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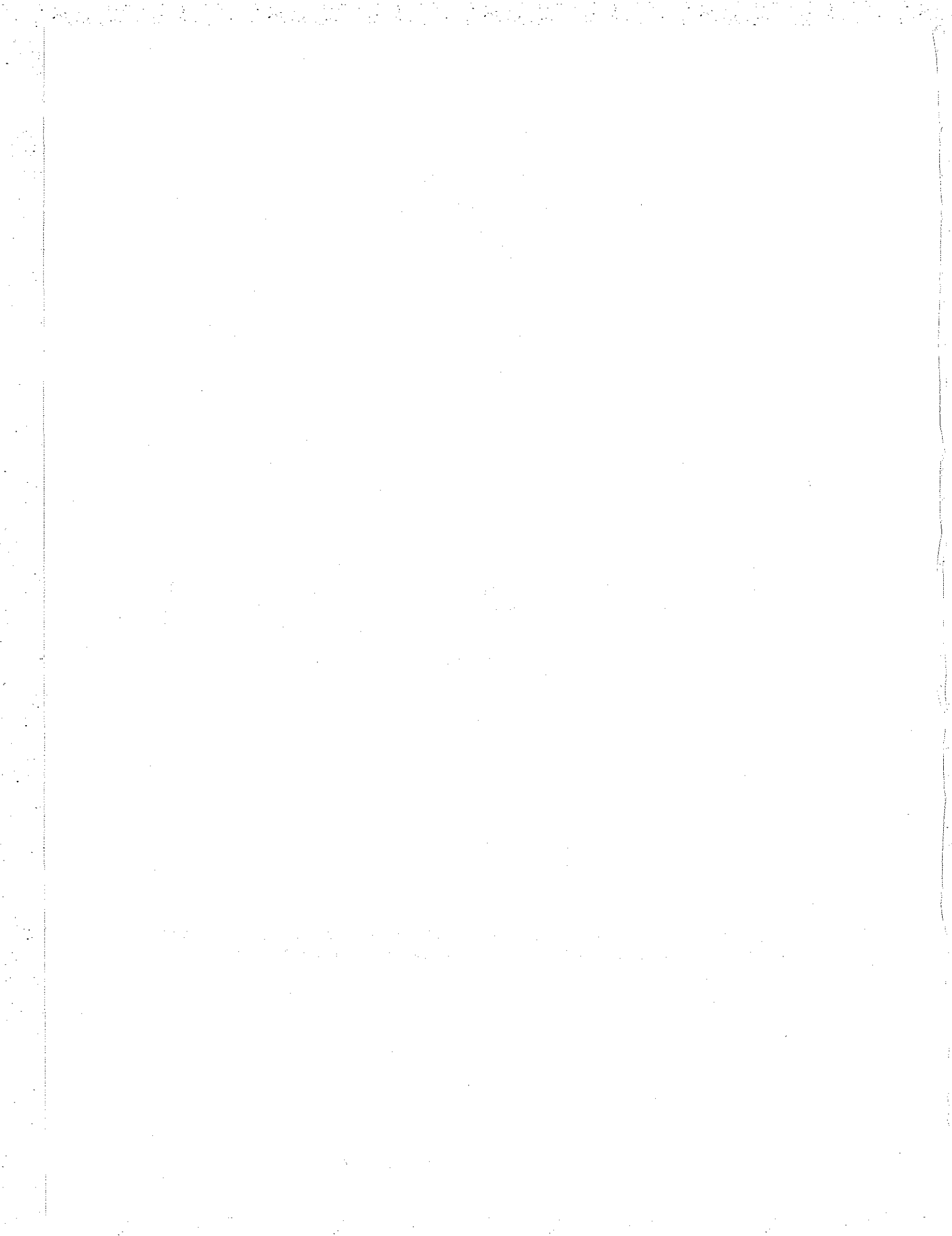
TO: The Governor and the Legislature  
of the State of New Jersey

The New Jersey State Commission of Investigation herewith submits its Report and Recommendations on its investigation of and public hearing on the Vernon Valley Recreation Association's leasehold in Sussex County. This transmittal is made under Section 10 of L. 1979, Chapter 254 (N.J.S.A. 52:9M-10), of the Act creating the Commission.

Respectfully submitted,

Arthur S. Lane, Chairman  
Henry S. Patterson, II, Commissioner  
Robert J. Del Tufo, Commissioner  
William S. Greenberg, Commissioner\*

\*Commissioner Greenberg did not participate in the investigation or public hearing because of prior professional associations.



CONTENTS

	Page
INTRODUCTION. . . . .	1
RECOMMENDATIONS IN BRIEF. . . . .	1
TESTIMONY - First Day (3-28-83) . . . . .	3
Opening Statement . . . . .	3
Terms of Lease Outlined/4	
First Probe of Man-Made Lake/7	
"No Permit Requested or Issued"/9	
State Forest Cut Down/13	
Land Misuse Dates Back to 1979/16	
Engineer's View on Construction/20	
Passing the Buck on Rent Withholding/21	
Lease Monitoring Duties Never Explained/31	
State Relied on Vernon Valley Accountant/39	
Vernon Valley Accountant's Version/42	
Were Ski Lessons Mandatory?/59	
Retracts Testimony on Lessons/60	
Lessons Voluntary and Cost Extra/61	
Best Customer Denies Lessons Requirement/62	
Another Client Denies Lessons Mandate/66	
No One Knew of Mandatory Lessons/67	
Revenue Diversion, Rent Withholding Traced/68	
TESTIMONY - Second Day (3-29-83). . . . .	75
Transition Statement. . . . .	75
Lease Problems Date Back to 1977-78/75	
Vernon Valley's Insurance Broker/85	
How Davis, Dorland Was Misused/95	
Recalls London & World Reinsurance/99	
CPA Testifies on London & World Assets/103	
He Signed as "Authorized Agent"/111	
London & World "Claims Department"/120	
CPA Confirms Insurance Was Inadequate/133	
State Labor Department's Role/138	
State Insurance Department's Role//145	
Tracing Mulvihill's \$175,000 "Premium" Check/148	
How \$175,000 Check was Disbursed/153	
SCI's Probe of London & World Assurance/161	
Surplus Lines Insurance Tax Problems/167	
Firemen's Relief Tax Payments Denied/183	
Further Firemen's Relief Fund Testimony/185	
State Firemen's Relief Association Comment/186	

TESTIMONY - Third Day (3-30-83) . . . . . 188

Transition Statement. . . . . 188

- Performance Bonds Faked/188
- Bonds Came From Mulvihill's Office/192
- "They Didn't Look Like Performance Bonds"/196
- The "Assistant Secretary of the Corporation"/201
- Handwriting Expert Testifies/204
- Who Was Michael Teschner?/207
- Vernon Valley Principals Refuse to Testify/214
- Passing the Buck on Lease Administration/214
- Chief Accountant's Financial Summary/221

Closing Statement . . . . . 225

RECOMMENDATIONS IN DETAIL . . . . . 227

Transmittal Notice. . . . . 227

Recommendations . . . . . 228

- Yearly Audits/228
- Establish State Insurance Safeguards/229
- Use Only State-Approved Insurers/229
- Centralize Lease Controls/230
- Enlarge DEP Staff Resources/231
- Add Criminal Penalties/232
- Terminate Vernon Valley Lease/232

STATE COMMISSION OF INVESTIGATION

Report on Public Hearing on  
Vernon Valley Recreation Association

Introduction

The SCI's public hearing on Vernon Valley Recreation Association (Vernon Valley), a ski resort and amusement park in Sussex County, was held on March 28-30, inclusive, in Trenton. The hearing focused on the administration of a lease by New Jersey's Department of Environmental Protection (DEP) with Vernon Valley and Vernon Valley's violations of the lease. At the conclusion of this hearing, the Commission publicly declared that the three days of testimony had revealed "marked evidence of wrongdoing" by the corporation as the lessee as well as "laxity and ineptness" on the part of State as the lessor.

This testimony confirmed nonpayment and tardy payment by Vernon Valley of hundreds of thousands of dollars in rents due to the State; the diversion by Vernon Valley of millions of dollars in income from the revenue base on which State rents are calculated; construction by Vernon Valley of a lake, dams and spillways, without required permission, that confront the area with serious flood hazards; the destruction by Vernon Valley of valuable timberlands without State authorization; the failure by Vernon Valley to obtain adequate liability insurance for prolonged periods; and the false representation by Vernon Valley of a "paper" company in the British West Indies as a legitimate liability insurance carrier, which also was utilized to launder a purported \$175,000 insurance premium back to Vernon Valley and to issue fake performance bonds. The testimony "particularly illustrated the arrogance with which Vernon Valley violated the terms of its lease," the SCI noted.

The public hearing testimony, which is abridged in this report, was the basis for a series of corrective recommendations submitted by the SCI on May 26 to the Governor and the Legislature. These recommended reforms of New Jersey's leasehold procedures involving public lands were proposed -- and are restated in this document -- with the hope that, in any continued or future rental of State property for private exploitation, there will be greater assurance that each party to the lease fulfills its extraordinary obligations to the true owners of such lands -- the public.

Recommendations in Brief

Following is a summary of detailed recommendations which will be found beginning at P. 227 of this report. These proposals are briefly stated at this point to assist the reader in grasping the highlights of the public hearing testimony. The recommendations in brief:

-- Require annual financial audits of State leases which require rent based on a percentage of lessee's revenues.

-- Require more stringent liability insurance safeguards when State acts as a landlord.

-- Require all of New Jersey's governmental entities -- State, county and local -- to utilize only those sureties licensed and approved by the New Jersey Insurance Department in insurance transactions, including performance bonds.

-- Require control of all leases of public property to private companies to be centralized in and monitored by the Bureau of Real Property Management in the State Treasury Department's Division of Real Property.

-- Enlarge DEP's staff of conservation officers, provide more appropriate public lands inspections and policing equipment and conduct training programs for State employees whose geographic area of responsibilities includes State lands leased to private entities.

-- Increase sanctions for violations of New Jersey's Safe Dam Act by including a criminal penalty.

-- Terminate the Vernon Valley Recreation Association lease with the State DEP.

THE TESTIMONY -- FIRST DAY  
MONDAY, MARCH 28, 1983

Opening Statement

SCI Chairman Lane opened the hearing with a statement pointing out that the proceedings would concern the 50-year lease by the New Jersey Department of Environmental Protection (DEP) with Vernon Valley Recreational Association, a subsidiary of the publicly traded Great American Recreation, Inc., in the Vernon Township-Great Gorge area of Sussex County.

Chairman Lane emphasized the Commission's belief that whenever the State rents State property for private commercial use, each party to the lease has to "automatically assume certain obligations to the actual owners of such property, the taxpaying public." He stated further:

These unstated but nonetheless compelling obligations include for the landlord, State government, the burden of safeguarding a continuing public ownership interest in the property, and for the corporate tenant a willingness to avoid any breach of public trust and confidence in maintaining its leasehold privilege. These obligations constitute the critical issue at this public hearing on the manner in which Vernon Valley Recreation Association operated its ski resort and amusement park on public property in Sussex County and the manner in which the State monitored the lease.

Forthcoming testimony will address a variety of issues, including whether Vernon Valley paid rent in a timely fashion; whether it presently owes large sums in rental monies to the State; whether Vernon Valley, through its outside auditors, has violated other provisions of its lease, including failure to provide the State with adequate and accurate reports of its ski revenues on which rent to the State is computed; whether the company also has failed to notify the State in advance of changes in the physical layout of its leasehold; whether Vernon Valley has for prolonged periods of time failed to obtain legally certifiable insurance coverage as required by its lease; whether a captive corporation was used to promote an illusion of insurance coverage that created for State government potential liability for death, injury and property damage claims; whether a purported insurance premium payment in the amount of \$175,000 was diverted to companies owned by

Vernon Valley's principal officer and shareholder; and, insofar as the State is concerned, whether blind acceptance of facts and figures reported by the lessee and the failure to properly inspect the premises fostered or permitted these wrongful acts.

#### **Terms of Vernon Valley Lease Outlined**

Sidney Ytkin, assistant commissioner for management and budgets of the DEP, was the first witness. Questioned by SCI Executive Director James T. O'Halloran, he described the lease between the State and the Vernon Valley Recreation Association, which was signed on June 6, 1968, and the 1977 lease between Vernon Valley and Great Gorge, under which Vernon Valley assumed all Great Gorge obligations to the State. Because of their importance to the proceedings, the witness was asked to read certain provisions of the leases into the public hearing record:

Q. I hand you what has been marked C-71 and ask you if that is not a true copy of the lease between the State of New Jersey and Vernon Valley Recreation Association?

A. Yes, it is.

Q. I direct your attention, Mr. Ytkin, to paragraph 4. Will you read that paragraph from the lease into the record, please.

A. "In addition to any benefits accruing to the Lessor as expressly herein provided, the Lessee shall pay to the Lessor a fixed minimum annual amount and rental of ten thousand (10,000) dollars for the premises herein demised or the following percentages of the gross receipts of the Lessee, whichever is the greater amount:

(a) On the lift or lifts heretofore erected or to be erected by the Lessee on the demised premises contiguous thereto, five (5) percent of the gross receipts. Said gross receipts include the dollar value of all passes used, gratuitous, seasonal or otherwise, issued by the Lessee for use of said lifts.

(b) From income derived from appurtenant, accessory and supportive general recreational facilities which are constructed by Lessee on land herein demised for this purpose by the Lessor, two-and-a-half percent of all gross receipts.



The Lessee agrees that it will maintain books and records in the usual course of business and it will make those portions of its books and records which are apposite to the rental set forth in Paragraph 4a and 4b available for the periodic examination on its premises by the Lessor. Said examinations will be conducted in such a manner as not to interfere with the usual course of the Lessee's business.

The fixed minimum annual rental of \$10,000 shall be paid not later than April 30 of each year and the balance due the Lessor, if any, as provided for in accordance with the gross receipts percentages set forth in Paragraph 5 shall be not later than August 31 of each year based on the fiscal year of the Lessee ending April 30.

There shall be filed with the Lessor a certified public accountant's statement of all gross receipts derived from facilities referred to in Paragraph 4a and 4b for the Lessee's fiscal period ending April 30 of each year by no later than August 31 of each year, and in addition thereto, the Lessee shall file with the Lessor a complete statement of its total operations for the said fiscal period."

- Q. Will you please read Paragraph 8.
- A. "Paragraph 7 of the lease agreement dated June 6, 1968, is hereby amended to read as follows: The Lessee agrees to indemnify and save harmless the Lessor, agents, servants and officials from any damages suffered by any person or persons by reason of the use, maintenance or operation of the lift or lifts or in connection with the use of said leased premises, including but not limited to any and all acts or omissions of the Lessor or Lessee.
- (b) The Lessee agrees that it will carry Public Liability Insurance in the amount of at least \$2,100,000/\$2,300,000 Personal Injury and \$2,025,000 Property Damage on the operation of the lift or lifts and other use of the demised premises by the Lessee, its servants, agents, employees licensees or invitees. Said public liability insurance shall specify as a named insured the Department of Environmental Protection of the State of New Jersey.

The Lessee hereby agrees to adjust the amounts of Liability and Property Damage Insurance from time to time during the term of this Lease upon the request of the Lessor, to levels consistent with the prudent business and insurance practices."

- Q. Now, Mr. Ytkin, you have testified that the State also entered into an agreement with Great Gorge for the lease of property in that same location in Sussex County and that the lease was entered into on a December 11, 1967; is that correct?
- A. That is correct.
- Q. Is that identical with the lease entered into with Vernon Valley?
- A. Yes, it is, sir.
- Q. There will be no need to read the paragraphs from that lease. I hand you now Exhibit C74 and I ask you to identify that.
- A. This is a lease between Vernon Valley Recreation and Great Gorge.
- Q. What is the date on that lease?
- A. The first day of May, 1977.
- Q. I direct your attention in that lease to Paragraph 3.2.3. Will you please read that?
- A. "3.2.3. State Lease Rentals. Tenant shall pay any monies which accrue to the State of New Jersey during the effective term hereof to the State of New Jersey under the Lease dated December 11, 1967. These payments shall be made when due and payable pursuant to said lease between Landlord and the State of New Jersey or at such time that the State and Tenant may agree. Landlord represents that all rentals accruing under said lease prior to May 1, 1976, have been fully paid."
- Q. Okay. Will you please now read Paragraph 3.2.5.
- A. "3.2.5 Liability Insurance. Tenant shall, at its own expense, during the term hereof maintain and deliver to Landlord public liability and property damage insurance policies with respect to the demised premises in which both Landlord and Tenant shall be named as insureds, with limits of at least \$100,000 for injury or death to any

one person and \$2 million for any one accident, and \$100,000 with respect to damage to property. Such insurance shall, however, be in such minimum amounts as may be required from time to time by the State of New Jersey pursuant to the lease referred to Section 3.3.3 above if in excess of the amounts set out. Such policy or policies shall provide for at least 10 days' notice to Landlord of cancellation. At least ten days before the expiration of any such policy tenant shall supply Landlord with a substitute therefor with evidence of payment of the premiums thereof. If such premiums shall not be so paid and/or the policies therefor shall not be so delivered, then landlord may produce and/or pay for the same, and the amounts paid by Landlord, with interest thereon at the rate of 10 percent per annum from time of payment shall be added to the installment of monthly rent becoming due on the first of the next succeeding month following delivery of each written invoice therefor to Tenant.

- Q. Under that lease agreement that you have been just reading from, 274, Vernon Valley has assumed all the obligations that Great Gorge had under its lease with the State of New Jersey; is that correct?
- A. That's correct.

#### **First Probe of Man-Made Lake**

The next witness, SCI Special Agent Raymond H. Schellhammer, described an investigation which he led on August 20, 1982, into the construction of a lake by Vernon Valley on Hamburg Mountain in Vernon Township. With Schellhammer at the time were Joseph Penkala, a DEP biologist, and Roger Nestel, a conservation officer. Schellhammer was questioned by SCI counsel James A. Hart, III, who conducted the Commission's Vernon Valley inquiry:

- Q. Could you describe for the Commission your observations that day?
- A. Yes, sir. After arriving at the lake by means of a four-wheel drive vehicle we walked around the entire lake taking notes of two earthen dams that had been constructed, piles of wood that had been cut and the appearance that heavy machinery had been used to clear a break around the lake and also to move earth in order to form a basin so the water could be retained.

- Q. Did you take any photographs of the lake and the surrounding area that day?
- A. Yes, sir, I did.
- Q. Did you have an occasion to go back to the lake a second time?
- A. Yes, sir. On October 8, 1982.
- Q. With whom did you go to the lake on that date?
- A. I accompanied Mr. John Moyle and Mr. Thomas Leslie, engineers with the Department of Environmental Protection, Flood Plain Management Unit.
- Q. During your visits to the lake were you able to determine the use to which the waters of the lake were being put?
- A. I could observe piping coming from the large dam which appeared to connect with the piping for the snow-making system at the area.
- Q. During the course of your investigation did you have occasion to obtain aerial photographs?
- A. Yes, sir, I did.
- Q. Did you prepare any slides of the lake from the photographs that you had taken?
- A. Yes, sir, they were prepared.
- Q. Are you prepared today to show some of those slides to the Commission?
- A. Yes, sir, I am.

Agent Schellhammer described the various areas of the man-made lake as depicted in his slide presentation, including several panoramic views which indicated the large size of the lake. He also showed photographs of several dams and a spillway that was part of the lake construction work. The large photographs and slides that were exhibited during Agent Schellhammer's testimony formed a backdrop for the testimony of subsequent witnesses.

**"No Permit Was Requested, or Issued"**

John H. Moyle, the principal environmental engineer for the Bureau of Flood Plain Management in DEP's Water Resources Division, was called to tell what he knew about the construction of the lake and dams at Vernon Valley. Questioned by SCI Deputy Director James J. Morley, he noted that one of his responsibilities is to conduct dam analyses and to "regulate the safe operation of dams in the State." Moyle's testimony began with his recollections of Agent Schellhammer's tour of the lake area:

- Q. As well as the dam, is there also another structure that had been built on the mountain in connection with the dam, specifically a dike?
- A. Yes, a dike was also there.
- Q. Now, the construction that you observed on Hamburg Mountain, this dam and dike, would that kind of construction ordinarily require the issuance of a permit to allow it to be built?
- A. Yes, it would.
- Q. Have you been able to determine through an inspection of the records of your bureau whether any permit was ever issued for this construction?
- A. All our files were researched and no permit was issued.
- Q. Have you been able to determine whether any request for permission to build these structures was ever made?
- A. No, there wasn't.
- Q. When applications are made to your bureau for purpose of construction of dams, specifically what kinds of considerations are taken into account when you review those applications?
- A. We require that complete construction drawings and specifications be prepared so that our office can review them and make sure they meet our standards for design.
- Q. Would it be accurate to say that you are concerned with structural integrity of the dam?
- A. That's correct.

Q. And are you also concerned with environmental considerations?

A. Yes, we are.

THE CHAIRMAN: If I may, when you approve such plans, blueprints, et cetera, and you are satisfied the safety factors are present, do you as a department observe the actual construction while it's going on? Do you visit the site and see that the construction is being carried out according to the plans?

THE WITNESS: Yes, we do. That is a condition in our permit before they are to do any construction; we are up there on a monthly basis; we try to go out there in the field.

Q. Mr. Moyle, referring to the photograph which has been marked as Commission's Exhibit 2, it's an aerial photo of an area on Hamburg Mountain, does it depict the area about which we have been discussing where this dam and dike had been constructed?

A. Yes, it does.

Q. Could you tell the Commission what are the dimensions of the dam?

A. The main embankment was approximately twelve-and-a-half feet high, 260 foot long with a 19-foot-wide crest.

Q. I would like you to look at a slide we are going to have projected up here. Can you tell us what is depicted in that slide?

A. There we see a picture looking along the crest of the dam and in the front part there is the concrete spillway. That's the channel immediately downstream from the spillway. The spillway carries the flood waters that would come in, or normal flows also. It protects the earth embankment from these waters.

