters are supposed to do an independent investigation of the accuracy of the prospectus. Clearly they were on notice here.''

Merrill and Goldman, Sachs & Co. led the public offering together. Davis said he didn't send his warning letter to Goldman.

In the prospectus, Merrill disclosed its previous transaction with Allegheny. Merrill said it had agreed on Jan. 8, 2001, to sell its energy-trading unit to Hagerstown, Maryland-based Allegheny for $490 million and a 2 percent interest in Allegheny Energy Supply, an Allegheny subsidiary.

Merrill Lynch, based in New York, didn't do anything wrong in its handling of the letter from Davis or the underwriting of Allegheny's stock sale, said spokesman Bill Halldin.

Allegheny Employee

``Based on our conversation with K2, this appeared to involve a former employee's personal investment that was in dispute,'' Halldin said. ``We knew Allegheny was aware of this situation involving their employee and that Allegheny had thoroughly looked into it.''

Allegheny spokeswoman Cynthia Shoop declined to comment on the allegations against Gordon.

On April 21, 2001, eight days after K2's attorney Davis sent the letter to Merrill and Allegheny, Gordon wrote a $3 million personal check to K2 as a ``break-up fee,'' in exchange for K2 withdrawing the letter and agreeing to keep its contents secret, Davis said. The agreement canceled the proposed $7 million investment in K2.

`Hush Money'

``The scenario makes it seem the money was more likely hush money than a break-up fee,'' said James Cox, a professor of law at Duke University in Durham, North Carolina.

James Livingstone, then-chief executive of K2, said in an interview that K2 had turned down a $5 million investment offer from another company because it was expecting the $7 million investment from Gordon's unit. He said the $3 million payment from Gordon was fair compensation. ``It was to make us whole,'' he said.

Merrill knew the dispute between Gordon and K2 had been settled, although it did not know the terms of that settlement, Halldin said. ``Within days, we learned that the dispute had been resolved to the satisfaction of the company that had made the complaint,'' he said.

Gordon is being investigated for embezzling $43 million from Merrill Lynch when he worked for the firm in 2000, according to a letter written by Assistant U.S. Attorney Jane Levine on Nov. 22, 2002, to Gregg Lepp, director of special prosecutions for the Alberta attorney general's office. Gordon disguised the theft as an energy trade, the letter said.

Gordon Was Fired

Gordon is also under investigation for allegedly defrauding Allegheny of $2.5 million by funneling Allegheny money to companies controlled by Gordon, the Nov. 22 Justice Department letter said.

Allegheny fired Gordon last September for violating conflict-of-interest rules, said Shoop, who declined to specify which rules were broken.

Gordon, who served as chairman of Daticon Inc., a legal-document-storage company in Norwich, Connecticut, until December, was reached on his mobile phone Wednesday night and hung up after the caller identified himself as a reporter. His lawyer, Alan Levine, managing partner of Kronish Lieb Weiner & Hellman LLP in New York, declined to comment.

K2 attorney Davis said he wasn't aware of the $43 million embezzlement when he wrote to Merrill in 2001. He said he was prepared to tell Merrill in April 2001 that Gordon had fraudulently concealed his involvement with an offshore company, Ostrich Capital Partners, in negotiations with K2. Shares of K2 are traded on the Toronto Stock Exchange.

$43 Million Moved

After the U.S. Justice Department began investigating Gordon, the investigators learned he had moved most of the $43 million through Ostrich, according to the Justice Department letter. Gordon incorporated the company, Ostrich Partners, in the Marshall Islands in the Pacific Ocean, the letter said.

The corporate climate in America has changed since accounting scandals sent Enron Corp. and WorldCom Inc. into bankruptcy, resulting in billions of dollars of losses to investors, said Frank Partnoy, a securities-law professor at the University of San Diego School of Law.

``If Merrill got that letter from K2's lawyer today, they'd be all over it,'' he said. ``The attitude financial services firms had several years ago was: Push it under the rug, nothing good can come from disclosure.''

Didn't Follow Rules

Assistant U.S. Attorney Levine wrote in the Nov. 22 letter that Merrill hadn't followed its own rules in allowing Gordon to wire $43 million of Merrill's money to an offshore shell company -- a company with no employees or operations.

``The usual credit-check and due-diligence procedures in place at Merrill Lynch were not followed,'' Levine wrote, citing interviews with witnesses in Merrill's credit department and internal communications.

The questions about Merrill mark the third time reported in the past year in which Merrill's due diligence has been challenged.

In March, Merrill agreed to pay $80 million to settle Securities and Exchange Commission charges that it had helped Enron Corp. commit accounting fraud. In April, Merrill agreed to pay $200 million to settle accusations by state and federal regulators that the firm allowed conflicts of interest by its research analysts.

Merrill neither admitted nor denied wrongdoing in either case.

Merrill is a passive, minority investor in Bloomberg LP, the parent of Bloomberg News.

Davis Letter

The letter from Davis, the K2 attorney, was sent by fax and Federal Express on April 13, 2001, to George Schieren, then senior vice president and associate general counsel of Merrill Lynch, and Michael Morrell, then senior vice president of Allegheny.

The letter said that K2 was negotiating with Gordon for an investment from Ostrich Capital Partners. It said K2 began negotiating with Gordon while he was still running Merrill's energy-trading unit, and the talks continued after Gordon moved to Allegheny.

``The nature and extent of the misconduct which has been visited upon K2 Energy Corp. is a matter of the utmost gravity for us,'' the letter said. ``Initiation of civil proceedings on behalf of K2 Energy Corp. for fraud and RICO violations, amongst other claims, would appear well justified.'' RICO refers to Racketeer Influenced and Corrupt Organizations, a federal law used to prosecute criminal enterprises.

Schieren, who left Merrill in January to become a partner at Clifford Chance US LLP, the world's largest law firm, was on vacation and unavailable for comment, his secretary said. Morrell didn't return a voicemail message requesting a comment.

Offer Declined

In his April 2001 letter, Davis offered to fly immediately from Montana with K2 Chief Executive Officer Livingstone to Merrill's corporate headquarters in New York and Allegheny's headquarters in Hagerstown to provide the executives with details of the allegations. Neither company took him up on his offer, Davis said in the interview.

Cox, the law professor at Duke, said that was a mistake.

``When you have a former chief energy trader and such a letter, I think that requires a serious internal investigation, including one that looks at any offshore vehicles,'' said Cox, co-author of ``Corporations,'' a multi-volume legal treatise, and ``Securities Regulations: Cases and Materials.''

Livingstone, K2's CEO, said was surprised Merrill and Allegheny hadn't taken Davis's letter more seriously. ``Getting a letter at the highest level at two companies telling you your poster boy isn't what you thought he was isn't something you sweep under the rug,'' he said.

Met With Gordon

Livingstone said he had lunch with Gordon at Merrill Lynch headquarters in New York on Feb. 5, 2001, to discuss the $7 million investment K2 was seeking from Gordon's unit. He said two Merrill employees who worked for Gordon flew to Calgary on Feb. 16, 2001, to negotiate terms for the investment contract.

On March 13, 2001, K2 issued a press release announcing that Ostrich Capital Partners, a Delaware corporation, had agreed to invest C$10.8 million (US$7 million) for control of K2, in the form of 27 million shares and 10.8 million options. The press release identified Ostrich as ``a Delaware corporation controlled by Daniel L. Gordon, an accredited investor.''

