Citation Search Result Rank 31 of 145 Database
10/18/97 LANCNE A1 NEWSWORLD-PRO
10/18/97 Lancaster New Era - Lancaster PA A1
1997 WL 17637789

Intelligencer Journal Lancaster, PA

Very critical story

Saturday, October 18, 1997

NEWS

Schools try to untangle financial web of deceit // County districts seek to recover $17 million in investments
Paul Bomberger

Last summer, Warwick School District officials canvassed banks and brokerage houses to see where they could get the best interest rate for a one-year investment.

Warwick had $2.1 million to invest. The money, borrowed from Dauphin Deposit Bank, represented the district's anticipated tax revenues next year. Warwick could invest it until the district started collecting 1998-99 taxes next July.

By borrowing against pending tax revenues at a 4.2 percent interest rate last July, the district could invest the $2.1 million at a higher rate and pocket the difference next July.

Devon Capital Management Inc. of Tyrone, a money management and advisory firm run by registered investment adviser John Gardner Black, offered Warwick the best return: 6.01 percent, meaning $128,100 in interest for one year.

The district never invested with Devon before, but other districts and brokers highly recommended the firm, citing its experience handling investments for public schools.

"I never met the man (Black) personally, but just in checking out their (Devon) credibility with other schools, the list of clients they used and also recommendations of others ... said they're a viable outfit," Warwick business manager David L. Zerbe said this week.

On July 1, Warwick wired the $2.1 million to a bank account Devon had set up for school district clients at **Mid-State** Bank in Altoona, a subsidiary of Harrisburg-based Keystone Financial Inc.

Warwick expected to be left with an annual gain of $39,900 next June 30, after using interest income from its one-year investment to pay $88,200 in interest on its short-term loan from Dauphin Deposit.

But in September, just two months after placing the money with Devon, Warwick was hit with a bombshell.

The Securities and Exchange Commission sued Black and his two investment firms - Devon and its affiliate, Financial Management Sciences - in federal court, alleging Black lied to and stole from 56 school districts statewide.

Now Warwick isn't sure if, or when, it can expect to recover its $2.1 million investment. And two other Lancaster County school districts are scrambling to get back the nearly $15 million they invested with Black, money that has been frozen as officials investigate the alleged fraud.

Penn Manor invested $3.5 million, and the School District of Lancaster invested $11.3 million.

A routine SEC audit revealed $71 million was missing of the $233 million Black invested and managed for the school districts.

The SEC alleges Black, 53, a former financial adviser to former Gov. Milton Shapp, devised a complex financial transaction to conceal investment losses from the schools and used more than $3 million of the money to pay his business and personal expenses.

It's believed to be the largest financial fraud perpetrated against public schools in Pennsylvania. So far, no criminal charges have been brought against Black, but FBI and IRS agents obtained a search warrant recently and seized financial data from his offices in Tyrone, Harrisburg and Pittsburgh.

***

The school districts are now in a jam. At the SEC's request, a federal judge on Sept. 26 put a temporary freeze on all the assets under Black's management to protect the funds.

Meanwhile, a trustee appointed by the court, former Gov. Richard Thornburgh, is examining Black's records to determine precisely how much of the schools' money is missing and what remains.

Thornburgh has enlisted the help of Price Waterhouse to audit Black's transactions with the districts.

Thornburgh assured representatives of the schools Oct. 3 the districts had done nothing wrong by investing with Black. Gov. Ridge has formed a task force to study the impact of Black's fraud on the state's school districts.

At the same time, the SEC continues its probe, pointing toward an Oct. 27 court hearing, where U.S. District Judge D. Brooks Smith must decide whether to lift the freeze on the schools' funds.

"We don't know the full scope and extent of his (Black's) fraud," Ronald Long, head of the SEC's Philadelphia office, said, indicating the SEC will ask the judge to keep the assets frozen.

Penn Manor and Lancaster school districts tried a legal maneuver last week to get access to their money. They are two of seven districts who used Black as an investment adviser, but placed their money in a separate custodial account at Dauphin Deposit Bank.

This meant Penn Manor and Lancaster's money wasn't mixed with the money from the 49 school districts whose funds Black held together in one custodial account at **Mid-State** Bank.

Lancaster lawyer Bill McCarty said Smith rejected an attempt by Penn Manor and Lancaster for release of their money. The judge did say he would reconsider the request later, then issued a separate ruling ordering the SEC to file legal papers by Friday in response to the issues raised by Penn Manor and Lancaster.

Penn Manor

Although seven districts had their investments in separate accounts at Dauphin Deposit, Long said Black had "control or access" to the money. For that reason, SEC investigators believe the seven districts could have been defrauded by Black the same way the other districts were; therefore, their money should be frozen until investigators get to the bottom of Black's scheme.

