IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

SECURITIES AND EXCHANGE COMMISSION 450 5th Street, N.W. Washington, D.C. 20549 Plaintiff, v. JOHN GARDNER BLACK, DEVON CAPITAL MANAGEMENT, INC., and FINANCIAL MANAGEMENT SCIENCES, INC., Defendants.	CIVIL ACTION NO. 97-265J

COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission") alleges for its Complaint the following:

1. This matter involves an on-going fraudulent scheme perpetrated by John Gardner Black ("Black") through two entities he controls: Devon Capital Management, Inc. ("Devon"), a Pennsylvania-based registered investment adviser, and Financial Management Sciences, Inc. ("FMS"), an affiliate of Devon's. This scheme has resulted in the loss of millions of dollars of municipal bond proceeds invested by school districts throughout western and central Pennsylvania.

2. Devon, acting through Black, manages approximately $345 million in assets for approximately 100 investment advisory clients, the vast majority of which are local school districts which are seeking to invest the proceeds of municipal bond

offerings. Black has invested approximately $233 million of these funds, on behalf of local school districts, in a form of investment called a Collateralized Investment Agreement ("CIA").

3. In promotional materials, Devon represented to these school districts that the CIA is an investment which pays a specified rate of return to clients over a fixed period, and which is fully protected or collateralized by a pool of securities equalling the amount of the client's principal investment. Contrary to Black's representation, the Devon advisory clients who have invested in the CIA program have suffered a combined loss of their principal investment of approximately $71 million.

4. In an effort to conceal this loss of principal from the school districts that have invested in the CIA, Black has misrepresented to them the value of the assets held as collateral, overstating the actual value of those assets by approximately $71 million.

5. Black has continued to accept new clients for investment into the CIA program without disclosing to these new clients that, as a result of the shortfall in the funds already under management, any funds that the new clients invested into the CIA program would be immediately diluted by as much as 45 percent. Devon must continue to attract new funds for investment in the program, in order to fulfill its entire obligations to current advisory clients in the CIA program.

6. Black, Devon and FMS have benefitted financially from this fraudulent scheme. From January 1996 through August 1997, at least $2 million of school district funds were used to pay for the defendants' personal and business expenses.

7. Defendants Black, Devon, and FMS, directly or indirectly, have engaged, and unless restrained and enjoined by this Court, will continue to engage in acts, transactions, practices, and courses of business which violate Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, thereunder.

8. Defendant Devon, aided and abetted by defendant Black, directly or indirectly, has engaged, and unless restrained and enjoined by this Court will continue to engage, in transactions, acts, practices, and courses of business which violate Sections 206 (1), (2) and (4) of the Investment Advisers Act of 1940 ("Advisers Act"), 15 U.S.C. 80b-6(1), 80b-6(2) and 80b-6(4), and Rule 206(4)-2, 17 C.F.R. 275.206 (4)-2, promulgated thereunder.

9. The Commission brings this action pursuant to Section 20(b) of the Securities Act, 15 U.S.C. 77t(b), Sections 21(d) and 21(e) of the Exchange Act, 15 U.S.C. 78u(d) and 78u(e), and Section 209(d) of the Advisers Act, 15 U.S.C. 80b-9(d), to enjoin such acts, transactions, practices and courses of business, and for other equitable relief.

10. Certain of the acts and practices constituting the violations alleged herein occurred within the Western District of Pennsylvania and elsewhere, and were effected, directly and indirectly, by making use of the means and instruments of transportation or communication in interstate commerce, or the means and instrumentalities of interstate commerce, or the mails.

11. This Court has jurisdiction over this action and all parties hereto pursuant to Section 22 of the Securities Act, 15 U.S.C. 77v, Sections 21 and 27 of the Exchange Act, 15 U.S.C. 78u(e) and 78aa, and Sections 209(d) and 209(e) of the Advisers Act, 15 U.S.C. 80b-9(d) and 80b-9(e).

THE DEFENDANTS

12. **Devon Capital Management, Inc.** is an investment adviser which has approximately 100 investment advisory clients and $345 million in assets under management. Devon's primary office is located in Tyrone, Pennsylvania with additional sales offices in Harrisburg and Pittsburgh, Pennsylvania. Devon has been registered with the Commission as an investment adviser since December 1989.

13. **John Gardner Black**, age 53 and a resident of Pennsylvania, is the president, portfolio manager and sole owner of Devon and defendant FMS. Black makes all investment decisions for Devon.