On April 5, Livingstone said he flew to New York for a scheduled meeting with

Gordon to sign the investment contract and receive the $7 million. Gordon canceled at the last minute, Livingstone said.

Two Ostrich Companies

K2 executives became alarmed when they discovered that Gordon controlled two companies called Ostrich Capital Partners, Livingstone said, one based in the Marshall Islands and incorporated in August 2000 and the other based in Delaware and incorporated on March 15, 2001.

Until the first week of April 2001, K2 believed there was only one Ostrich, he said. Gordon never disclosed this second Ostrich to them, he said.

K2 learned of the two companies from Michael Ritter, president of Newport Pacific Financial, an Edmonton, Alberta-based company that Gordon used to set up his offshore companies, Davis said.

Davis said he began to have doubts about Gordon when Ritter told him he found that Gordon had altered the investment contract provided to the Marshall Islands Ostrich company, which was held in trust by an affiliate of Newport Pacific. The concealed contract had removed all references to the 10.8 million options, which Ostrich was to receive in addition to stock for its $7 million investment.

Became Suspicious

Davis said Ritter told him he suspected Gordon had set up the Delaware corporation to steal the 10.8 million options from the Marshall Islands company called Ostrich and conceal the options transfer from Ritter, whose firm was the trustee of the offshore company.

``We thought a bad broker was trying to screw his clients who weren't in the U.S.,'' Ritter said in an interview. He said his discussions with Gordon led him to believe Gordon was a stockbroker for Merrill.

It was this offshore Ostrich, as well as Falcon Energy Holdings SA, another shell company incorporated in the Caribbean island of Anguilla, that Gordon might have used to embezzle and launder $43 million of Merrill Lynch money in August 2000, according to prosecutor Levine's letter.

Ritter said in an interview that he became suspicious of Gordon after $32.5 million of the Merrill money was wired out of the offshore accounts shortly after they were opened. The rules for the account required Gordon to keep at least $15 million of the $43 million at AIG Private Bank Ltd. in Zurich.

Contacted Merrill

Ritter said he contacted Merrill lawyers shortly after Allegheny purchased the Gordon-run energy unit from Merrill on March 16, 2001. Ritter said he tried to alert Merrill to his suspicions the account had been used for money laundering.

``They didn't seem concerned,'' Ritter said. ``They seemed relieved it wasn't their problem.''

In the week following Davis's April 13 letter to Merrill and Allegheny, Gordon tried to cancel the proposed $7 million investment in K2, Davis said.

Gordon was represented by the Washington law firm of Williams & Connolly LLP to negotiate with K2 on his behalf, Davis said. On Saturday, April 21, Davis and Livingstone flew to Washington and picked up a check, written on Gordon's personal account, for $3 million, written to K2.

Williams and Connolly partner Gerald Feffer declined to comment.

`That Smells'

Theresa Gabaldon, professor of securities law at George Washington University Law School, said the settlement didn't resolve allegations of wrongdoing. ``That almost makes it look worse to me, that Gordon was willing to pay $3 million, or 40 percent of the proposed investment, to walk away,'' she said.

``That smells."

One week later, on April 27, K2 issued a press release saying its previously announced investment agreement with Ostrich Capital Partners, a Delaware corporation, had been canceled, and K2 was paid a ``break-up fee" of C$4.6 million Canadian (US$3 million).

On the same day, Allegheny Energy issued a release saying Merrill Lynch was co-underwriting a stock sale to the public. Allegheny raised $667 million by selling 14.3 million shares, at $48.25.

Allegheny shares have fallen 72 percent since the sale, with shares unchanged at $8.68 at 4:01 p.m. New York Time on trading at the New York Stock Exchange.

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Story illustration: See {MER <Equity> CNP 01817630101 <GO>} for a series of graphs about Merrill Lynch & Co. To pause on a screen, press the space bar. To resume, press GO.

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Gordon's Merrill Scam Traps `Shocked' Doctor in India (Update2)

Sept. 5 (Bloomberg) -- Dr. Rakesh Gilhotra runs a four-bed clinic in the northern Indian city of Dehradun in the foothills of the Himalaya Mountains -- 7,100 miles from Wall Street.

Gilhotra, 48, says he was ``shocked and hurt'' when he was shown a document, bearing his purported signature, that was used by Daniel Gordon, a New York-based energy trader, to allegedly embezzle $43 million from Merrill Lynch & Co., the world's largest securities firm.

The document, obtained by Bloomberg News and shown to Gilhotra by a reporter, was an Aug. 18, 2000, contract requiring Merrill to pay $43 million in what was supposedly an energy trade. It was signed with what Gilhotra says looks like a copy of his signature.

``This is clearly a forgery,'' Gilhotra said in an interview. ``These documents are fake.'' The family doctor, who is also a cardiologist and chest specialist, says he has heard of Merrill Lynch but doesn't know what the firm does and has never been contacted by anyone at Merrill. He says he was unaware of the contract until this week, and never received any money.

The U.S. Justice Department is investigating Gordon, 27, Merrill's former chief energy trader, for stealing the money and then laundering it through offshore shell companies, according to federal documents.

The theft would be the largest embezzlement from a major U.S. financial institution since OpVantage, a unit of Fitch Risk, began tracking control breakdowns at financial firms a decade ago, says Penny Cagan, senior vice president of OpVantage.

Handwriting Expert

Ashok Kashyap, a New Delhi-based handwriting expert with 40 years of experience, says Gilhotra's actual signature doesn't match the signature on the document accepted by Merrill.

``It speaks volumes about Merrill Lynch's controls, or lack thereof,'' says Walter Schuetze, chief accountant of the U.S. Securities and Exchange Commission's enforcement division from 1997 to 2000.

Merrill spokesman William Halldin says Gordon deceived the firm by hiding his financial interest in Falcon Energy Holdings SA, the offshore company supposedly represented by Gilhotra.

``In our transactions approval process, questions were asked of Mr. Gordon, and he misled people at Merrill Lynch,'' Halldin says.

If Merrill had done research properly, it would have found that Falcon was a shell company with no operations or employees and that Gilhotra's identity had been stolen, Schuetze says.

Long-Time Client

Gordon incorporated his offshore companies through Edmonton, Alberta-based Newport Pacific Financial Group SA. Michael Ritter, chief executive of Newport, says Gordon told Newport in 2000 that Gilhotra was a long-time client of his at Merrill. Ritter says Gordon provided him with a copy of Gilhotra's passport.

Gilhotra says he has never heard of Daniel Gordon or Michael Ritter.

Gordon, who owns a home in Old Lyme, Connecticut, was reached on his mobile phone Wednesday evening, and hung up after the caller identified himself as a reporter. He has declined to comment since he was first reached on Aug. 20.

Gordon's lawyer, Alan Levine at Kronish Lieb Weiner & Hellman LLP in New York, declined to comment.

A federal grand jury in New York is investigating Gordon and his use of shell companies, including Falcon Energy, according to a letter sent by U.S. Postal Inspector Andrew Trilling to the Royal Canadian Mounted Police on Dec. 18, 2002.

The letter includes a copy of instructions from the Federal Reserve Bank of New York for the wire transfer of $43 million on Aug. 24, 2000, from Merrill Lynch to a Swiss bank account for the benefit of Falcon Energy.

