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Collapse of Portland, Ore., Investment Advisory Firm Spawns Numerous Lawsuits

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As federal investigators plow through the financial wreckage of Capital Consultants LLC, looking for evidence of criminal fraud, clients of the former Portland investment advisory firm are searching for deep pockets to recoup their losses.

Twenty-eight labor union trust funds and 10 union locals from nine states have filed three suits against Capital Consultants and its former chief executive, Jeffrey Grayson, and a host of companies and individuals Grayson did business with.

Members of four of the unions, meanwhile, have sued the trustees of their funds, accusing them of recklessly investing millions of dollars of their retirement and benefits money with Capital Consultants.

The battalion of lawyers, investigators and accountants now girding for war has led to anxiety on two fronts. Some union workers and retirees worry that professional fees will devour much of what victims hope to recover. Meanwhile, law firms, accountants and others who worked for or with Capital Consultants face the possibility that they could be named as defendants.

Besides Grayson and Capital Consultants, the union trusts also have sued Portland financiers Andrew Wiederhorn and Larry Mendelsohn, their current company, Wilshire Real Estate Investment Inc., and nine other Wilshire companies that they formerly operated. Union members and trustees have said in court filings that they reserve the right to add other businesses that worked with Capital Consultants to the suit. Some of those businesses -- including high-profile professional firms -- already have hired legal counsel to represent them.

The alleged pension scam, the biggest by a U.S. investment manager, according to federal officials, has spawned nine lawsuits so far involving four federal agencies, five federal judges and an estimated 60 attorneys.

"Look around the room and think how much money is being spent on lawyers and litigation," U.S. District Judge Garr King said at a Dec. 5 hearing attended by at least 43 attorneys.

A federal receiver appointed to liquidate the disgraced Portland company estimates that Capital Consultants clients have lost more than \$ 240 million, mostly from union trust funds. The losses will almost certainly take a significant toll on some union workers' retirement funds, though authorities

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don't yet know the extent of the damage.

The legal positioning started Sept. 21 when the U.S. Securities and Exchange Commission and the Department of Labor each filed civil fraud complaints against Capital Consultants in U.S. District Court in Portland. Those complaints said most of the money the company lost -- \$ 160 million -- went into poorly secured loans to the former Wilshire Credit Corp. When Wilshire failed to pay the money back, the SEC and the Labor Department alleged, Grayson devised a Ponzi-like scheme to pay some of the trusts back with their own investment funds.

Complicating the civil actions is an ongoing criminal investigation. Agents for the Department of Labor, Internal Revenue Service, SEC and FBI continue to dig into the business affairs of Grayson, Wiederhorn and Mendelsohn.

King made it clear that he will do his best to minimize legal bills and not let the remaining Capital Consultants assets be eaten up by lawyers "sitting around and just observing and doing nothing and being paid." After last week's hearing, King discussed with the gathered attorneys a proposal from the Portland attorneys representing Oregon union trustees to settle all seven of the lawsuits filed so far in one global mediation instead of holding trials.

But the case could grow larger before it gets smaller. Having already embroiled two of Portland's most flamboyant entrepreneurs in Grayson and Wiederhorn, the case may eventually entangle some prominent legal and accounting firms.

Lawyers for both the trustees and the union members who are suing the trustees have served notice that they may sue, for instance, Lane Powell Spears Lubersky, Capital Consultants' longtime law firm. Also, the lawyers are eyeing Moss Adams, a major regional accounting firm that served Capital Consultants. Both firms have substantial liability insurance coverage that could be tapped by a verdict, said Stephen English, a Portland lawyer representing nine Oregon-based union trusts.

If the victims' lawyers do decide to go after the professional advisers, they would be following a well-established legal precedent. Government lawyers turned aggressively toward the law and accounting firms that served failed thrifts in the savings and loan crisis on the grounds "they were aware of the unsafe, unsound conduct," said Steven Bender, a University of Oregon Law School professor.

Cases against professional advisers can be difficult to prove. Plaintiffs would have to show that the advisers knew of illegalities and assisted in them, Bender said.

In the case of the savings and loans, many of the institutions parceled out legal work to several firms, so that "no one firm got a view of the whole landscape," he said. Nevertheless, he added, many of the savings and loan advisers chose to settle their cases with substantial payouts rather than go to trial.

