By Emily Thornton

Looking Out For Number One

The private-equity gold rush is encouraging some fund executives to cross the line. While cases of fraud at private equity firms are rare, some schemes are outright brazen. Consider the case of John A. Orecchio. On Sept. 8, the Securities & Exchange Commission charged the 40-year-old president and co-owner of AA Capital Partners Inc. and the firm with fraud, alleging that at least $10.7 million had been misappropriated from pension-fund investors.

Chicago's AA Capital Partners carved out a small but comfortable niche in the world of private equity. The firm manages $194 million for six unions. When Orecchio asked clients to put $68 million in trust accounts to be used at the firm's discretion for "capital calls," it appeared to be business as usual.

But law enforcers allege much behind-the-scenes malfeasance. A total of $5.7 million was allegedly diverted from clients' trust accounts between May, 2004, and October, 2005. Some of that went to a horse farm in Michigan and a company that manages a strip club in Detroit, both of which were owned by Orecchio. He allegedly described the money to his chief investment officer as "reimbursements" for what he claimed was a miscalculation of taxes, and the CFO carried out the money transfers. The SEC alleges an additional $5 million in client funds was used to cover a shortfall between the firm's revenues and operating expenses.

The SEC asked a judge to appoint a lawyer to take control of AA Capital. The lawyer has since brought in forensic accountants to comb through AA Capital's records. Among the items: $4.3 million in travel and entertainment expenses that Orecchio racked up in 2006, $1 million of which appeared to be routed to interest groups such as the Michigan Democrats and Citizens for Greater Detroit. Hundreds of thousands of dollars went to private-plane rentals and visits to nightclubs in Las Vegas.

"We know how much [money] is left," says the court-appointed lawyer, W. Scott Porterfield, although he declines to reveal the amount. The more complicated question, he says, is to what extent investors' money was commingled, devoted to Orecchio's many personal expenses, or disguised as "capital calls." Through his lawyer, Orecchio declined comment.

AA Capital Partners isn't the only one tainted by fraud charges. In June, 2005, Todd Berman, a founder and partner of the New York private-equity firm Chartwell Investments, began serving a five year sentence in a Pennsylvania prison for stealing more than $3.6 million from the firm, its portfolio companies, and its investors. Berman pleaded guilty to fraud charges brought by the Justice Dept.

For 18 months, Berman misled Chartwell's investors concerning the financial condition of one of the firm's portfolio companies by falsely claiming it needed to borrow funds to meet operating expenses. Instead, Berman transferred the money to his personal bank account, along with fees paid by portfolio companies. Berman also charged some 600 personal expenses to the companies and the firm, many of which were incurred while he was on vacation. They included a private-jet bill for $78,795 for a trip to South Africa and an $80,468 bill for a trip to Antigua, according to the Justice Department Berman could not be reached for comment. Chartwell Investments declined comment.