14. **Financial Management Sciences, Inc.** is an affiliated entity of Devon. FMS shares office space with Devon, and is wholly owned by Black. Pursuant to agreements with Devon, FMS

holds the money and securities of Devon's investment advisory clients and pays Devon a fee for managing those assets.

FACTS

Background

15. Devon provides what it describes as cash management services to approximately 75 local government units ("LGUs" or "clients"), primarily school districts located in rural communities in western and central Pennsylvania.

16. Devon, acting by and through Black, requires each LGU that uses its investment advisory services to enter into an investment advisory agreement with Devon ("LGU Advisory Agreement") under which the LGU gives Devon full discretion to invest the funds raised by the LGU from the public through bond offerings.

17. Pursuant to the LGU Advisory Agreements, Devon agrees to use the proceeds of the bond offerings to purchase only investments authorized by Pennsylvania law. The LGU/client agrees to pay Devon a monthly fee based on an annual rate ranging from 12 to 25 basis points (.12%-.25%) of the average month-end balance of the assets under management.

18. The LGU Advisory Agreements specifically state that Devon will not take custody of LGU/client funds. However, the Advisory Agreements provide that Devon may direct the LGU/client to enter into certain transactions with a Devon affiliate, FMS, which Devon states is primarily owned by Devon shareholders. In fact, Devon and FMS are both wholly owned by Black.

19. In promotional materials sent to potential clients/LGUs, Devon touts its years of experience providing investment advice to local governments, especially school districts, and promises to provide clients with "a high level of investment performance."

20. Devon has never obtained an independent audit of the assets invested in the CIA program on behalf of its advisory clients.

The Collateralized Investment Agreement

21. Devon, acting by and through Black, has invested $233 million of the approximately $345 million under Devon's management in a form of investment contract called a Collateralized Investment Agreement ("CIA"). The CIA is an agreement between Devon, on behalf of each LGU/client, and FMS, pursuant to which FMS guarantees a fixed rate of return specified in the LGU Advisory Agreement.

22. According to the CIA, FMS agrees to secure or collateralize each LGU's principal by securities having a fair market value equal to 100% of the investment in accordance with Pennsylvania law.

23. The CIA provides that Devon and FMS will mark the underlying securities to the market on a weekly basis in order to ensure that adequate collateral is being maintained. (A security is "marked to the market" by determining its current value based on current market prices for that security).

24. Each CIA is for a fixed time period, usually two years.

During the term of the CIA, Devon distributes back to each LGU/client a portion of their principal in accordance with a draw schedule attached to the CIA. The last principal payment terminates the CIA. However, each LGU/client is entitled to a return of its full principal investment upon written request made at any time prior to the expiration of the CIA.

25. The CIA provides that Devon will effect the transfer of the LGU's funds to FMS through a "Custodial Account" maintained at Mid-State Bank and held in the LGU's/client's name. FMS then deposits the LGU's funds into an account maintained in FMS' name ("Main Account") at the same bank, where they are pooled with funds invested by all of the LGUs participating in the CIA investment program. Black has signatory authority over the Main Account and the Collateral Account.

26. Pursuant to the terms of the CIA, Devon agrees to purchase only authorized investments with these pooled funds, whereupon FMS places the investment securities into another FMS account, the "Collateral Account." This account holds securities which are maintained as collateral for the benefit of Devon's LGUs/clients who are invested in the CIA program. When interest payments and draws are to be made to individual LGUs, payments are made from the pooled assets, either directly from the Collateral Account to the LGU or from the Collateral Account to the Main Account and then to the LGU.

27. Seven of the advisory clients who have invested in the CIA have requested to hold their own securities (or collateral)

outside of the Collateral Account. In those instances, FMS and Black have allowed these LGUs to hold specified securities, purchased with the pooled funds from the Main Account, in separate collateral accounts held for the benefit of these LGUs.

28. When funds are generated by the securities in these separately-held accounts, the returns are transferred from the separately-held accounts, put into the Main Account and then distributed to all of the LGUs on a pro rata basis, at the rates specified in the LGU Advisory Agreements.

29. Devon has also entered into an advisory agreement whereby FMS grants Devon full investment discretion over funds invested with FMS in the CIA program. FMS has agreed to compensate Devon at an annual rate equal to 25 basis points (.25%), payable in monthly installments. At no time did Devon or Black disclose this fee arrangement to LGUs/clients participating in the CIA investment program.

The Fraudulent Scheme

The Concealment of Trading Losses

30. Beginning in at least January 1995 and continuing through the present, Black has incurred at least $50 million in realized trading losses in the Collateral and Main Accounts. Approximately 80% of these losses were incurred in 1995 alone. The effect of these losses is that the value of the securities being held in the Collateral Account is actually as much as a 45% less than Black has represented it to be.