The Contract

The contract with Gilhotra's name on it required Merrill to pay $43 million within three days to Falcon Energy. In return, Falcon agreed to sell Merrill as much as 3,690 megawatts of power in California during emergencies from July 1, 2003, through Dec. 31, 2012. One megawatt-hour can power 800 typical U.S. homes for an hour, according to the federal Department of Energy.

Assistant U.S. Attorney Jane Levine wrote to Canadian prosecutor Greg Lepp on Nov. 21 seeking cooperation in tracking Gordon's use of offshore accounts to launder money.

``Substantial evidence emerged suggesting that Gordon, possibly working with others, had committed fraud with respect to the Falcon hedge trade,'' Levine wrote.

Gordon hasn't been charged with any crimes. White-collar investigations often take months or years because many cases are complex, says Alan Bromberg, professor of securities law at Southern Methodist University School of Law in Dallas.

``There usually are cover-ups,'' Bromberg says. ``You need enough evidence to get approved up and down at the Justice Department.''

Gordon Fired

Gordon moved to Allegheny Energy Inc. after Merrill sold its energy-trading unit to the Hagerstown, Maryland-based utility company in January 2001. Allegheny fired Gordon a year ago because he violated conflict-of-interest rules, says spokeswoman Cynthia Shoop, who declined to specify which rules were broken.

Gilhotra, the doctor in India, says he thinks his name may have been used after he filed immigration papers for entry into the U.S. with the help of his American-born nephew Dinesh Verma, a lawyer with Nankin & Verma PLLC in Washington.

Verma, 30, studied at Boston University at the same time as Gordon, who graduated in May 1996 with a bachelor of arts degree in economics and political science.

Verma's Baltimore-based lawyer, former federal prosecutor David Irwin, declined to comment and says he advised Verma to do the same. Verma didn't return calls seeking comment.

Clinic at Home

Gilhotra runs his clinic on the ground floor of his house in Dehradun. Inside the five-room clinic, green paint peels off the cracked walls.

On Sunday morning, Gilhotra, who stands about 5 feet, 3 inches tall, was still in his nightclothes while treating patients, wearing a stethoscope around his neck and a long-sleeved flowing kurta, or shirt, over loose pajama pants.

It would take a family doctor in India with an annual income of about $55,000 almost 800 years to earn $43 million.

Gilhotra received his medical degree at Dayanand Medical College, Ludhiana, in 1980. He won a medal from the Post Graduate Institute of Medical Education and Research in Chandigarh in 1983 for being the top student in his class.

``The doctor is a person of high standing in the city,'' says Shivshankaran Kannan, the assistant general manager at the Central Bank of India in Dehradun.

Elephant-Headed God

Kashyap, the handwriting expert who says Gilhotra's signatures on the Falcon documents appear to be forgeries, has examined documents in 3,000 court cases. He's a member of the U.S.-based International Association for Identification and the Canadian Identification Society.

Gilhotra spoke in his examination room below a light box for viewing X-rays and a poster of the elephant-headed Hindu god Ganesh -- the remover of obstacles. The doctor says he first applied for immigration papers to the U.S. in 1986 and intensified his efforts to get a green card, and gain approval to set up a practice there, in 1999.

Gilhotra says he sent dozens of letters and forms to relatives and agencies in the U.S. He says he sent qualification documents, reference letters, professional background information and letters seeking advice. He says it took him several attempts to win permission to work in the U.S.

The doctor says he got U.S. approval for a green card on April 5, 2000, after his nephew Verma's future wife, Sonal J. Mehta, a Washington-area immigration lawyer, helped him to reapply.

Months Later

In August 2000 -- four months after Gilhotra got his green card approval -- Verma told Gilhotra he needed a signature verification from Gilhotra's bank to update his records, Gilhotra says. He says the request didn't surprise him because he'd become accustomed to sending so many papers to the U.S.

On Aug. 17, 2000, the doctor went to the Central Bank of India in Dehradun to have his signature verified by a bank officer. Bank manager Kannan signed Gilhotra's verification letter. The doctor says he then faxed the document to Verma in the U.S.

The next day, Aug. 18, Merrill Lynch received a three-page energy-hedging contract between Merrill and Falcon Energy, Merrill's Halldin says. Gilhotra's name was at the top of the contract, and his signature was the only Falcon name listed.

A telephone number for Gilhotra on the contract is no longer in service and is operated out of the U.K. by a company that routes calls to clients' phones worldwide. Gilhotra says he had never seen that phone number before.

`Fraudulent Contract'

The contract also includes a signature of a Merrill official. Merrill's Halldin says the signature, which is indecipherable, is that of a Merrill trading operations manager whom he declined to name.

Assistant U.S. Attorney Levine described the contract as ``fraudulent'' in her November letter to Canadian prosecutors.

``Falcon was not a legitimate company, but rather an offshore shell corporation, controlled by Gordon and used as a vehicle to receive and launder the $43 million Merrill Lynch-GEM wired to Falcon,'' she wrote. GEM was Merrill's Global Energy Markets unit.

Gilhotra says he and his family went to Baltimore in September 2000 to pick up his green card and to consider moving there. While his family stayed in the U.S. for a month, Gilhotra says he returned to India, bought gifts for the wedding of his nephew Verma to Mehta and returned to Baltimore in November to attend the ceremony.

The gifts included clothing for the groom and close friends, and a traditional Hindu necklace called a mangalsutra, worn by women as a sign of lifelong commitment to marriage.

Broke Ties

Gilhotra says Verma then broke off ties, and Verma accused the doctor of not having done enough to help with the wedding. The Gilhotra family then returned to India.

The doctor says he and his wife, Ratnesh, decided it would be too hard for him to leave his practice in India and start again in the U.S. Ratnesh Gilhotra, 38, holds a doctorate in biotechnology and runs a diagnostic lab at the Dehradun clinic.

Rakesh Gilhotra's signature appears on requests on Sept. 17, 2000, and Sept. 27, 2000, to transfer $33 million and $9.5 million from Falcon to Ostrich Capital Partners Inc., another offshore company controlled by Gordon, according to the Justice Department.

The doctor says he didn't sign those documents, which were obtained by Bloomberg News and shown to him.

Falcon, incorporated in the Caribbean island of Anguilla, is one of two companies set up for Gordon by Newport Pacific, according to Newport's Ritter.

Merrill Stationery

Ostrich was incorporated in the Marshall Islands in the Pacific Ocean and represented by a Joginder Kaur.

Ritter says Gordon gave him a signature verification for Kaur that was dated Aug. 23, 2000, which was six days after Gilhotra signed his signature verification in India. He says Gordon described Kaur as a woman from India who had been a long-time client of his at Merrill.

The Kaur document, dated Aug. 23, 2000, is written on Merrill Lynch stationery and contains two paragraphs that are almost identical to those in the Gilhotra signature verification.

The signature of a Samuel S. Rattner, identified as first vice president of Merrill Lynch, was at the bottom of the document that said: ``Mrs. Joginder Kaur is a client that is in good standing at our institution and is personally known to us.''

Kaur couldn't be located.

Merrill's Halldin says no one named Samuel Rattner has worked for Merrill. Merrill doesn't disclose its clients, he says.

