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# Missing music king loses his throne

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By David Lieberman, USA TODAY

NEW YORK — Anyone who's met Lou Pearlman can see he likes to live large.

The music impresario, who became famous by creating and managing boy bands including the Backstreet Boys and 'N Sync, enjoyed flaunting his Gulfstream V private jet, 2004 Rolls-Royce Phantom, Louis XIV bed and \$250,000 Rolex watch.

Most of these trappings of success are gone.

Instead of living large, Pearlman is *at* large.

Florida's Office of Financial Regulation says it hasn't been able to reach him since he left the country in January, two months after one of his oldest friends committed suicide and as state and federal officials swarmed in on what could be one of the biggest fraud cases in Florida history.

They believe that Pearlman, 52, created a Ponzi scheme that milked about \$317 million from more than 1,400 individual investors and an additional \$150 million from banks.

Pearlman got investors to put money into what he is accused of billing as a secure, interest-bearing savings fund. But he didn't reinvest their cash in profit-making ventures, the Florida Office of Financial Regulation said in a circuit court filing.

The filing alleges that he pocketed much of the money and often hid the fact by shuffling money among dozens of companies he controlled, including his best-known firm, Trans Continental Enterprises.

Investors had no way to know. When they needed to make a withdrawal, according to court documents, he'd pay them — with cash from new customers.

"We did bank analyses for a three-year period and confirmed that \$150 million went somewhere other than where it should have gone," says Bob Rosenau, chief of financial investigations for Florida's Office of Financial Regulation.

The scheme came apart in the fall. A state circuit court in February put Pearlman's odd collection of entertainment and travel companies into the hands of a receiver who's looking for assets to use to repay investors and creditors.

To date, no government agency has charged him with a crime.

But the Justice Department, IRS and Federal Deposit Insurance Corp. are considering actions they can take against Pearlman or to help the investors. In mid-February these agencies, armed with search warrants, raided his home and business offices.

Some lenders have asked a U.S. bankruptcy court to put Pearlman and several of his Trans Continental companies into involuntary bankruptcy. It may be too late.

"Short of Lou Pearlman showing up and saying, 'I did take \$100 million, and it's in a bank account in the Caymans,' I don't see much in the way of hard assets that are worth anything or are not already fully encumbered" with debt, says Gerard McHale, the court-appointed receiver.

**Investors may be out of luck**

The consequences could be tragic for some individual investors.

"We represent some disabled vets, and this is everything they made in the world," says lawyer Bob Persante, a partner at Persante & McCormack, who represents eight of Pearlman's individual investors. "They pumped it in there, and it's gone. And where did it go? To his 16,000-square-foot house and other ventures."

While officials can't reach Pearlman, he sent a letter to the *Orlando Sentinel*, published on Feb. 4, saying he was in Germany promoting a new boy band, US5. He wrote that he wouldn't comment on the investigation, but "My executive team and I are working hard to resolve the issues."

E-mail to Pearlman and an assistant was not answered.

In early March, he told German teen magazine *Bravo* that he's eager to prove his innocence.

Still, it's hard to imagine how Pearlman can ever regain the stature he enjoyed just a few years ago.

"There was a time when he was king of the music business," says Strauss Zelnick, a partner at media holding company ZelnickMedia and former CEO of BMG Entertainment.

In addition to his late 1990s success with the Backstreet Boys and 'N Sync, Pearlman developed in 2000 one of the first prime-time talent shows, a contest that aired on ABC called *Making the Band*.

For the back cover of his 2003 book, *Bands, Brands, & Billions: My Top 10 Rules for Making Any Business Go Platinum*, pop stars including Lesley Gore, Gary Wright, Jose Feliciano and Harry Wayne Casey (KC of KC and the Sunshine Band) offered glowing tributes.

No one was more effusive than his famous cousin Art Garfunkel, who said Pearlman's "decency and his love of having fun at life earned him my trust many years ago."

Growing up in Queens, N.Y., the son of a partner in a dry-cleaning business, Pearlman liked to cast himself as an entrepreneur who lived the American dream.

After odd jobs at airports, he says in his book, he devised a low-cost way to lease helicopters to shuttle executives the 10 miles between Manhattan and their company planes at New Jersey's Teterboro Airport.

He used the profits to build a charter-jet service, Trans Continental Airlines, that, among other things, ferried stars including Paul McCartney, The Rolling Stones, Michael Jackson and Madonna to and from concerts. He says he hit on the idea of creating boy bands — typically, five good-looking guys who can harmonize and dance — after transporting New Kids on the Block and seeing how much money they made.