Q. Essentially, it's a way for water to get out of the impounded area without flooding or eroding the surrounding area; is that right?

A. That's right.

- Q. With respect to the dike which you located on the picture to the east of the main dam, could you tell us what the dimensions of the dike are?
- A. The dike is approximately nine foot high and is sixty foot long.
- Q. What's the engineering purpose of that dike as it relates to the dam?
- A. It's a low area around the perimeter of the lake which has to be dammed up to prevent water from going in that direction down the mountain.
- Q. Were you able to determine what was the area of the impounded water area?
- A. We estimated that it would impound approximately 100 acre feet of water.
- Q. Could you explain for us what an acre foot of water is?
- A. An acre foot of water would be an acre of one foot deep water.
- Q. How large a land area is covered by water?
- A. I will have to check my files.
- Q. Would it refresh your recollection if I told you that you had previously testified it was about ten acres?
- A. Yes, that's about right.

Dam Rated as a "High Hazard Potential"

- Q. Is there a generally accepted method of rating the hazard potential of dams?
- A. Yes. We use the guidelines that were prepared by the Army Corps of Engineers under the National Dam Safety Program.
- Q. Did you make a rating of hazard potential of this particular dam?
- A. Yes. We classified it as a high-hazard potential.
- Q. What is the definition of high-hazard potential?

- A. High-hazard potential is the possibility of loss of life.
- Q. Did you make a close visual inspection of the dam, the dike and the surrounding area?
- A. Yes, we did.
- Q. Could you look at a slide that's been marked as Commission's Exhibit 61 and tell the Commission what's depicted there?
- A. This picture shows seepage at the main dam. On the downstream side of the dam.
- Q. Is seepage, and especially seepage in the areas that you have identified, a cause for concern with respect to the integrity of the dam?
- A. Yes, it is.
- Q. Why is that?
- A. It's water that's coming from the impoundment and it's seeping through the embankment and if it is not monitored or not corrected, the seepage can increase and as the water increases, the velocities increase and it takes particles of the dam out which may cause a collapse of the structure.
- Q. As a result of your inspection, were you able to form an opinion as to the adequacy of the spillway that we saw connected with the dam?
- A. We determined the spillway was inadequate.
- Q. Is it correct to say that if you had reviewed the plans that were used for the construction of that spillway prior to its being constructed, you would not have approved its construction in that form?
- A. That's correct.
- Q. Were you able to form an opinion as to the structural integrity of the dam itself?



A. We couldn't do that because we didn't have any information as far as construction materials, what were used to construct the dam, the properties of the material, if an impervious material was used for the dam and also if the depth of foundation was adequate for that type of dam.

Q. Those are the kinds of things you would have found out if an application had been made for approval to construct that dam?

A. Yes. All that information should be submitted with an application.

THE CHAIRMAN: I suppose you would monitor the actual construction?

THE WITNESS: That's correct.

Q. Is it your opinion that this dam could have been designed and constructed without the benefit of someone with an engineering background?

A. It could be, but it shouldn't be.

Q. In your opinion, was this built -- if you can form an opinion; it's a tough question: Was this probably built by someone without an engineering background?

A. It doesn't meet today's criteria. Whether or not an engineer did supervise the construction, I don't know.

#### **State Forest Cut Down**

Steven E. Dietrich, a forester employed by the State Bureau of Forest Management, testified next about his inspection of the site of the man-made lake and his estimates of the value of the timber that Vernon Valley cut down, again without State permission. Dietrich, a silviculturist qualified by the United States Forest Service, is a specialist in research on and the development of woodlands. Although his job responsibilities involved technical forestry assistance to private landowners and municipalities, he recalled an inspection made on October 18, 1982, of the results of Vernon Valley's timber cutting, which he evaluated at the request of Joseph Penkala of the State Fish and Game Division. Counsel Morley questioned him:

Q. On October 18, 1982, did you have occasion to inspect an area on Hamburg Mountain in Vernon Valley Township, Sussex County?

A. Yes, I did.

- Q. Could you tell us what prompted your inspection on that date?
- A. On the request of Joseph Penkala from the Division of Fish, Game and Wildlife, he wanted a professional forester to come up to the -- what was known as the Hamburg tract and assess the construction site and the inherent value of the wood trees in that disturbance area. Through me, our bureau's technical agency was to provide this assistance.
- Q. Could you tell us briefly what you found when you got up to the area Mr. Penkala wanted you to inspect?
- A. Yes, I can. I noticed there was a body of water approximately ten acres in size, saw quantities of piled wood products, tremendous stems, logs, some road construction, portion of land that had been thinned and areas where a lot of wood chippings were deposited.
- Q. Was it your opinion on inspection of that area that the wood chips and the logs and so on were the product of the construction that had gone into building the lake there?
- A. Yes, it was.
- Q. Were you able to make an estimate of the quantity of wood which was removed from this area to make the construction of the lake possible?
- A. Yes, I did. In two product classes I estimated that there were 140 cords of wood removed and 20,000 board feet of sawed timber removed.
- Q. What's the reason for breaking it down into two classifications, cord wood and sawed timber?
- A. Basically the size qualifications and the tree involved which would lend to a highest and best use; larger trees, taller trees generally have higher value used as saw timber, the purpose of making lumber. Smaller trees, defective trees usually of smaller size commonly used for a lower value type product such as fire wood.
- Q. Did you make an estimate of the value of the cord wood, the fire wood product which had been removed to construct the lake?

- A. Yes, I did. At \$20 per cord stumpage value; \$2800 I estimated the value.
- Q. What about the value of the sawed timber?
- A. Stumpage value of \$27, value of \$1400.
- Q. That's total stumpage value of \$4200 for all the wood?
- A. That's correct.
- Q. What's the meaning of the term stumpage value?
- A. Stumpage value is the appraised value of that product while it still exists growing on the site.
- Q. Is it correct to say that the market value of that same wood would be considerably higher than its stumpage value?
- A. Most definitely.
- Q. How much higher can you estimate what the maximum value of that wood might be?
- A. For the sawed timber product class possibly another 50 to 75 percent higher. For the fire wood value maybe another 25 to 30 percent higher.
- Q. In your experience in your work, do you have occasion to deal with contracts between private individuals and the state in which the private individual is permitted to remove timber from state lands?
- A. No.
- Q. Are you familiar with such contracts?
- A. Yes.
- Q. Okay. In these harvesting contracts is there typically a penalty clause for the unauthorized removal of timber?
- A. Generally, yes.
- Q. In your experience, what commonly is the penalty?

A. For sawed timber product type harvests there is for an average value type sale penalty costs generally three times the appraised value or stumpage price.

Q. What about the other type of wood?

A. It's more difficult, but because it is such an overvalue, it could be higher, the penalty clause.

**EXAMINATION BY THE CHAIRMAN:**

Q. I understand in order to remove woodlands or trees from a state-owned property, there has to be permission granted by the Division of Environmental Protection; is that correct?

A. That's possible.

Q. If there is going to be a penalty imposed for the removal of trees without permission, I suppose it's illegal to remove without that permission?

A. It's only my opinion, but yes.

**Land Misuse Dates Back to 1979**

Roger C. Nestel, a conservation officer for the State Fish and Game Division, and the next witness, was responsible for patrolling a 250-square-mile area. That included Sussex County and the Vernon Valley resort area. Under questioning by counsel Morley, he testified that he was never informed by his superiors about the terms of the Vernon Valley - Great Gorge leasehold, that he knew of no one who could tell him what Vernon Valley "was allowed to do or not allowed to do." According to his testimony, Vernon Valley's violations of the State lease began as long ago as 1979, although he knew of these actions at the time only in the form of complaints from hunters:

Q. Did there come a time when you received complaints about construction going on at the top of Hamburg Mountain?

A. Yes, sir.

Q. When did you receive those complaints?

A. Those complaints were given to me by some local deer hunters approximately, would have been in December of 1979.

Q. What was the nature of those complaints?

- A. They wanted to bring it to my attention that it was possibly some work going on at the top of the mountain.
- Q. You didn't know whether anyone had permission to do work at the top of the mountain?
- A. Correct.
- Q. Did you report those complaints to anyone at that time?
- A. At that time I talked to the area biologist who would be in charge of all Northern Jersey management areas, which Hamburg Mountain is. He is a biologist who works for Fish and Game.
- Q. What's his name?
- A. Russell Spinks.
- Q. What did he say when you told him about these complaints?
- A. Okay. Because of the terrain and the (lack of) accessibility to that piece of property, he suggested that possibly he could contact an individual who had an airplane, not a state airplane, but a private individual with an airplane, and that sometime in the future we would fly over that spot in question.
- Q. Did there come a time when you did fly over the spot in question?
- A. Yes, we did.
- Q. When was that?
- A. March 7, 1980.
- Q. Between December of 1979 when you first got the complaints and March of 1980 when you flew over the area, you made no further reports to anybody else in the department about the complaints?
- A. No, I didn't.
- Q. Will you look at the aerial photo here, of an area up on top of Hamburg Mountain. Does this depict the area where you did your fly-over?
- A. Yes, sir.

- Q. Did you see anything remarkable when you made your flight up there?
- A. At that time I believe there was a bulldozer parked somewhere in this area. There had been some cutting. You could see some vegetation had been pushed around, stumps were evident. That's generally in this area here.
- Q. Did you think that somebody was cutting trees or clearing an area up there on the mountain?
- A. Yes, sir.
- Q. Did you know whether or not Vernon Valley had any right to do construction or even to remove trees in this area at the time that you were flying over there?
- A. I had no knowledge, as I stated before. I wasn't really aware of what they were allowed to do and what they weren't allowed to do in that lease.
- Q. After you had done the fly-over, did you report your observations to anybody higher up in the department?
- A. I believe I did call one individual.
- Q. Who?
- A. That was Mitch Smith. This was all over the phone.
- Q. When did you call Mitch Smith?
- A. The day of the flight. When Russ and I had landed, we both drove up to Vernon Valley and attempted to contact somebody there in charge in its office. At that time nobody was around and since Russ was the regional biologist, I am sure he contacted someone, someone else in Trenton.
- Q. Who is Mitch Smith?
- A. He is a biologist who works for us in charge of land acquisitions.
- Q. When did you report it to Mitch Smith?
- A. Approximately the next week. That day of the flight was a Friday.

- Q. Did you file any written report to your own superiors about your observations?
- A. A daily patrol log which we had to submit; that was it. There were no formal reports written other than that.
- Q. What happens to that log in the ordinary course of operations after you have completed it? Is it reviewed? Do you know whether it's reviewed by somebody?
- A. It's sent down to my district office and then it's sent to Trenton. Whether it's closely scrutinized, I can't say.
- Q. Do you know whether Mitch Smith ever did anything with the information that you gave him?
- A. I can't say.
- Q. Did you ever go back to the area after March 7 to reinspect it to see what might be going on?
- A. Yes, I did.
- Q. When was that?
- A. That was this past summer, 1982.
- Q. What prompted you to do that?
- A. That was at a request of one of your investigators from the SCI.

One Man Covers 250 Square Miles

EXAMINATION BY COMMISSIONER DELTUFO:

- Q. Mr. Nestel, you mentioned you administer an area of approximately 250 square miles?
- A. Yes, sir.
- Q. How many people did you have on your staff to administer that area?
- A. The whole bureau of law enforcement of Fish and Game including the chief and supervisor of personnel is only approximately 50 people...depending on the other officer that's in the county with me, I could have

the whole county, you know, on one day. When he's off, I would have to cover the whole county. On my days off, he would have to cover the whole county.

Q. It can be a one-man operation to cover that area?

A. Yes, sir.

Q. You also mentioned this fly-over of the top of the mountain. Before the fly-over, was the top of the mountain readily available to you for inspection? Did you have the right vehicles or it was difficult to get there?

A. It was very difficult to get there. You need a four-wheel drive and during the winter when there is snow on the slopes, you are not going to take a vehicle up there unless you have some type of off-the-road terrain vehicle. There is no accessibility.

Q. When those complaints were first made to you, then it was virtually impossible for you to inspect that area by ground means?

A. At that time, yes, sir.

Q. Did you at any time ask anybody for a copy of the lease between the state and the lessee?

A. At one time I believe I did, but I was told that it wasn't really my concern.

Q. You were interested in the lease to find out what the mutual obligations of the parties were?

A. Right.

#### **Engineer's View on Lake Construction**

John Lehman, a professional engineer who "worked on and off" for Vernon Valley for four or five years, recalled that the first time he knew the man-made lake existed at Vernon Valley was when he was shown a photograph of the lake, dams and spillway at an SCI executive session in the fall of 1982. Questioned by SCI counsel Hart, the witness recalled certain incidents with respect to his appearance at that private hearing:



Q. When you were subpoenaed to Executive Session back in November of 1982 you were requested to bring with you certain documents. I will read for you the third request on that subpoena. The request that you bring "all municipal, county, State, Federal permits, authorizations and/or approvals of construction of the man-made lake and its accompanying dams and dikes located on state property on Hamburg Mountain within block 190 lot 18 of the Township of Vernon." You did not produce any such documents in Executive Session; is that correct, Mr. Lehman?

A. I had not prepared any such documents, nor could I find any such documents.

Q. Upon receipt of the subpoena did you undertake any search or make any inquiry of anyone as to where such documents could be?

A. I spoke with Mr. Mulvihill and asked if such documents existed and he said they did not.

Q. Who is Mr. Mulvihill?

A. Mr. Mulvihill is the chairman of the board of Vernon Valley Recreation Association?

Q. Does Vernon Valley Recreation Association have its own in-house construction crew?

A. Yes.

COMMISSIONER PATTERSON: Do you know what Mr. Mulvihill's background is? Is he an engineer?

THE WITNESS: He is not.

COMMISSIONER PATTERSON: Could a non-engineer do this kind of work? From a design point of view?

THE WITNESS: A dam of that nature should be designed by a professional engineer.

### **Passing the Buck on Rent Withholding**

The first public hearing confirmation of the inept manner in which the State administered its lease with Vernon Valley, to the extent that no one questioned or resolved the problem of nonpayment of rents due to the State, came from the next witness, Charles Lloyd, administrator for DEP's Division of Environmental Quality. Lloyd was administrator for fiscal and personnel matters at the Fish and Game Division in 1977 when bureaucratic conflicts arose over who was responsible for enforcing the lease. Although Lloyd's

division apparently was responsible for receiving and recording the rents, Lloyd's testimony put the blame elsewhere during a period of three years when the rents weren't paid. Lloyd was questioned about his role in connection with the Vernon Valley lease by SCI counsel Gerard P. Lynch:

Q. What were your duties in 1977 regarding the rentals?

A. I only regarded my duties as being one of taking the money in and making sure the payment was recorded. At that point in time my understanding was the leases were to be administered by the Division of Green Acres.

Q. You were receiving rentals and you were recording those rentals, were you not?

A. That's correct.

Q. Who posted the rentals?

A. There was a rental clerk within the division and (her) only responsibility was to record the collection of the money.

Q. Did you receive these rentals directly or did they come via the Green Acres section of your department?

A. My recollection is they may have come both ways, but primarily through the Division of Green Acres.

Q. How were you able to monitor the rent payments that you were receiving to determine if they were accurate and in accordance with the terms of the lease?

A. It would be very difficult because one of the problems had been the prompt submittal of an annual report of a CPA firm and these came sporadically and were not always on time, and I guess only through analysis of the financial statements you would be possibly able to tell the total amount due.

Q. Other than that, you had no way of monitoring these payments as to whether or not they were accurate?

A. No, sir.

COMMISSIONER DELTUFO: What CPA firm were you referring to?

THE WITNESS: My recollection is that -- the only firm I know of would be Klatzkin, as I recall.

COMMISSIONER DELTUFO: That's the CPA for the lessee?

THE WITNESS: For Vernon Valley/Great Gorge, yes.

Q. Mr. Lloyd, I am now showing you copies of payment cards for the Vernon Valley/Great Gorge rentals. These cards, besides listing all of the rentals every year, also indicate that in 1979, 1980 and 1981 there were no payments listed for Vernon Valley but there were payments listed for Great Gorge. Since you are now aware from this investigation that Great Gorge did not pay rentals of '79, '80 and '81 until after this Commission began its investigation, how do you account for the entries on these payments cards if you were a supervisor of this division?

A. I don't think I understand your question.

Q. These payment cards indicate that no rental payments were listed under Vernon Valley for the years 1979, 1980 and 1981.

THE CHAIRMAN: You see that that is so; there are no such payments listed?

THE WITNESS: I see no such payment.

Q. Could you tell us since Great Gorge had not made any payments for the years '79, '80 and '81 until after our investigation began in 1982, how do you account for the fact that Great Gorge was credited with the rentals and not Vernon Valley?

A. The only explanation I would have would be a clerical error on the part of the clerk making the recordings.

THE CHAIRMAN: The question is how do you account for no payments being recorded as to Vernon Valley during those years? How do you account for it?

THE WITNESS: It's either an error on the part of the recording or no payments were received.

THE CHAIRMAN: You may have received payments but didn't record them?

THE WITNESS: Or recorded them on the wrong set of cards.

Q. Mr. Lloyd, I would like to refer you to chart C-3\* and taking it in conjunction with the payment cards that you have before you, it indicates in this chart that in 1978 the total reported income was \$3.1 million. Then in 1979 the reported income would be in the black area on the bottom which is \$1.3 million; 1980, \$1.4 million and 1981, \$1.7 million. Could you tell us after looking at this chart and looking at the payment cards you have before you in conjunction with the memo that Mr. Boscarell had given you, should you not have been put on notice that there was a glaring discrepancy of the rentals that had been received by your department in 1979, '80 and '81?

A. If it had been my responsibility to keep track of this, yes, I certainly would think there would be a glaring notice. However, it would be my understanding during this period of time up until I think approximately mid-1980 that the lease had been administered by the Division of Green Acres and they are the people who would have followed up with the Vernon Valley/Great Gorge complex.

Q. Would you not have been put on notice that the income that was due your division was cut in half after 1978?

A. It would appear so, yes.

THE CHAIRMAN: We want to know how you account for that. What's your knowledge of this?

THE WITNESS: I have no knowledge of this basically. The payments were received and recorded and from the standpoint of my responsibility and I believe even the division's responsibility, at that point in time that's all we were responsible for.

\* See Chart, next page.

### VERNON VALLEY AND GREAT GORGE REVENUE CHART

UNREPORTED  
GROUP LIFT  
REVENUE



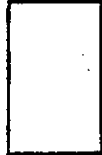
\$3.8M.

UNREPORTED  
GREAT GORGE  
REVENUE

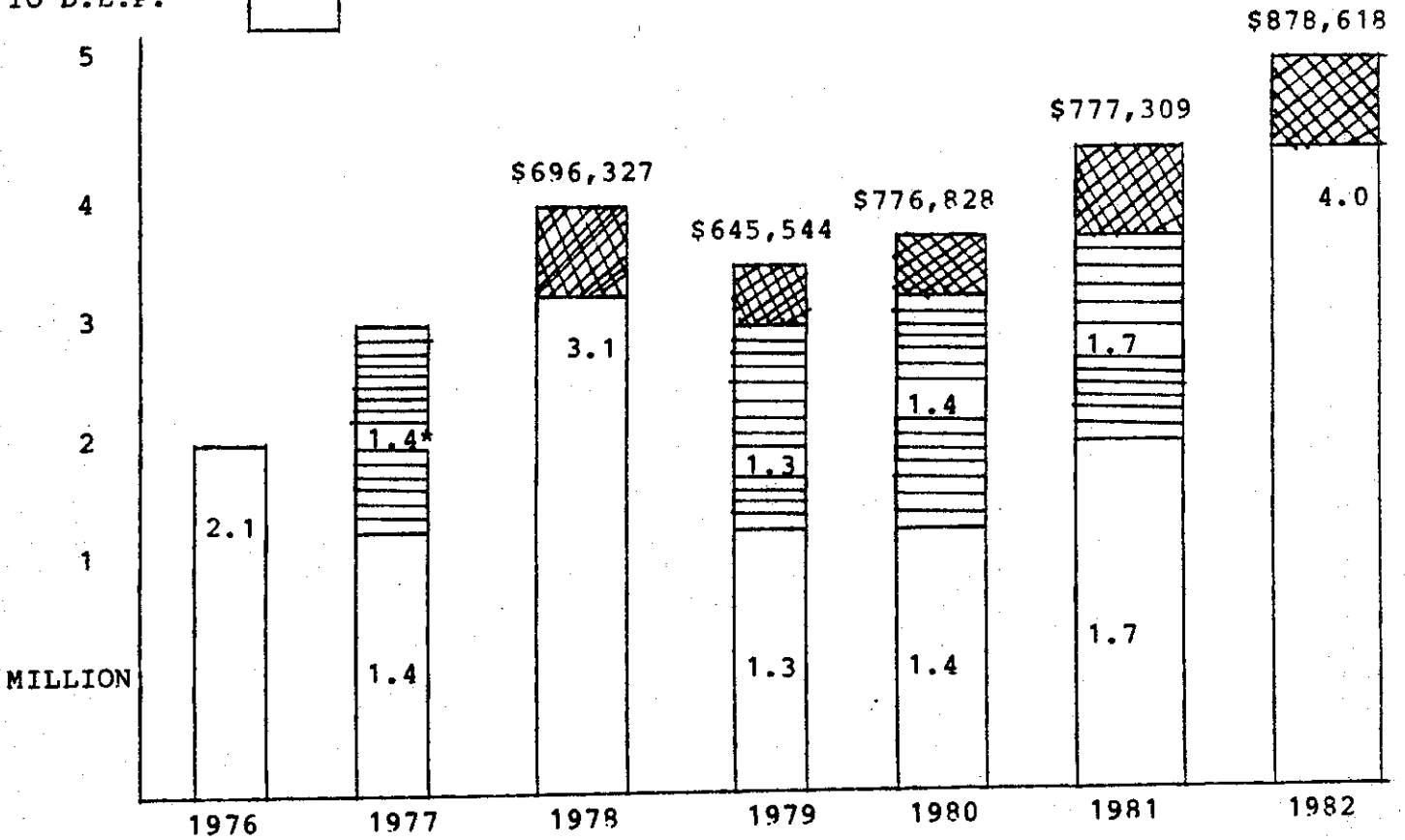


\$4.4M.