The Doctor's Address

Bank accounts for both Falcon and Ostrich were opened in Zurich at AIG Private Bank Ltd., a unit of American International Group Inc., the world's biggest insurance company. The doctor's address in Dehradun was listed in account-opening documents for Falcon.

Ostrich Capital used Kaur's name as the authorized signature for transactions. A Kaur signature authorized three wire transfers of Merrill funds on an undated Ostrich document, including a transfer of $2.5 million to Gordon.

Gordon transferred $30 million from Falcon to Ostrich and then to a New York bank account for Kings Holdings LLC, owned by Gordon, in October 2000, according to the letter by Assistant U.S. Attorney Levine. Gordon canceled the $43 million contract with a $550,000 termination agreement on July 30, 2002.

$25.3 Million Wired

On Nov. 14, 2000, Gordon wired $25.3 million to an unidentified Connecticut law firm to buy a 70 percent stake in Daticon Inc., according to the Justice Department letter. Gordon's father, Glenn, 57, now runs Daticon, a Norwich, Connecticut-based company that scans and organizes documents used in litigation.

Glenn Gordon declined to comment on Aug. 13 and hasn't returned phone calls requesting interviews since. Devon Nagle, an outside spokesman for Daticon, declined to comment on the Gordons.

Assistant U.S. Attorney Levine wrote that Merrill hadn't followed its own internal credit-check and due-diligence procedures.

``Either the alleged fraud was more sophisticated or the cash control systems were much less sophisticated than the rest of the Street,'' says Sanford C. Bernstein & Co. brokerage analyst Brad Hintz, who worked as treasurer at Morgan Stanley from 1992 to 1996.

Normally the credit department at a brokerage firm has to approve a trade, and then the operations department has to set up confirmation procedures, such as checking where a delivery or money transfer should go, Hintz says.

Then the legal department draws up a

trading agreement to detail what happens if the contract isn't respected, Hintz says. Risk managers then frequently assess hedge contracts such as the $43 million Falcon contract with Merrill, he says.

Checks and Balances

``There's so much money that gets moved around, somebody can mask it and hide it under the radar,'' says Guy Gleichmann, senior trader with U.S. Energy Group in Hollywood, Florida. ``There should be a checks-and-balances system in place to prevent someone from manipulating money and moving it about like that.''

Merrill's Halldin declines to say specifically what actions the firm took to research Gordon and his transactions.

``We've taken steps to strengthen our controls as a result of our review of this matter,'' says Halldin, who declines to say what the steps are.

Standard & Poor's credit analyst Tom Foley says Wall Street firms have improved their internal controls following new federal rules and laws adopted since the bankruptcies of Enron Corp. and WorldCom Inc., as well as the state and federal settlements with securities firms charged with conflict-of-interest violations.

Control Improvements

``I'd really expect that Merrill Lynch today is much better situated,'' Foley says. ``The finance and compliance departments within Merrill and everywhere else have been extremely careful in the past year.''

In India, Gilhotra, who has two sons, nine and 12 years old, says he's worried about his reputation in Dehradun. A sign in his clinic advises that ``It's never a wrong time to do the right thing.''

Gilhotra shakes his head, saying he can't understand why anyone would use his name for a financial scheme.

``The letter Verma asked for was so innocuous that I can't even think in my dreams that it would be used for something like this,'' he says. ``We've seen things like this happen only in movies.''

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Story illustration: See {MER US <Equity> CNP 01817630101 <GO>} for a series of graphs about Merrill Lynch & Co. To pause on a screen, press the space bar. To resume, press GO. For news about financial services companies and crime, type or click {TNI FIN CRIME <GO>}

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Merrill's Gordon Left a Paper Trail as Firm Lost $43 Million

Sept. 25 (Bloomberg) -- Even in high school, Daniel Gordon could charm his way out of a jam. ``He was a teacher's dream because he was so intelligent,'' says Melissa Chipman, who was a classmate of Gordon's in 1991 at the Williams School, a prep school in New London, Connecticut. ``He worked the system.''

Chipman, now an English teacher in New Orleans, says Gordon was kicked out of school for forging teacher recommendations to college. Former Williams Headmaster Steve Danenberg confirms that Gordon never graduated; he declines to elaborate. ``He got away with murder because he was so well-liked,'' Chipman says.

Twelve years later, Gordon is embroiled in a scandal on a far larger scale: the embezzlement of $43 million from Merrill Lynch & Co. in 2000 while Gordon was a 24-year-old energy trader there.

The U.S. Justice Department is investigating Gordon, who it says disguised the theft as an energy trade. A federal grand jury in New York is looking into his use of shell companies, according to a letter sent by U.S. Postal Service Inspector Andrew Trilling to the Royal Canadian Mounted Police on Dec. 18, 2002.

In his time at Merrill and later at Hagerstown, Maryland-based Allegheny Energy Inc., Gordon left a trail of forged documents in seven countries.

Paper Trail

The paper trail included documents for offshore companies incorporated on the Caribbean island of Anguilla and the Marshall Islands in the Pacific Ocean and purportedly owned by investors in India, trusts for those companies established in Belize, and Swiss bank accounts to hold and transfer the money, incorporation documents and bank records show.

The theft is the biggest embezzlement from a major U.S. financial institution since OpVantage, a unit of Fitch Risk, an affiliate of Fitch Ratings, began tracking such incidents a decade ago, according to Penny Cagan, senior vice president of OpVantage.

Gordon managed to elude controls at the world's largest securities firm because he was dishonest, says Merrill spokesman Bill Halldin. ``In our transactions approval process, questions were asked of Mr. Gordon, and he misled people at Merrill Lynch,'' Halldin says. Merrill Chief Executive Officer Stanley O'Neal declined to comment.

Merrill should have been more vigilant, says Alan Bromberg, professor of securities law at Southern Methodist University School of Law in Dallas. ``It sure doesn't speak well for Merrill Lynch's due diligence or disclosure to the public,'' he says.

Merrill Didn't Disclose

Merrill learned of the loss in October 2002 but never disclosed it in public filings. Merrill's Halldin declined to say why Merrill didn't make that disclosure.

Assistant U.S. Attorney Jane Levine, in a Nov. 22, 2002, letter to Canadian prosecutors, seeking their cooperation in the investigation of Gordon, wrote that Merrill hadn't followed its own due diligence and credit check procedures in releasing the $43 million for what now appears to have been a fraudulent energy trade.

Merrill is a passive, minority investor in Bloomberg LP, the parent of Bloomberg News.

Gordon, 27, the 6-foot-4-inch son of a Connecticut lawyer and a real estate agent, hasn't been charged with any crimes. Gordon was reached on his mobile phone twice in August, hanging up each time after the caller identified himself as a reporter. He's declined to comment since he was first reached on Aug. 20.

Gordon's lawyer, Alan Levine at Kronish Lieb Weiner & Hellman LLP in New York, declined to comment.

`It's a Tragedy'

``If the allegations are true, it's a tragedy, because he had everything going for him," says Laurence Greenberg, a New London, Connecticut, attorney who's a colleague of Gordon's father and who's represented a bank that lent money to Daniel Gordon on several occasions. He declined to name the bank.

``He was bright," Greenberg says. ``He had a nice personality. He didn't come on strong like one of those guys always going after money."

Another Gordon deception emerged in Lyme, Connecticut, where Gordon lives, according to Town Clerk Ruth Perry. She says Gordon's wife, Laura, came into the town hall a few months ago and asked to see land records.

