

POSTED
4/19/12

**BEFORE THE
Federal Communications Commission
WASHINGTON, D. C. 20554**

In re Application of)
BERNARD DALLAS LLC)
and)
PRINCIPLE BROADCASTING)
NETWORK-DALLAS LLC)

For Assignment of License of)
KFCD(AM), Farmersville, Texas)

For Assignment of License of)
KHSE(AM), Wylie, Texas)

File No. BAL-20070216ABA
Facility ID # 43757

File No. BAL-20070216ABB
Facility ID # 133464

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FCC Mail Room

TO: Honorable Marlene H. Dortch
Secretary of the Commission

ATTN: The Commission

**PETITION FOR LEAVE TO FILE SUPPLEMENT
AND
SUPPLEMENT TO APPLICATION FOR REVIEW**

David A. Schum, on behalf of himself and fellow petitioners, J. Michael Lloyd, Frank D. Timmons, Carol D. Kratville, Brian M. Brown, Robert E. Howard, Edwin E. Wodka, John W. Saunders and Richard J. Drendel (Petitioners), all qualifying parties under FCC 1.106(b)(1), hereby respectfully submits this Petition for Leave to File Supplement and a Supplement to the pending "Applications for Review" filed on March 20, 2008 and June 19, 2009 appealing the letter rulings of the Chief, Audio Division, Media Bureau dated and released February 19, 2008, 23 FCC Rcd 2642 and May 20,

2009, denying Petitioners' "Petition to Deny" against the above-captioned applications related to AM Broadcast Stations KFCD, Farmersville, Texas (KFCD) and KHSE, Wylie, Texas (KHSE). In addition to the facts and arguments already presented by Petitioners including the supplements filed on November 22, 2011 and February 21, 2012, there are newly discovered facts which require the Commission to vacate the grant of the above-captioned application and to dismiss or deny it or designate it for hearing.

For purposes of this filing, petitioners will be referred to as "Schum." Daniel B. Zwirn, Zwirn Holdings, LLC, D.B. Zwirn & Co., L.P., DBZ GP, LLC, Bernard Dallas, LLC, and Bernard Radio, LLC may collectively be referred to as "Zwirn." The hedge funds FKA as D.B. Zwirn Special Opportunities Fund, L.P. which was domiciled in New York, New York, and D.B. Zwirn Special Opportunities Fund, Ltd. which was domiciled in the Cayman Islands, are now known as "Fortress Value Recovery Fund 1 LLC," are managed by Fortress Investment Group and both will be referred to as "Fortress."

Petition for Leave to File Supplement

It is our understanding that a party may seek leave to file a supplement where new information has materialized since the last time the party had an opportunity under the FCC's rules to present information in a pleading recognized by the FCC's Rules. FCC 1.106(2) (i) and (ii) read as follows:

(2) Where the Commission has denied an application for review, a petition for reconsideration will be entertained only if one or more of the following circumstances are present:

- (i) The petition relies on facts or arguments which relate to events which have occurred or circumstances which have changed since the last opportunity to present such matters to the Commission; or
- (ii) The petition relies on facts or arguments unknown to petitioner until after his last opportunity to present them to the Commission, and he could not through the exercise of ordinary diligence have learned of the facts or arguments in question prior to such opportunity.

The Petitioners last had an opportunity to file a pleading in June, 2009, over two years ago. The Petitioners requested leave to file a supplement to the June, 2009 filing on November 22, 2011 and on February 21, 2012. The information contained in this filing was not available to the petitioners until February 29, 2012 which was after the previous filings although the information contained in Exhibit A was available to Zwirn, Fortress and their attorneys at an earlier time. The public interest, convenience and necessity would be well served by a consideration of the new information presented in this document. Therefore, we respectfully seek leave to file this Supplement.

NEW INFORMATION

Zwirn's Fall From Hedge Fund Glory a Horror Story of Doing the Right Thing

The above heading is the title of an article that was written by William D. Cohan for Bloomberg which was published on February 29, 2012 (Exhibit A). On page 2, paragraph 2 under the heading "Triple Major" the author admits to having worked with Zwirn from 1993-1995 which explains the one sided "fluff piece" nature of the article. It does reveal several relevant facts as they relate to the above named cases at the FCC.

Hedge funds in general and Zwirn in particular are as secretive as the Ku Klux Klan when it comes to ownership (membership), their finances and their activities. The Klan is famous for the hoods that they wore at "events" to hide their identity. The reason: when you pulled the hood off you just may find a U.S. Senator, a federal judge or a convicted child molester, none of whom wanted to be identified as Klan members and participants in the illegal acts.

The FCC has full disclosure of ownership rules that were put into place to prevent secretive organizations and individuals with criminal backgrounds from taking control of broadcast licenses. The rules are supposed to apply to all applicants and are

not to be enforced on a selective basis. Zwirn has refused to provide ownership information forcing Schum to piece it together with information as it becomes available.