REVENUE  
REPORTED  
TO D.E.P.



\$16.4M



\*NOTIFIED D.E.P. & PAID IN INSTALLMENTS

THE CHAIRMAN: You say the payments were received; if this chart is correct, only half the payments were received.

THE WITNESS: That's what it would appear to me sir, yes.

Q. Mr. Lloyd, is it not a fact that in the summer of 1979 you took part in discussions with personnel from Green Acres, specifically Jeanne Donlon, where it was discussed that your division, Fish and Game, was to take over responsibilities for policing the Vernon Valley/Great Gorge leases?

A. I am sure I was to some of them but not all.

Q. When you were involved in these discussions, was it not decided that your division and specifically you were to take over the responsibilities for policing this lease in the summer of '79?

A. Whenever the leases were taken over, it may have been the responsibility of the division to police and administer them, but I don't really feel it was my responsibility personally as the administrator. My understanding or feeling was that whatever legal counsel that the division may have employed would have been responsible for the administration of a lease. I personally don't feel that I had ever had qualifications nor was it departmental practice to have the individual divisions administer the negotiations of the leases.

THE CHAIRMAN: You are saying, in effect, that in your judgment the legal people should have found that only half of the income is reported in each of those three years?

THE WITNESS: The legal people.

THE CHAIRMAN: Where, what division?

THE WITNESS: Depending on the point in time you are referring to, sir; it was at the time that the -- prior to the transfer of that responsibility, it would have been Green Acres. After the leases or the documents were, in fact, transferred that would have been in the Division of Fish and Game.

THE CHAIRMAN: What responsibilities do you think you had as to these three years?

THE WITNESS: My basic understanding was to insure that the monies we received were recorded and deposited. That's the extent.

Q. Mr. Lloyd, during these discussions that you were having with Green Acres was it ever decided, during these discussions, that the legal staff of the division that would police the leases were in opposition to your policing the lease?

Did the legal staff tell you or Director Cookingham tell you that it was not your responsibility to police the lease and it was the legal staff's responsibility?

A. No, sir, I don't believe that was ever specifically stated.

Q. What do you base your assumption on that you were not responsible but the legal staff was responsible?

A. The assumption being that these leases had been troublesome for a period of time and that they were extremely complex. No one at the division level had ever administered these leases. There was not the continuity of the legal staff but there was the majority of the department. Some of the conversations that went on in regard to the leases I may have been privy to. It would not have been my desire to have the leases transferred to the division.

Q. I am now showing you a memorandum directed to you by a Donald Stout from Green Acres regarding Vernon Valley. This is dated July 8, 1980, and in this memorandum Mr. Stout is recounting a conversation that he had with you wherein he appears to be very specifically pointing out all the aspects of the lease that have to be policed. If it was not your responsibility, why would Mr. Stout, the attorney for Green Acres, be sending this memorandum to you?

A. There were two meetings that were held, as I recall, with Mr. Stout for discussions of transferring the lease, some of the lease documents and some of the lease responsibilities. On the first meeting, as I recall, with Mr. Stout, the attorney for the division had been present. The subsequent

meeting when the records were, in fact, transferred, the attorney could not make it and I on his behalf accepted these documents, but my background or training, I think it's fairly obvious, that I have no expertise in the legal manipulations and of the leases.

- Q. I am now showing you exhibits that were obtained from the files of the Department of Environmental Protection, your department. They are marked C-278, C-197, C-279, C-281, 282 and 283. These are letters from Klatzkin & Company who are the auditors for Vernon Valley. The letters are dated 8/22/77, October 5, '77, and November 10, '78, and are rentals which were due both from Vernon Valley and Great Gorge. The letters that you have before you dated 9/26/82, 2/8/80 and 9/23/81 specifically only mention Vernon Valley payments. Great Gorge's name is not on those letters. Should you not have been put on some kind of alert that there were possible rental irregularities just by these documents alone?

Ignored Alert on Rent Irregularities

- A. I may have been on alert, but it would not have been my responsibility in doing anything about it.

- Q. You would have noticed by these letters that the income they were reporting was as is indicated on this chart for the years 1979, '80 and '81; don't you feel there was some responsibility that you as the administrator of the Division of Fish and Game would have in this matter?

- A. Possibly so if you had time to look at them, but we were frequently insufficiently staffed and even in looking at these documents I would have to go back and review them to see how they relate to the figures that you have on the chart to my right.

THE CHAIRMAN: The question is did you do that?

THE WITNESS: No, sir, I did not.



Rent Collection Problems Were "Continual"

Q. Mr. Lloyd, were you aware that prior to your division taking over the responsibility for policing this lease that Green Acres was having problems collecting the rents from Vernon Valley and Great Gorge?

A. There had been continual problems in the collection of monies from these two entities.

Q. What did you do to remedy this problem of collecting the rentals since you were responsible for actually collecting them?

A. On a monthly basis there was a financial report that was always prepared for the director and counsel which they could see if the monies were collected. There had been a couple of requests for audits from the department on the Vernon Valley/Great Gorge complex. Beyond that, specifically looking into the records, no, I don't recall doing it.

Q. Do you recall whether or not these rentals or these accounting reports were filed on a timely basis?

A. They were almost never filed on a timely basis to my recollection.

THE CHAIRMAN: Did you do something about that or did anybody in the department say let's move this up and get the reports in on time?

THE WITNESS: I believe that my office had asked and I believe the people at Green Acres had asked, the director of my division had asked and I believe the people in the Fiscal and Support Services at the department had asked at various times.

Q. Did you get compliance after that?

A. Usually, as I recall, there had been compliance, belatedly in most cases.

THE CHAIRMAN: You asked them to be on time. After that request or warning, were those payments made on time?

THE WITNESS: Not to my knowledge, no.

THE CHAIRMAN: No improvement?

THE WITNESS: No.

Also Ignored Problem of Insurance Coverage

Q. During your tenure with the Division of Fish and Game did you either personally or did you delegate responsibility to someone else to make an inquiry as whether or not Vernon Valley had sufficient insurance coverage to protect the State's interests?

A. No, sir, I personally did not.

Q. Were you not aware of the result of the discussions of Jeanné Donlon and members of her staff that there was a problem with the insurance coverage?

A. I believe there was a problem with insurance coverage.

Q. As a supervisor of the division, you had no responsibility of remedying this problem?

A. My understanding was that the terms of the lease were administered at that point in time by Green Acres and, therefore, I did not have any personal responsibility.

Q. I am talking about the lease after it was taken over by the Division of Fish and Game.

A. I did not have the responsibility for administering that lease after it was taken over by the division.

THE CHAIRMAN: Who did?

THE WITNESS: My understanding would have been that at the director's direction it would have been the legal counsel for the division.

THE CHAIRMAN: For your division?

THE WITNESS: In my division, what was my division at that point.

Q. Did you ever discuss this with the director that the legal division would take the responsibilities?

A. No, sir, I did not.

- Q. Were you ever informed by Vernon Valley personnel or by Klatzkin & Company or anyone else that the revenue upon which rent was based was being reduced by any percentage by Vernon Valley because of ski lessons that had to be provided to group attendees?
- A. I was never informed of that, no.
- Q. When did you leave the Division of Fish and Game?
- A. Approximately December 15, 1980.
- Q. When you left the Division of Fish and Game, did you at any time give any instructions to your successor as to what responsibilities you, in fact, had regarding this lease?
- A. No, sir, I did not.
- Q. Why not?
- A. There was very little communication from members of the staff at the point in time that I left the division.

#### **Lease Monitoring Duties Never Explained**

John Marchetti, an accountant and a supervisor at the Fish and Game Division, was assigned responsibility for recording the Vernon Valley/Great Gorge rentals after he joined the Division in 1977. Counsel Lynch sought an explanation from Marchetti about Vernon Valley's failure to meet its obligation to submit rental payments on behalf of Great Gorge during a three-year period:

- Q. I show you the payment cards of Vernon Valley and Great Gorge and besides listing all of the rentals, it indicates that payments were paid and credited to Great Gorge in the years 1979, 1980 and 1981 when, in truth, Great Gorge did not submit any rentals during those three years until after the State Commission of Investigation conducted an inquiry. How do you account for that?
- A. The money was recorded as Vernon Valley/Great Gorge Association. We assumed it was one organization.
- Q. When you entered the division, though, you were aware that Vernon Valley and Great Gorge had been consolidated into one entity known as V & G Management?
- A. Yes.

Q. Looking at that chart,\* those payment cards would have indicated in 1978 there was \$3.1 million income recorded whereas in 1979 \$1.3 million was reported.

THE CHAIRMAN: Now we go to '79 and you see \$1.3 million?

THE WITNESS: Okay.

THE CHAIRMAN: That was the income reported in '79, \$1.3. We understand that in addition to that 1.3, the company actually had other revenue of 1.3, do you understand?

THE WITNESS: Yes, I do.

THE CHAIRMAN: It is our contention and our belief that there should have been reported to you or your division 2.6 for that year; do you understand that?

THE WITNESS: Yes, I do.

THE CHAIRMAN: Look at '80 and '81 and the same thing pertains there.

THE WITNESS: Okay.

THE CHAIRMAN: Do you understand the chart?

THE WITNESS: Yes, I do.

Q. The question is should you not have been able to realize there was such a glaring discrepancy in the rentals that you would have had to question it to your superiors?

A. In some cases no. The ski rent when it's reported, it's according to the season. In other words, I am not sure if 1979 was a good ski season. Every year the rent changes as far as the weather. This particular year here it was all rain, hot weather. You don't get the ski rents in. The difference if you look from the beginning, their rents have all been different every year. It has been -- some years higher, some years it's been lower and that is because of the weather, but in 1980 we did suspect when we only received \$50,000 that we should have received more revenue and we did request an audit from the department.

\*See Chart, next page.

VERNON VALLEY AND GREAT GORGE  
REVENUE CHART

UNREPORTED  
GROUP LIFT  
REVENUE



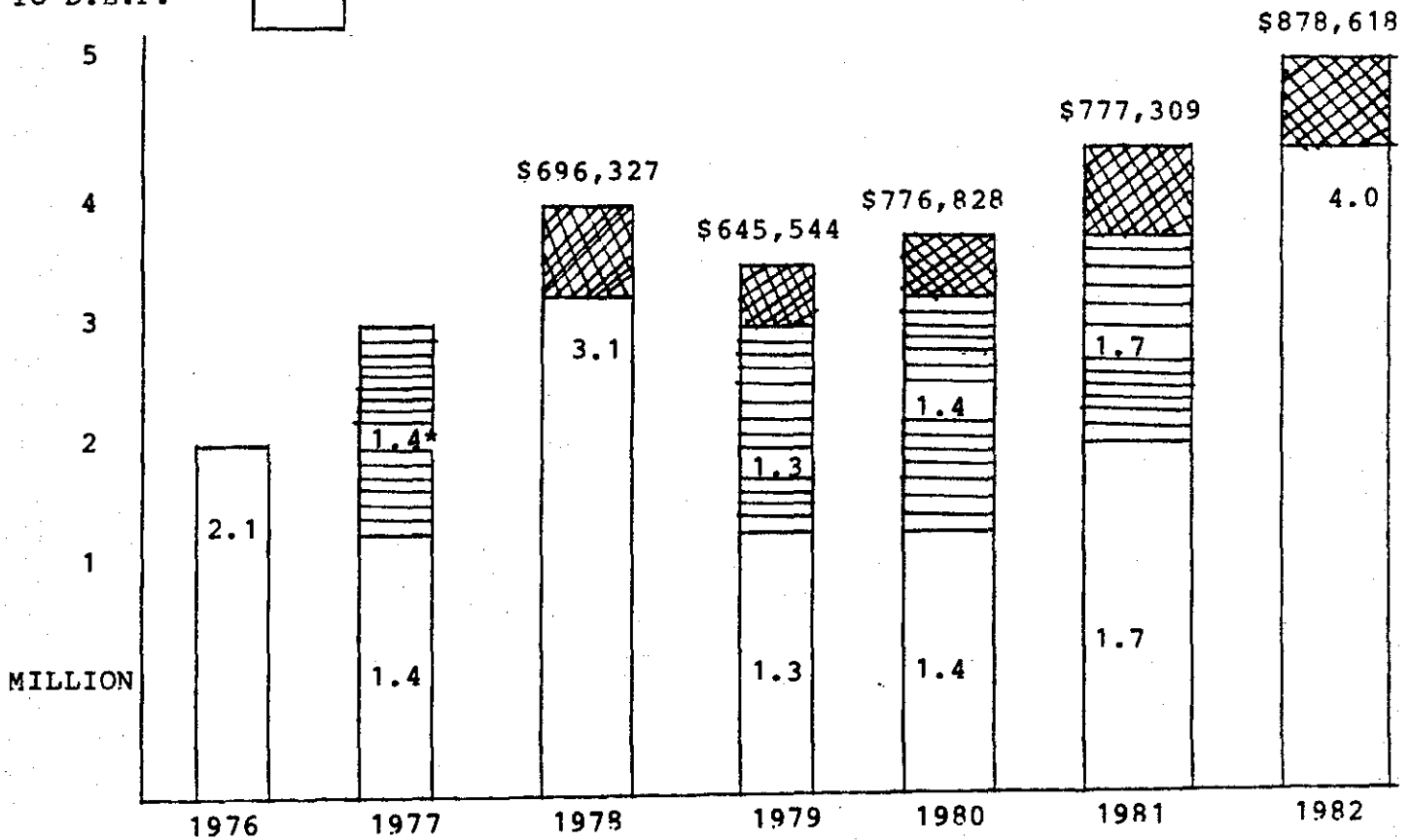
\$3.8M.

UNREPORTED  
GREAT GORGE  
REVENUE

\$4.4M

REVENUE  
REPORTED  
TO D.E.P.

\$16.4M.



\*NOTIFIED D.E.P. & PAID IN INSTALLMENTS

THE CHAIRMAN: Are you telling us that you know as matter of fact on examination and study that for '79, '80 and '81 the weather was an atrocity and hence that was the reason for reporting those low figures?

THE WITNESS: No, I am not saying that. In 1980 it was a good season and we did suspect there was an understatement of income and that's when we asked the department to check it out.

Learned Lease Policing Duties After Probe Began

Q. When did you assume full responsibility for policing this lease?

A. January of '81.

Q. When you took over the administration of this lease did your predecessor give you any instructions on how to police the lease?

A. No, he did not give me an entire description of what my duties were as far the lease is concerned.

Q. Did Director Cookingham ever tell you those duties?

A. No, he did not, other than to account for the rents.

Q. Is it not a fact that you learned your responsibilities after the State Commission of Investigation began an inquiry as to whether or not the lease provisions were being properly policed?

A. Yes.

Q. Since this Commission began its inquiry of the procedures for policing this lease, have the procedures been changed by you?

A. Yes, they have.

Q. What are the procedures at this time?

A. At this time when the money comes in on the mail list I get a copy of the check and notice; when it comes in, it comes to me; the girl makes a copy of the check and notifies me. It also goes to the girl, principal clerk in the back that handles the leases. She records it on her files; in addition, the insurance expiration dates are noted both to her and to my accountant and the accountant that works for me, he additionally, when we get the CPA report from Klatzkin & Company or other CPA's, we double-check the figures as far as total revenue against the percentages that they are supposed to give us as far as the 5 percent for the lease, and the two-and-a-half percent for the Alpine Slide, and the dates are made known to everyone that we -- on April 30 we should get \$20,000, \$10,000 from both Vernon Valley/Great Gorge; and in addition on August 31 we are supposed to receive the balance of -- our rental payments are due on or about August 31 and we should also have the CPA report at that time.

Q. Based upon your experiences has Vernon Valley paid its rentals on a timely basis even to the present?

A. No, they have not.

COMMISSIONER DELTUFO: When you refer to a CPA report, what are you referring to?

THE WITNESS: Part of the lease agreement states that Vernon Valley must provide us with a CPA report telling us how much total ski rental income was produced at Vernon Valley and how much total money revenues were collected through the Alpine slide and based on that report they give us the 5 percent for ski rental and two-and-a-half percent for Alpine slide.

COMMISSIONER DELTUFO: Is this the Klatzkin & Company?

THE WITNESS: They are the current CPA firm.

THE CHAIRMAN: It's based on that submission that you accepted the calculations of Vernon Valley, isn't it?

THE WITNESS: That's correct.

Q. After you had been contacted by members of this Commission, did you then contact any members of Vernon Valley regarding the Great Gorge rentals?

A. Yes. It's part of our responsibility if they are late with a payment. They were late with a ground rental payment for \$10,000 and I called them on a few occasions and a check finally came in for \$10,000. I believe it was December of 1981 that the check did come in.

Q. Did the remainder of \$94,000 that was due at that time come in within one month after that?

A. I don't think it was; I think it was a couple months later.

Vernon Valley Wanted SCI Off Its Back

Q. Who did you speak to at Vernon Valley?

A. Roger Scott. He is the secretary/treasurer and vice-president of Vernon Valley/Great Gorge.

Q. Did Roger Scott have any comment regarding this investigation?

A. Yes, he did.

Q. Will you tell us what that was?

A. He wanted to know how long the investigation was going to be because he wanted to get back to running his business.

Q. Did he tell you he wanted you to get this Commission off his back?

A. Yes.

Q. You indicated you requested an audit in 1980 when you noticed there was a decrease in the rentals that were coming in?

A. This audit request was made through my director, my former boss, Mr. Lloyd.

Q. I show you a memorandum dated November 22, 1980. It's addressed to you, John Marchetti, from Richard E. Kocsis, Chief Certified Audit. Will you read the body of that letter into the record?



A. The subject is Vernon Valley Certified Audit. "Enclosed is a copy of the certified report prepared by Klatzkin & Company, Certified Public Accountants. As the auditor has given an unqualified opinion, the department should have no reason not to accept this. In addition, the calculations of the rental due under the lease dated June 6, 1968, is included. Please let me know if we can have any further assistance.

Q. Did this reply by Mr. Kocses in any way alleviate your concern that the rentals were not totally accurate?

A. No.

Q. I show you a letter dated March 30, 1982, from Klatzkin & Company to the Department of Environmental Protection and ask you if you are aware of what the sum of \$233,128 meant when you received this letter, what it was for?

A. At first I didn't but after reading the letter I did note there is a couple of little phrases here, "for all those years except those detailed as below for Great Gorge," so they are telling us it was an understatement of income for Great Gorge's lease.

Q. Since you had received that payment had you been at any time aware that Vernon Valley was not paying the rentals?

A. No.

Q. Did Klatzkin & Company or Vernon Valley ever apprise you of the fact that Great Gorge rentals were not being paid?

A. No.

THE CHAIRMAN: Not only not being paid by Vernon Valley but not being paid by any other entity at all; is that correct?

THE WITNESS: That's correct.

Q. I have here an annual report for the Great American Recreation Incorporation, which is a successor to the Vernon Valley Recreation Incorporation for the year ending 4/30/82. Have you seen this report?

A. I believe I have.

Q. Will you look under the column for 1981 where it indicates land rental?

A. Yes.

Q. What does it say for land rental, which is a liability?

A. \$233,125.

Q. When you received this annual record, were you able to pick up that fact that Vernon Valley was reporting in its annual report that \$233,000 was still outstanding?

A. We did not receive this particular annual report from the company. The only thing we received from Klatzkin & Company was a statement to the total revenues that the Vernon Valley Association -- we did not receive a copy of this report.

Q. You did have a copy?

A. Yes, it was supplied by the SCI.

Vernon Valley Ignored State Landlord

Q. During the time you were handling this lease has Vernon Valley ever requested permission from your division to build a man-made lake on a portion of the land they rented?

A. No, they have not.

Q. Do you know who Gene Mulvihill is?

A. I do now. He's the president of Vernon Valley.

Q. And you know who Mr. Scott is, do you not?

A. Yes, I do.

Q. Have either of these gentlemen or anyone else from Vernon Valley ever called you up and indicated that they were not paying the Great Gorge rentals?

A. They have not.

THE CHAIRMAN: No notification at all or from anybody connected with these two entities?

THE WITNESS: No. Mr. Scott has requested a postponement of his rentals for 1982, but we told him no. We sent a letter back requesting payment in full.

Q. Did anybody from Vernon Valley or Klatzkin tell you that they were reducing the rentals due to the State because they had to provide ski lessons for groups?

A. No, they did not.

#### **State Relied on Vernon Valley Accountant**

Richard N. Kocses testified next as chief of the accounting and auditing bureau of DEP whose financial responsibilities included the Vernon Valley/Great Gorge lease. Asked by Counsel Lynch if his responsibilities included auditing that lease, Kocses responded that he received "certified financial statements from the Vernon Valley accountants, the CPA firm of Klatzkin & Co.," and "so I never ordered an audit as a result of reliance on their statement." The Commission sought more clarification of this reliance by the State on the accountants for the State's tenant:

Q. I am going to show you six exhibits, letters that your department received from Klatzkin & Company regarding monies that were due for the years 1979, 1980 and 1981. They specifically mention only the name of Vernon Valley and they do not mention the name Great Gorge as had been mentioned in the 1978 letters. Could you tell us what you interpreted by them mentioning only Vernon Valley and not Great Gorge when Klatzkin sent these documents to your department?

A. We understood these were for the entire obligation.

Q. You understood it was for both Vernon Valley and Great Gorge?

A. Yes.

Q. Was any audit performed or requested of you?

A. There was an operational audit that was performed by my predecessor Maurice Rosenberg, I believe, around '78 considerably before I came on. It was not financial in scope. We relied because we had independent certified financial statements which expressed an unqualified opinion; we relied on those, sir.

THE CHAIRMAN: By Klatzkin & Company?