``She went into the vault and came out with a question," Perry says. Perry says Laura Gordon asked if the $3.5 million, 16-acre property where the Gordons live was titled to Gordon only. Laura Gordon said her husband had purchased the property in his name, while promising her she'd have half interest and giving her a document confirming that, Perry says.

Fake Document

Laura Gordon showed the clerk the document her husband had given her. The document had Perry's purported signature on the bottom, and at the top it showed a volume number and page number that were identical to the original deed. Perry says she never signed the document Gordon had given his wife and that it was never filed with the town.

``She said to me, `Could this be fake?'" Perry says. ``And I said, `Absolutely.' And she started to cry. I said to her, `You had better get yourself an attorney.'"

The top of the document Gordon gave his wife says Greenberg, the New London attorney, prepared it. ``I didn't prepare it," Greenberg says, adding that he called Gordon to ask about the document. ``He said he had put my name on it by mistake," Greenberg says.

Laura Gordon couldn't be reached for comment.

Gordon's father, Glenn, who earned a Bronze Star in Vietnam, had served until Sept. 9 as CEO of Daticon Inc., a Norwich, Connecticut-based company that scans and organizes documents used in litigation. The company was purchased by his son in 2001 with proceeds from the Merrill energy trade, according to the letter by Assistant U.S. Attorney Levine.

Yale Master's Degree

Glenn Gordon declined to comment. Gordon's mother, Nancy, a Columbia University-educated teacher and real estate agent, also declined to comment.

Daniel Gordon and his younger brother Jared grew up in Old Lyme, a town of 36,000 in southeastern Connecticut. Even though he never graduated from the Williams School, at which annual tuition currently amounts to $16,500, Gordon went on to receive a bachelor's degree in economics from Boston University and a master's degree in international and development economics from Yale University before he was 22.

After graduating from Yale in 1997, Gordon joined Constellation Energy Group Inc. in Baltimore. Constellation wouldn't comment on Gordon. In early 1999, he joined Merrill Lynch, and by early 2000, he was running the newly formed energy-trading unit.

Offshore Accounts

At 24, he managed a 20-member trading staff in New York. Merrill's Halldin declined to say why the firm put such a young person in that position.

On Aug. 3, 2000, Gordon faxed a letter with markings indicating it had come from Merrill Lynch headquarters in New York to

Newport Pacific Financial Group SA, an Edmonton, Canada-based firm that opens offshore accounts, says Michael Ritter, Newport's CEO.

Ritter says Gordon told him he was a stockbroker for Merrill Lynch, representing two clients in India who'd become rich from investments in biotech companies and derivatives trading. (Gordon was never a stockbroker, says Merrill's Halldin.)

Newport's Web site said in August 2000 that the Canadian company offers clients ``total anonymity in ownership and management of assets if desired,'' with the assurance that ``our officers face criminal sanctions for any breach of confidentiality.''

Ritter says Gordon asked for help in setting up companies on behalf of the clients in India. ``They'd like to be structured offshore,'' is how Ritter recalls Gordon's describing the requirements of the clients -- Rakesh Gilhotra and Joginder Kaur -- who Gordon said were business partners.

Diners Club Card

``When money comes from a bona fide like Merrill Lynch, you don't question its pedigree,'' Ritter says.

Two weeks later, on Aug. 16, Gordon used his Diners Club card to pay $14,625 toward Newport's $36,000 fee to incorporate two companies: Falcon Energy Holdings SA, incorporated in Anguilla, with Gilhotra as the beneficial owner, and Ostrich Capital Partners Inc., incorporated in the Marshall Islands, with Kaur as beneficial owner.

Newport placed the shares of each company in a trust in the Central American nation of Belize and opened Swiss bank accounts in the names of each company, Ritter says.

Ritter himself -- along with Gordon -- is under investigation by the Royal Canadian Mounted Police for money laundering, says Gregg Lepp, director of special prosecutions in the Alberta attorney general's office.

The Merrill Contract

Ritter, 46, with a neatly trimmed beard, gray hair and green eyes, has a suite of offices with rosewood furnishings and modern art on the 18th floor of an Edmonton high-rise. He denies any wrongdoing.

Falcon was incorporated on Aug. 17, 2000. The following day, Falcon sent to Merrill Lynch a contract purportedly signed by Gilhotra. The option contract, dated Aug. 18, 2000, required Merrill to pay $43 million to Falcon in return for Falcon's agreement to sell Merrill power it could resell in California from July 1, 2003, through Dec. 31, 2012.

On Aug. 24, Merrill made the wire transfer to a Falcon account at AIG Private Bank in Zurich through the Federal Reserve Bank of New York, according to wire transfer records later retrieved by U.S. Postal Service investigators.

Ritter says Gordon agreed that at least $15 million would remain on deposit -- a restriction imposed by AIG Private Bank, which manages the assets of wealthy individuals. The bank, based in Zurich, is a subsidiary of American International Group Inc., the world's largest insurance company.

Money Transfers

Gordon then transferred most of the money from Falcon to Ostrich, which had been incorporated on Aug. 23, according to Assistant U.S. Attorney Levine's letter.

On Sept. 22, 2000, $2.5 million was wired from Ostrich to Gordon's personal account at Merrill, wire transfer records show. During the first two weeks of October 2000, another $30 million was transferred out of the Ostrich account to an account for Kings Holdings LLC at HSBC Bank in New York, bank records obtained by U.S. prosecutors show.

Kings Holdings is a Delaware corporation formed and 100 percent owned by Gordon, according to Levine's letter.

As a result, only about $10.5 million remained in the Ostrich account, which violated the agreement with AIG Private Bank. That was the first sign of trouble for Gordon, Ritter says.

Then, on Oct. 20, 2000, a letter bearing Kaur's signature asked Newport to wire $8 million of the remaining money from Ostrich's account to Daniel Gordon at Mellon Bank in Pittsburgh. Ritter says he ignored the instruction.

`A Scathing Letter'

On Oct. 27, 2000, Ritter told Gordon to return the money to the AIG accounts. ``I wrote a scathing letter to Dan Gordon,'' Ritter says. ``I told him we were freezing the account from any more cash outflows.''

On Nov. 1, 2000, the head of AIG Private Bank's wealth management unit, Thomas Durmuller, wrote to Newport Pacific, concerned about the withdrawals.

``The owners of Ostrich Capital Partners have tried by all means to get the entire amount of USD 43 Mln back to the U.S. and I somehow have the feeling that they do not have any intention of transferring the assets back to their account with AIG,'' Durmuller wrote.

No more money was wired in or out after that by Gordon. Durmuller didn't return a phone call requesting an interview. AIG spokesman Andrew Silver declined to comment.

On March 13, 2001, Ritter says, one of his employees showed him a press release from K2 Energy Corp., a Calgary-based natural gas exploration company, announcing that Gordon, operating through Ostrich Capital, would invest $7 million in K2.

Doctor in India

Ritter says that when he read that Gordon called Ostrich's money his own, he assumed Gordon was trying to embezzle from his Indian clients.

Wrong, says the man whose signature appears on the Falcon documents. Gilhotra, 49, a cardiologist and chest specialist who runs a four-bed clinic in Dehradun in the foothills of the Himalayas, first saw the contract he had supposedly signed in 2000, when a Bloomberg News reporter showed it to him on Aug. 31.