The petitioners had business dealings with Zwirn beginning in fall of 2003. During this time span, Zwirn has tightly controlled the available information about the funds, the partners, shareholders and activities. The web address DBZwirn.com showed only a picture of a New York office building with an address and phone number. There was never a link to a website that showed employees, company philosophy or testimony of satisfied customers as is typical. Initially, the internet was less informative and sophisticated than it is today and there was little information about Zwirn available.

Zwirn's FCC ownership filings reflect this secretive control of information. Zwirn has refused to identify the controlling partners and shareholders calling them insulated with the exception of Daniel Bernard Zwirn who had less than a 1% interest. In previous filings, we have pointed out to the FCC that Zwirn was removed as manager of the hedge funds in June, 2009. This article confirms that removal. In Exhibit A, page 1, paragraph 3 the author states:

"Fortress Investment Group LLC took over the management of the D.B. Zwirn's investments in 2009 and hasn't made returns publicly available."

Immediately prior to the management takeover of the Zwirn investments which includes the radio licenses for KFCD and KHSE and assets associated with them a "pro forma" transfer of control was rushed through the FCC by Zwirn and Fortress. The original application was submitted on May 20, 2009, it was amended on May 26, 2009 and the FCC granted it on May 27, 2009. That is not a typo – one day service for approval.

This transfer is reflected in the most recent ownership filing which discloses a "pro forma" transfer to a company called RL Transition Corp purportedly controlled by Daniel Bernard Zwirn. This disclosure relies on two falsehoods:

1. The first falsehood is that Daniel Bernard Zwirn was in control of the Zwirn license ownership prior to the establishment of RL Transition Corp.

In previous petitions and supplements, Schum provided evidence Daniel Bernard Zwirn was not in control of the Zwirn entities as he was voted out against his will on June 1, 2009 and Fortress now manages the funds. It begs the question: How does one get forced out of an entity that they control?

Previously, the point was made that almost 60% of Zwirn was domiciled in the Cayman Islands, outside of US taxation and jurisdiction. In Exhibit A, page 5, paragraph 1 under "Heart Attack Moment" the author reinforces our contention that Zwirn's overseas (offshore) and domestic (onshore) funds were being operated as one fund –

"he'd also taken management fees from investors before they were due and had borrowed money – without interest paid or documentation – from Zwirn's overseas fund to make it possible to do more deals in the domestic fund."

2. The second falsehood is that Daniel Bernard Zwirn is in control of the licenses after the establishment of RL Transition Corp.

Exhibit A, Page 9, paragraph 2 under the heading 'Not Absolving Dan' reads:

"After a total of \$2 billion departed the funds, Zwirn decided in February 2008 to wind them down. Fifteen months later the remaining \$2.5 billion in illiquid assets were transferred to an affiliate of Fortress Investment Group (FIG) LLC, which continues to manage them. "My life's work is gone," Zwirn said."

Exhibit A, Page 10, paragraph 2 under the heading "Patient Was Dead" reads:

"Zwirn is not impoverished, He has pieces of two small banks as well as a small commercial finance company and an office building in Beverly Hills. 'It doesn't take a lot of my time,' he says of his remaining investments, 'but it's a fine thing.'"

Daniel Zwirn does not mention RL Transition Corp which according to Zwirn's counsel and FCC filings Dan Zwirn controls. RL Transition Corp is supposedly operating at least seven radio stations in three different markets including the #5 market in the

country – hardly an easy thing to oversee let alone overlook as one of the things that occupies your time. Over the past five years, over \$5,000,000 in LMA fees have been paid for these stations. Federal tax returns and audited financial statements for RL Transition Corp may help provide insight into who is in control of the licenses.

Dan Zwirn was not in control of Zwirn prior to the "pro forma" transfer. He admits he has nothing to do with RL Transition Corp after the "pro forma" transfer. The "pro forma" transfer is fraudulent.

Fortress Investment Group has been part of this ruse since they assumed the management of the liquidation of the Zwirn funds in June, 2009. Fortress has had its own SEC issues. At about the same time that Fortress took over Zwirn, Daniel Mudd became CEO of Fortress. Just like Zwirn, Daniel Mudd was the target of an SEC investigation and recently resigned his position with Fortress. He is named in an SEC security fraud lawsuit which claims that he had given false information related to risky mortgage loans when he ran Fannie Mae including giving false testimony to Congress.

Fannie Mae has been accused of participating in and encouraging predator lending in the home mortgage market under Mudd's leadership. Zwirn also was a predator lender preying on small businesses including small broadcast companies. Exhibit A, Page 1, Paragraph 2:

"Instead the firm provided capital to about a thousand companies ..."

