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’92 Ponzi Case Missed Signals About Madoff

By ALEX BERENSON

Seventeen years ago, federal investigators questioned for the first time whether Bernard L. Madoff was connected to a Ponzi scheme. Their inquiry centered on Frank Avellino, an accountant who had been funneling investors to Mr. Madoff since the 1960s.

The investigators did not get far. Within days, Mr. Avellino agreed to return to investors the money he and his partner had raised and to pay a small fine to the Securities and Exchange Commission. The inquiry petered out, and Mr. Avellino — represented in the case by Ira Lee Sorkin, the same lawyer who now represents Mr. Madoff — kept sending money to Mr. Madoff.

Now questions have again arisen about the ties between Mr. Madoff and Mr. Avellino. A lawsuit claims that Mr. Avellino warned his housekeeper, who had invested with him, that her money was lost 10 days before Mr. Madoff’s fraud became public.

Through his new lawyer, a former federal prosecutor, Mr. Avellino declined to comment on his relationship with Mr. Madoff.

But archived court documents from the 1992 case reveal numerous red flags that raise questions about the S.E.C.’s failure to examine Mr. Avellino and Mr. Madoff long before Mr. Madoff’s apparent Ponzi scheme spread worldwide. The documents show that Mr. Avellino and Michael Bienes, his business partner, kept almost no records at Avellino & Bienes, a firm that oversaw $440 million. When court-appointed auditors asked Mr. Avellino to prepare a balance sheet, he responded that “my experience has taught me to not commit any figures to scrutiny.”

Subsequently, Mr. Sorkin and Mr. Avellino managed to curtail the audit, even though a federal judge eventually concluded that Mr. Avellino had not been a credible witness in the case.

The S.E.C. also took at face value Mr. Avellino’s depiction of the deal he offered investors, which guaranteed returns of up to 20 percent a year while requiring him and Mr. Bienes to make up any shortfalls.

It is unclear whether commission investigators even discussed the case with Mr. Madoff. His name does not appear in the agency’s complaint, which referred only to an unnamed broker.

The government lawyers who handled the case are now in private practice. Richard Walker, then head of the S.E.C.’s New York office, is general counsel of Deutsche Bank. Kathryn Ashburgh, the lead lawyer on the case, works from her home in McLean, Va. And Keith W. Miller, a senior lawyer in the New York office, is a partner at Paul, Hastings, Janofsky & Walker. Through a spokesman, Mr. Walker declined to comment on the case. Mr. Miller and Ms. Ashburgh did not return calls.

Mr. Avellino did not respond to calls or visits to his homes in Nantucket, Mass.; Palm Beach, Fla.; and New York, or to messages left with his son Joseph Avellino in Chester, N.J. Gary Woodfield, the former federal prosecutor who represents Mr. Avellino, also declined to comment. Francis B. Brogan, a longtime lawyer for Mr. Avellino and a partner at Greenberg Traurig in Fort Lauderdale, Fla., asked that questions be e-mailed to him, then did not respond.

Mark Raymond, a lawyer for Mr. Bienes, said that his client had no knowledge of Mr. Madoff’s fraud and had lost tens of millions of dollars, most of his savings, in the fraud. Mr. Bienes worked mainly as a fund-raiser, while Mr. Avellino actively managed Avellino & Bienes, according to court documents and people who knew the men.

Mr. Avellino has been connected to Mr. Madoff for his entire career. After graduating from the City University of New York in 1958, Mr. Avellino began working as an accountant at a firm run by Saul Alpern, Mr. Madoff’s father-in-law.

Mr. Madoff also briefly ran his securities business from the firm’s offices. As early as 1962, according to the S.E.C.’s complaint against him, Mr. Avellino began raising money for Mr. Madoff, who was running a small brokerage company. Mr. Bienes joined in 1965.

In 1977, Mr. Avellino and Mr. Bienes formed an accounting firm in Midtown Manhattan. Mr. Avellino owned half the company; the remainder was owned by Mr. Bienes and his wife, Dianne. In 1980, the Bieneses moved to Fort Lauderdale, while Mr. Avellino remained in New York.

The two men gradually shifted their focus from accounting to raising money for Mr. Madoff. Their business expanded until 1992, when the S.E.C. received marketing materials showing that Avellino & Bienes had promised investors annual returns of up to 20 percent. Commission officials said at the time that they believed they had stumbled upon a Ponzi scheme.

But when the investigators went to Mr. Avellino, they found, to their surprise, an apparently legitimate explanation. The money, $441 million from 3,200 clients, was being managed by Mr. Madoff, whose brokerage firm by then was one of the biggest stock traders on Wall Street. In a deposition, Mr. Avellino explained that he had promised returns of 13.5 to 20 percent a year. If Mr. Madoff fell short of producing those returns with his stock trades, Avellino & Bienes would make up the difference, Mr. Avellino said.