``This is clearly a forgery,'' Gilhotra says. ``These documents are fake.'' Gilhotra says he's never heard of Gordon. He says he's heard of Merrill Lynch but doesn't know what the firm does and has never been contacted by anyone at Merrill.

``This is something very serious, but I don't understand how I'm involved,'' Gilhotra says, speaking in an examination room one Sunday morning in August. He has a stethoscope around his neck and is wearing a long-sleeved, flowing kurta over loose pajama pants. Above him is a poster of the elephant-headed Hindu god Ganesh --the remover of obstacles.

A Falling Out

Gilhotra says his name may have been used after he filed immigration papers for entry into the U.S. with the help of his American-born nephew Dinesh Verma, a lawyer with Nankin & Verma PLLC in Washington, D.C.

On April 5, 2000, the doctor won approval for a U.S. green card with the help of Verma's future wife, Sonal J. Mehta, a Washington-area immigration lawyer. In August 2000, Verma asked Gilhotra for a signature verification to update his records.

A month later, Verma and Gilhotra had a falling out, Gilhotra says, because Verma accused the doctor of not having done enough to help with Verma's wedding. The doctor says he bought Verma several gifts, including clothing for the groom and close friends as well as a Hindu necklace called a mangalsutra, which women wear as a sign of commitment to marriage.

`Get Ahead Quickly'

Verma studied at Boston University at the same time as Gordon, who graduated in May 1996. Verma's Baltimore-based lawyer, David Irwin, declined to comment and says he advised Verma to do the same. Verma didn't return repeated calls and written requests seeking comment.

On Aug. 17, 2000, Gilhotra says, he faxed his signature verification to Verma. Gordon gave that document to Newport to help satisfy the company's due diligence requirements on Gilhotra, Ritter says. The next day, Aug. 18, Gilhotra's signature appeared on the Falcon contract with Merrill.

Gilhotra's address in Dehradun was listed in account-opening documents for Falcon. And his signature appears on requests made on Sept. 17, 2000, and Sept. 27, 2000, to transfer $33 million and $9.5 million from Falcon to Ostrich.

``Young people today are in a race to get ahead quickly,'' Gilhotra says. ``My feeling is, something similar has happened here using my name.''

Ostrich Capital used Joginder Kaur's name as the authorized signature for transactions. A Kaur signature authorized three wire transfers of Merrill funds on an undated Ostrich document, including a transfer of $2.5 million to Gordon.

Another Fake Signature

Gordon had given Ritter a signature verification document dated Aug. 23, 2000, listing Kaur's name and written on Merrill Lynch stationery, Ritter says. A Samuel S. Rattner, supposedly a Merrill first vice president, also signed the document. Merrill's Halldin says no one by that name has worked at the company.

In October 2000, a letter with Kaur's signature instructed Newport to wire $150,000 to Mandeep Singh Chhabra at Mellon Bank in Pittsburgh. Chhabra, a 28-year-old personal injury attorney in Annapolis, Maryland, declined to comment or respond to written requests for an interview. Like Verma, Chhabra attended Boston University at the same time as Gordon.

A copy of Gilhotra's Indian passport shows that Chhabra notarized it on Aug. 28, 2000. Virginia Lewis, who says that at that time she worked for Chhabra, notarized Kaur's Indian passport on Aug. 22, 2000. Gordon supplied the copies of both passports to Newport Pacific before the Swiss bank accounts were opened, Ritter says.

Gordon Buys Daticon

Kaur, who's 76, according to the copy of her passport, couldn't be located.

In November 2000, Gordon bought a 70 percent stake in Daticon for $29 million and installed himself as chairman and his father as CEO. A year ago, he moved the company to a new, $9 million glass-and-steel headquarters in Norwich, aided by an $800,000 grant and $2.5 million in tax breaks from the Norwich City Council. Glenn Gordon is a former member of the council.

Daniel Gordon visited Daticon only ``a few times'' during his tenure as chairman, which ended when he resigned in December, says Roger Tamer, 68, Daticon's cofounder. Gordon made an impression when he did show up, flying from New York to Groton-New London airport by helicopter, Tamer says.

On Sept. 5, Thoma Cressey Equity Partners Inc. bought Daticon for $55 million, of which $38 million went to Gordon.

In March 2001, Merrill sold its energy-trading unit to Allegheny Energy for $490 million and a 2 percent interest in its subsidiary Allegheny Energy Supply.

`I Had Confidence'

At the time of the sale, executives who'd worked with Gordon had no idea he was anything other than a bright, fast-rising star, says Alan Noia, 56, retired chairman of

Allegheny, who hired Gordon to run the unit. ``He was very smart,'' Noia says. ``He seemed to understand the business a lot better than many investment bankers I had run across. I had confidence in him.''

Gordon didn't make a positive impression on everyone. ``He was a very secretive person,'' says Mark Williams, 40, former head of risk management at Citizens Power LLC, a Boston-based energy-trading firm owned by the Edison Mission Energy unit of Edison International.

He met with Gordon first in 2001 -- while Gordon was at Allegheny. ``He had this really peculiar habit of keeping the lights off in his office,'' Williams says. ``You'd go in there and meet this guy, and he was just scared of the light.''

Four weeks after Allegheny bought Merrill's energy trading unit, Allegheny and Merrill received a warning that Gordon was not what he seemed. K2 Energy, the Canadian company that had announced Gordon's plan to invest $7 million in it three days before Allegheny bought the energy-trading unit, cautioned that Gordon might be involved in a criminal fraud.

Altered Contracts

``I wrote a very pointed letter to Merrill and Allegheny warning of possible criminal conduct by Dan Gordon,'' says attorney Max Davis of the law firm of Davis, Hatley, Haffeman & Tighe PC in Great Falls, Montana. ``Merrill and Allegheny were on notice that something stinky was going on with this guy.''

Davis, acting for K2, became suspicious of Gordon after speaking with Ritter, who'd set up the offshore companies. Davis says Ritter told him he found that Gordon had altered the K2 investment contract in an apparent effort to steal some assets and hide the theft from the Ostrich trustee.

K2 Chairman James Livingstone also discovered that Gordon owned a second company with the same name as the Marshall Islands company -- Ostrich Capital Partners Inc. -- incorporated in Delaware.

Taped Phone Call

On April 18, 2001, Gordon called Ritter at 12:30 p.m. to discuss Davis's warning letter, according to a transcript of that call. He said he was concerned that criminal charges might be filed against him, the transcript shows.

``He was very amicable, very slick,'' Ritter says. ``He was extremely accommodating.'' Ritter says he recorded the 13-minute-long conversation, which was later transcribed by the Royal Canadian Mounted Police, which seized the recording during a search of Newport Pacific's offices in December.

During the conversation, Gordon said of his actions, ``I can appreciate it looks awful, and I personally feel very badly about it.''

Gordon never made the $7 million investment in K2. On April 21, 2001, Gordon wrote a personal check for $3 million to K2 to cancel the proposed investment, Davis says.

Two weeks after Merrill received the warning letter from Davis, the securities firm underwrote a $667 million public stock offering for Allegheny, which a month earlier had closed on the purchase of Merrill's trading unit. Halldin says Merrill didn't do anything wrong by not disclosing the warning it had received in the letter before it helped sell the stock to the public.

