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STATE

DISTRICTS WARNED ABOUT BLACK THE SUPERINTENDENTS OF THE TWO DISTRICTS COULD NOT
RECALL BEING WARNED BY CASEY'S OFFICE.
MIKE BUCKSKO, POST-GAZETTE STAFF WRITER

Two school districts that invested funds with a Blair County financial adviser who is accused of fraud were warned last summer that their investments violated the state School Code, Auditor General Robert P. Casey Jr. said yesterday.

The warnings were issued orally just weeks before the U.S. Securities and Exchange Commission shut down the operations of John Gardner Black and his two companies, Devon Capital Management Inc. and Financial Management Sciences Inc.

The SEC has charged that Black, 53, of Tyrone, misappropriated \$71 million from 75 school districts between January 1995 and July. The agency padlocked his businesses and froze his personal and business assets while moving to obtain sanctions against him and to bar him permanently from involvement with securities.

The SEC filed suit against Black on Sept. 26, about six weeks after a surprise audit had uncovered the reported fraud. In July and August, state auditors found what their attorneys consider a violation of the School Code, Casey said.

He said yesterday during testimony before a Senate panel that there was little his office could do but issue the warnings, because state law permitted little else.

"We have very little authority to root (fraud) out and virtually no authority to do something about it," Casey told the Senate Democratic policy committee.

He was the first of six witnesses who appeared before the panel during a daylong hearing in Oakland. Other witnesses included the superintendents of the districts audited last summer by Casey - Joseph Marasti of the Penn-Trafford School District and William Miller of the Tyrone Area School District.

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Marasti and Miller said they did not recall any warning from Casey's office.

The 75 school districts that invested \$233 million with Black did so through a Black creation called a collateralized investment agreement. The agreement guaranteed the districts a certain rate of return on their investment and that the investment proceeds would be fully collateralized.

Casey's legal advisers contend that the agreement violated the School Code because it took from school districts control over their investments. Under the code, districts can invest directly in securities which they own or invest indirectly by buying shares in another company, said Richard Spiegelman, Casey's chief counsel.

The agreement with Black also allowed him to invest the money from the school districts through Financial Management Sciences, which became the custodian of the money, unbeknownst to the investors. The SEC has charged that Black violated federal regulations by his failure to disclose to investors his interest in both Devon and FMS.

Many of the questions from the senators on the panel concerned what school districts could have done to prevent the fraud. Black kept investors in the dark about the fraud by including false financial statements indicating that their investments were safe, according to the SEC.

Casey and lawyer Ira Weiss, a former Allegheny County solicitor who has extensive experience in municipal bond issues, testified that there was little the districts or the auditor general's office could have done to uncover the fraud before it was found by the SEC.

"If what the SEC says is true, what happened here was fraud and no provisions of the School Code could have rooted that out," Casey said.

As a school solicitor, Weiss said he advised several school districts not to invest with Black. All but one took his advice, he said.

School officials across the state have said they were attracted to Black and Devon because they promised the highest rate of return on their investments. Weiss said Black managed to entice investors by a combination of "insufficient disclosure and unrealistic promises."

"If something appears too good to be true, it probably is," Weiss said. "This was too good to be true."

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Most of the money invested with Black was proceeds of bond issues passed to build or remodel schools.

Penn-Trafford began investing with him six years ago as it started a construction program to keep up with growth in the Westmoreland County district, Marasti said. Out of a total \$26.7 million investment, the district has received back all but about \$330,000 so far, he said.

Most of the money was withdrawn to pay off construction debts as they came due, Marasti said.

The Tyrone Area School District is in the opposite position.

Tyrone not only invested \$21.2 million in bond proceeds for construction, it invested \$1.06 million from its general fund, nearly \$3 million from its capital reserve fund and another \$1 million in loan proceeds. All of that money was frozen when the SEC moved on Black, but Tyrone is expected to receive \$7.3 million from its investment as part of an emergency distribution approved by U.S. District Judge D. Brooks Smith a week ago, Miller said.

The \$7.3 million, coupled with a \$2.7 million subsidy from the state Department of Education, will allow the district to pay its bills until May, he said. However, the district could end up losing \$12 million if the SEC's calculations are correct, Miller said.

The 2,200-student district, about 30 miles west of State College, draws from a poor, rural area, he said.

"We stand to take a \$12 million hit," Miller told the Senate panel. "We cannot survive."

Tyrone, like virtually every other district that invested with Black, hired an outside attorney to pursue its remedies with the SEC. The district has already spent about \$30,000 in legal fees and will spend much more, Miller said.

In a separate development, Smith recused himself Friday from the case, citing a conflict because his wife is an officer with Mid-State Bank, the Altoona-based bank in which Black deposited the majority of proceeds from investors.

Karen Smith is a vice president of the bank and is involved in Mid-State's lending department, bank spokeswoman Lana Burkhardt said.]

Smith, who travels between Pittsburgh and Johnstown, was handling Black's case in Johnstown. U.S. District Court Judge

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Donetta W. Ambrose has been assigned the case and will move all of the hearings to Pittsburgh.

In his order, Smith wrote that a "significant portion of the assets" in the case were in the custody of ~~Mid-State~~ and that it was likely that the bank "will figure prominently in this litigation through the production of documents and the need for certain of its officers to appear as witnesses."

Burkhardt said Karen Smith had no connection with any of the dealings with Black's companies.

In a related development, the North Hills school board decided last night not to accept \$9.3 million offered by the SEC and the trustees in the case because it would have been required to give up its legal standing to recover the entire \$18.6 million in district funds that were frozen in the case.

The district would have had to agree to a continuation of the temporary restraining order that froze the funds Sept. 26 if it accepted the \$9.3 million, district solicitor Michael Witherel told the board.

"It's economic blackmail, telling us they will give us half the money if we sign off on the right to ask for a hearing on the case," Witherel said. "We're not going to take the \$9.3 million with strings attached. We're going to request that we be granted a hearing as soon as possible."

The district had previously filed a motion for a hearing, saying its funds were frozen illegally because they were never in Devon's pooled asset fund.

Witherel filed a motion Oct. 6 seeking relief from the SEC's freezing of the money. The district has not been granted a hearing to date. It will file a new motion with Ambrose tomorrow requesting one.

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