THE WITNESS: Yes. I might add certainly with two people at the outset and even if we had 30 it would still be our practice, in the sense of the economy for the state whenever we had certified statements which were unqualified, we would trust those. There would be no need to redo their work.

THE CHAIRMAN: That isn't true economy if the state is losing rental money as a result, is it?

THE WITNESS: I guess not. It's presumed in the profession that if you are given unqualified opinions, that we would have every reason to rely on them.

- Q. Couldn't you have gone to Klatzkin and examined their work records without performing a full-blown audit?
- A. Do you realize the size of the Environmental Protection and the size of the responsibility I was entrusted with with two auditors at the time. In my opinion, two auditors would not even be enough for the Division of Water Resources alone. We were grossly understaffed.
- Q. Wouldn't these letters that were submitted to you by Klatzkin and Company indicate rentals for the years 1978, 1979 and 1980 and 1981?
- A. They did.
- Q. Shouldn't you have done a little more than rely on Klatzkin & Company when you had such a drastic reduction in rentals from the papers you had before you?
- A. We didn't compare them from the point I got in. To go back and look at the old reports, we literally didn't have enough time to do that.

"Amazed and Shocked" at Admission of Unpaid Rent

- Q. I show you Exhibit 273, which is a letter from Klatzkin & Company, wherein they report (rent due) of \$233,128. What was your

reaction when you obtained this letter from Klatzkin & Company?

A. We were amazed and shocked.

COMMISSIONER DELTUFO: Can you describe what information was given to you in that letter? It had to do with revenues from Great Gorge and additional revenue.

THE WITNESS: The date on this is March 30, 1982, and this is to the State from Klatzkin & Company...They are basically saying the firm serves as accountants for Vernon Valley...on an annual basis since 1971. They are also saying they have reported for Great Gorge, as well, and in view of our examination the year ending April 30 the total unpaid rents were 233,000 due from Great Gorge and Vernon Valley.

COMMISSIONER DELTUFO: On the first page is there an indication of non-reporting of the revenues in the revenue base upon which the rental is computed?

THE WITNESS: Right. '77, '78, '79, '80 and '81. '77 was 74,000. '79 was 58,000. '80 was 72,000 and '81, \$88,000.

COMMISSIONER DELTUFO: This is rental money?

THE WITNESS: Right.

THE CHAIRMAN: Is there an explanation for that?

THE WITNESS: No. They give the compilation by year and understand that this liability was paid. 1981 was 10,000. 1/25/82 it was 94,000. March 11, 1982, 128,000 for a total of \$233,000.

COMMISSIONER DELTUFO: You mentioned you were shocked when you received the letter. Could you describe your reaction in a little more detail?

THE WITNESS: We were amazed, horrified to believe that something was amiss here in terms of the reporting.

COMMISSIONER PATTERSON: Does that report confirm that during those years Vernon Valley/Great Gorge was not reporting its full income?

THE WITNESS: Yes, sir.

Q. Mr. Kocses, this Commission has also received evidence that in addition to the unreported Great Gorge revenue that some 3.8 million in revenue has not been reported to the Division of Environmental Protection because of an allocation that was made in certain revenue categories to which the group lift revenues where ski lessons were required to be performed by Vernon Valley. Were you aware at any time prior to this Commission's investigation that any such allocation was being arbitrarily done by Vernon Valley?

A. No, not prior to the investigation.

EXAMINATION BY COMMISSIONER PATTERSON:

Q. I want to make sure I understand. Going back to the report from Klatzkin & Company, do I understand that that report was given to D.E.P. unsolicited by D.E.P.? D.E.P. didn't ask for it?

A. That was sent unsolicited.

Q. That there was 200-some-odd thousand additional rents. That came at a time when the SCI was investigating Vernon Valley/ Great Gorge?

A. Yes.

#### **Vernon Valley Accountant's Version**

Stephen Klein, a partner in the CPA accounting firm of Klatzkin & Co., retained as auditors by Vernon Valley since 1971, refused to attend the public hearing on the basis of a claim of constitutional privilege. Therefore the Commission authorized that portions of Klein's prior testimony as transcribed at executive sessions of the SCI be read into the hearing record, with counsel Hart repeating the questions he asked at the private hearing and Julius Cayson, the SCI's chief accountant, reciting Klein's answers. Klein, who said he was responsible for the Vernon Valley account, was first asked at a private hearing in February, 1982, to explain why he 1) failed to report to the New Jersey DEP Great Gorge ski lift revenues and 2) reported only Vernon Valley's revenues in 1977 and from 1979 through 1981. As previously

noted, DEP lease arrangements with Vernon Valley required its rent payments to the State to be based on a percentage of both Vernon Valley's and Great Gorge's ski lift revenues. Thus, any withholding of ski lift revenues from either of these operations would reduce Vernon Valley's rent to New Jersey, contrary to the terms of the lease. Klein's testimony on this issue, as voiced by counsel Hart and chief auditor Cayson, follows:

"Q. Now, you have been reporting or Klatzkin has been reporting to the State gross lift revenues since 1971 earned by Vernon Valley Recreation Association.

"A. That is correct.

"Q. Do you or have you ever reported to the Department of Environmental Protection the gross lift revenues earned by ski lifts that are located on Great Gorge property?

"A. Yes.

"Q. Which years did you report for Great Gorge as well as for Vernon Valley?

"A. 1975 we reported for Great Gorge.

"Q. Did you also report for Vernon Valley that year?

"A. Yes, we did.

"Q. How about 1976?

"A. 1976 we reported for Vernon Valley and Great Gorge.

"Q. And 1977?

"A. 1977 we reported just for Vernon Valley.

"Q. 1978?

"A. We reported for Vernon Valley and Great Gorge.

"Q. 1979?

"A. We reported for Vernon Valley.

"Q. You did not report for Great Gorge in 1979; is that correct?

"A. That is correct.

"Q. 1980?

- "A. 1980 is for Vernon Valley only.
- "Q. 1981?
- "A. For Vernon Valley only.
- "Q. Can you tell me, sir, why in 1977 you did not report gross revenues earned by the lifts on the Great Gorge property?
- "A. Well, we were not asked to.
- "Q. Meaning, I take it, that in 1975 and 1976, for example, you were asked to report --
- "A. That is correct.
- "Q. Was Klatzkin & Company ever retained by Great Gorge, Incorporated?
- "A. Yes.
- "Q. And would you know from these records, sir, what years your company was retained by Great Gorge?
- "A. I looked back. It is 1975, April 30, 1975.
- "Q. So, in 1975 you were retained both by Great Gorge and by Vernon Valley?
- "A. That's correct.
- "Q. And in 1976 would that be the same case, you were retained by both?
- "A. I don't believe so.
- "Q. Nevertheless, you reported Great Gorge revenues in 1976?
- "A. That's correct.
- "Q. Because you were asked by Great Gorge to do that?
- "A. Great Gorge or Vernon Valley personnel.
- "Q. In 1978 you again reported revenues earned both by Vernon Valley and by Great Gorge. Were you asked by someone to report both?
- "A. Yes.
- "Q. And who asked you to report both?
- "A. Would have been probably Vernon Valley personnel.



"Q. You were not retained, or your firm was not retained in 1978 by Great Gorge; is that correct?

"A. That is correct.

"Q. In 1979 you did not report Great Gorge revenues, the reason being what, sir?

"A. We were not asked to.

"Q. In 1981 you did not report Great Gorge revenues and the reason for that?

"A. We were not asked.

"Q. Did anybody at D.E.P. ever ask why there was no audit for Great Gorge for those years for which your firm did not submit an audit report?

"A. I don't remember them asking me.

"Q. You are the partner in charge? You're the likely person they would have asked?

"A. Yes.

"Q. Then, to the best of your knowledge, nobody from D.E.P. ever asked why no report on Great Gorge?

"A. To the best of my knowledge, they never asked me, that's correct."

#### Vernon Valley Pays Back Rent After SCI Hearing

Within six weeks after Klein confirmed during his executive session testimony at the SCI that Vernon Valley had not reported certain annual revenues of its affiliate, Great Gorge, the accountant wrote a letter to DEP admitting the failure. In addition, since Vernon Valley's rents to the State are based on a percentage of the ski revenues, Klein's letter prompted the submission to the DEP of unpaid back rent due the State because of the increased amount of revenues subject to rental calculation. Klein was questioned about this letter when he next appeared at an SCI executive session on June 22, 1982. Portions of this testimony by Klein were read into the hearing record by counsel Hart and Chief Accountant Cayson:

"Q. Is that the letter that you prepared and sent to the State Department of Environmental Protection?

"A. Yes, it is.

"Q. And what's the date of that letter, sir?

"A. March 30, 1982.

"Q. Does that letter reflect unreported revenues for fiscal year 1977 insofar as Great Gorge is concerned?

"A. Yes, I believe it does.

"Q. And what was the total amount of revenue earned by Great Gorge that year, sir, the lift revenue I am speaking of?

"A. \$1,496,587.

"Q. What's the total amount of rent that was due to the state based upon the revenue base of \$1,496,587?

"A. 5 percent or \$74,829.

"Q. Now, was there also ancillary revenue earned by Great Gorge that year that was to be computed into the rent base?

"A. Yes, there was.

"Q. What type of activity was that revenue derived from?

"A. That was from a small restaurant on top of the state property.

"Q. And what percentage of that revenue would make up the rent due to the state from that Summit Lodge?

"A. Two-and-a-half percent.

"Q. And total rent, then, sir, for 1977 due to the state from the Great Gorge facilities would be what?

"A. \$74,903.

"Q. Now, for the fiscal year ending April 30, 1979, does your letter reflect the total amount of lift revenue that was not reported to the state from the Great Gorge facilities?

"A. Yes, it does.

"Q. What is that figure, sir?

"A. \$1,164,193.

"Q. And does your letter reflect the total amount of rent due to the state from that revenue in 1979?

"A. Yes, \$58,210.

"Q. Fiscal year ending April 30, 1980, Mr. Klein; what was the total amount of unreported lift revenue earned by the Great Gorge facilities?

"A. \$1,445,634.

"Q. And the rent due to the state from that revenue?

"A. \$72,282.

"Q. Now, fiscal year ending April 30, 1981, what was the total amount of unreported lift revenue from the Great Gorge facilities?

"A. \$1,764,174.

"Q. And the rent due to the state from that figure?

"A. \$88,290.

"Q. Now, as a result of the figures that you included, Mr. Klein, in this letter, do I understand correctly that a check or checks were sent by Vernon Valley Recreation Association, Incorporated, to the Department of Environmental Protection covering this unpaid rent from these several years; is that correct?

"A. We did not view the checks but we were told that checks were forthcoming.

"Q. Now, those checks that were sent to the Department of Environmental Protection, Mr. Klein, do the amounts include any interest on the money that had not been paid for those past years?

"A. Not to my knowledge.

"Q. Now, when you last appeared before the Commission, Mr. Klein, you stated, and I am going to paraphrase, if I may, that you did not report Great Gorge revenues for these years in question because you were not instructed by anyone to do so; is that correct; is that a fair statement to make?

"A. Yes, it is."

BY CHAIRMAN LANE:

"Q. Were you instructed by anybody not to report them?

"A. I don't remember if I was instructed not to, sir, but I was basically the auditor for Vernon Valley. Vernon Valley was my client, and certain years I was requested to report for Vernon Valley and Great Gorge, and in certain years I was requested to report for Vernon Valley only, and that was the reason why our reports to the state either included, you know, both Great Gorge and Vernon Valley or Vernon Valley only."

BY MR. HART:

"Q. Mr. Klein, I show you what's been marked C-2 for identification, the copy of the lease that you produced for this Commission. That lease is between Vernon Valley and Great Gorge by which Vernon Valley leases from Great Gorge certain lands that Great Gorge had first leased from the state. Now, would you turn to Page 99 of that lease, please, and look at paragraph 3.23. Could you read that paragraph into the record, please?

"A. It's entitled 'State Lease Rentals. Tenant shall pay any monies which accrue to the State of New Jersey during the effective term hereof to the State of New Jersey under the lease dated December 11, 1967. These payments shall be made when due and are payable pursuant to said lease between landowner and the State of New Jersey or at such time that the state and tenant may agree. Landowner represents that all rentals accruing under said lease prior to May 1, 1976, have been fully paid.'

"Q. Now, the tenant referred to there, sir, is your client, Vernon Valley Recreation Association; is that correct?

"A. That's correct.

"Q. And the landowner is Great Gorge, Incorporated?

"A. That is correct.

"Q. What is the date of that lease, sir?

"A. May 1, 1977.

"Q. Now, that lease states that Vernon Valley is responsible for paying the Great Gorge rent, does it not, in that paragraph you just read?

"A. That's correct.

"Q. When did you receive a copy of this lease, sir?

"A. Probably during the summer of 1977."

Accountant Knew Rents Should Have Been Paid

SCI counsel Hart turned next to executive session testimony that proved that Klein knew that the rents withheld should have been paid to the State by his client Vernon Valley. Evidence of this knowledge was the annual auditor's statement for Vernon Valley that Klein had prepared. Another proof was Vernon Valley's annual 10-K report to the S.E.C. Testimony from the executive session transcript on these issues follows:

"Q. Now, do you, sir, pursuant to your duties as the outside auditor for Vernon Valley, have occasion to prepare financial statements for that corporation, annual financial statements?

"A. Yes, we do.

"Q. Would you look at that, Mr. Klein, and tell me if you recognize it, sir?

"A. That's a copy of our annual audit for 1980, April 30, 1980.

"Q. Now, does that cover the fiscal years ending in '79 and '80, sir?

"A. Yes, it does.

"Q. Now, I would like you to look at Page 15 of your audit, sir, under note 9, which is entitled 'Contingent Liabilities and Commitments' and I'd like you to read a portion of your report that's underlined in red, sir.

"A. 'The Great Gorge facilities are leased for a one-year term with annual renewal options through April 1984. The lease payments are approximately 270,000 per year plus real estate taxes and land rents to the State of New Jersey.'

"Q. Does that indicate, sir, that Vernon Valley was responsible for paying the Great Gorge rental payments to the State of New Jersey?

"A. Yes, it does.

"Q. In your duties as the outside auditor for Vernon Valley, have you ever had occasion to prepare a form for the Securities and Exchange Commission known as the 10-K?

"A. Yes.

"Q. Now, let me show you what's been marked as C-4. Would you tell me if you recognize it?

"A. Without looking at it in detail, it appears to be the form 10-K which is the Vernon Valley's annual report to the Securities and Exchange Commission.

"Q. Would you have seen this document before it was sent to the Securities and Exchange Commission?

"A. Yes, we would have.

"Q. I ask you to look at Page 12, sir, of that form and read it into the record, that portion that's underlined in red.

"A. 'As additional rent the company is required to pay all rental payments under the lease between Great Gorge and the State of New Jersey and all taxes, utilities, insurance premiums and repairs, as well as certain monthly payments of principal and interest of \$1,675 per month on mortgage indebtedness of Great Gorge.'

"Q. Does that seem to indicate to you, sir, that Vernon Valley was responsible for paying the Great Gorge rent to the State of New Jersey?

"A. Yes, it was.

"Q. Now, my question to you, sir, is, notwithstanding the contents of the lease, which you admittedly received in July or in the summer of 1977 and notwithstanding the contents of the financial report on the copy that you prepared, and notwithstanding the contents of the 10-K that was sent to the Securities and Exchange Commission, why is it that you had to be instructed by someone before including the Great Gorge revenue in the amounts that you reported to the State Department of Environmental Protection for 1979, '80 and '81?

"A. My client is Vernon Valley. We were not hired by Great Gorge. We are the auditors for Vernon Valley. Their obligations under leases, under their lease to Great Gorge included a liability, an indirect liability for the State of New Jersey for the rentals. All rentals to the State of New Jersey under the Great Gorge land lease were accrued on the books of Vernon Valley and are included as current liabilities under incorporated in the Vernon Valley's consolidated liabilities on their financial statements, so that any obligation to the state is reflected in Vernon Valley's financial statement.

"Q. That's my position, sir, that the financial statement says that Vernon Valley is responsible for paying that rent to the State of New Jersey. This particular financial statement was prepared, you said, in July by your firm or in the summer of 1980, I believe. July of 1980, a month after that is when you prepared your report for the State of New Jersey indicating what the revenues are and what the rent is.

"A. That's correct.

"Q. The financial report that was prepared in July, states that Vernon Valley is responsible for paying to the State of New Jersey rent due on the Great Gorge facilities. Approximately, one-and-a-half months later you report to the State of New Jersey that revenues earned up at the ski resort, but you only report the revenues earned by Vernon Valley not those earned by Great Gorge."

"The CHAIRMAN: We want to know the reason why.

"THE WITNESS: I was trying to explain before. Maybe I didn't explain it sufficiently. We, as professionals, are hired by Vernon Valley Recreation. That corporation is our client. Vernon Valley has a lease with the State of New Jersey. That lease calls for annual reporting of revenues, certain revenues. Vernon Valley requested that we report those revenues to the State of New Jersey. Vernon Valley has a lease with Great Gorge, Great Gorge has a lease with the State of New Jersey. Great Gorge is not our clients. I cannot report to the State of New Jersey something unless I'm instructed by my clients to do. I indicated

to you, included in the financial statements for Vernon Valley were all amounts due and owing to the State of New Jersey on all income, on all income derived from Great Gorge, so that the financial statements include the proper liabilities due to the state."

"THE CHAIRMAN: Is your company, your company as outside auditor, didn't you have an obligation knowing that this income from Great Gorge was due and the responsibility for it was in Vernon Valley and you recognized that, and a month and a half later you put out a report excluding the Great Gorge -- not including the Great Gorge income. Didn't you, as outside auditors, have a duty to tell your principals, tell your client that this is incorrect?"

"THE WITNESS: Yes, we did, and we did do that.

"THE CHAIRMAN: When?"

"THE WITNESS: At some point one of the years involved, it may have been the first year or the second year, we instructed them that Great Gorge should advise the state under their lease.

"THE CHAIRMAN: But you realize that they hadn't followed your recommendation or assertion as to that in subsequent years?"

"THE WITNESS: Yes, sir."

#### How Vernon Valley Diverted Ski Income

The amount of rent Vernon Valley had to pay the State was based on a percentage of certain revenues, primarily those from the sale of ski lift tickets. Therefore, if revenues were reduced the rent would be reduced. During executive session testimony by Stephen Klein, the Vernon Valley accountant, he confirmed the diversion of certain ski lift revenues into a ski lessons account, which was not subject to any rental calculation. SCI counsel Hart resorted to Klein's accounting "work papers" to help refresh his memory of the diversion since 1977 of 78 percent of group ski revenues to ski school lessons. From that time on, the category of group lift revenues was eliminated and, according to Klein, 22 percent of group sales (the balance after the deduction for the purported lessons) was to be added "by the client, which is an entry on the books which would have classified the portion of the group income that was attributable to lifts into a lift regular category." Reading from a transcript of Klein's executive session testimony, counsel Hart recited the questions and accountant Cayson repeated Klein's answers, as follows:



"Q. Now, the question becomes, Mr. Klein -- let me ask you this: You have been the accountant for Vernon Valley since approximately 1971?

"A. That is correct.

"Q. And in 1971 and in 1972 right up through 1977 there was always a revenue account entitled group sales in the papers that you prepared or in your worksheets in calculating the rent that was due to the State of New Jersey; isn't that correct?

"A. I believe so, without going back and looking at each year, I would assume so.

"Q. And in each of those years group sales was a fairly substantial sum of money, was it not? In the latter years we're talking about six, seven, \$800,000. Is that a fair statement?

"A. Yes.

"Q. Now, in each of these years up to 1977 the entire amount of the revenue listed in those accounts was reported to the State of New Jersey, was it not?

"A. Yes.

"Q. On your worksheets when you were calculating rents due to the State of New Jersey?

"A. Yes.

"Q. You had a category entitled group sales or group lifts?

"A. Yes.

"Q. And in reporting that total amount to the state of group lift, you took 5 percent of that figure and that was part of the rent that was paid to the state; is it not?

"A. That is correct.

"Q. Now, in 1978 there was no group lift revenue account included in your work papers; is that correct?

"A. That is correct.

"Q. That is the year, I believe, you indicated when an allocation started to be made, 78 percent to ski schools, 22 percent to lift regular; is that correct?

- "A. That is correct.
- "Q. Is ski school income revenue included in the rent base?
- "A. It is not.
- "Q. And the question becomes why was this allocation made beginning in 1978?
- "A. In 1978, fiscal April 30, 1978, this was the first year that the company started giving mandatory group lessons to all of the participants of the groups that attended. Back in those days there were many accidents caused, not only caused at Vernon Valley, but other ski areas; and management, for a number of reasons, felt it prudent to improve the quality of skiing at Vernon Valley and Great Gorge and, in fact, started giving members of the various groups that came a mandatory ski lesson, which included either a lesson or testing of the skiers to see their ability to determine which lifts they should be allowed to ski on, which trails, whether they should be allowed on the beginner slopes or the intermediate or advanced, and depending on their level of expertise, they were given an appropriate -- in addition to the testing they were given lessons to improve the quality of their skiing and to improve the safety on the mountain, which from a business standpoint, was very important, because the bulk of your skiers from the groups are children and many of them are not concerned with their own safety, let alone that of other people, and the normal or the full-paying skiers that came up, not in groups, became afraid to be out on the mountains on the slopes with the large quantities of children or other group members, principally children who were reckless. And from a business standpoint, management made a decision to give group lessons authorized to improve the safety of not only the group skiers, but also the safety on the mountain for the full-paying skiers, and so it was a business decision.
- "Q. Were lessons mandatory for individuals coming up to ski as opposed to mandatory lessons for groups?
- "A. No.
- "Q. And whose decision, specifically, was it that made group lessons mandatory?