Not disclosed in the article is the number of companies forced to liquidate by Zwirn and their legal team. Schum is unaware of any Zwirn borrowers that were not forced out of their business or into liquidation usually in a bankruptcy proceeding.

The Zwirn loans were not the home mortgage type that provided 80% – 100 % of the home value. Zwirn loaned 25% to 35% of the appraised value, documented the loan with 130 page loan agreements loaded with covenants impossible to not violate and

then swooped in with a team of lawyers to take control of the company and their assets. In Zwirn's quarterly correspondence with their partners and shareholders, they didn't talk about loans being paid back - instead they talked of "harvesting assets." The small companies could not match Zwirn's legal assault. In Schum's case, the law firm of Vinson & Elkins represented Zwirn in the bankruptcy proceeding that Zwirn forced Schum into. Zwirn was the only secured creditor and yet Vinson & Elkins had five attorneys working on the case with legal bills of over \$700,000 within the first two years. This included a hearing attempting to get the bankruptcy judge to compel Dave Schum to sign an FCC form that contained documented false information. Those legal fees were passed through to Dave Schum in a personal judgment. Zwirn the predator was not happy with ruining companies; they needed to destroy individuals as well.

In addition to the Schum licenses, in the year or so that Zwirn pursued "lending" to small broadcast companies, Zwirn managed to wipe out over 10% of the independently black owned stations in the country. Fortress is currently involved in even more. This is counter to the FCC stated philosophy of encouraging local ownership and wanting licensees to operate stations for at least five years before selling them.

Exhibit A, page 1, last paragraph, Daniel Zwirn says that his most prized possessions of his "new life" are the letters from the SEC that he beat the rap with them and that his former CFO Perry Gruss has been sued by the SEC for improper transfers. At Zwirn, "the buck stops here" did not apply. Exhibit A, Page 9, paragraph 3 under the heading 'Not Absolving Dan' discloses the nature of the SEC investigation. It states:

"Instead Zwirn turned over more than 15 million documents, and the commission took sworn testimony..."

Exhibit A, page 9, paragraph 1 under the heading "SEC Staffing" it states:

"Here they had one staff attorney with supervision."

This lays out an attorney trick that is as old as copy machine technology. Just imagine, one person needs to review 15 million documents to find evidence of wrong doing. According to the SEC attorney, the SEC did not perform their own audit and went by the documentation that was provided by Zwirn after Gruss left.

Exhibit A clearly illustrates that Daniel Bernard Zwirn, in order to avoid prosecution or removal from the industry, went to great lengths to convince the SEC, Zwirn shareholders, partners and almost anyone else that he did not have any idea about the day to day operations or finances of the business. At the same time, Zwirn and counsel have been representing to the FCC that Daniel Bernard Zwirn was the only one in control of the business. Can he have it both ways?

Exhibit A is the launch of Dan Zwirn's new image that he is trying to create for himself. He now says he was not a micromanager as most knew him. Instead, he was too busy "seeing around corners," seeing things that others can't but at the same time in a Nutty Professor kind of way he just didn't pay attention to the little day to day things like do my socks match, do I have \$18 million in my checking to buy the Gulfstream IV or does the onshore fund have \$865 million to make our predator loans with. He also forgot that he is running a multi market radio company, a 24/7 business, with millions of dollars in FCC licenses and assets forcefully taken from small business owners.

The last line of defense for small independent radio licensees to prevent predators like Zwirn and Fortress from destroying their business and illegally taking premature control of the licenses and then transferring the licenses to non-eligible entities is the FCC and the rules that govern broadcasters as set up by Congress. It is not in the best interest of the public to have secretive and offshore funds, pursuing unrealistic returns for the managers and shareholders, wiping out local ownership of licenses using large greedy law firms to overwhelm the entrepreneurs. Schum is asking

the FCC to apply the rules as set up by Congress to the Zwiir and Fortress applications and not allow them to use shell games to avoid the rules and destroy small businesses.

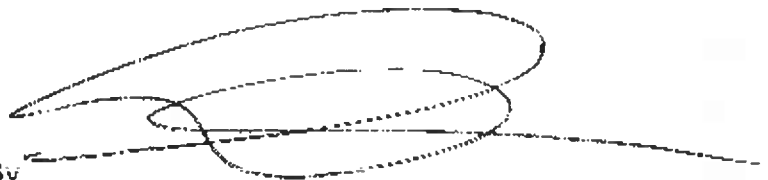
Requested Relief

Wherefore, the Petitioners hereby ask the Commissioners to grant Leave to File this supplement, to take into consideration this new and relevant information filed under FCC 1.106(b)(2)(i) & (ii), use it in addition to the existing filings and urge that the above-captioned application BE DISMISSED, DENIED OR DESIGNATED FOR HEARING UPON APPROPRIATE ISSUES.

Pursuant to Section 1.52 of the FCC's Rules, this is to verify the foregoing pleading and state that, to the best of the undersigned's knowledge, it is true and correct.