Among the professional advisers who worked closest with Capital Consultants is Robert Maloney Jr. and his Portland law firm, Lane Powell Spears Lubersky. Capital Consultants for many years ranked as one of the largest clients of Lane Powell's 70-employee Portland office, the sixth largest in the city.

So close is Lane Powell to Capital Consultants that when various litigants

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complained about the difficulty of obtaining the investment firm's internal documents as part of the discovery process, Judge King directed Lane Powell to make its own complete set of Capital Consultants records available.

Maloney is keeping a low profile in the current lawsuits, representing neither Grayson nor Capital Consultants. Instead, Milo Petranovich, Maloney's partner at Lane Powell, is defending Capital Consultants. Petranovich said ethical obligations prevented him from commenting in detail on the case.

"Lane Powell takes great pride in our integrity, professionalism and the quality of our work," Petranovich said in a prepared statement furnished to The Oregonian. "We provided advice to (Capital Consultants) on some aspects of the transactions covered by these lawsuits. (Capital Consultants) also retained other lawyers because of their expertise in ERISA matters. Well-respected counsel represented all of the parties in these transactions."

Grayson also went to Robert Eccles, a lawyer at Washington, D.C., powerhouse O'Melveny & Meyers, for advice on the Employee Retirement Income Security Act (ERISA), the federal law that governs pension investing.

Eccles confirmed that he has worked for Capital Consultants but declined further comment.

Another prominent firm that has done legal work for the Wilshire group of companies is Stoel Rives, the largest law firm in Oregon, with 300 attorneys and 400 support staff.

Stoel Rives lawyers represented the former Wilshire Credit in a 1994 loan transaction between Wilshire Credit and Capital Consultants and West State Inc., a now-defunct Portland ship repair firm.

The Oregon union trustees claim in their lawsuit that the West State loan was "the beginning of a conspiracy involving a series of reciprocal loans and favors by and among Wiederhorn, Mendelsohn, Wilshire Credit Corp., Wilshire Financial Services Group, Grayson and Capital Consultants for their mutual personal benefit to the detriment of plaintiffs."

Unlike some of the other firms, Stoel Rives did not have an attorney of record for the Tuesday hearing, and it's uncertain whether it ultimately will be drawn into the case.

Steve Babson, Stoel Rives' managing partner, declined to comment on the matter.

Moss Adams, the largest accounting firm in Oregon and Washington in terms of number of accountants, worked for Capital Consultants in a number of accounting and business appraisal roles. Moss Adams valued the collateral that Wilshire Credit Corp. offered up as security for the \$ 160 million it borrowed from Capital Consultants.

The trusts and the court-appointed receiver claim that the collateral put up by Wilshire Credit was woefully inadequate to secure \$ 160 million in loans.

Attorneys representing Lane Powell and Moss Adams attended the Dec. 5 hearing.

"There are plaintiffs who have said they intend to go after the professional advisers," said Thomas Tongue, one of two Portland lawyers representing Lane

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Powell. "I'm sure many law firms, unfortunately, will find themselves getting notices at some point."

Portland lawyer John Barker is representing Moss Adams. "Moss Adams and everyone else involved are cooperating to try and figure out where responsibilities lie, and we expect to continue to do so and work toward a successful resolution of this matter," Barker said.

The lawsuits against union trustees also could yield more defendants.

A handful of union workers claim some of the trustees of their funds are **guilty** of more than negligence. Certain trustees "were influenced in their decision to retain Capital Consultants by gifts . . . including, but not limited to, subsidized hunting and fishing trips," said a complaint filed against trustees of the Office and Professional Employees International Union, Local 11, 401(k) plan.

Advisers to the trust funds also could be in the line of fire.

Portland lawyer Mort Zalutsky of Zalutsky & Klarquist serves as counsel for the nine Oregon-based union pension and benefit trusts.

David Anderson, a trustee for the Office and Professional Employees International Union, Local 11, 401(k) fund, proposed at the trusts' Nov. 3 meeting that the trustees fire Zalutsky and name him as a defendant in their lawsuit against Capital Consultants.