- "A. I don't know whose, one particular person's decision, it was.
- "Q. Were these mandatory lessons the result, sir, of an insurance policy that your client had, a liability insurance policy?
- "A. I don't know if they were a direct result in terms of being required by the insurance company. I think there was some memo to the effect that it was suggested that it might reduce the premiums if, in fact, there were lessons given, but I don't think it was specifically required.
- "Q. Didn't you advise Mr. Cayson at your office on the one day that he was over there speaking to you that these lessons were mandatory because of a requirement of the insurance company?
- "A. Well, if I used those exact words, I don't remember the exact words I used, but if, in fact, I used those words, I think I was incorrect."

The memo that chief accountant Cayson had obtained from Klein's office was from London & World Assurance, a "paper" company created by Vernon Valley that the SCI subsequently determined was not a legitimate liability insurance carrier. The executive session testimony by Klein on this issue continued:

- "Q. Could you read that into the record, please?
- "A. Sure. This is a memo from London & World Assurance Limited to Roger Scott from Joseph Peterson; date, October 17, 1978. 'As we discussed before we can submit a premium quotation in the 5 percent area, we need affirmative assurance that all groups will be required to receive instruction from the ski school.' Signed Joseph Peterson.
- "Q. And who is Mr. Roger Scott?
- "A. He is controller or vice-president of finance at Vernon Valley.
- "Q. Do you know who Mr. Joseph Peterson is?
- "A. I assume he's an officer or an agent with the insurance company.
- "Q. Now, for 1978, for the fiscal year ending in April of 1978 your report to the state on revenues and rent was due August 31; is that correct?

"A. That is correct.

"Q. And this memo from from the insurance company apparently requiring group lessons was dated October 17 of 1978; is that correct?

"A. That is correct.

"Q. So, prior to October 17, 1978, any mandatory requirement of ski lessons for groups would have been determined by the management of the Vernon Valley Recreation Association; is that correct?

"A. It's correct in the fact that management always has the decision, makes the decision as to whether or not they're going to do something. In this case, they made a decision to give group lessons. It wasn't mandatory, as you can see, from the tone of that memo. It was if you (don't) want a 5 percent discount, you don't have to give lessons. Management made the decision to give lessons. I believe that the date to that memo is incorrect. I can't prove it, but if you look back at my work papers, which Mr. Cayson has, there is another letter which is dated November of 1977 to all of the group instructors advising them that starting in December of or November of '77 that they're going to start giving lessons. Now, I believe that that memo dated '78 from the insurance company was just a typographical error and was, in fact, received by us or by the company, by our clients in '77, otherwise, I can't imagine the company giving, you know, writing a letter to their groups unless they did it without a memo from the insurance company.

"THE CHAIRMAN: You're somewhat speculating when you indicate there might be a change of date or a mistake in date in the calendar year change?

"THE WITNESS: It's a typo.

"THE CHAIRMAN: You mean somebody putting down 1980 instead of 1981, instead of 1982?

"THE WITNESS: Possibly a typo.

"THE CHAIRMAN: But that is most unusual. Most of us know what year we are operating in.

BY COUNSEL HART:

"Q. Now, you testified that the breakdown was 78 percent to ski school, correct, 22 percent to lift regular?

"A. Yes.

"Q. Who made the decision to set the allocation at 78 percent, 22 percent? As opposed to 50/50, 60/40, 70/30?

"A. That's a good question. I thought I addressed it. I obviously did not. The ratio was arrived at by taking the equation which consisted of numerator being \$7, which was the regular price of a group lesson over the denominator, which was \$9, which was the average price, average group price per individual and that gives you 78, 22 percent ratio.

Brochure Contradicts Testimony

"Q. Let me show you what's been marked as C-14 for identification. Is that a copy of a brochure that Mr. Cayson obtained from your office?

"A. Yes. It's part of a brochure. It's one page in a brochure.

"Q. And there's a category on there entitled ski school lessons; is there not?

"A. Yes, there is.

"Q. What does the first sentence say under ski school lessons?

"A. One hour group lessons ranging from beginner to expert is \$4.50.

"Q. And your clients made an allocation of 78 percent of, let's say, \$9 which would have been \$7?

"A. That's correct.

"Q. And he made that \$7 allocation at a time when his group lessons normally were \$4.50; is that correct?

"A. Not entirely correct. His group lessons if individuals came there and wanted a group lesson, it would be \$7 as indicated in the other brochure.

- "Q. But you told me that this was for groups, this first page?
- "A. That's correct.
- "Q. Wouldn't this \$4.50 be the price of a lesson for a person who is a member of a group?
- "A. This, in fact, is the price of a second lesson to a group member. In other words, the mandatory lesson is already included in the fee that they pay, so that this price is a discounted price or further discounted price, because it's a second lesson if the individual choose to take one.
- "Q. The first lesson is \$7, the second lesson is \$4.50, although this doesn't say anything about this being a second lesson?
- "A. This is correct. It's understood from the literature that went out to the groups that --
- "Q. If I understand correctly, then, what you're saying is that in a year, an earlier year such as 1977, a person is a member of a group and he goes to a ski resort with that group, and to make it easy we will assume that the cost of his ticket or whatever he had to buy to ski at the resort was \$9, all right?
- "A. Yes.
- "Q. 1977 or earlier. All of that \$9 got reported to the State Department of Environmental Protection as revenue that formed part of the rent base?
- "A. That is correct.
- "Q. Now, 1978 comes along, that same individual comes up to the resort in a group and, we will assume the price remains at \$9, and he pays his \$9 and only \$2 of that 9 gets reported to the Department of Environmental Protection as revenue forming part of the rent base?
- "A. That's correct.
- "Q. And \$7 of that \$9 ticket does not get reported as part of the rent base?
- "A. That is correct.

"Q. To your knowledge, did you or anyone else ever communicate with the Department of Environmental Protection and ask them about this procedure that was being implemented in 1978 whereby their rent base was being minimized?

"A. No, I did not.

"Q. Do you know whether anyone from Vernon Valley Recreation Association, Incorporated did?

"A. I don't know."

#### **Were Ski Lessons Mandatory?**

The next scheduled witness, Diane Westerveld, could not appear because of serious illness in her family. Miss Westerveld was the ski school director at Vernon Valley at the time of her appearance at an executive session of the SCI on February 16, 1983. Except for the winter of 1975, she had directed the ski school at Vernon Valley since 1973. She testified that ski lessons were mandatory at Vernon Valley/Great Gorge, a statement which was contradicted by subsequent witnesses who brought large groups of skiers to the facility. Portions of her executive session testimony were read into the record by SCI counsel Michael V. Coppola and Special Agent Wendy Bostwick, primarily to highlight refutations of her commentary by later testimony:

"Q. Miss Westerveld, let me show you what's previously been marked as C-85. I would like you to look at that and read it and specifically read the second paragraph.

"Have you ever seen that document before?

"A. No.

"Q. It's a letter, is it not, addressed Dear Group Advisers, with the names Greta Christiansen and John Kopec on the bottom?

"A. Right.

"Q. And doesn't the second paragraph of that letter indicate that a new policy is being implemented whereby lessons are to be given to group members attending Vernon Valley?

"A. Yes.

"Q. And that letter is dated November of 1977, is it not?

A. Yes.

"Q. Can you tell me why such a letter would have to be sent to group advisors informing them that a new policy was being undertaken when you have testified that the policy, that being mandatory lessons, was in effect since 1973?

"A. I couldn't be sure why they sent that particular letter. I know I've had trouble getting people to take lessons. I have to take their lift ticket off to take a lesson. I still do it every day of the week right now. Some people think they can just go out and ski. That's about my only input with Greta Christiansen, to force people to take lessons.

"Q. But that had been the policy since 1973?

"A. Yeah, anyone who comes to the area must come to ski school and take a lesson."

#### **Retracts Testimony That Lessons Were Mandatory**

Between 1975 and 1980 Greta Christiansen worked for Vernon Valley as group sales director and then as sales and marketing director. When she first appeared at an SCI executive session she testified that group skiers were required to take lessons and that such a requirement had been in effect since 1977. At a subsequent executive session appearance, however, Mrs. Christiansen recanted that testimony at least to the extent, as SCI counsel Coppola noted, that "she did not really remember whether lessons were required or not." Mrs. Christiansen, in a claim of constitutional privilege, did not appear at the public hearing. Therefore, excerpts from her executive session testimony were read into the public hearing record by counsel Coppola and SCI accountant Chris Klagholz:

"Q. Mrs. Christiansen, just to make sure I understand, C-85 is a letter of November, 1977, which has your name typed on the bottom and John Kopec. Who is John Kopec?

"A. My assistant at that time.

"Q. The second paragraph of that letter indicates that ski lessons were required for insurance purposes; is that correct?

"A. Yes. That's what the letter shown to me says.

"Q. You didn't write the letter?

"A. No. I don't remember that letter.

"Q. You don't know whether, in fact, the lessons were required?



"A. That's right.

"Q. And the brochures you looked at earlier in your testimony this afternoon would indicate that the lessons were not required because they certainly weren't mentioned in the brochure?

"A. Not in the later two, right. The first one, if the letter was sent out, it wouldn't necessarily, you know, because the printing would have been done so much sooner. But if it was a continued policy, it should have been in the next two.

"Q. It wasn't?

"A. I didn't see it there."

#### **Lessons Not Only Voluntary, But Cost Extra**

Not only were ski lessons voluntary, but there was an extra charge for them, according to yet another former Vernon Valley employee. This also contradicted earlier testimony in which the Vernon Valley accountant recalled that 7/9ths of group ski revenues were diverted to a ski lesson fund because the lessons were reflected within the group rates. The next witness, John J. Kopec, whose name appeared with that of Greta Christiansen on the 1977 letter purportedly sent out by Vernon Valley to declare mandatory lessons as a group policy, was more candid than others in denying that policy. Kopec was questioned by counsel Coppola:

Q. Mr. Kopec, were you employed at Vernon Valley Recreation between approximately 1971 and 1982?

A. That's correct.

Q. And did your responsibilities include servicing the various group ski people that came up to Vernon Valley?

A. Yes.

Q. And did your employment responsibilities also include coordinating the group people with the ski school?

A. That's correct.

Q. Isn't it correct to state that if an individual went to Vernon Valley as part of the group, as part of a group, the individual would get a lift ticket as part of the price?

A. Yes.

- Q. And suppose they wanted a ski lesson? Would that be extra?
- A. Yes.
- Q. Now, while you were employed at Vernon Valley, was it ever an official company policy that group attendees were required to take a lesson prior to going on the ski slopes?
- A. No, it was not.
- Q. Never, between 1971 and 1982, when you left, was it ever an official policy that a skier from a group would have to take a lesson before he would be allowed to get on the ski slope; right?
- A. There were times, especially in the late '70's when the school business was such that there were so many kids on the slopes out of control, they were forced to take lessons given by the ski school.
- Q. That would be after the fact, after the person demonstrated his inability on the ski slope?
- A. That's correct.
- Q. I show you Commission Exhibit C-80. It's a letter dated November 1977, on the stationery of V & G Management Corporation. Says Vernon Valley in the left-hand corner, Great Gorge in the right-hand corner. It's addressed to "Dear Group Advisor." There are type-written names on the bottom of the name Greta Christiansen, John Kopec, and I direct your attention to the second paragraph and ask you to read that paragraph out loud.
- A. "First of all, pursuant to information received from our insurance carrier, we are revising our group policy. From this point on each lift ticket purchased will automatically include a lesson, be it the one-hour beginner's or intermediate lesson or advanced skier in skier etiquette. We feel that by adopting and administering this policy each member of your group will become a better skier and in turn derive more enjoyment and be a better person on the slopes."
- Q. Is your name typed on the bottom of that exhibit?

A. Yes.

Q. While you were employed at Vernon Valley did you ever see that letter?

A. No.

Q. Was the contents of the letter, specifically that second paragraph, ever discussed with you by anyone while you were employed at Vernon Valley?

A. Not to my knowledge, no.

Q. Do you know whether, in fact, that letter was sent to group advisors?

A. I can say that it was not.

Q. Would it be fair to state that the policy that's mentioned to the second paragraph of that letter was never, in fact, implemented?

A. Yes.

#### **Vernon Valley's Best Customer Denies Lesson Requirement**

Charles Kelly, director of parks and recreation for Wayne Township, testified next as the director of probably the largest group skiing program ever to assemble on the Vernon Valley/Great Gorge slopes. Although his township once sent 33 buses of local school students to the area each week, it was sending 23 bus loads weekly at the time he testified on the issue of Vernon Valley's purported ski lesson requirement. This issue grew out of earlier public hearing testimony that Vernon Valley had reduced its revenue base on which its State rent was calculated by diverting group ticket sales income from this revenue base to a mandatory ski lesson account. Kelly was questioned by SCI counsel Paul D. Amitrani:

Q. Mr. Kelly, to your knowledge, in all the years that you were up at Vernon Valley, was your group ever required to take ski lessons by Vernon Valley?

A. No, they never were.

Q. Were you ever advised at any time that ski lessons were now mandatory because of insurance reasons?

A. No. The answer is definitely not.

Q. Mr. Kelly, your students stick with you pretty much from grade school on up to adult even.

- A. Yes.
- Q. What would their reaction have been had they been told that they had to take ski lessons?
- A. They'd be very reluctant because they start in second grade taking lessons, though we recommend through grammar school and junior high school. If they're in high school, they would be very, very reluctant.
- Q. Fair to say a mini-mutiny had they been required to take lessons?
- A. Yes.
- Q. Mr. Kelly, I'm going to show you what's been marked for Public Exhibit C-80. It has previously been shown to you in Executive Session and it was C-85 at the time. It is a letter, correct, from Vernon Valley/Great Gorge?
- A. That's correct.
- Q. It's dated November of 1977?
- A. That's correct.
- Q. And it's captioned "Dear Group Advisor," that is correct?
- A. That's correct.
- Q. I want to direct your attention to the second paragraph of that letter. It's already been read into the record. I'd like you to read it, and is it fair to say that this second paragraph deals with the fact that your ski lift ticket was now going to include a one-hour lesson?
- A. That's correct.
- Q. Were you ever advised of the contents of this letter by any of the personnel?
- A. No, I was not.
- Q. Were you ever advised that your ski lift costs now included a lesson?
- A. No, I was not.

Wayne Township Also Questioned Insurance Coverage

Q. Mr. Kelly, turning to another area; did you ever have any doubts about the insurance coverage of Vernon Valley/Great Gorge?

A. Yes, I did.

Q. Is it important for your program that the place where your students ski have adequate insurance?

A. Definitely. I got worried about the liability of the township.

Q. Would it be fair to say you would have canceled or moved your program if it was inadequate?

A. Reluctantly, yes.

Q. With the group of your size, that would have meant considerable loss of revenue to Vernon Valley?

A. Yes.

Q. Did you ever request proof of insurance?

A. Yes, I did.

Q. Were you ever sent a certificate of insurance?

A. Yes, I did.

Q. And this was given to you by Greta Christiansen?

A. Either Greta or somebody from Great Gorge/Vernon Valley sent it down.

Q. I'm now going to show you what's been marked C-96. This is a certificate of insurance; correct?

A. That's correct.

Q. And the company listed on the top is London & World Assurance Limited?

A. Yes.

Q. And the name of the insured is listed on the certificate as Vernon Valley Recreation Association?

- A. That's correct.
- Q. And it is addressed down at the bottom to Wayne Recreation Department?
- A. Yes.
- Q. The signature at the bottom is Joseph Guy Dasti?
- A. Yes.
- Q. Is there a policy number on this certificate of insurance?
- A. I don't see one, no.
- Q. Did you ever require proof beyond the certificate that was given to you by Greta Christiansen that there was, in fact, a London & World Assurance Company or that this was a valid insurance policy?
- A. No, there was no reason for me to. All I wanted to verify was the fact that they were insured.

#### **Another Group Customer Denies Lessons**

Theodore T. May, the ski advisor as well as a science teacher for the West Essex Regional School District, also testified that not only were ski lessons not required for ski groups but also that the handful of students who did want lessons paid extra for them -- at \$4.50 per lesson over and above their group skiing tickets. May was questioned by SCI Counsel Amitrani:

- Q. Did Vernon Valley ever require mandatory lessons from your group?
- A. No, they didn't.
- Q. Did Vernon Valley ever require, before this year, a mandatory ski-off or safety test?
- A. No.
- Q. I am going to show you a letter that has been marked C-80, and it has been previously marked in Executive Session as C-85. It's a letter dated November of 1977, to group advisors signed by Greta Christiansen and John Kopec. Do you ever recall receiving that letter?
- A. No, I don't.

Q. Do you ever recall being verbally advised that ski lessons were now required of your group?

A. No.

Q. Do you ever recall being verbally advised that the cost of your lift ticket would include a one-hour lesson?

A. No, not to my knowledge.

#### **No One Knew of Mandatory Lessons**

To further check the validity -- or lack of it -- of the purported letter of November, 1977, in which Vernon Valley said ski lessons were mandatory, SCI agent Raymond H. Schellhammer asked numerous customers, individual skiers as well as sponsors of skiing groups, if they had ever heard of such a policy or had seen the letter that Vernon Valley had indicated was sent out to group customers. No one had, according to Schellhammer's answers to counsel Amitrani's questions:

Q. Would you please advise this Commission as to what schools and what recreation programs you spoke to?

A. Yes, sir. Township of Wayne, Township of Montville, Wayne Valley High School, which is a separate program from their recreation department, Hanover Township Recreation Department, East Hanover Recreation Department and the County College of Morris.

Q. All right. Did you speak to them about any requirements they may have had or that may have been placed upon them by Vernon Valley concerning mandatory ski lessons?

A. Yes, sir, I did.

Q. What did they advise you?

A. They advised me that lessons were not mandatory.

Q. Did you ever show them that letter from Greta Christiansen?

A. In each case I either showed or spoke to the individual that I contacted concerning that letter and in each case I was told that they were not aware of any insurance requirement and a mandatory policy of lessons, and that in each case, lessons were a paid extra that was paid for by the individual.

- Q. Do any of those people ever recall seeing that letter?
- A. In no interview was I ever told that that individual had observed that letter or received it in the mail.

**Diverted Revenues, Withheld Rents Traced by SCI**

The SCI's chief accountant, Julius Cayson, the final witness of the first hearing day, explained the extent of Vernon Valley's revenue diversion scheme and its resultant rent withholding by means of charts. Cayson discussed the data on these charts in detail in response to questions by SCI counsel Hart:

- Q. During the course of the investigation, did there come a time when you examined the work papers of Vernon Valley's accountant, that is Klatzkin & Company, relating to their audits for the fiscal years 1977 through 1981?
- A. Yes, I did.
- Q. Could you tell us what you found in examining those work papers, Mr. Cayson?
- A. Well, I found, among other things, that there was unpaid rent applicable to the Great Gorge facility which they are subleasing. I also found that there was unreported group lift revenue for the years 1978 to 1981, and if I may refer to the chart I'll show -- Chart 4, please.\*
- Q. Does that chart contain a summary of what you found in the accountant's work papers?
- A. Yes. First of all, let's take the unreported rent payable by Great Gorge by Vernon Valley, and that was for 1979, it's 1.1 million; 1980, 1,445,634; 1981, \$1,764,174 for a total of \$4,374,001.
- Q. That is the Great Gorge revenue that was not reported that we heard about this morning?
- A. That's right, this is the sum and substance of the Stephen Klein CPA letter, the independent auditors...The rent due on that was \$58,210; \$72,282; \$88,209 for a total of \$218,701.

\*See Chart, next page.



VERNON VALLEY - GREAT GORGE  
INTEREST DUE ON RENT - AS INDICATED

<u>YEAR</u> <sup>1</sup>	<u>UNREPORTED GROUP LIFT REVENUE</u>	<u>RENT DUE AT 5%</u>	<u>MONTHS OUTSTANDING AT 12/31/82</u>	<u>INTEREST</u> <sup>2</sup>
1978	\$ 696,323	\$ 34,816	52	\$ 22,633
1979	645,544	32,277	40	17,132
1980	776,828	38,841	28	15,041
1981	777,309	38,865	16	8,201
1982	878,618	43,931	4	2,171
	<u>\$3,774,622</u>	<u>\$188,730</u>		<u>\$ 65,178</u>

GREAT GORGE RENT PAYABLE BY V.V.R.A.

<u>YEAR</u> <sup>1</sup>	<u>LIFT REVENUE</u>	<u>RENT DUE AT 5%</u>	<u>MONTHS OUTSTANDING AT 12/24/81</u>	<u>INTEREST</u> <sup>2</sup>	<u>TOTAL INTEREST PAYABLE</u>
1979	\$1,164,193	\$ 58,210	28	\$ 30,898	↓
1980	1,445,634	72,282	16	17,275	
1981	1,764,174	88,209	4	5,537	
	<u>\$4,374,001</u>	<u>\$218,701</u>		<u>\$ 53,710</u>	

<sup>1</sup> FOR FISCAL YEAR ENDED 4/30; PAYMENT DUE 8/31 OF YEAR INDICATED  
<sup>2</sup> COMPUTED AT PREVAILING PRIME RATE BY FINANCIAL PUBLISHING CO. BOSTON, MA.

AVERAGE PRIME RATE --

8-31-78 to 12-31-78	10.451220
12-31-79	12.665068
12-31-80	15.200137
12-31-81	18.832878
12-31-82	14.824658

THE CHAIRMAN: That amount is strictly from the unreported Great Gorge revenue?

THE WITNESS: That's correct.

Q. You also mentioned unreported group lift revenue. Did you find any work papers in Mr. Klein's files regarding that?

A. Yes. His papers indicate for the years, fiscal years, that is, 1978, 1979, 1980 and 1981, and I might add 1982, that the amounts, as stated in this first column, were omitted from the reportable revenue, based on the allocation that is mentioned so far this afternoon. And, of course, the rent due on this particular money is at five percent, and that comes to \$188,730.

Q. The unreported group lift revenue, Mr. Cayson, you just mentioned an allocation, are you referring to that 78 percent, 22 percent allocation that came out this morning in the reading of Mr. Klein's testimony?

A. That's correct, sir.

Q. Those amounts that are shown in that column, are those the amounts that were allocated to the ski school accounts of Mr. Klein's worksheets?