Respectfully submitted,

DAVID A. SCHUM et al



By _____

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March 28, 2012

CERTIFICATE OF SERVICE

It is hereby certified that true copies of the foregoing pleading dated March 28, 2012 were served by first-class United States mail, postage prepaid, on this 28th day of March, 2012 upon the following:

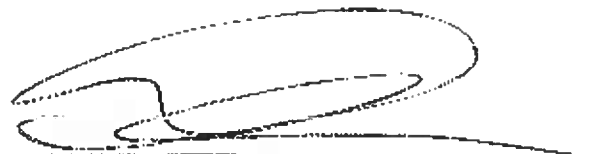
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David A. Schum

Exhibit A

Zwirn's Fall From Hedge Fund Glory a Horror Story of Doing the Right Thing

**By William D. Cohan
For Bloomberg.com**

Dated February 29, 2012

11 pages

Bloomberg

Zwirn's Fall From Hedge Fund Glory a Horror Story of Doing the Right Thing

By William D. Cohan - Feb 29, 2012

On the lengthy list of things Dan Zwirn has lost, a few items jump out. There's the \$17 million condo on Central Park South, the summer place in Quogue, New York, and the \$18 million Gulfstream IV jet. Then there's D.B. Zwirn & Co., the hedge fund that once managed \$12 billion in assets, employed 275 people in 14 global offices, and created the roughly \$700 million in personal wealth that made so many of Zwirn's spectacular purchases possible. Zwirn, 40, misses his money and the things it afforded him. But what he misses most, he said, is his "beautiful machine."

That's Zwirn's term of endearment for his now-defunct hedge fund. The beautiful thing about it was its discipline. D.B. Zwirn abstained from the directional or leveraged bets that other hedge funds make. Instead the firm provided capital to about a thousand companies with few other financing options -- companies such as a small New York-based Spanish-language radio group and a company that leased slot machines to casinos on Indian reservations. The one and only strategy was to learn everything about the prospective borrowers, figure their odds of repayment, crank up the interest rate to the proper pain point and grind out 1 percent a month in profits, Bloomberg Businessweek reports in its March 5 edition.

For 49 straight months, Zwirn, who aspired to be the hedge fund world's scrappy singles hitter, got paid like a home run champ. The D.B. Zwirn Special Opportunities Fund had gross returns of 21.8 percent in 2003, 21.6 percent in 2004, 18.9 percent in 2005, 24 percent in 2006, and 16 percent in 2007. As machines go, Zwirn's was a Ferrari. (Fortress Investment Group LLC took over the management of D.B. Zwirn's investments in 2009 and hasn't made returns publicly available.)

Kafkaesque Fight

Seated behind the desk in his personal office in midtown Manhattan, Zwirn, who's built with the compact force of a small linebacker, reaches for what have become the most prized possessions of his new life: two Lucite tombstones. They could be from any number of deals he did in his early career as an investment banker and private equity investor. Instead, each contains a replica of a

letter from the Securities and Exchange Commission. The first, dated Feb. 23, 2011, absolves Zwirn -- after a four-year investigation -- of any personal blame for the implosion of his firm. The second, dated April 7, 2011, clears D.B. Zwirn of any wrongdoing. This past summer, Zwirn settled most of the outstanding civil litigation against him. "For the first time in five years, I have not been thinking of catastrophic personal downside," he says, managing a faint smile.

After a Kafkaesque fight with his firm's auditors, PricewaterhouseCoopers, and the SEC, Zwirn said the tombstones give him hard-won proof of his innocence. What the letters can't restore are his firm or the roughly 98.6 percent of his fortune that vanished over the past five years. They also don't say that he's without his share of responsibility.

Gulfstream Loan

In April 2005, Zwirn decided he needed a Gulfstream IV. He was 33 and the boss of a rapidly growing global financial behemoth. He didn't ask anyone's permission. He just gave the order, and it fell to Harold Kahn, the fund's chief operating officer, to arrange the financing.

Merrill Lynch agreed to provide 90 percent of the \$18 million purchase price on a non-recourse basis and required only a \$1.9 million letter of credit from Zwirn's management company to close the deal. Citibank initially agreed to provide the letter of credit; after a series of delays in obtaining the Citi loan, Zwirn still needed \$3.8 million in September 2005 (including cash collateral) to meet what Merrill required to get the jet. For a firm the size of D.B. Zwirn, it was a tiny sum. Zwirn could have just written a check, but that's not particularly creative or cost-effective for a specialist in the art of using other people's money. In any event, Zwirn says he was not aware that difficulties had emerged in getting the final piece of financing.