31. Devon and FMS, acting by and through Black, have

concealed these trading losses from LGUs/clients by preparing and sending to them monthly statements which falsely represent that the LGU's/client's investment is fully collateralized.

32. Black also has provided false collateral reports to LGUs who have invested in the CIA program and who have requested statements reflecting the identity and value of their collateral.

Over-valuation of the Collateral Account

33. In an effort to conceal the trading losses and the deficit of principal in the Collateral Account, Devon, acting by and through Black, has substantially overstated to the LGUs/clients the value of a security purchased with pooled LGU/client funds and held in the Collateral Account. This security is a collateralized mortgage obligation in an interest-bearing form known as an inverse floater (hereinafter, "CMO"). The CMO is issued by the Federal National Mortgage Association with a maturity date of September 25, 2023 and was purchased by Black in January 1996 for approximately $14 million.

34. In calculating the value of the assets held in the Collateral Account, Black has valued the CMO at $83 million as of July 31, 1997. However, as of that date, the actual market value of the CMO was between $12 and $14 million.

35. By overvaluing the CMO in his calculation of the value of the assets held in the Collateral Account, Black has been able to maintain the appearance that LGU/client investments are safe and being marked to market on a weekly basis to ensure that they are maintained at 100% of fair market value, as required by the

CIA and state law. In fact, Devon and Black could not cover the collateral guarantee to preserve 100% of client investments if the portfolio of assets held in the Collateral Accounts were sold at this time.

Misrepresentations and Omissions

36. By concealing the trading losses and failing to disclose the deficit of principal in the Collateral Account, Devon has attracted new clients, which it needs to pay existing clients and fund its operations. In order to meet obligations to current LGUs/clients in the CIA program, Devon must continue to attract new funds for investment in the program. Devon has also retained existing LGUs/clients by lulling them into believing their investments are fully protected.

37. When soliciting new clients, Devon does not disclose that, due to the trading losses and deficit of principal in the Collateral Account, new clients' investments will be immediately diluted by 30 to 45 percent.

38. In addition, since 1996, Devon has received $185,000 in undisclosed advisory fees through its relationship with FMS. These fees are paid from LGU/client funds held in the Main Account and are in addition to the disclosed advisory fees that the LGUs pay directly to Devon pursuant to the LGU Advisory Agreement.

39. On at least two occasions, Black provided to school districts, for use by their auditors, false collateral statements in which he reported the inflated value for the CMO. These

statements purported to show that the LGUs' investments in the CIA program were fully collateralized when, in fact, they were not.

40. The foregoing misrepresentations and omissions were material.

41. Black, as the person who owned and controlled Devon and FMS, knew, or was reckless in not knowing, that the representations and omissions described in paragraphs 37 to 39 were materially false and/or misleading.

Misappropriation of LGU/Client Funds

42. From January 1996 through the present, Devon, FMS and Black have misappropriated a total of approximately $2 million of LGU/client funds invested in the CIA program in order to pay personal and business expenses. This $2 million figure represents payments made from LGU/client funds to benefit Devon, FMS or Black in excess of the fees that Devon is entitled to receive from the LGUs/clients pursuant to the Advisory Agreements. These uses of LGU/client funds were never disclosed to or authorized by Devon's LGU/clients who invested in the CIA program.

43. Between January 1996 and August 15, 1997, Black withdrew a total of approximately $1.2 million of LGU/client funds from the Main Account, which funds were used for the benefit of Devon, FMS and Black. For example, in September 1996, Devon, acting by and through Black, paid $400,000 from LGU/client funds to a former partner as part of a settlement in a lawsuit

filed against Devon. In addition, Black used LGU/client funds from the Main Account to pay Devon's and FMS's business expenses, including salaries and rent.

44. In addition to the $1.2 million, as part of the legal settlement, Black also transferred $600,000 of Treasury securities from the Main Account to a separate escrow account, established at Mellon Bank for the purpose of paying Black's former partner approximately $120,000 per annum for five years.

45. Black, as the person who owned and controlled Devon and FMS, knew, or was reckless in not knowing, that he was spending client funds without the authorization, knowledge or approval of those clients.