A. Yes, Mr. Hart, they were.

THE CHAIRMAN: Let's take 1978 unreported group lift revenue. Now, what relationship does that have to the 78 percent or seven over nine deduction?

THE WITNESS: Judge Lane, that is the seven-ninth's, the 78 percent, the 696,323.

THE CHAIRMAN: That was deducted by the company which we believe and we maintain should have been reported and should have been paid.

THE WITNESS: That's right, sir. And I might add that we have an interest factor here, because the Department of Environmental Protection advised us that they want interest on these outstanding balances. And I asked what do you want to charge as interest, and they said we'll demand that we be paid the then prevailing average prime rate for '78, '79, '80, '81 and '82.

THE CHAIRMAN: Those figures you have there represent prime rate interest amount?

THE WITNESS: That's right. But, sir, at simple interest. We did not compound the interest. We took it at simple interest. That's a very, very complicated thing to do because the prime rate changes daily.

So, therefore, we prevailed upon the Financial Publishing Company of Boston Massachusetts to do the job for us. Their report is part of this Commission's archives. And, for instance, in 1978, this \$34,816 is outstanding as of 12-31-82 for 52-months. This should have been paid on August 31, 1978.

So we took it up to 12-31-82, 52-months or 40-months at seven-ninth's, and total interest comes to \$188,888 on the unpaid balance, and this is at simple interest. It would have been substantially more, sir, had it been compounded.

Q. Mr. Cayson, during your examination of Mr. Klein's work papers, did you find any notations or records setting forth a rationale for this seven-ninth's, two-ninth's allocation?

A. Yes, there was sir.

Q. What did you find in the work papers?

A. I found a letter from the insurance company by the name of London & World. I found Greta Christiansen's letter, and there was a notation "letter from G.M." and then there was a notation by Mr. Klein, himself, that the bulk of the costs to the client was in the ski area. That was the total reference in the work papers.

Q. You mentioned, Mr. Cayson, a letter contained in Mr. Klein's files from London & World Assurance. Is that letter what has been marked as Exhibit C-268?

A. That's correct, sir, yes.

Q. What was the substance of that letter, do you recall?

A. The substance of that letter was, in effect, that in order for them to get a particular premium quote from this London & World that they would suggest that lessons be given.

- Q. You also mentioned that there was a notation in Mr. Klein's files concerning a letter from Greta Christiansen. Is that Exhibit C-80 that we were referring to earlier today?
- A. That's right, yes.
- Q. And the third thing you mentioned was a letter from G.M.?
- A. That's right.
- Q. Did you speak to Mr. Klein or did you ask Mr. Klein what the initials G.M. stood for?
- A. I asked him then and we subsequently wrote him a letter requesting again what G.M. stood for, and whether he had the letter maybe in some other files. His reply was that the letter was not in his files and he had no recollection that the letter was ever in his files.
- Q. Did he ever tell you what the initials G.M. stood for?
- A. Gene Mulvihill.
- Q. Lastly, you mentioned that he had a notation that the bulk of the costs to the client was in the ski school area. Did you take any steps to verify the validity of that rationale?
- A. Yes, I did. May I refer refer to Chart 5,\* please? Chart 5 gives us historic perspective of the relationship of the ski school payroll to the ski school revenue. And we get a percentage thereof. There that is in the year 1974, its ski school payroll was 93 percent of all ski revenue.

In 1975, the figures are as indicated. There are 58 percent. In 1976 it was 51 percent.

In 1977, it was 41 percent, and I might add this ski school payroll isn't just all payroll. I must admit that the chart should have indicated that this has some overhead applied to it, but this is the bulk of the \$71,00 is payroll.

\*See Chart, next page.

VERNON VALLEY - GREAT GORGE  
SKI SCHOOL PAYROLL & REVENUE

<u>YEAR</u>	<u>SKI SCHOOL PAYROLL</u>	<u>SKI SCHOOL REVENUE</u>	<u>PAYROLL/ REVENUE%</u>
1974	\$ 26,407	\$ 28,306	93
1975	38,595	66,613	58
1976	42,464	83,921	51
1977	71,820 4,200 <sup>1</sup>	173,364	41
1978	UNAVAILABLE 5,140 <sup>1</sup>	882,932 <sup>2</sup>	-
1979	UNAVAILABLE 4,000 <sup>1</sup>	763,715 <sup>2</sup>	-
1980	68,862 5,250 <sup>1</sup>	805,178 <sup>2</sup>	9
1981	80,514 5,825 <sup>1</sup>	832,417 <sup>2</sup>	10

<sup>1</sup>SKI SCHOOL DIRECTOR'S SALARY

<sup>2</sup>AFTER ALLOCATION BY C.P.A.

Now, when we come to 1978 to 1979, we served a subpoena duces tecum on Vernon Valley/ Great Gorge for their ski school payroll records and we were told that those records prior to 1980 are unavailable. So, therefore, we don't have any records, or presumably neither do they, for 1978 or '79.

However, the figure in red is the annual salary of the ski school director, that's Miss Westerveld. She made, in '77, 4,200, 5,140, 4,000, 5,250, and 5,825, and if one were to do a little extrapolation one could come up with a ball park figure for the ski school payroll in '78 or '79. However, the figures were unavailable so, therefore, we'll call it that, unavailable. However, it should be noted that in 1977 the ski school revenue was \$173,000 and it jumps in 1978 to \$882,932.

Now, I will make this bit of projection: had the payroll ratio obtained from just the prior year they would have had to have had in the neighborhood of \$350,000 in payroll in order to give \$882,000 worth of lessons.

THE CHAIRMAN: Using that same percentage of payroll revenue the year before?

THE WITNESS: That's correct. So let's go down to a year that we do have records for, and there the payroll was \$68,862, and the ski school revenue was \$805,178.

In 1981, the payroll was \$80,514 and the ski school revenue was \$832,417 and again, the director, Miss Westerveld, made 5,250 this particular year and 5,825 in the other year.

- Q. What is the significance of the findings that are depicted on that chart insofar as the rationale that the bulk of the cost was in the ski school area?
- A. Based on available evidence, I would say that that particular contention is totally without any credible validity.

**THE TESTIMONY -- SECOND DAY  
TUESDAY, MARCH 29, 1983**

**Transition Statement**

Opening the second day of the SCI's public hearing on the State's lease with Vernon Valley, Commissioner Henry S. Patterson, II, recalled that the previous day's testimony had: 1) confirmed Vernon Valley's "failure to make timely payments of rent and failure to include large sums of revenue in the income base upon which its rents are calculated;" 2) revealed that the rent avoidance scheme was linked to a British West Indies company, London & World Assurance, which Vernon Valley claimed was providing liability insurance required by the State lease; 3) revealed how Vernon Valley contended that ski lessons were mandatory in order to support its revenue diversion to a ski lesson fund which was not part of the rent calculation base; 4) highlighted statements by sponsors of large ski groups that lessons were neither mandatory nor extensively given, and 5) "questioned the actuality of insurance coverage at Vernon Valley by London & World Assurance." Commissioner Patterson also stated:

Testimony that we will record here today will demonstrate that for prolonged periods of time the State of New Jersey may not have had protection from potential damage claims. Today's testimony will also raise additional questions about the laxity with which the State monitored compliance with major provisions of its Vernon Valley lease.

**Leasehold Problems Date Back to 1977-78**

Jeanne Donlon, an attorney who is land acquisition chief for the Green Acres Division of the Department of Environmental Protection, was chief of DEP's Bureau of Leases and Facilities Management in 1977, at which time her responsibilities included the State's lease with the Vernon Valley ski resort and amusement park corporation. As the first witness at the second day of the Commission's hearing she was asked to recall various problems -- and suspicions -- that developed when she questioned Vernon Valley's purported insurance coverage and while she acted as the forwarding agent for Vernon Valley's rent payments. She testified that the rental payments "were based on the statements of certified public accountants" employed by Vernon Valley and that whatever rents were paid were "submitted" to DEP's Fish and Game Division and "reviewed" by DEP's Division of Fiscal and Support Services. Until 1977, she recalled, Vernon Valley and Great Gorge paid State rents as separate corporate entities. In September, 1977, she testified, she was notified by letter that Vernon Valley, which had absorbed the Great Gorge facility, would assume Great Gorge's rental obligations.

Donlon also recalled that Vernon Valley's vice president and treasurer, Roger W. Scott, requested in the September letter that DEP adopt a "deferred rental payment schedule" for Vernon Valley and mentioned the corporation's desire to construct a lake to provide more water supply at their ski facility. Although a deferred payment schedule was approved, according to Donlon's answers to questions by SCI counsel Michael V. Coppola, the proposal for a man-made lake was not:

Q. As of September 14, '77, the State of New Jersey had not given them permission to actually build that lake?

A. That's true.

Q. Did you notify Mr. Scott?

A. Yes, I did.

Q. Did you do that by letter?

A. Yes.

Q. Now, I show you C-102 for identification. You recognize that as a letter received by yourself from Mr. Scott dated January 14, 1978?

A. That is correct.

Q. Now, again, does that letter also mention the request or the need for an additional lake by Vernon Valley/Great Gorge?

A. That letter does reiterate that.

Q. And there had been no permission from the Department of Environmental Protection to grant permission for that lake?

A. That's my understanding, yes.

Fiscal Audits Would Have Exposed Rent Withholding

In 1977 and 1978, Donlon said, the Vernon Valley accountants, Klatzkin & Co., treated both Vernon Valley and Great Gorge as a single unit for the purpose of rent payments, in accord with State lease and corporate merger requirements. But the accounting firm excluded Great Gorge from the rental payments during the following three years, as SCI Chief Accountant Julius Cayson had previously revealed. Counsel Coppola questioned Donlon about this default and about future safeguards against such lapses:



Q. And is it your understanding that Klatzkin & Company did in fact treat both of those entities as one for purposes of rental payments?

A. They so say it in their letter.

Q. Now, if I were to tell you for the fiscal years '79, '80 and '81 Vernon Valley did not report revenues earned by Great Gorge, a portion of the facility, and, therefore, Vernon Valley did not pay the rent to the State for Great Gorge land that was rented, could you make a recommendation as to any procedure that could be implemented so that such a situation could not arise again in the future?

A. I suppose that periodic financial audits by the Department might have some effect.

Q. To your knowledge, was any audit performed, let's say, in 1978?

A. Yes.

Q. Was that a financial audit?

A. It is my understanding that that was an operational audit.

Q. Is it fair to say that an operational audit does not really delve into the books and records of the entity under review for purposes of determining what is in the books, the accuracy and things of that nature?

A. That is my understanding.

Q. Do you think it would be a good idea for an annual financial audit to be conducted by the State agency as well as an operational audit?

A. Yes.

#### She Questioned Insurance Coverage in 1978

Donlon's testimony next focused on the London & World insurance company that, according to SCI investigative findings, Vernon Valley had falsely represented as a legitimate liability insurer. She said she had in June, 1978, received from Vernon Valley certificates of insurance by London & World covering the resort for the years 1977 and 1978 -- one, as SCI counsel put it, "with the purported signature of Joseph Guy Dasti at the bottom" and the other "allegedly signed by a Joseph Peterson." She also received other related papers pertaining to alleged liability

coverage. Counsel Coppola questioned her about these:

Q. Did those documents satisfy you that London & World was a bona fide insurance carrier?

A. No.

Q. In order to learn whether or not London & World was in fact a bona fide company, did you have correspondence with an attorney?

A. Yes, I did.

Q. I show you two exhibits marked C-106 and C-107 for identification. Do you recognize those documents?

A. Yes. These are letters to Charles Carella, the attorney at that time for Vernon Valley, by myself. C-106 is dated June 15, 1978, and at that time I requested further information and submitted to him a copy of the insurance policy that Vernon Valley had sent to me.

C-107, dated July 27, 1978, I again wrote to Mr. Carella and I stressed the urgency of finding out the bona fides of London & World Assurance Company.

Donlon sent copies of her letter to the attorney to Betty Wilson, then the deputy DEP commissioner; Russell Cookingham, director of the Fish and Game Division; Robert Solan of DEP counsel staff; Gene Mulvihill as chairman of the Vernon Valley board, and to the law firm of McCarter & English, which also represented Vernon Valley. In further attempts to obtain proof that London & World was a legitimate carrier, Donlon also talked directly with Mulvihill who told her the signer of one of the insurance certificates, Dasti, "was a representative of London & World." She also contacted Mulvihill's executive secretary, to request proof that New Jersey as well as Vernon Valley had liability coverage. She said she received a "typewritten endorsement" alleging that New Jersey was covered. Eventually, in September, 1978, she received a reply to her request for insurance proof from attorney Carella. These documents of "proof" aroused further doubts in Donlon's mind about the validity of the insurance carrier since they indicated that London & World was not created until ten months after the January 2, 1977, certificate of insurance from London & World that was to demonstrate coverage for all of 1977. Donlon's testimony on her tracking of London & World included these excerpts:

Q. Can you tell us what Mr. Carella submitted to you concerning the bona fides of London & World?

A. Mr. Carella submitted, attached to this letter, a copy of the certificate of incorporation for London & World; a copy of the letter forwarded to his attention indicating that Vernon Valley paid the sum of \$175,000 as a premium for insurance from London & World Assurance, Limited; he gave the address of the registered office of London & World in Grand Cayman, British West Indies; and he included the names and addresses of the original subscribers to the stock of the company.

Q. Did that information satisfy you that London & World was in fact a bona fide carrier?

A. No, it didn't.

THE CHAIRMAN: Exhibit C-110 seems to read, from Klatzkin & Company, that they conducted an audit of the financial statement of Vernon Valley Recreation Association, Inc., for the year ending April 30, '78, and found they paid \$175,000 deposit premium for a liability insurance policy.

THE WITNESS: Yes.

Q. In response to that packet of information, did you tell Carella that you needed immediate evidence of the financial responsibility of London & World in the form of a certified financial statement and the name of the local broker?

A. Yes.

Q. Can you tell us when London & World was allegedly incorporated?

A. October 13, 1977.

Q. And where was London & World incorporated?

A. In the Cayman Islands, British West Indies.

Q. I previously showed you a certificate of insurance marked C-104 for identification. It's a certificate of insurance of London & World insuring Vernon Valley/Great Gorge?

A. That is, yes.

Q. That stated the effective date, according to the certificate of insurance, was January 2nd, 1977, which predated the incorporation of the London & World Company by some 10 months?

A. Yes.

Q. Did that strike you as odd when you reviewed the paperwork?

A. Yes. It made it all the more important to find out the financial responsibility of this company.

Q. Now, after talking to Carella did you then contact the State of New Jersey Department of Insurance?

A. Yes.

Q. And did you relate to them your concerns about London & World?

A. Yes, I did.

Q. Did they offer you any suggestions?

A. They suggested that although they did not have information on carriers outside of the State of New Jersey that I might contact a firm in New York which represented Lloyds of London in this country.

Lloyds of London "Never Heard of" London & World

As suggested by the State Insurance Department, Donlon wrote to the New York law firm of LeBoeuf, Lamb, Lieby and MacRae, which represents Lloyds of London, and asked them what they knew about London & World. The testimony on this issue continued:

Q. I show you what's marked C-110A for identification and ask if you recognize it?

A. C-110A is a letter to me dated September 15, 1978, signed by James F. Johnson, IV. In that letter he says, "Thank you for your letter of September 7, 1978, which I received today. I'm afraid that the certificates of insurance do not provide us with much more information than we had, which is very little indeed. All the sources I approached, both in the United States and in London, have never heard of this insurer or Joseph Dasti, whose facsimile signature appears on this item. I therefore advise you use extreme caution accepting the security of this insurer until

you receive proof positive of its bona fides and financial solidity."

Since Johnson's letter corroborated her suspicions about London & World's legitimacy, Donlon again contacted Mulvihill at Vernon Valley by letter on October 2, 1978:

Q. Can you summarize, please, for us what the letter contained?

A. In this letter I reiterated the requirements of the lease regarding insurance and the amount of coverage that was due, and stated that in the past I had informed him that I required the bona fides of the insurance carrier. I reported to him that considerable investigation had failed to establish that this company is in fact a legitimate insurance carrier with assets sufficient to pay claims in the amount specified in the policy.

Q. Did you also advise him of your dealings with Mr. Carella?

A. Yes, I did. I said, "Obviously, the payment of a premium to a company incorporated by parties with an interest in V & G Management Company or their designees would not be in compliance with the terms of the lease agreement. If the requested information is not immediately forthcoming, notices of default will be issued to all parties in interest."

Lease Did Not Require a New Jersey Licensed Carrier

Donlon sent copies of her letter warning Mulvihill that the State might have to take default action against Vernon Valley to her associates in DEP, to Deputy Attorney General David B. Harris and to Vernon Valley's lawyers. Asked if various DEP administrators, such as Wilson or Cookingham, had offered any help in solving the problems she faced, she responded, "not to my recollection." Harris did give her certain legal advice, she recalled:

Q. And what did he advise or what did he suggest, if you recall?

A. He suggested that I reexamine the lease agreement to see if it required that the insurance carrier be licensed to do business in the State of New Jersey.

Q. Had you already done that?

A. Yes.

Q. And what was the result?

A. That was not a requirement of the lease.

On October 9, 1978, Mulvihill wrote Donlon confirming that he would "obtain an accounting statement that will satisfy you of the financial ability of London & World." He also said that Vernon Valley was "negotiating with two other carriers which are more widely known than London & World" and that, "at any rate, the insurance problem would be resolved to your satisfaction" within five weeks. Donlon testified that the issue of the legitimacy of London & World was never resolved to her satisfaction.

On October 27, 1978, Donlon again received a letter from Mulvihill, this time stating that Vernon Valley had negotiated for \$1 million insurance coverage by the Admiral Insurance Company, \$900,000 by Dover Insurance Company and \$100,000 by London & World. She recited portions of the letter which stated that since the companies responsible for \$1.9 million of the liability coverage are "well recognized," that "should settle the insurance question." The testimony continued:

Q. Did this letter settle the insurance question in your mind?

A. No, it did not.

Q. As a result of this letter did you then attempt to investigate the bona fides of Admiral and Dover?

A. Yes, I did. I contacted the State Department of Insurance again regarding Admiral and Dover, and they informed me that one company was a well-recognized carrier with the State of New Jersey, but the other one was in some financial difficulties and may have been in danger.

Q. Was it the Dover Insurance Company that had no status in New Jersey and was reputed to be in very serious financial straits?

A. That's correct.

Q. Did you advise Mr. Mulvihill of the results of your investigation?

A. Yes, I did.

On November 2, 1978, Donlon not only wrote Mulvihill about the derogatory information she had received on the Dover Insurance Company but also reminded him she had not yet received the financial statement from his accountant on rents due the State. She also notified her superiors and other associates in DEP of her continuing problems with respect to the Vernon Valley lease. She got a limited response to her departmental memo. By the end of 1978, she had still not received any proof of liability coverage

from Mulvihill. What happened next did nothing to ease her doubts about London & World, according to her testimony:

Q. By the end of 1978 had you received proof of liability coverage from Mulvihill as you had requested and as he had promised?

A. No.

Q. Did you continue to request that he provide it?

A. Yes. C-119 is a letter dated January 31, 1979, signed by me, and it's addressed to Mr. Mulvihill. It says, "This is to confirm receipt of the rental revenue for '77, '78. I wish to remind you as of yet I received no proof of liability insurance coverage. Please forward these documents to me without delay."

Q. I show you C-120 and C-120A for identification and ask if that was Mulvihill's response to your latest request?

A. Yes, this was a letter to me dated February 1st, 1979. It's addressed to me, signed by Gene Mulvihill. It states that, "I have enclosed correspondence which shall satisfy you as to the ability of London & World together with its reinsured to meet any potential claim."

Q. I direct your attention to C-120A, the first page. That was part of the enclosure?

A. Yes.

Q. Is the first page a certificate of insurance with London & World named as the insurance company?

A. Yes, it is.

Q. Naming the insured as Vernon Valley Recreation, Inc., for the time period 1/2/79 to 1/2/80. Wasn't that the same sort of document he had been submitting all along?

A. Indeed it was.

THE CHAIRMAN: It's not very official looking, is it?

THE WITNESS: No.

THE CHAIRMAN: It isn't in keeping with the type of document that you receive regularly in insurance matters, is it?

THE WITNESS: We receive certificates of insurance, some of which perhaps being similar but usually on a more official looking piece of paper.

THE CHAIRMAN: This looks like homemade form to me.

With his letter to Donlon on February 2, 1979, Mulvihill enclosed a letter to Richard Schuessler of Davis, Dorland & Company from the accounting firm of Arthur Kupperman & Company. The witness was asked to read from the letter:

A. The letter addressed to Mr. Schuessler states, "I'm in the process of preparing the certified financial statement for London & World Assurance, Limited. As of December 31, 1978, it appears that the above company has an excess of \$2 million of unencumbered assets and fully secured unconditional continuing guarantees available to cover claims in the State of New Jersey. Upon receipt of various confirmations, I will release copies of financial statements to you."

Q. And Mr. Mulvihill was cc'd on that letter?

A. Yes, he was.

Q. So, now, were you ever informed by Mulvihill or Kupperman or Schuessler that the assets of London & World were in fact encumbered assets?

A. No.

Q. Or that the assets referred to in the letter that you just spoke about were in fact Mulvihill's personal assets?

A. No.

At about this time Donlon was transferred to another DEP post which she said had no jurisdiction over the Vernon Valley lease. She recalled that DEP's Green Acres division shifted responsibility for administering the lease to the Fish and Game Division, despite opposition by certain individuals in that division. Whatever the transfer arrangements, bureaucratic buck-passing on Vernon Valley's lease problems was compounded.



### Vernon Valley's Insurance Broker

Richard J. Schuessler, the next scheduled witness, was during the late 1970s a vice president of Davis, Dorland & Company and the broker who handles Vernon Valley's insurance matters. He did not appear at the public hearing because, as Chairman Lane announced, "he has indicated to us that he would, on the basis of a claim of privilege, be unwilling to testify in this matter."