Triple Major

To close the deal, Kahn sent e-mails to Perry Gruss, Zwirn's chief financial officer, and an accountant at the firm named Li Anne Law. Gruss authorized that almost \$1.8 million be taken from the firm's domestic hedge fund and about \$2 million from a \$500 million account managed by Zwirn for Highbridge Capital Management. Zwirn got his jet. He says he didn't know or ask about how it was paid for.

Zwirn grew up in the Pittsburgh suburb of Mt. Lebanon, the only child of a hospital accountant father and a mother who was a teacher with a Ph.D. in literature. In 1993 he graduated from the University of Pennsylvania's dual-degree program with a B.S. in computer science and a triple-major in accounting, finance, and corporate control from the Wharton School. He then headed to Wall Street. (Zwirn and I worked together on a few deals at Lazard Frères between 1993 and 1995.)

After getting an MBA at Harvard Business School in 1998, Zwirn used a connection with a Lazard partner to get a job at the hedge fund Davidson Kempner Capital Management. He bounced from fund to fund before partnering with hedge-fund mogul Glenn Dubin at Highbridge Capital, later acquired by JPMorgan Chase. In 2004, Highbridge spun Zwirn out with his own fund to manage.

'Rare Ability'

Like many people who live at the nexus of complex math and high risk, Zwirn is disarmingly intense and, by common acclaim, brilliant. "Dan has the rare ability to see the next asset class to invest in much sooner than others," said Anthony Gellert, founder of Livingston Capital, who worked with Zwirn at Lazard. "He has the ability to see around corners. I know that's a cliché, but it's absolutely true."

What he's not is detail-oriented about such things as the back-office operation of his business. Zwirn saw himself at the wheel of the Ferrari; he hired other people to work under the hood.

Hiring Gruss

One of those people was Perry Gruss. A graduate of SUNY Oneonta in upstate New York, Gruss, now 44, worked for more than a decade at Nomura Securities in New York in its distressed debt and real estate businesses. In early 2002, when Zwirn was still part of Highbridge but doing his own investing, he hired Gruss to be his fund's CFO. Near the end of 2003, Gruss was being recruited by Wachovia to be chief financial officer of a 1,000- person division. Zwirn and Highbridge persuaded him to stay.

"Every data point was that his old colleagues loved him," Zwirn said. "He was a big kind of EQ type of guy."

Gruss completed the purchase of Zwirn's jet quietly. By Nov. 10, 2005, the delayed Citibank loan had closed, allowing Gruss to repay what he'd borrowed from the Highbridge account and the domestic fund.

The jet was a relatively simple transaction, but D.B. Zwirn was an increasingly complicated operation. Zwirn started his firm with \$500 million under management in 2004. Within a few years he had \$5 billion. "Dan had a core group of people who were competent for a \$500 million firm but not necessarily for a \$5 billion firm," said Lawrence Cutler, who joined D.B. Zwirn as chief compliance officer in 2005 and continues to work part-time for what remains of the Zwirn management company. "Within a few months of being spun off from Highbridge, Dan upgraded

the senior staff and brought in a number of experienced people to overhaul the firm's infrastructure."

SEC Registration

It was already too late. In a shift in federal policy, all hedge funds were required to register with the SEC by February 2006. As D.B. Zwirn prepared to file, all sorts of improper paperwork surfaced, including the financing documents for the G IV. According to court documents, Tim Wong, who had been hired as the firm's controller in December 2005, told Cutler and general counsel David Proshan that he noticed money from the domestic fund and the Highbridge managed account "had been improperly used to finance the purchase" of the plane. The funds had been repaid after a month, but without interest, and management fees had been taken earlier than contractually agreed—a violation of the Investment Advisers Act of 1940.

'Inadvertent Mistakes'

At first, Cutler was unconcerned. "I've seen or heard of inadvertent mistakes in the industry frequently over the years," he said. "Errors occur, and they are corrected, and as long as they don't continue, things are OK." Cutler said he asked: "We're not doing this anymore, correct?" He was told the firm was not. Cutler then asked Wong to get all the documentation for the transfers so he could figure out whether the mistake needed to be disclosed to investors and the SEC. Cutler also alerted the hedge fund's outside counsel, Schulte Roth & Zabel.

When Cutler first arrived at D.B. Zwirn, the firm didn't have a unified record of the bank accounts, the signatory authorities, or of who owed what money to whom. Cutler says he advised the team: "You can't keep opening up new funds. We've got to get this cleaned up."

When Cutler, Kahn, and Gruss briefed Zwirn, the CEO agreed to ease up. "It will be the summer of digestion," Zwirn said, coining a phrase that spread around the firm to explain the slowdown in activity. In the meantime, Zwirn asked Schulte Roth & Zabel to investigate the financing of the G IV. Zwirn says he expected they'd find "some sort of clerical issue" and that he "wanted to make sure it was dealt with in as draconian a manner as possible to set an example for other young guys."