Anderson's motion was not seconded and did not go to a vote of the entire trust, according to minutes obtained by The Oregonian. Anderson withdrew his motion at a later meeting and suggested instead that they review all of the trusts' professional advisers. That motion too died for lack of a second, said David Bacon, Anderson's Los Angeles attorney.

Zalutsky chose not to comment. Larry A. Brisbee, a Hillsboro lawyer who represents Zalutsky for the Professional Liability Fund, the attorney malpractice insurance arm of the Oregon State Bar, said, "We don't really have any comment at this point because we haven't really been implicated other than it's pretty obvious they're looking for anybody" to sue.

"If something is pitched in his direction," Brisbee said, "we'll deal with it at that time."

The Oregon union trustees have hired the same Portland law firm -- Bullivant Houser Bailey -- to prosecute their suit against Capital Consultants and to defend them in the class-action lawsuits brought by the rank-and-file union members.

The foundation of the trustees' defense is that Grayson was so convincing a salesman that the trustees had no hope of detecting the problems.

Capital Consultants, Grayson and the other defendants "secretly schemed and conspired to give away collateral, release various defendants from personal guarantees, make false statements, prepare and submit false financial reports and appraisals, and take other actions in furtherance of their personal financial gain and to the detriment of the plaintiffs," the Oregon trusts claim in their lawsuit.

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Chrys Martin, one of the Oregon trusts' lawyers, said she hopes that her clients can recover all of their trusts' lost money by going after the defendants' personal assets and insurance. The trustees have spent more than \$ 100,000 in union funds on their team of lawyers and private investigators.

The potential claims against the professional advisers become important to the trusts and union members because Grayson has lost his company and it's unclear how much money he has independent of that.

Grayson submitted to the federal court on Dec. 1 a statement of his remaining assets, which did not reveal much. The statement listed assets of \$ 4.4 million and liabilities totaling \$ 23.6 million. However, the statement failed to value many of Grayson's assets and lumped together both his real and contingent liabilities, such as personal guarantees on loans.

Wilson C. Muhlheim, a Eugene lawyer who filed Grayson's statement, acknowledged the statement assigned no value to most of his holdings while emphasizing his liabilities by including contingent as well as current debts. He said he will ask the court to let him submit a more informative financial statement under seal, where it would be accessible to the parties in the lawsuit but not to the public.

But Muhlheim insisted that Grayson's net worth is nowhere near what the plaintiffs might imagine. "Nothing is stashed away in the Cayman Islands," he said.

Barclay Grayson, former Capital Consultants president and also a defendant, listed assets of nearly \$ 2.2 million in a document filed with the court.

The union trustees are also taking dead aim at Wiederhorn and Mendelsohn, as well as their wives. The trustees' complaints detail what one described as the "undisclosed corrupt relationship between Grayson and Wiederhorn." The complaints alleges that the relationship included **bribes**, kickbacks and a protracted conspiracy to defraud the trusts.

As the Wilshire companies collapsed in 1999, a bankruptcy court wiped out the \$ 160 million debt. Grayson on behalf of Capital Consultants released Wiederhorn and Mendelsohn from their personal guarantees to repay it. The lawsuits allege that the Wilshire executives secretly had plied Grayson with personal financial favors to obtain millions from the trust funds.

Robert A. Shlachter, a Portland attorney representing Wiederhorn, chose not to answer the charges specifically. "We will try this case in the court, not the media," he said.

The personal net worth of Wiederhorn and Mendelsohn is difficult to gauge.

Wiederhorn, current chief executive officer of the Wilshire Real Estate Investment Trust Inc., and his family own \$ 2.3 million worth of stock or options in the Portland-based company. Wiederhorn's wife, Tiffany, also a defendant in the lawsuits, has been listed since Oct. 14, 1998, as owner of their \$ 3.6 million, 8,000-square-foot West Hills mansion, as well as a \$ 4 million beach compound in Gearhart.

Mendelsohn, Wiederhorn's second-in-command at Wilshire Real Estate, and his family own \$ 1.4 million in Wilshire Real Estate stock and options. Mendelsohn's

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wife, Joyce, is listed as the owner of a \$ 1.6 million home in Portland's Dunthorpe neighborhood and another house in Arizona valued at \$ 1.2 million.

By Jeff Manning and James Long

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