FIRST CAUSE OF ACTION

Violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder By Defendants Black, Devon and FMS

46. Paragraphs 1 through 45 are realleged and incorporated herein by reference.

47. From in or about January 1995 through the present, defendants Black, Devon and FMS, in connection with the offer, purchase and sale of securities, directly and indirectly, by use of the means and instruments of transportation and communication in interstate commerce, or the means and instrumentalities of interstate commerce, or the mails, or the facilities of a national securities exchange:

(a) employed devices, schemes and artifices to defraud;

(b) obtained money and property by means of, and made, untrue statements of material fact, and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and

(c) engaged in acts, transactions, practices, and courses of business which operated as a fraud and deceit upon offerees, purchasers and prospective purchasers of securities.

48. By reason of the foregoing, defendants Black, Devon and FMS have violated and, unless enjoined, will continue to violate Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, thereunder.

SECOND CAUSE OF ACTION

Violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-2 thereunder By Defendants Devon and Black

49. Paragraphs 1 through 48 above are realleged and incorporated herein by reference.

50. From in or about January 1995 through the present, defendant Devon, aided and abetted by Black, in connection with its business as an investment adviser, directly and indirectly, by use of the mains and the means and instrumentalities of interstate commerce:

(1) has employed, is employing and is about to employ devices, schemes, or artifices to defraud;

(2) has engaged, is engaging, and is about to engage in acts, practices, or courses of business which have operated, are operating and will operate as a fraud; and

(3) has engaged, is engaging, and is about to engage in acts, practices, or courses of business which are fraudulent, deceptive, or manipulative.

51. As described in this Complaint, defendant Devon, aided and abetted by defendant Black, deposited substantial amount of client funds and continues to deposit client funds in accounts controlled by Devon and Black. As a result, Devon had, and currently has, custody or possession of client funds.

52. As part of its fraudulent, deceptive or manipulative practice or course of business, defendant Devon, aided and abetted by defendant Black, failed to maintain client funds of which it has custody in accordance with the federal securities laws. Specifically, defendant Devon, aided and abetted by defendant Black, failed to conduct at least annual examinations by an independent public accountant to verify such funds.

53. Additionally, Devon, aided and abetted by Black, engaged in a fraudulent scheme whereby it obtained client funds for personal and business expenses, without the knowledge, authorization or approval of the clients.

54. All of Devon's acts which constitute these violations were carried out by Black who had knowledge of them.

55. By reason of the foregoing, defendant Devon, aided and abetted by defendant Black, singly and in concert, directly and indirectly, has violated, and unless enjoined, will continue to violate, Sections 206(1), 206(2) and 206(4) of the Advisers Act, 15 U.S.C. 80b-6(1), 80b-6(2) and 80b-6(4), and Rule 206(4)-2, 17 C.F.R. 275.206(4)-2, thereunder.

WHEREFORE, the Commission respectfully requests that this Court:

I.

Issue an injunction permanently restraining and enjoining defendants Black, Devon and FMS, their agents, officers, servants, employees, attorneys, and those persons in active concert or participation with them, directly or indirectly, singly or in concert, from violations of Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5, thereunder.

II.

Issue an injunction permanently restraining and enjoining defendants Black and Devon, their agents, officers, servants, employees, attorneys, and those persons in active concert or participation with them, and each of them, directly or indirectly, from violating, or aiding and abetting violations of, Section 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

III.

Issue an order directing defendants Black, Devon and FMS to disgorge all unlawfully obtained proceeds, together with prejudgment interest, derived from the activities set forth in this Complaint, in accordance with a plan of disgorgement acceptable to the Court and to the Commission.

IV.

Issue an order requiring defendants Black, Devon and FMS, and each of them, to pay civil penalties, pursuant to Section 20(d) of the Securities Act, Section 21(d)(3) of the Exchange Act, and Section 209(e)(1) of the Advisers Act, as a result of defendants' violations as set forth herein.

V.

Issue an order requiring defendants Black, Devon and FMS to account for all unlawful proceeds received as described herein.

VI.

Issue an order appointing a receiver to, among other things, act as an equity receiver over the assets of defendants Devon and FMS, to take and retain immediate possession, custody, and control of all assets and property and the books and records of original entry of these defendants; and to take all steps necessary to immediately secure and protect the assets and property of these defendants.

VII.

Order such other and further relief as this Court may deem just and appropriate.

Respectfully submitted,

Merri Jo Gillette PA Bar No. 37075
Michael J. Newman PA Bar No. 42816
Deborah E. Siegel
Carol I. Rosenblat

Attorneys for Plaintiff

SECURITIES AND EXCHANGE COMMISSION
The Curtis Center, Suite 1005E.
601 Walnut Street
Philadelphia, PA 19106
(215) 597-3100

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