'Heart Attack Moment'

In September 2006, Schulte reported the findings of its four-month, \$2 million investigation to Zwirn, Cutler, and other senior executives in a tense Sunday evening meeting. Gruss was excluded, which should have been a signal to Zwirn of what was about to take place. But the meeting was two

days before the birth of his first son and, Zwirn said, "in my mind I was thinking I'm going to see a 24-year-old who screwed something up."

Instead, Zwirn had a "heart attack moment." He learned that Gruss had arranged for the improper use of funds to finance the purchase of the jet. Among other things, he'd also taken management fees from investors before they were due and had borrowed money—without interest paid or documentation—from Zwirn's overseas fund to make it possible to do more deals in the domestic fund. Gruss had thrown sand into the gears of the beautiful machine, and Zwirn had no idea.

'Now I'm Terrified'

"In the six weeks after that day, I lost 18 pounds," Zwirn said. "I'm not saying I didn't need to, but not that way." His mind raced back to Martin Mayer's *Nightmare on Wall Street*, the 1993 book about Salomon Brothers CEO John Gutfreund's failure to report the 1991 scandal involving the firm's trading in Treasury securities. "Now I'm terrified," Zwirn recalls.

He decided at that moment to tell the SEC everything he'd just discovered. It was the right thing to do, and Zwirn also hoped that by self-reporting he could take advantage of an emerging legal precedent based on a case involving Seaboard Corp. in which firms that voluntarily admitted to wrongdoing could get swifter and more favorable treatment from the SEC. But Zwirn's decision turned out to have numerous unforeseen consequences. Frank Goldstein, a lawyer familiar with Seaboard at Severn, O'Connor & Kresslein in Frederick, Maryland, urges companies to have sensible expectations when self-reporting. "It's still a good way to go, but it doesn't work all the time and it can kill you in terms of timing," Goldstein says. "It's not a panacea."

Trading Lawsuits

Zwirn said he understood what he was doing and felt he had no choice but to go to the SEC. "The agony was that I knew that to do that would mean I was putting myself into a horrible position of being [mistakenly] accused."

The full scope of the accounting misdeeds at D.B. Zwirn came to light publicly in the second half of 2009, when Gruss and Zwirn traded lawsuits in federal court in New York seeking financial retribution from each other. On April 8, 2011, the day after Zwirn got his final absolution letter from the SEC, the commission added to the legal pile by filing its own a suit against Gruss. According to the SEC's 14-page complaint, on 25 occasions between March 2004 and July 2006, Gruss "knowingly misused the signatory and approval authority he had over the funds held in client accounts and directed and/or authorized more than \$870 million in improper transfers of

client cash, both between client funds and from client funds to the investment adviser" -- D.B. Zwirn -- "and third parties."

Early Payments

The SEC also noted that Gruss had authorized taking management fees before they were due. Without the early payments, the SEC says, the management company "would have faced severe liquidity constraints and might have been unable to fund its disbursements for operating expenses," a charge that, if true, reveals the extent to which the D.B. Zwirn funds lacked internal cash management and accounting controls. It's a rare hedge fund company with billions under management that finds itself stretched so thin that it cannot make payroll. But, according to the SEC complaint, the management company would have been short \$2 million to \$10 million at the end of 2005 and the beginning of 2006 if Gruss had not taken the fees early.

Still incredulous, Zwirn said he had no idea the management company was so short of cash; rather, he says, he thought the firm was flush from its steady profits and growing management fees. "Gruss has characterized what he did as, in effect, no harm, no foul," according to Zwirn's court filings. "Gruss has also admitted that he did not tell Zwirn or anyone in senior management about the practice."

'Improper' Transfers

Although the SEC hasn't accused Gruss of pocketing any D.B. Zwirn funds, it notes that the transfers were "improper," were not permitted by the Zwirn offering documents, were not disclosed to investors until after Gruss resigned in September 2006, and were violations of the Investment Advisers Act. Unless Gruss "is permanently restrained and enjoined," the SEC wrote in its complaint, "he will continue to engage in acts, practices and courses of business of similar type and object." All of which might be news to Gruss's current employer, the U.S. subsidiary of Babcock & Brown. After making and breaking six appointments to give his account of what happened at D.B. Zwirn, Gruss decided not to comment for this story. Babcock & Brown didn't return requests for comment.

Overseas Fund

At least a few people at D.B. Zwirn suspected Gruss was out of his depth. The first documented instance of Gruss's moving money between funds occurred during the first quarter of 2005. Silvia Wu, a senior accountant at the firm, received a funding request for an unspecified investment in the domestic fund and realized the fund didn't have the cash to cover it. She asked Gruss how to proceed, and Gruss told her to take the money from the overseas fund. According to the SEC,

"Thereafter, a practice developed of using cash" from the overseas fund to cover the domestic fund's investments, with Gruss approving the transfers in e-mails.