But when the Backstreet Boys, 'N Sync and others of his acts established success, they frequently went to court to challenge the control he wielded and cash he took while acting as both their manager and producer.

When his control of the bands ended, so did his winning streak. *Making the Band* fell off the ABC schedule after one season, although it survived two more years on MTV. Pearlman didn't follow through on a plan with Zelnick in 2002 to create bands that would take on the identities of comic-book characters The Archies and Josie and the Pussycats. At least one was to be prepped for a TV series similar to *The Monkees*.

That same year, he bought Options Talent, a scandal-plagued firm that offered to help talent agents find modeling and acting clients using the Internet. It filed for bankruptcy protection a year later.

"It doesn't appear that any of these businesses, especially after 'N Sync and the Backstreet Boys, were profitable," McHale says.

Few could tell, though, until recently.

For example, in 2003, Orlando promised Pearlman loan guarantees and tax breaks for buying a majority stake in a venture trying to revitalize Orlando's historic Church Street Station district. He vowed to create a bustling commercial and entertainment center out of the virtual ghost town left by developments at Disney's and Universal's theme parks. He moved his offices to the district and promised to build a state-of-the-art recording studio.

Where did he score the cash?

Florida's Office of Financial Regulation says in its court document that for at least 15 years he was luring customers to deposit cash in a program at his charter air service that set up what he called an Employee Investment Savings Account, or EISA.

The problem? "Nothing like that even exists," says Persante, the lawyer for some investors. "There's ERISA (an acronym for the federal Employee Retirement Income Security Act that guarantees pensions). But there is no EISA. But it sounds like ERISA, so it sounds like it's legitimate."

It looked like a great deal, too. Court filings say that Pearlman and his agents assured customers that their money was safe: the EISA was insured by the FDIC, Lloyd's of London or AIG insurance, they said. What's more, they said, it paid above-market interest rates.

"He didn't go crazy with the interest rate," Persante says. "He would give you 1% more than you could get in the market. It wasn't like all of a sudden someone was getting 17%, something ridiculous that would raise a red flag."

Although Pearlman and his agents told people that the plan was developed for employees, they flattered potential clients by telling them that they could get in as one of the highflying executive's friends.

To clients, the company and its account seemed to be doing well. They received quarterly reports audited by an accounting firm called Cohen & Siegel.

The thing is, the accounting firm was fake, according to the court filing. And their accounts weren't insured, by anyone. "Cohen & Siegel's Coral Gables (Fla.) office is actually the location of an answering service whose services were paid for in part" by Trans Continental Airlines "to receive, transfer and conceal investor funds," Florida's Office of Financial Regulation told a state circuit court in the filing asking it to turn Pearlman's businesses over to a receiver.

### **The early signs**

Even before officials made the findings of their investigation public, cracks were appearing in Pearlman's empire. The Church Street project missed construction deadlines, and the onetime music mogul failed to file required financial reports with the city. Orlando officials warned that they might have to call back the city's loans or withdraw tax breaks.

All eyes turned toward Pearlman in November when Frankie Vasquez Jr., one of his most-trusted aides, committed suicide. He and Pearlman had grown up in the same apartment building; Pearlman babysat Vasquez, who was seven years younger. They became lifelong associates, with Vasquez becoming, as Pearlman wrote, "an invaluable part of my business."

Among other things, Vasquez had been a managing partner at several Church Street businesses, including a steakhouse, a cafe and a cigar-and-wine club.

McHale, the court-appointed receiver, speculates that Vasquez became despondent because he discovered "what was actually going on at Church Street, that it's a scam. Like most scams, Mr. Pearlman appears to have run a very good silo program. Each segment of the company only knows what it needs to know. And there's only one person that has the key to opening the scam, and that's him."

### **A fast collapse**

After Vasquez's suicide, Pearlman's silos began to quickly collapse. The Florida Office of Financial Regulation publicly confirmed its ongoing investigation of Pearlman's empire. By the end of November, Pearlman's EISA stopped withdrawals.

The Pearlman entity that owned the Church Street project filed for bankruptcy protection in February. Developer Cameron Kuhn bought it for \$34 million in a bankruptcy auction April 5. That likely will mean little to EISA investors who are out their money. The property has about \$33 million in debt.

Now, the music has died in what Pearlman used to call O-Town — his name for Orlando and a name he also gave one of his bands. Officials are trying to figure out what they can do. And angry investors are looking for people to blame.

Rosenau, the financial investigator, says the experience simply underscores a lesson people should have known before the Trans Continental disaster.

"This case clearly illustrates the risks of investing without fully researching the investment opportunity," Rosenau says. "Check before you invest."

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