***

In court papers, the SEC alleged Black started bilking the schools in 1995. The investments Black made with the districts' funds had begun losing money. He allegedly covered that up by sending false investment statements to the schools.

To try to make up the money he lost, the SEC alleges, Black purchased a collateralized mortgage obligation security, called an "inverse floater," from the Federal National Mortgage Association (Fannie Mae). Then, Black overvalued its worth on Devon's financial books.

The SEC said the floater Black purchased with the schools' money is a bond with a $12 million to $14 million value now but would be worth $83 million in the year 2023.

Black's investment statements sent to the schools reflected the future value of the bond as a way to hide up to $71 million that disappeared from their investments.

Furthermore, the SEC alleged Black ignored required annual audits by an independent public accountant for fear his present overvaluation of the "inverse floater" would be discovered.

Notwithstanding the fraudalent financial scheme the government has accused Black of concocting, Penn Manor and Lancaster school district officials said their money is safe, because the principal invested and the interest was held at Dauphin Deposit Bank, separate from the large pool of money Black held in a custodial account at Mid-State Bank for the other districts.

"He never had access to our money," Penn Manor Superintendent Michael Moskalski said of Black. "He was more of an (investment) adviser for us. As soon as we invested, the money went to Dauphin Deposit.

"Since the beginning, Dauphin has all our money," Moskalski said. "That differentiates us from the others. Whether that makes a difference, we don't know yet. We think it does."

Penn Manor has $3 million left in its Dauphin custodial account managed by Black. In March 1996, the district invested $20 million of proceeds from bonds sold to pay for its $30 million high school renovation.

Since then, Penn Manor has withdrawn $17 million from the Dauphin account to pay construction contractors for the high school project, which is almost finished. As long as the $3 million is frozen in the Dauphin custodial account, Penn Manor will have to delay paying its contractors, district officials said.

***

Likewise, Lancaster school district invested $14.8 million last March in proceeds from bonds sold to pay for construction at McCaskey High School. Just as Warwick did, Lancaster chose Black as an investment adviser because he promised the best return: 5.8 percent to Lancaster.

Robert A. Schoch, the district's business manager, said $11.3 million of the money remains safe in a custodial account at Dauphin bank to pay construction bills.

But that money is frozen, forcing Lancaster to pay its construction bills from the district's general fund, Schoch said.

When the freeze is lifted, the bond fund will reimburse the general fund.

If the court blocks Lancaster from withdrawing any of the $11.3 million for three or four more months, the district will have to borrow money to continue paying its construction bills, Schoch said.

While Penn Manor and Lancaster school district officials are confident they will emerge unscathed from Black's financial problems, Warwick officials can't be certain.

They feel they were betrayed.

"Absolutely, we were defrauded, put it that way," Zerbe, Warwick's business manager, said. "If all the documents given to us (by Black) and transferred to us in good faith were in fact incorrect, then that's a case of fraud. That's something you can't know or anticipate in a case like this."

For example, Warwick officials were led to believe they had a custodian agreement with **Mid-State** Bank when, in fact, the agreement was only between Devon Capital and **Mid-State**, a bank official said.

Lana Burkhardt, marketing director for asset management for **Mid-State** and other affiliate banks owned by Keystone Financial Inc., said **Mid-State's** job was to preserve the assets placed by Devon at the bank and make sure "nobody other than Devon" touched the assets.

Burkhardt stressed the bank's client was Devon, and not the school districts that invested with Devon; the bank simply held assets for the investment firm. Upon approval from Thornburgh, **Mid-State** Thursday began mailing copies of the custodian agreement it had with Devon to the 56 school districts involved.

Also, Black told Warwick officials he would invest the district's money in only U.S. government securities, the safest investment vehicles. But Long said the SEC isn't sure he kept his word.

***

Warwick officials said they plan to do whatever it takes to get all their money back.

John R. Bonfield, Warwick's superintendent, said the district may have to force other districts to forfeit money Black paid them with new funds invested by other schools and go after **Mid-State** Bank, whom the district believes should have protected Warwick's $2.1 million investment. X

"If the money is missing ... the case gets to be **Mid-State** was our custodian, and we need to initiate an action against **Mid-State** and their holders ... in terms of making this good, because they were operating as a custodian of the account," Bonfield said.

Zerbe said Warwick doesn't have a budget surplus to cover the $2.1 million, if the money is lost and the district gets nothing back.

He and Bonfield said Warwick is exploring its options should that occur, but it's too early to speculate if that could involve a tax increase to cover such a loss.

"It's going to be our goal to see to it that the district doesn't suffer any loss," Bonfield said.

--Intelligencer Journal staff writer Alyssa Roggie contributed to this story.

---- INDEX REFERENCES ----

KEY WORDS: SCHOOL; BOARD; FINANCE; BANK; FRAUD; TAXES

Word Count: 1778
10/18/97 LANCNE A1
END OF DOCUMENT