Wu resigned in June 2005 "because she was uncomfortable with the interfund transfer practice," according to court documents. Zwirn said Gruss told him she left because she wanted to have a baby. According to the SEC, Wu's replacement, Li Anne Law, "repeatedly expressed concern to Gruss about the practice of transferring cash between funds." On April 18, 2005, after Gruss had approved another transfer, Law wrote him an e-mail. "Is there a game plan? Or is this something that the back office must 'learn to accept?'" Gruss's e-mail response: "What's our altwrnatives? [sic]" Law quit the company in June 2006 "for the same reason" as Wu, according to court documents, and told her successor "not to allow herself to get drawn into the practice of making interfund transfers." Law has moved to London and changed her name. Wu now lives in Asia. Neither could be reached for comment.

Gruss Seeks Dismissal

Gruss has filed a motion to dismiss the SEC's lawsuit. Nathaniel Akerman, Gruss's attorney, argues that interfund transfers "were permitted in general as part of the basic operations of both funds, and all of the monies that were advanced to the [domestic fund] were continuously returned to the [overseas fund] either in kind or in cash with only \$108 million remaining to be paid as of October 2006," after Gruss left the company. According to Zwirn, these transfers were made without his authorization, despite what the documents might have permitted.

Strict 'Micromanager'

In his lawsuit, Gruss seeks more than \$10 million for defamation and breach of contract from Zwirn and D.B. Zwirn. In his July 2009 federal court filing, Gruss argues that Zwirn was hardly the disconnected genius behind the beautiful machine. Zwirn was actually "a micromanager" who "paid strict attention to every detail of his business" and "was involved intimately in all aspects of the company's investment, legal, financial, managerial, and operational details." Zwirn was "such a micromanager," Gruss contends, that the CEO "spent endless hours poring over details and data and would constantly demand that reports be provided to him immediately, day or night, weekdays and weekends." Gruss says Zwirn "needed a scapegoat" and a "fall guy" for his firm's problems, which he described as "growing at an uncontrollable pace."

In his suit against Gruss, Zwirn and his management company have demanded \$45 million from Gruss. The SEC's lawsuit against Gruss and the suits between Gruss and Zwirn are pending.

Following the Script

After Gruss tendered his resignation in September 2006, Zwirn hired lawyers. Gibson Dunn was brought in to investigate the interfund transfers, and Fried Frank was retained to represent D.B. Zwirn in its dealings with the SEC. Gibson Dunn hired Deloitte & Touche to do forensic accounting work. "Now the meter's really running," said Zwirn.

Following a carefully vetted script, Zwirn called each of his investors to explain what Schulte Roth had uncovered and what Gibson was setting out to do, and followed up with a memo on Nov. 3 reiterating his "chagrin" at the accounting errors. Zwirn relinquished all authority over the Gibson Dunn investigation to Cutler and David Lee, who was elevated to CFO of the hedge funds from his job as a Zwirn portfolio manager. Zwirn also forfeited his ability to claim any of his documents, actions, or conversations as privileged. "If David and I thought that something needed to be passed over to the lawyers that would put Dan in jail for 20 years, Dan had no say in it," Cutler said. "That's really scary, especially since David and I had no clue if there was a smoking gun."

Eight-Page Memo

On March 26, 2007, Zwirn shared Gibson's conclusions with his investors in an eight-page, single-spaced memo. "Although the cumulative impact to our fund's investment performance is not quantitatively material, the conduct identified is completely unacceptable to us and deeply embarrassing," Zwirn wrote, blaming the errors on "substantial growth over a relatively short period of time." A number of other infractions—such as miscalculating NAVs and the value of certain illiquid securities—were reported. The firm also announced that it had hired Warren Rudman, the former U.S. senator from New Hampshire, to advise it on "best practices" for governance and compliance.

Zwirn paid \$8.5 million from his own pocket to the overseas fund to compensate it for the lost interest on the money that Gruss had transferred. He also paid an additional \$35 million for the cost of the investigations. (Neither Gibson Dunn nor Schulte Roth would make their full investigative reports available; Zwirn said he was not given copies of them, only their conclusions.)

Pushing for Audit

When word of the accounting issues at D.B. Zwirn leaked in December 2006, Zwirn decided to stop accepting new money, though money was the least of his problems. D.B. Zwirn's real enemy was time. Zwirn kept pushing PricewaterhouseCoopers to produce the 2006 audit so Zwirn's investors could get their K-1s in order to file their tax returns. But the accounting firm would not start the 2006 audit until the Gibson Dunn report was completed in March 2007. Then Pricewaterhouse

fielded a 90-person team, led by partner Scott Sulzberger, to comb through nearly every aspect of the business. Despite pressure from Zwirn to complete the audit swiftly, it wasn't finished until Dec. 24, 2007, at a cost of \$23 million. Between September 2006 and November 2007 investors redeemed \$1.4 billion, in large part because the slow-rolling audit meant a delay in giving investors their K-1s, which then impeded their ability to file their own tax returns.