Allegheny Investigates

``Based on our conversation with K2, this appeared to involve a former employee's personal investment that was in dispute,'' Halldin says. Allegheny spokeswoman Cynthia Shoop declined to comment on the allegations against Gordon.

Halldin says Merrill trusted that Allegheny was investigating Gordon after receiving the warning from K2. Allegheny did investigate, finding more than K2 had written about.

Gordon is now also being probed by the U.S. attorney's office for allegedly defrauding

Allegheny of $2.5 million, according to Assistant U.S. Attorney Levine's letter to Canadian prosecutors.

An investigation by Allegheny found that Gordon had arranged a payment of $2.5 million of company funds in 2002 to an unidentified real estate company he controlled, the prosecutor wrote.

Gordon Is Fired

Allegheny fired Gordon last year for violating conflict-of-interest rules, says Shoop, who declined to specify the violations.

Those who've crossed paths with Gordon still speak of him with wistful admiration. ``He was a sharp guy,'' says Steve Doyle, 45, former head of coal and emissions contracts at Allegheny Global Markets and now president of Doyle Trading Consultants LLC, a coal-trading adviser based in Glade Park, Colorado.

``He asked the right questions,'' Doyle says. ``I was in awe of what he had accomplished.''

So was retired Allegheny Chairman Noia. ``I did trust him and wanted him to succeed,'' Noia says. ``He duped us. He took advantage of the trust that we had in him.''

Just like in his days at Williams prep, with his intelligence and charm Gordon won over those who knew him. And just as in his school days, those he won over ended up sorely disappointed.

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Gordon Will Face Money-Laundering Charge, U.S. Says (Update1)

(Adds ranking of theft in 13th paragraph.)

Oct. 13 (Bloomberg) -- Daniel Gordon, under investigation for the embezzlement of $43 million from Merrill Lynch & Co. in 2000, will be criminally charged with money laundering, according to a letter written by a U.S. Justice Department official to Swiss law enforcement authorities on April 22.

``There is no doubt that Gordon will be charged with money laundering,'' wrote Mary Ellen Warlow, director of the office of international affairs of the criminal division of the Justice Department in Washington. The letter asked that any money in Gordon's Swiss accounts be frozen. Gordon, 27, the former head of Merrill's energy-trading unit, allegedly disguised the theft as an energy trade, according to the U.S. Justice Department.

The letter, obtained by Bloomberg News, also cites an ``ongoing investigation'' into the January 2001 sale by Merrill Lynch, the world's largest securities firm by capital, of its energy-trading unit to Allegheny Energy Inc., for $605 million. The letter said no more about that probe. Justice Department spokeswoman Casey Stavropoulos declined to comment, citing agency policy.

``It makes one very curious what the investigation of the sale is about and what it may show,'' said Alan Bromberg, professor of securities law at Southern Methodist University. He said the complexity of the case explains why the Justice Department is taking time to investigate before filing charges.

In a Jan. 3 request for assistance from the U.S. Justice Department to Swiss authorities, Warlow wrote that if Gordon was charged with money laundering, he could face up to 20 years in prison.

`Significant Criminal Charge'

Peter Djinis, a senior prosecutor in the criminal division of the Justice Department from 1986 to 1990, said that when a U.S. prosecutor writes a letter as Warlow did, criminal charges are likely to follow.

``The Justice Department is not about to make a frivolous statement to its counterpart in Switzerland concerning its intention to file a very significant criminal charge,'' said Djinis, who was executive assistant director for the U.S. Treasury's Financial Crimes Enforcement Network until last year.

``The Justice Department is not about to cry wolf, because that could jeopardize its ability to get Swiss cooperation in the future,'' Djinis said.

William Halldin, spokesman for Merrill Lynch, based in New York, and Cynthia Shoop, spokeswoman for Allegheny, based in Hagerstown, Maryland, declined to comment.

Gordon was reached on his mobile phone twice in August, hanging up each time after the caller identified himself as a reporter. He's declined to comment since he was first reached on Aug. 20.

Merrill Wired Money

Merrill Lynch wired $43 million in August 2000, at Gordon's request, to a Swiss account that supposedly belonged to an energy firm doing business with Merrill, according to Justice Department documents. The money went to Falcon Energy Holdings SA, a Caribbean-incorporated shell company controlled and set up by Gordon the same month, according to the Justice Department.

Gordon arranged to wire about $33 million of the money back to U.S. accounts he controlled, Justice Department documents show.

The theft is the biggest embezzlement from a major U.S. financial institution since OpVantage, a unit of Fitch Risk, an affiliate of Fitch Ratings, began tracking such incidents a decade ago, according to Penny Cagan, senior vice president of OpVantage.

Gordon Fired

Gordon was hired by Allegheny to run its energy-trading unit in 2001, after the purchase from Merrill. Allegheny fired Gordon in September 2002 for unspecified violations of its conflict-of-interest rules, Shoop said.

Gordon's lawyer, Alan Levine at Kronish Lieb Weiner & Hellman LLP in New York, declined to comment.

The Jan. 3 letter from the Justice Department asked Swiss criminal authorities to freeze the bank account that held what remained of the $43 million.

``The prosecutor further requests that any funds remaining in the accounts be frozen to prevent their removal or dissipation and as a preliminary step to forfeiture under United States law,'' the Justice Department wrote in the letter, a copy of which was obtained by Bloomberg.

Swiss officials located $2 million linked to the embezzled $43 million and froze the account, said Giorgio Bumio, an attorney with the Swiss Federal Office of Justice in Bern.

The April 22 letter asked Swiss criminal officials to extend the freeze. ``The money in the restrained account is traceable to money laundering, in addition to fraud,'' Warlow wrote.

Freeze Lifted

The freeze was lifted in June or July when no victim came forward to claim the money, Bumio said.

``It was not so clear who the victim was in this case,'' Bumio said in a telephone interview. ``It's up to the authorities in the U.S. to inform the victims.''

The U.S. Justice Department was unable to identify the victim, Warlow wrote in the April 22 letter, citing continuing litigation between Merrill Lynch and Allegheny over the sale.

``While in most fraud cases, we are able to identify the victims and advise them to immediately file a civil action in Switzerland, in this case we haven't been able to do that,'' Warlow wrote.

It's not uncommon for fraud victims to remain silent in large, cross-border financial crimes, said Jonathan Winer, former U.S. deputy assistant secretary of state for international law enforcement, without commenting specifically on the Gordon case.

``While you sometimes find lily white victims, not every victim is without a sin,'' Winer said.

`Something Dubious'

``A good reason not to claim the money might be the investigation revealed something dubious, or worse,'' Bromberg said.

Merrill Lynch sued Allegheny in September 2002, alleging $115 million of the purchase price remained unpaid. Allegheny then sued Merrill, alleging the firm made fraudulent representations about the energy unit's revenue and Gordon's qualifications. The suits have been consolidated in federal court in New York.

Merrill Lynch is a passive, minority investor in Bloomberg LP, the parent of Bloomberg News.

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Ex-Merrill Trader Gordon Admits Guilt in Fraud Case (Update6)

(Adds details of conspiracy allegations in the third paragraph.)

Dec. 19 (Bloomberg) -- Former Merrill Lynch & Co. chief energy trader Daniel Gordon pleaded guilty to money laundering and wire fraud, admitting he embezzled $43 million in 2000 from Merrill, the world's largest securities firm.