Therefore the Commission authorized its counsel, James A. Hart, III, to put portions of Schuessler's prior testimony at executive sessions of the SCI into the public hearing record. SCI Special Agent Raymond H. Schellhammer read Schuessler's responses from transcripts of the executive session interrogation. At the outset Schuessler said he handled Vernon Valley's insurance for about eight years and that, while he primarily dealt with Roger Scott, the company's vice president, he had both a business and a social relationship with Mulvihill. Despite this long association, which extended through Vernon Valley's insurance problems with DEP, Schuessler testified that, until an SCI agent gave him the details about Vernon Valley's lease, "I was unfamiliar with their lease or insurance requirements with the State."

One of the first issues raised with Schuessler was the utilization by Vernon Valley of so-called "certificates of insurance" to indicate to the DEP that it had liability coverage by London & World Assurance, Ltd. Counsel Hart asked about the certificate forms and Agent Schellhammer gave Schuessler's replies:

"Q. I take it this form is a blank or they come in pads, for instance?"

"A. They come in pads. They come in sets. They come just blank and you make photocopies of them.

"Q. I notice, for example, the name of the insurance company Canadian Universal is just typed in, is that correct?"

"A. That's correct.

"Q. Did you have these forms available at Davis, Dorland?"

"A. Yes.

"Q. Did you ever give any of these forms to Mr. Gene Mulvihill?"

"A. Yes.

"Q. Did you give him blank forms, sir?"

"A. Yes."

A Certificate of (Duplicate) Insurance Coverage

According to Schuessler's private testimony, Vernon Valley utilized one of the blank "certificate of insurance" forms in 1977 -- with an odd result, since it indicated that the ski resort had contracted for duplicate insurance coverage. The incident followed the cancellation of Vernon Valley insurance by Canadian Universal Insurance Company on July 22, 1977. Canadian Universal had provided liability coverage for Vernon Valley in 1976 and for 1977 up to the date of the cancellation notice. Schuessler's testimony on what happened as a result of that cancellation follows:

"Q. Let me show you what was marked as C-35 for identification and would you look at that and tell me if you can recognize that, sir?

"A. This is a certificate of insurance.

"Q. The same type of document we were talking about before that you indicated was a form in which the blanks were filled in?

"A. That is correct, and this is on the London & World Assurance Company, which is a company which Mr. Mulvihill got involved with. It's from the Cayman Islands, British West Indies, and Davis, Dorland effected reinsurance for this London & World Assurance Company. Actually the transactions of this insurance company were all handled by Mr. Mulvihill, and I assume the certificate came from the London & World and the British West Indies.

"Q. This is the same type of certificate that you gave to Mr. Mulvihill in blank, is that correct?

"A. Yeah.

"Q. This particular certificate issued in the name of London & World indicates a policy number of SNJ 10101, is that correct?

"A. That's correct.

"Q. Effective date and the expiration date as set forth on that certificate are what?

"A. January 2, 1977, to January 2, 1978.

"Q. The limits of liability are what?

"A. \$2 million.

"Q. This policy or the policy that this certificate represents would have been in effect at the same time as the insurance that you obtained for Vernon Valley in the calendar year of 1977, is that correct?

"A. That is correct.

"Q. Wouldn't that be unusual, sir -- or maybe it wouldn't be, I don't know -- would it be unusual for Vernon Valley or any company to have two policies overlapping in that manner?

"A. Yeah, that would be unusual.

"Q. Why would it be unusual?

"A. It would be a duplication of insurance coverage."

No Reinsurance of London & World Until End of 1978

During Schuessler's executive session testimony, he was asked by counsel Hart to identify a copy of a London & World Assurance policy for Vernon Valley for the period January 2, 1978, to January 2, 1979. Schuessler agreed that no reinsurance was provided for this policy. He further identified the policy number as GLASNJ 10101, and its liability limit as \$2 million, its premium as \$175,000. He next identified a London & World renewal policy for January 2, 1979, to January 2, 1980, on which he said the Davis, Dorland company had provided reinsurance as of December 15, 1978. He explained that reinsurance is a procedure by which an insurance company "lays off" part of its risk to another company, "a common practice in the insurance world." In line with this practice, Schuessler said, the Davis, Dorland company issued a "cover note" or "reinsurance certificate" as evidence that the Dover Insurance Company held \$900,000 of the risk in excess of the \$100,000 risk assumed by London & World. He said that the reinsurance was obtained through Ed Pendergast of Risk Design, an insurance broker and a reinsurance intermediary who was scheduled to testify later. At this point, John J. Francis, Esq., whose term as SCI commissioner had not yet expired and who was presiding at the executive session, interjected:

"COMMISSIONER: "Let me ask you directly, had you undertaken to make any inquiries as to who London & World was?"

"THE WITNESS: The only thing that I had seen was the certificate of incorporation, and I believe I gave a copy of that to Ed Pendergast to give to the Dover, or to whoever he was going to so they could check on them in the Cayman Islands, and I had a letter or something from the accountant stating that the London & World had 2 or \$3 million in assets; and I had the assurances

from Gene Mulvihill that he knew all the people who were involved with the London & World and it was a viable insurance company and he hoped he could get the thing off the ground to a point where he could go out and contact those that he knew in the ski area business and have them insure with the London & World."

Schuessler then was shown a London & World Assurance policy for the period February 15, 1979, to February 15, 1980, which he said was subsequently extended to March 30, 1980. He also identified the Dover certificate of reinsurance of \$900,000 of the risk over the \$100,000 assumed by London & World. In addition, he identified the authorized representative named on the policy as Michael Teschner, who he believed to be the president of London & World. Since evidence that Teschner's signature was forged would subsequently be introduced into the public hearing record, Schuessler was questioned about this individual, as follows:

"Q. Did you in any way, shape or form play a part in Vernon Valley obtaining that policy from London & World?

"A. No, sir.

"Q. Do you recognize the name of the authorized representative that's down in the right-hand corner?

"A. Yes.

"Q. What is that name, sir?

"A. Michael Teschner. He, I believe, is the president of London & World Assurance.

"Q. Did you ever speak to him on the phone?

"A. I spoke to him on the phone.

"Q. Did you call him or did he call you?

"A. I believe I called him.

"Q. Did you have to call the British West Indies to speak to him on the telephone?

"A. No. He was either in New York or New Jersey. I believe he was in a hotel in New York. It was when I was interested in obtaining reinsurance for the company and Gene Mulvihill gave me his telephone number.

"Rebate" Or "Returned Premium?"

Schuessler next was questioned about terminology that was used in a memo from London & World, signed by one M. VonAmond, that would not normally be used by an insurance professional. The memo, to the Klatzkin & Company accounting firm, said that "we have been asked by our client Vernon Valley Recreation Association, Inc., to write you confirming a rebate of \$96,497.44 due to experience rating our premiums through April 30, '79 --." The memo identified the Davis, Dorland company as "our agent." An explanation of the use of the word "rebate" in the London & World Assurance, Ltd., memo was sought from Schuessler:

"Q. What would that mean in the insurance business, sir?

"A. In the first place, rebate, I think, in an insurance broker's connotation, would be where you rebate the premium or a part of the premium back to the customer, which is illegal. You can't do that. I think the general public uses a word rebate meaning a returned premium, which is the way a broker would refer to it ... (that) he was entitled to a refund. They are referring to it as rebate.

"Q. One would assume that an insurance company such as London & World would know the difference between a rebate and a returned premium; one would expect them to use the term returned premium?

A. That's correct. Although they are not Americans.

"You Can Set Up An Insurance Company"

Witness Schuessler was reluctant to state that London & World was the creation of Eugene Mulvihill, the Vernon Valley board chairman, but prolonged executive session interrogation forced him to concede that it was a "captive" company. By "captive", he meant that London & World was established solely to insure the risks of its sponsor, Vernon Valley. Although Schuessler insisted that his company, Davis, Dorland, was "not at any time" the London and World agent, his testimony indicated that he, as the Davis, Dorland representative, went to unusual lengths to promote Mulvihill's efforts to obtain financial credibility for London & World and to find a company that would reinsure most of London & World's Vernon Valley risks. Schuessler said he suggested to Mulvihill in long hand on a Dover Insurance Company form how an insurance company financial statement should be structured. Schuessler said he obtained advice from "one of the big" accounting firms on how an insurance company would prepare such a statement. Then-

Commissioner Francis interjected:

"Q. Why would you want to show Mulvihill, or why would Mulvihill want to know from you? Why would it be set up? Why wasn't it rejected? Why tell Mulvihill? Why even show him how it should be done?

"A. As far as I know, with all of these Bermudian and Cayman Island insurance companies, most of them were just attorneys' offices and U.S. corporations and whoever wants to get into the insurance business out of the United States to Bermuda or the Cayman Islands, and you can set up an insurance company, and if you want to send out, you know, documentation as to what the company is, somebody has to prepare these documents. So all Gene and these other guys had from the Cayman Islands was presumably the 2 and \$3 million and a certificate of organization for an insurance (firm) that was owned reasonably by certain stockholders who would put up their assets at risk, and their accountant, or whoever had set this up, came up with a three-line thing not signed by anybody, and I supposed to take that and go to reinsurance markets and have them reinsure this company.

"EXAMINATION BY MR. HART:

"Q. Did Mr. Mulvihill set up the London & World Assurance, Limited, company?

"A. I would say he did not set it up. What he was doing was screaming about his insurance premiums and screaming to me about a lot of other people who had money, and he was telling me, as well as these other people, that, gee, you ought to get into the business of insuring ski areas because insurance companies are charging exorbitant rates, the losses aren't there, and I have a lot of buddies in the ski area business, and you should be able to make a fortune by insuring ski areas. What he had told me, he had gone to several firms trying to find out where to go to get an offshore insurance company.

"Q. Did Mr. Mulvihill have control over whether or not claims were settled or contested by the London & World Assurance company?

"A. Yes. I am assuming that. That was one of the purposes that he wanted to, you know, do business with somebody that would do what he wanted them to do. He was irate when he had to pay claims.

"COMMISSIONER FRANCIS: Didn't you understand because he had that control and because he was the guy who provided that financial statement and he was the guy who suggested how it would be restructured, that he, at least, had an interest, if not control, in London & World Assurance?

"THE WITNESS: I wouldn't question that he probably did have an interest financially or otherwise, sure.

"BY MR. HART:

"Q. Did you ever tell Mr. Edwin Pendergast of Risk Design that Mr. Mulvihill owned London & World Assurance, Limited?

"A. I may have, but I can't specifically recall.

"Q. Did you tell Mr. Pendergast that Mr. Mulvihill owned London & World Assurance?

"A. I assume I must have if you are telling me.

"Q. I'm asking you whether you did or not, sir?

"A. I don't remember. I may have.

"Q. Mr. Schuessler, let me show you what's been previously marked as C-16 for identification. Would you look at that and tell me if you recognize it?

"A. This is a letter addressed to me from a certified public accountant, Arthur Kupperman, saying he was in the process of preparing a certified financial statement for this London & World Assurance company and it appeared that the company had an excess of \$2 million in assets.

"Q. Did Mr. Pendergast request you to obtain one, that is a certified financial statement on London & World, because the Dover Insurance Company wanted it for reinsurance purposes?

"A. I believe he may have. I can't swear one way or the other. It may have been on my own instigation that I would have contacted Gene Mulvihill and said, hey, you have got to give me something, and so that's what I got.

"Q. Did Mr. Mulvihill contact Mr. Kupperman?

"A. Yes -- I don't know.

"Q. You are assuming he did?

"A. Yes.

"Q. You spoke to him, meaning Mulvihill, about obtaining a certified financial statement on London & World?

"A. Yes.

"Q. Let me show you what's been marked C-17 and tell me if you have seen that before, sir?

"A. It says it's a financial statement, London & World Assurance Company, Limited, November 30, 1977, but then it's a balance sheet and it shows assets totaling \$3,465,000.

"Q. It's uncertified and unsigned, is it not?

"A. That's correct. I may have shown this to Ed Pendergast or someone at Davis, Dorland and they said -- first place I know myself that -- this is a balance sheet, not a financial statement. It may have been as a result of my having requested this that I went to Mulvihill and said, hey, this is how the Dover does it. You have got to have figures -- you have got to show -- if this is an insurance company, where is the activities of the insurance company? Where are their liabilities?

"Q. From whom did you receive that document?

"A. This -- I would assume I got this from Gene Mulvihill.

"Q. What's a captive insurance company?

"A. Captive insurance company would be one generally set up to handle the insurance for a specific insured or specific number of insureds that were related by virtue of being members of an association or something of that type.



"Q. They insure a specific company or a specific company and its subsidiaries, affiliates and related companies?

"A. Right.

"Q. Wasn't London & World a captive of Vernon Valley Recreation Association, Incorporated, and its subsidiaries?

"A. I honestly don't think it was, but it may have been.

"Q. Why do you say it was not, sir?

"A. Because Mulvihill seemed to be interested in having this insurance company set up. By definition I just said it was to insure companies linked together by association. So by that definition it was a captive. I don't believe that Mulvihill intended to have a company set up simply to insure Vernon Valley. I believe his intent was, as with other of his business endeavors, this would be one more business endeavor to get into the insurance business and the market place of this insurance business. What he was interested in getting into was the market place of ski areas because he realized that they all, like himself, were being charged exorbitant premiums and the claims just weren't there. I believe he honestly felt that it would be a way for himself to make money and service other ski areas by having a company that would specialize in insuring ski areas, and I don't feel that he intended to be a captive specifically for Vernon Valley.

"Q. Did London & World insure any ski areas other than those with which Mr. Mulvihill was associated?

"A. Not that I know of.

"Q. Did it insure companies other than those which Mr. Mulvihill was associated?

"A. Not that I know of.

"Q. By your definition London & World was a captive of Vernon Valley Recreation?

"A. I guess the answer would be yes. I have no way of knowing that.

"Q. Did you ever suggest to Mr. Mulvihill that he set up a captive insurance company?

"A. I may have. I don't think, though, with Gene Mulvihill you had to suggest too much. He had plenty of ideas of his own."

To pin Schuessler down in the issue of whether he had actually advised Mulvihill to form a captive insurance company, counsel Hart read into the private hearing record a letter from Schuessler to Mulvihill on July 25, 1977. In this letter Schuessler said he was having difficulty obtaining liability insurance for Vernon Valley's ski operation but that an alternative would be "the forming of a captive insurance company, the details of which can be fully explained to you..." The testimony:

"Q. In July of 1977 you did suggest to him, Mr. Mulvihill, one alternative he had was to form a captive insurance company?

"A. Yes."

Counsel Hart next had Schuessler read into the executive hearing record another letter he wrote to Mulvihill, in January, 1981, further corroborating the witness' knowledge of the reasons for the existence of London & World. After noting that a partial premium payment was now due and another payment would be due in February, 1981, Schuessler read the remainder of the letter:

"This would allow you time to consider whether or not coverage should be continued with London & World. The main thing to keep in mind is that you do not want to lose the advantage that you have now in controlling whether a claim is to be paid or denied and defended.

"There are few companies who would be willing to reinsure the London & World without financial data on them and without having accident reports submitted for all instances as they occur.

"If you purchase direct insurance even with a large deductible, the insurance company may allow you to retain Eric Karg and Sam DeGonge, but will insist upon receiving all incident reports. The insurance company and not you will then dictate whether claims can be fought or insist that they be paid."

At the conclusion of Schuessler's executive session testimony, the issue of Vernon Valley's insurers requiring lessons to be taken by all ski groups, as Vernon Valley had claimed, was raised:

"Q. Did the Dover Insurance Company in any of the reinsurance policies they issued to London & World through you require that groups attending the ski resorts receive ski lessons before being allowed to ski?

"A. No."

#### **How Davis, Dorland Was Misused**

The next witness was William Kirkwood, chairman of Davis, Dorland & Company, the insurance brokerage firm through which Schuessler had been handling Vernon Valley insurance matters. He testified that Schuessler left Davis, Dorland in February, 1982. As part of an agreement, Davis, Dorland transferred to Schuessler all business "which we characterized on our records as his." One of the files relative to Vernon Valley was not, however, given to Schuessler as part of his personal account until four months after his departure because the name of the file had been changed. SCI counsel Gerard P. Lynch asked Kirkwood about this:

Q. Is it not a fact, Mr. Kirkwood, that you didn't become aware that one of your casualty folders had been changed from Vernon Valley to London & World until after this Commission began its investigation?

A. That is correct.

Q. Was the change either authorized or proper?

A. We were unable to locate the folder initially under Vernon Valley or one of the subsidiaries and at that time I was not aware that the top of the folder had been changed actually to London & World. This is not a proper connotation since London & World were really not the insured, they were the beneficiaries, supposedly, to the reinsurer. However, I will admit that.

Among the documents in the Schuessler folder on Vernon Valley that had been misnamed London & World were copies of certain checks written by Vernon Valley and payable to Davis, Dorland, to be applied against premiums due to the Dover Insurance Company from London & World as the latter's reinsurer. These checks were for \$18,000 on June 14, 1979; \$63,000 on February 2, 1980, and \$31,000 on February 19, 1981. Counsel Lynch questioned Kirkwood on these checks:

Q. Would this be unusual for the insured, either Mr. Mulvihill or Vernon Valley, to have submitted these monies to Davis, Dorland rather than the primary insurer, London & World?

- A. Well, there are a number of matters pertaining to this that, quite frankly, I do not understand and cannot comment on. Normally a premium for reinsurance would be paid by the party that is being reinsured. However, there are cases in insurance where, to purchase reinsurance, involves an additional charge, and I have known -- in the direct insurance field, not the reinsurance field, I have no familiarity with that, that the additional charges for reinsurance are paid by the client.

Another exhibit discussed with Kirkwood involved Schuessler's unauthorized use of the name of an inactive Davis, Dorland company. This inactive company, Kirkwood recalled, was the Davis, Dorland Securities Corporation, which was transformed into Davis, Dorland Intermediaries on Kirkwood's insistence so that Davis, Dorland could handle reinsurance transactions in accordance with State law. However, the name of the inactive concern, Davis, Dorland Securities, was typewritten on a letter signed by Schuessler and which accompanied an invoice for \$52,500 to London & World Assurance, Ltd., in Grand Cayman in the British West Indies. The Commission noted that these papers were sent by Vernon Valley's Mulvihill to DEP's Jeanne Donlon in February, 1979, at a time when she was questioning the validity of London & World as a legitimate liability insurance carrier. Counsel Lynch and Kirkwood discussed this correspondence:

- Q. Was this done at the period of time when Mr. Schuessler was still working with your company?
- A. The answer is yes.
- Q. Did such an invoice, as you see there, ever come out of your company?
- A. No.
- Q. Did your records indicate whether any transaction ever took place between Davis, Dorland Securities Company, as stated in this invoice, and London & World, Limited?
- A. It didn't and it could not have. Not one item of business was transacted through Davis, Dorland Securities Corporation.
- Q. Let me ask you this, Mr. Kirkwood, would anyone outside of an employee of Davis Dorland & Company know of the existance of Davis, Dorland Securities Corporation at that time?

- A. No. However, I might offer this suggestion, that Mr. Schuessler was aware of my plan to convert Davis, Dorland Securities Corporation by an amendment of named insured, purpose of corporation and subsequent licensing. Now, whether this was premature, I can't say, but it certainly is not in order.

THE CHAIRMAN: What's the stationery, what's the letterhead on that document you're referring to?

THE WITNESS: I believe it is on plain white paper and on the top of it says Davis, Dorland Securities Corp., 2 World Trade Center, New York, New York, 10048.

THE CHAIRMAN: At that time did you have letterhead stationery for that company?

THE WITNESS: No, sir, we have never had stationery for Davis, Dorland Securities or Davis, Dorland Intermediaries.

- Q. Was this invoice actually prepared by Dick Schuessler, can you tell by looking at it?
- A. The letter -- it is his signature, his initials on the bottom and his secretary's initials.
- Q. Mr. Kirkwood, can you tell us whether or not Davis, Dorland & Company or Davis, Dorland Intermediaries or Davis, Dorland Securities Corporation ever received any premium payment checks from London & World Assurance, Limited?
- A. To my knowledge, definitely not.
- Q. Was Davis, Dorland & Company ever a contact office for London & World Assurance, Limited?
- A. Not to my knowledge.
- Q. Do the names M. Von Amond or Klatzkin & Company mean anything to you?
- A. No, sir.
- Q. I'm now going to show you an exhibit which is marked C-133. This contains a undated letter to Klatzkin & Company from an M. Von Amond. Now, it states in that letter, and I'm going to quote it: "If you have any further questions, please contact us through

our agent, Davis, Dorland, 99 Church Street, New York, New York."

Mr. Kirkwood, has Davis, Dorland ever been an authorized agent for London & World?

A. No.

Counsel Lynch next showed Kirkwood exhibits which consisted of four performance bonds listing London & World as the surety which were submitted to Vernon Township on behalf of Mulvihill's condominium company, Stonehill. They were discussed with Kirkwood because each bond listed the Davis, Dorland company as London & World's contact in the United States:

Q. Do your records reflect whether Davis, Dorland & Company ever arranged for the procurement of these bonds?

A. Our records do not indicate the formal handling of any bonds of this kind.

THE CHAIRMAN: Would you have known of such a filing of a bond with your company's name on it if it had been properly done?

THE WITNESS: What I did do was to review our payable records and also our expiration records to see whether any such bonds were there, and I could locate nothing, which certainly to me indicates that they were not processed through our office.

Q. Mr. Kirkwood, I now show you a letter dated October 31, 1979, (which) indicates that these documents were transmitted to Mr. Schuessler on behalf of Stonehill Corporation.

If your corporation didn't arrange for the procurement of the bonds that I just mentioned, do you have any idea why Mr. Schuessler would be receiving these documents relating to the Stonehill Corporation?