PricewaterhouseCoopers did not respond to requests for comment.

'Not Absolving Dan'

Jason Papastavrou, the founder of Aris Capital, had between \$10 million and \$20 million invested in Zwirn's fund. "Look, we are not buddies," he said of Zwirn. "I am never going to go to lunch or dinner with him." Papastavrou said Zwirn's biggest mistake was hiring Gruss, but, "I am not absolving Dan for what happened. His name was on the door." Still, he doesn't think Zwirn deserves his fate. "Dan was beyond a workaholic. He was not some guy out in the Hamptons, chasing chicks in his Ferrari. Dan used to have 7 a.m. meetings on Saturdays in Central Park with his portfolio managers. Nobody worked harder."

After a total of \$2 billion departed the funds, Zwirn decided in February 2008 to wind them down. Fifteen months later the remaining \$2.5 billion in illiquid assets were transferred to an affiliate of Fortress Investment Group (FIG) LLC, which continues to manage them. "My life's work is gone," Zwirn said.

Meanwhile, the SEC investigation churned on. According to Steven Witzel, Zwirn's counsel at Fried Frank, Zwirn could have made the decision "lawfully" not to self-report the incidents to the SEC because the amounts of money involved were nonmaterial. Instead Zwirn turned over more than 15 million documents, and the commission took sworn testimony from a dozen Zwirn employees and interviewed many others.

SEC Staffing

"Many cases take longer than we would like -- in fact that's typical," Witzel said. "The staff wants to make sure they are thorough. Here they had one staff attorney with supervision. Typically, we'd like to see it over sooner, but the SEC in this case didn't have the personnel to do it any faster."

Why the SEC didn't add more people to the investigation and ignored the Seaboard precedent is a question the commission hasn't answered. George Canellos, the director of the SEC's New York office and the most senior official involved with Zwirn's case, did not return phone calls seeking comment. The SEC made one of its lawyers available to discuss the Seaboard precedent but only on background and not in relationship to the Zwirn investigation or its active case against Gruss.

Changed View

Zwirn has been changed by his tribulations. His once- ubiquitous self-confidence is gone, and he's more cynical; he says he no longer believes the world is meritocratic or that doing the right thing always yields the right result. He reserves most of his anger for the SEC and PricewaterhouseCoopers, with a special citation for Robert Khuzami. Prior to D.B. Zwirn's assets being sold to Fortress, Zwirn tried to partner with Deutsche Bank to buy back his firm. Khuzami, then the bank's general counsel for the Americas, was one of the people Zwirn spoke with regularly. Zwirn says Khuzami knew about Gruss and the money transfers when he joined the SEC as its chief enforcement officer and could have helped bring about a faster resolution. But Khuzami recused himself. Khuzami didn't respond to a request for comment made in an e-mail to an SEC spokesman.

The two letters encased in Lucite have brought Zwirn a modicum of relief. Still, Zwirn and others at the now defunct firm are astonished at the way in which D.B. Zwirn vanished. As a result of all the delays, "he lost the support of his investors because he wasn't able to provide them [with] what they ultimately needed, which was enough information -- like the K-1s -- to keep them happy," said Cutler.

'Patient Was Dead'

"Dan went down because basically we as a firm decided to go public with the issues in the organization, which in hindsight is a difficult thing to do. We spent tens and tens of millions of dollars providing a tremendous amount of information to regulators. In the end, the resolution was great. But by then the patient was dead." Zwirn doesn't blame Gruss -- "Perry's activities didn't kill the business on their own," he says -- but he also doesn't hesitate when asked what he would have done differently: "Hired a different guy to be my CFO."

Zwirn is not impoverished. He has pieces of two small banks as well as a small commercial finance company and an office building in Beverly Hills. "It doesn't take a lot of my time," he says of his remaining investments, "but it's a fine thing."

He lives in a rental apartment on the Upper East Side of Manhattan with his wife, a fixed-income research analyst at Morgan Stanley, and their two young sons. He's thought about returning to school to get a Ph.D. in philosophy or foreign policy and considered turning his positions on the board of the Brookings Institution and as a member of the Council on Foreign Relations into full-time research gigs. He hopes to reclaim his reputation, noting that Google searches of his name do him no favors.

Potential Investors

Not surprisingly, Zwirn would also like to get back behind the wheel. He recently returned from visiting potential investors in London, flying business class on a commercial jet. "The macro environment for what I know how to do is exceptional and has prospects of being so for quite a long time," he said. "I got a lot of clarity from this process. It's what I am actually doing for 15 hours in a day that's important. And so there's lots of forms that could take as long as I'm able to do something that has the levers and buttons and control panel on it."

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