Gordon, 27, admitted creating a phony energy trade between Merrill and an offshore company he incorporated. In documents filed in federal court in Manhattan, the government alleged he conspired with unidentified Merrill managing directors to falsify financial information. He faces as long as 55 years in prison, Assistant U.S. Attorney Jane Levine said.

The theft from Merrill was the largest embezzlement from a major U.S. financial institution since OpVantage, a unit of Fitch Risk, began tracking corruption at financial firms a decade ago, OpVantage Senior Vice President Penny Cagan said. Gordon told the court his superiors knew he was altering records to improve the energy unit's earnings in preparation for its $490 million sale to Allegheny Energy Services Corp. in 2001.

``The decision was made by my superiors to make the division look more profitable by altering certain of the data,'' Gordon told the court. Merrill spokesman Mark Herr declined to comment.

Gordon pleaded guilty to one count of wire fraud, one count of money laundering and one count of conspiracy to falsify records of a public company. Gordon has agreed to cooperate with prosecutors as part of his plea and to forfeit the $43 million he stole. He faces a fine as high as twice the amount he stole.

Years in Prison

``The prosecutors will try to find out if he has any information that would implicate others in the wrongdoing,'' Duke University law professor James Cox said on Bloomberg Radio's ``Big Picture'' program. ``His cooperation will earn him fewer months in jail, perhaps even years in jail.''

Even with cooperation, Cox predicted Gordon will spend many years in prison.

``If he's charged with laundering all the $43 million he allegedly stole, he'll be looking at a potential sentence closer to the maximum, under the money laundering laws,'' said Peter Djinis, a senior prosecutor in the criminal division of the U.S. Justice Department from 1986 to 1990.

In August 2000, the 6-foot, 4-inch Gordon incorporated two offshore companies without telling Merrill Lynch, and set up a phony energy trade with one of the companies, Falcon Energy Holdings SA, according to a Nov. 21, 2002 letter written by Levine said.

Gordon told the court he created a fictitious entity to which he routed money after he was unable to create an insurance hedge for a Merrill transaction in 2000.

`Ingenious' Scheme

Gordon, whose home is in Lyme, Connecticut, persuaded Merrill to wire $43 million to the Swiss bank account of one of those companies, Falcon Energy Holdings SA, supposedly in return for power Merrill could sell in California from July 1, 2003, through Dec. 31, 2012, Levine wrote.

``He was pretty ingenious in setting up a scheme of moving money through shells that enabled him to eventually channel $43 million into his own pocket,'' Duke University's Cox said.

Merrill spokesman Bill Halldin said in September that Gordon deceived the world's largest securities firm by hiding his financial interest in Falcon. ``In our transactions approval process, questions were asked of Mr. Gordon, and he misled people at Merrill Lynch,'' Halldin said then. Halldin declined to comment yesterday.

Merrill is a passive minority owner of Bloomberg LP, the parent of Bloomberg News. Merrill Lynch shares fell 16 cents to $56.85 at 2:26 p.m. in New York Stock Exchange composite trading.

Inadequate Due Diligence

Levine wrote that investigators interviewed witnesses in Merrill's credit department and examined internal Merrill communications. ``The usual credit-check and due-diligence procedures in place at Merrill Lynch were not followed with respect to'' Gordon's transactions, she wrote.

Duke University's Cox said regulators will want to know why Merrill's safeguards broke down.

``I'm curious about why Merrill didn't follow its own procedures,'' Cox said. ``They were a victim here, but at the same time, they do have an obligation under the law for oversight.''

The Justice Department's investigation of Gordon was disclosed in a December 2002 letter that U.S. Postal Inspector Andrew Trilling sent to the Royal Canadian Mounted Police.

Merrill was unaware of the alleged theft until October 2002, two years after it wired the $43 million to the Swiss account, Halldin has said. By that time, Merrill had sold its energy-trading unit to Allegheny Energy Inc. The Hagerstown, Maryland-based utility company hired Gordon to continue running the unit in early 2001.

Conflict of Interest

Allegheny fired Gordon in September 2002 for violating unspecified conflict-of-interest rules, spokeswoman Cynthia Shoop has said. Gordon is being investigated by the Justice Department for defrauding Allegheny of $2.5 million, Levine wrote in the November 2002 letter.

Gordon's phony energy trade with Merrill left a paper trail of forged documents in seven countries, according to documents obtained by Bloomberg News.

The paper trail included documents for offshore companies incorporated on the Caribbean island of Anguilla and the Marshall Islands in the Pacific Ocean and purportedly owned by investors in India, trusts to own those companies established in Belize, and Swiss bank accounts to hold and transfer the money, incorporation documents and bank records show.

Newport Pacific Financial Group SA, a Canadian consulting company based in Edmonton, Alberta, set up the offshore companies and accounts.

`Shocked and Hurt'

The $43 million contract with Merrill was purportedly signed by Rakesh Gilhotra, supposedly the head of Falcon Energy. Gilhotra was located and interviewed by Bloomberg News in August. He is a doctor running a four-bed clinic in the northern Indian city of Dehradun in the foothills of the Himalaya Mountains.

Dr. Gilhotra, 48, said he was ``shocked and hurt'' when he was shown documents bearing his purported signature. ``This is clearly a forgery,'' he said. ``These documents are fake.''

The family doctor, who is also a cardiologist and chest specialist, said he had heard of Merrill Lynch but didn't know what the firm did. The doctor said he never heard of Gordon and had never been contacted by anyone at Merrill. He said the August interview was the first time he'd heard anything about the $43 million embezzlement.

Ashok Kashyap, a New Delhi-based handwriting expert with 40 years experience, said Gilhotra's actual signature didn't match the signature on the document accepted by Merrill.

Money Laundering

After Merrill wired the $43 million to the

Swiss account, Gordon transferred the money between several accounts, and in October 2000, he wired about $32.5 million back to himself in accounts he held in the U.S., Levine wrote. That movement of the money constitutes money laundering, wrote Mary Ellen Warlow, a U.S. Justice Department official.

Warlow sent a letter to the Swiss Justice Department last April 22, asking the Swiss to freeze any remaining money in Gordon's Swiss bank accounts. In the letter, Warlow wrote, ``There is no doubt Gordon will be charged with money laundering.''

In November 2000, a month after Gordon received the $32.5 million in his U.S. accounts in the name of Kings Holdings LLC, which he owned, Gordon acquired a 70 percent interest in Daticon Inc. Daticon is a Norwich, Connecticut-based company that scans and organizes documents used in litigation.

Home Dispute

On Sept. 5, Gordon agreed to sell Daticon to Thomas Cressey of Equity Partners Inc.

In addition to his criminal case, Gordon has yet to resolve a matter with his wife, Laura. Lyme town clerk Ruth Perry said in an interview in September that Laura came to her with a document that said Gordon would share ownership of their $3.5 million home, which was purchased in 2000 in Gordon's name only.

Perry said the document Gordon gave his wife, promising to divide ownership equally, was a fake. Gordon remains the sole owner of the property, according to town real estate records. Laura Gordon has declined to comment.

``She said to me, `Could this be a fake,''' Perry said. ``And I said, `Absolutely.' And she started to cry. I said to her, `You better get yourself an attorney.'''

The case is U.S. vs. Daniel Gordon, in New York.

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