“If I was short and there was a shortfall, I would be in trouble,” Mr. Avellino said in a deposition.

No one at the securities commission seems to have questioned why Mr. Avellino and Mr. Bienes offered clients a double-digit guaranteed return on money that they did not even control. Nor do the records offer any hint that the commission considered whether Mr. Madoff, rather than Avellino & Bienes, might be operating a Ponzi scheme.

Instead, once the commission was satisfied that the money existed in Mr. Madoff’s accounts and would be returned, it quickly reached a deal with Mr. Avellino and Mr. Bienes. Through Mr. Sorkin, the lawyer who once oversaw the regulator’s New York office, the men agreed to return the money to investors, shut down their firm, undergo an audit and pay a fine of $350,000.

So went the public version of the case presented by the agency. “There’s nothing to indicate fraud,” Martin Kuperberg, an administrator at the commission, told The Wall Street Journal on Dec. 1, 1992.

But court records reveal a much messier investigation. On Nov. 17, 1992, as part of the deal, a federal judge ordered Price Waterhouse to audit the financial statements of Avellino & Bienes.

The accountants soon learned that Avellino & Bienes did not keep conventional books, only the basic ledgers necessary to prepare tax records. Price Waterhouse then asked Mr. Avellino to put together records for 1992. He declined.

“My experience has taught me to not commit any figures to scrutiny when, as in this case, it can be construed as ‘bible’ and subject to criticism,” Mr. Avellino wrote somewhat ungrammatically. “In this present instance, quite severely. I explained how the profit and loss can be computed from the records you now hold in your possession that Bernard L. Madoff and I supplied.”

Even after learning of the missing records, the commission did not reopen its investigation.

The case then took an unusual turn. Mr. Avellino and Mr. Sorkin complained about Price Waterhouse’s fees and demanded that federal Judge John E. Sprizzo, who was overseeing the case, quickly end the audit.

“I am not a cash cow, and I will not be milked,” Mr. Avellino wrote in an affidavit.

By the end of January 1993, both the securities investigation and the Price Waterhouse audit were effectively over. But in a hearing over the disputed fees in April, Judge Sprizzo sharply criticized Mr. Sorkin, who acknowledged that Avellino & Bienes had agreed to the audit in part to avoid a deeper investigation.

“If you didn’t consent to the audit, the commission could have pursued other remedies. They would have asked for a hearing, they would have asked for discovery,” Judge Sprizzo said.

“That is true,” Mr. Sorkin said.

Judge Sprizzo said he did not believe Mr. Avellino’s testimony. Mr. Avellino “was worried about self-incrimination,” the judge said. He ordered Avellino & Bienes to pay Price Waterhouse its bill of $428,679 in full.

In an interview, Mr. Sorkin said this week that he could not recall whether Mr. Madoff referred Mr. Avellino and Mr. Bienes to him. He has known Mr. Madoff since at least the early 1980s, he said, but did not represent Mr. Madoff at the time of the Avellino case.

After the settlement, Mr. Avellino and Mr. Bienes disbanded their firm. The Bieneses, who own a $7 million house in Fort Lauderdale, became philanthropists, contributing millions of dollars to Holy Cross Hospital in Fort Lauderdale and the Broward County Library. Mr. Avellino and his wife, Nancy, split their time between Nantucket, Manhattan and south Florida. In 2003, the Avellinos bought a $4.5 million house in Palm Beach less than five blocks from Mr. Madoff’s house there. Their Manhattan apartment is similarly close to Mr. Madoff’s apartment.

Through Mr. Brogan, his lawyer, Mr. Avellino set up a web of foundations and partnerships, including the Kenn Jordan Foundation. The foundation had $6 million in assets, at least some of which were invested with Mr. Madoff, and was nominally controlled by a man named Kenneth Jordan, who lived in a small Fort Lauderdale apartment.

Lola Kurland, who retired as the office manager for Avellino & Bienes, said in an interview that Mr. Jordan was a “personal friend” of Mr. Avellino. After Mr. Jordan died in 1999, the Kenn Jordan Foundation transferred its assets to Mr. Avellino’s family foundation and was dissolved. But Mr. Avellino continued to use Mr. Jordan’s name to raise money from investors, according to a lawsuit filed against him in state court in Nantucket last month.

His former housekeeper, Nevena Ivanova, alleges in that suit that Mr. Avellino raised $200,000 from her and her husband in September 2006 — and he directed her to make out her check to Kenn Jordan Associates, “a fictitious entity.” In July 2008, Ms. Ivanova asked Mr. Avellino to return her investment, which at the time stood at $124,000. He put her off for months, according to the lawsuit. Then, on Dec. 1, 10 days before Mr. Madoff’s Ponzi scheme became public, Mr. Avellino told Ms. Ivanova that her money had been lost.