A. No, I do not.

Q. I'm also going to show you additional papers you supplied to us from your files, among which is a paper addressed to Mr. Schuessler dated November 4th, 1979, from Wes Smith, general manager of V & G Management. Now, among these papers is a copy of a performance bond in blank form.

Does this blank form compare with the performance bonds received by the Township of Vernon on behalf of the Stonehill Corporation that we have just described?

- A. Yes, with the appropriate information added.

THE CHAIRMAN: Whose signature's on that letter.

MR. LYNCH: That's Wes Smith from Vernon Valley, Mr. Chairman.

- Q. Finally, I have one more exhibit, a letter on London & World stationery wherein Davis, Dorland Intermediaries is typed under the letterhead and this was then sent to the Township of Vernon.

Did your company authorize that Davis, Dorland Intermediaries act as the authorized agent for any of the bonding relating to the Stonehill Corporation?

- A. Absolutely not.

#### **Recalls London & World Reinsurance**

Edwin T. Pendergast, the next witness, had been an insurance broker and a reinsurance intermediary for 30 years. At the time of his appearance at the SCI's public hearing, he was employed by Risk Design, a reinsurance agent. He recalled that Risk Design was requested in late 1978 to obtain reinsurance for London & World covering Vernon Valley through the brokerage firm of Davis, Dorland. From the outset, Pendergast made clear, broker Richard Schuessler was the prime mover in the effort to reinsure London & World for the Vernon Valley risk. Pendergast also testified that a letter from CPA Arthur Kupperman to Schuessler, indicating that London & World had in excess of \$2 million in "unencumbered assets", was "one of the considerations" on which he relied in obtaining the requested reinsurance. Counsel Lynch and Pendergast engaged in the following discussion:

- Q. Were you at all looking past the financial statement of London & World toward the assets of Vernon Valley itself in making a determination as to whether or not reinsurance was to be granted?

- A. Reinsurance is granted to an insurance company.

- Q. That's correct.
- A. Vernon Valley was to take a deductible of \$1,000, as I understand it, from the London & World. We understood that Vernon Valley and London & World were the same ownership.
- Q. Did you ever have any discussion with Mr. Schuessler where he supplied additional information to you regarding the fact that they, London & World, had been insuring Vernon Valley for quite some time prior to approaching you?
- A. I believe that is correct, that they had been insuring London & World prior to our being approached for reinsurance.
- Q. Have you ever heard of the term captive insurance company?
- A. Yes, I have.
- Q. What is such a company?
- A. A captive insurance company is a company which is owned to insure its own risk.
- Q. Would you have classified London & World Assurance, Limited, as a captive insurance company?
- A. Yes, sir.
- Q. What would you base that on?
- A. In that it was insuring its own risk, namely Vernon Valley, which we understood was the same ownership.
- Q. Do you know who the owner of the risk was in this situation?
- A. We were told who it was, yes.
- Q. Who?
- A. A Mr. Mulvihill.
- Q. Who told you that Mr. Mulvihill was the owner of the risk?
- A. It would have been the broker.
- Q. Mr. Schuessler?
- A. Mr. Schuessler.



- Q. You knew also Mr. Mulvihill was the principal owner for Vernon Valley?
- A. We were told that, yes.
- Q. Did Mr. Schuessler advise you that Mr. Mulvihill was the main principal in both Vernon Valley and London & World during the negotiations for the reinsurance?
- A. That's when it would have come up.
- Q. How many years had the Dover Insurance Company, through you, written policies for London & World?
- A. It was two years.
- Q. Do you have an independent recollection of the dates of those policies?
- A. They were from December 15, 1978, and then it was renewed December 15, 1979, for another year and then extended for three months up to March 15, 1981.
- Q. Mr. Pendergast, I show you a policy of insurance of London & World Assurance, Limited, GLA 10117, which is dated 1/2/79 to 1/2/80, and its general liability is \$1 million. Do you recognize that document?
- A. Yes, I do.
- Q. Was this policy provided to you by Mr. Schuessler while you were considering the reinsurance?
- A. This was prepared, I believe, afterwards. This is the policy of the London & World during that period which we reinsured.
- Q. I show you exhibit C-160, Mr. Pendergast, which is an insurance policy for the period 12/79 to 12/80, again from London & World for \$1 million. Was this also supplied to you by Mr. Schuessler?
- A. Yes, it was.
- Q. And lastly I'm going to show you two exhibits marked C-239 and C-241. Do these documents which are dated respectively for the periods 12/15/78 to 12/15/79, and then 12/15/79 to 12/15/80 for a \$900,000 coverage, do these denote the coverages that Dover supplied for London & World?

A. That's correct.

Dover Insurance Never Required Ski Lessons

Q. While you were involved with the Dover reinsurance of London & World, did Dover Insurance Company ever require, in order to provide the insurance coverage, that people attending the ski resort as a group receive skiing lessons before they were allowed to ski down the mountains?

A. No, sir.

Q. Such an endorsement would have been supplied on your reinsurance policy, would it not have?

A. That's correct.

Q. And did any of the policies that you submitted on behalf of Dover ever have that?

A. No, sir.

Q. Based on your experience in the insurance business, would it be an unusual stipulation for any insurance company to require such skiing lessons before issuing insurance?

A. Yes, it would be.

Q. Do you feel that such a provision would be enforceable in any insurance policy?

A. No, I do not.

Q. Have you ever required such provision or stipulation in rewriting insurance or reissuing reinsurance?

A. No, I haven't.

Q. And in your experience have you ever seen such a provision or stipulation?

A. No, I have not.

Q. Did you consider Mr. Schuessler to be a spokesman for Mr. Mulvihill who was the principal owner of London & World in your mind?

A. Yes.

Q. Is this why you dealt with Davis, Dorland rather than dealing with London & World for the reinsurance?

- A. Our client is Davis, Dorland. We do not deal with the insurance company nor Vernon Valley. It's not our business.

**CPA Testifies On London & World Assets**

Arthur Kupperman, a certified public accountant, was called to testify about his role in the effort to establish assets for Mulvihill's London & World Assurance, Ltd. His initial answers to questions about the ownership of London & World contradicted his sworn testimony at a prior SCI executive session, as SCI counsel Hart clarified for the public hearing record:

- Q. Did he ask you to perform any other type of accounting services for him?
- A. After that he had asked me to prepare a certified financial statement for London & World Assurance.
- Q. Did Mr. Mulvihill tell you who the owner was of London & World Assurance, Limited?
- A. No, he did not.
- Q. Did anyone tell you that London & World Assurance, Limited, was Mr. Mulvihill's company?
- A. No.
- Q. Mr. Kupperman, I would like you to look, sir, at the transcript of your Executive Session testimony which occurred on July the 22nd, 1982. Would you turn, please, to page eight of that transcript and I'm reading from line four.

Mr. Kupperman, do you recall being asked the following question and giving the following answer?

"Can you tell me who told you it was Mr. Mulvihill's company?"

"Answer: I believe it was Gene that had told me it was his company."

Does that refresh your recollection as to whether or not Mr. Mulvihill told you that London & World was his company?

- A. Going back in time, I'm not sure whether that was a factual statement or just a supposition on my part.
- Q. Let me ask you this, sir, is your memory better today of the events that occurred when you met with Mr. Mulvihill than it was back in July of '82?
- A. Probably equally as poor.
- Q. What else did Mr. Mulvihill, if anything, tell you about this company, London & World?
- A. That it was going to act as the insurance carrier for coverage at Vernon Valley and Great Gorge.
- Q. Was anyone else present when Mr. Mulvihill told you that?
- A. I don't believe so.
- Q. Now, he asked you to prepare a certified financial statement on London & World, is that correct?
- A. That's correct.
- Q. Was there a written engagement letter?
- A. I do not believe so.
- Q. Did you actually perform the services that he requested, that is the preparation of a certified financial statement?
- A. I had started to do the work needed to prepare the financial statement and then I withdrew from the engagement.
- Q. Did Mr. Mulvihill provide you with any documentation you would need in order to begin your preparation of the certified financial statement?
- A. Yes, I believe he gave me whatever it was that I had needed.
- Q. What type of information or documentation did you need to prepare a certified financial statement?
- A. There were certain assets that were going to be pledged for London & World. I needed a list of what the assets were, where they were located so I could confirm them to prepare a financial statement.

Kupperman was asked to review certain documents in connection with his preparation of a certified financial statement for London & World from an audit file that the SCI had subpoenaed. The testimony about these documents follows:

Q. What is that document?

A. An interim financial statement for the nine months ending September 30, 1978, of the condition and affairs of London & World Assurance, Limited.

Q. You say you received it from Mr. Mulvihill?

A. I believe so.

Q. Did Mr. Mulvihill tell you anything about that document?

A. I don't recollect at all.

Q. Did he tell you who prepared it?

A. No, he did not.

Q. Did he tell you that Richard Schuessler of the insurance firm or the insurance brokerage firm of Davis, Dorland filled out the handwritten portions of that statement?

A. I really don't recall whether he had said that or not.

Q. Does that statement set forth what the total assets were of London & World?

A. Yes, it does.

Q. What are the total assets listed there?

A. As of September 30, 1978, \$1,395,000.

Q. What is the listing under liabilities?

A. \$45,200.

Q. Would you look, Mr. Kupperman, at Commission Exhibit C-143. Was that document given to you by Mr. Mulvihill?

A. Most likely, yes.

Q. What is the title of that document?

A. Financial Statement, November 30, 1977.

Q. The second page of that document sets forth assets of the company as of November the 30th, 1977, is that correct?

A. That is correct.

THE CHAIRMAN: What company?

THE WITNESS: London & World Assurance, Limited.

Q. What are the total assets listed in that financial statement?

A. \$3,465,000.

Q. And what about liabilities, were they listed?

A. No liabilities.

Kupperman next identified the letter he sent to Schuessler at Davis, Dorland on January 9, 1979, stating that he was in the process of preparing the London & World financial statement as of December 31, 1978. Kupperman testified that he "believed" that Mulvihill asked him to write the letter but he couldn't recall why. The Commission was particularly concerned with Kupperman's statement in the letter that "it appears that the above company has in excess of \$2 million of unencumbered assets and unconditional continuing guarantees available to cover claims in the State of New Jersey." The letter added that he would release copies of the financial statements to Schuessler "upon...confirmation." Counsel Hart questioned Kupperman about the indicated assets and guarantees:

Q. In the second paragraph of that letter it appears that the company, London & World, has in excess of \$2 million of unencumbered assets and unconditional continuing guarantees. Where did you get that figure in excess of \$2 million?

A. There were certain mortgages that were assigned to London & World and the face value of the mortgages was in excess of \$2 million.

THE CHAIRMAN: We want to know where you got that information?

THE WITNESS: It was from information Gene had given me. He had given me some information concerning mortgages that he was going to assign to London & World.

Q. Would you look at Commission Exhibit C-145, Mr. Kupperman, and tell me what that is?

A. This is a request for a bank confirmation sent to First National State Bank of Central Jersey.

Q. What is the date of that request?

A. January 13, 1979.

Q. And who prepared it?

A. I believe I had prepared it and brought it up to Gene's office for them to type it and Gene to sign.

Q. What is requested in that bank request?

A. A bank confirmation as of December 31, 1978; a confirmation of the balances as of January 12, 1979; and a statement of account activity from January 1, '79, to January 12, 1979.

Q. It's requesting the balances in whose account?

A. Vernon Valley Recreation Association, Inc.

Q. Can you tell me why it refers to the Vernon Valley bank account as opposed to a London & World bank account?

A. Vernon Valley, from what I can remember, was going to assign the money in that account to London & World.

Q. Did Mr. Mulvihill tell you that?

A. I believe so.

Q. Would anyone else tell you that if not Mr. Mulvihill?

A. I don't think so.

The First National State Bank of Central Jersey, in its reply to the Mulvihill-Kupperman request on February 9, 1979, reported that Vernon Valley had \$639.22 in its account as of December 31, 1978, and \$100,639.22 on January 12, 1979. The fact that Vernon Valley had only \$639.22 in its bank account at the end of 1978, irrespective of any later, larger balances, was one of the reasons Kupperman cited for subsequently withdrawing from servicing Vernon Valley, according to the testimony:

Q. You stated earlier, Mr. Kupperman, that you withdrew from your engagement to prepare a certified financial statement of London & World Assurance, Limited. Can you tell me why you withdrew from that engagement?

A. When I got the confirmations back I was a little bit unsure of what was happening because of the assignment and the fact that the money was not in there on December 28. So I had gone up and discussed -- at that point I said I really wasn't interested in doing the work and we didn't pursue it.

Q. If I understand, are you saying that the money that Mr. Mulvihill represented would be in those bank accounts assigned to London & World was not there on the date that you were suppose to prepare the certified financial statement for it?

A. For example, in the case of the \$100,000, First National State Bank, it wasn't there on the 31st. It was there on January (12). So January (12) is not December 31.

Q. You were to prepare the statement as of December 31?

A. Correct.

Kupperman also was questioned about certain mortgages that Mulvihill told him were being assigned to London & World as part of the company's assets. Questions arose during the testimony about Kupperman's use of the word "unencumbered" with respect to these mortgages. The testimony on this issue:

Q. Would you now look at exhibit C-148 and tell me what that is?

A. This is a reply to the confirmation that I had sent to Arizona Title and Insurance Company.

Q. And why did you send to the Arizona Title and Insurance Company?

A. They were the servicing agency for the mortgages that were being assigned from Mayland Properties to London & World.

Q. These were the mortgages that Mr. Mulvihill told you were going to be assigned to London & World?

A. That is correct.



Q. Can you tell me what is Mayland Properties or Mayland, Inc.?

A. Mayland Properties I believe is a company owned by Gene Mulvihill?

Q. What does that response show from Arizona title?

A. That one trust had mortgage receivables of 1,500,000, \$1,571,719.83, and the other trust of mortgages receivable had a balance of \$1,210,106.78.

Q. Is there an indication that those trusts were encumbered in any way?

A. It looks like there was an assignment of two and a half percent in one trust and 10 percent in the other trust.

THE CHAIRMAN: Are there any indications on the terms of the trust that these mortgages were held under?

THE WITNESS: There was no indication under the terms of the trust but what came with it was a computer listing of all the individual mortgages making up each trust.

Q. Would you look, please, at Commission Exhibit C-149 and tell me what that is?

A. It's a letter on Mayland Properties stationery to London & World. "Please be advised that we have assigned trust number 6156 to be held by you as an asset on your books. Enclosed is a computer run for the same." The amount of assignment was 1,171,467.25.

Q. And what's the date on that document?

A. December 28, 1978.

Q. Now, would you look at Commission Exhibit C-150 and tell me what that is?

A. This is a letter to London & World Assurance indicating that certain monies were deposited into various accounts for the benefit of London & World.

Q. And what is the letterhead that that document was sent out under?

A. V & G Management Corporation.

- Q. Do you know Mr. Mulvihill's association with that company?
- A. Based on the letter, he's chairman of the board.

Kupperman also indicated that reservations about the mortgages Mulvihill said he was assigning to London & World also were a factor in his withdrawal as Mulvihill's accountant:

- Q. What about the confirmation from the Arizona Title that caused you to withdraw from the engagement, if anything?
- A. Again, it was just an assignment that I wasn't sure of. It was my understanding that these were unassigned. However, there is a minor assignment that is made in them. The balance is still more than sufficient to cover the \$2 million.
- Q. Did you withdraw from the engagement in writing, Mr. Kupperman?
- A. No, I did not.
- Q. Did you meet with Mr. Mulvihill and tell him verbally that you were withdrawing from the engagement?
- A. I believe so.
- Q. Did you tell him why?
- A. Yes, I believe so.
- Q. I presume the reason would have been those that you just stated here today, is that correct?
- A. That's correct.
- Q. After withdrawing from the engagement did you prepare a letter of retraction and send it to Mr. Schuessler in view of the first letter that you sent him saying there were excess of \$2 million of unencumbered assets?
- A. No, I did not.
- Q. Can you tell me why you didn't do that?
- A. I didn't see no necessity to because it was my understanding in time when he didn't receive the statement he would understand that there were none.

Q. Did Mr. Mulvihill tell you he would notify Mr. Schuessler?

A. I don't recall.

THE CHAIRMAN: I would assume that you would have to know the terms of the trust to determine whether these mortgages were assignable or not, would you not?

THE WITNESS: I'm really not sure whether I would need to know the terms of the trust to determine whether or not they were assignable. If, for example, I was the grantor of the trust, and the trust agreement allows me to assign them, obviously I can assign them.

THE CHAIRMAN: Exactly. You'd have to know there was that provision in the terms of the trust?

THE WITNESS: That's correct, but I didn't get that far.

THE CHAIRMAN: My simple question was, you'd have to know the terms of the trust?

THE WITNESS: Yes.

COMMISSIONER DELTUFO: What you found were mortgages that were in a trust, right?

THE WITNESS: That's correct.

COMMISSIONER DELTUFO: They were not unencumbered mortgages, they were subject to the terms and conditions of a trust agreement, isn't that right, which you didn't know anything about?

THE WITNESS: That is correct.

COMMISSIONER DELTUFO: As far as their ability to be assigned, you'd have to know the terms of the trust?

THE WITNESS: That's correct.

#### **He Signed As "Authorized Agent"**

Joseph Guy Dasti, who was scheduled to testify next, claimed a constitutional privilege and did not appear. In his absence, the Commission authorized that his prior testimony at an executive session of the SCI be read into the public hearing record. SCI counsel Lynch explained the significance of Dasti's testimony in

connection with the legitimacy of Vernon Valley 's liability surety as follows:

Mr. Chairman, we're going to read from the transcript of Mr. Dasti. He ran Mr. Mulvihill's Mayhill Insurance Agency. There were over a dozen certificates of insurance that were sent to State agencies on behalf of London & World as the insurer for Vernon Valley and related entities. The signature on those certificates of insurance was either Mr. Dasti's own signature or a stamped signature of Mr. Dasti. Mr. Dasti had testified in our Executive Session that he did not know anything about London & World and he was not their authorized agent.

With attorney Lynch reading the executive session questions and SCI Special Agent Bruce Best reciting Dasti's answers, the initial testimony concerned Dasti's relationship with Mulvihill and Mulvihill's various companies, many of which were located at 215 Main Street, Chatham. Dasti said he was a stockholder and the registered principal and president of Seaboard Planning Corporation, which is owned and chaired by Mulvihill; that he has a real estate license in connection with his work as a broker for Mulvihill's real estate company, Mayland Properties, and that he is licensed to sell life and health insurance as the broker and president of Mayhill Agency, Mulvihill's insurance company. Dasti was unable to say whether he is licensed to sell casualty insurance and added that he was "not sure" if he ever was so licensed. Dasti testified that he was employed by Mulvihill in various capacities for 14 years.

Dasti contended in his executive session testimony that prior to receiving an SCI subpoena he had no knowledge of London & World Assurance, Ltd., despite the fact that his signature or signature stamp appeared on so many of London & World's "certificates of insurance." He also denied that he ever was an "authorized agent" for London & World, even though his signature always appeared with that title. Agent Best, reading from a transcript, recited Dasti's answers to questions about his signature on such certificates:

"Q. Would you describe for the record what that document is, sir?

"A. Well, it says, 'Certificate of Insurance.'

"Q. It's blank, is it not?

"A. Yes.

"Q. Can you tell me what this type of document is used for in the insurance business?

"A. Well, it's used to certify that a company has insurance, a policy.

"Q. Can you tell me where you have seen a document similar to this?

"A. I've seen that document when it was presented to me for signature. That's the only time I've seen it.

"Q. How often was such a document presented to you for your signature?

"A. My recollection is that maybe three times, four times. I don't know.

"Q. Were you presented with such a document while you were working at 215 Main Street, Chatham?

"A. Yes.

"Q. And can you tell me who presented you with those documents for your signature?

"A. It was one of the secretaries in the office. It could have been one of a number of girls that came into my office with it.

"Q. Why would it have been necessary for you to sign such a document, sir?

"A. Well, I don't know why it was necessary for me to sign it. I know why I signed it, if you want to ask me that question.

"Q. Why did you sign such a document when it was presented to you?

"A. Well, it was brought into my office and at the time my recollection was that Vernon Valley had an insurance policy and the State wanted substantiation that there was an insurance policy in force and they came in to me as a broker for the Mayhill Agency that signed that Vernon Valley had the insurance.

Dasti: "I Never Looked At What I Signed"

"Q. When you were asked to sign these certificates of insurance, sir, what was the name of the insurance company that was typed across the top?

"A. Well, I know the name now, but I didn't -- I never even realized at the time. I never looked at it. I never read the document.

"Q. Were the documents blank when you were asked to sign them or were they filled out?

"A. I couldn't tell you because I never read it.

"Q. You simply affixed your signature?

"A. They simply came in and asked me to sign my name to it and I did it because I had faith in the people I work with and I sign a lot of documents. I sign a lot of letters. I take for granted, I took for granted, which I shouldn't have, I took for granted they were going to give me a document to sign, you know, that there's no problem with.

"Q. This only happened two or three times?

"A. To my recollection, maybe three, four times. I didn't even know the last time I signed it. It's been quite a while.

"Q. Did Mr. Mulvihill ever ask you to sign a certificate of insurance?

"A. To my knowledge, my recollection, no.

"Q. Did Mr. Mulvihill ever give you any blank certificates of insurance?

"A. Mr. Mulvihill never, never gave me that document, if that's what you're referring to.

"Q. I show you what's been marked as C-35 for identification, sir. Would you look at that and tell me if you recognize it, please?

"A. Yeah, this is, this is a document that I -- with my signature on it.

"Q. This is a certificate of insurance, is it not?

"A. Yes.

"Q. Down in the right-hand corner over the line marked "Authorized Representative" appears the signature "Joseph Guy Dasti," is that correct?

"A. Yes, it is.

"Q. Is that your signature, sir?

"A. It's my stamp.

"Q. That's a signature stamp?

"A. It's the way I sign my name. It's a stamp.

"Q. The stamped signature on that document, I take it, is an accurate facsimile of your signature, is it not?

"A. Yes, it is.

"Q. Did you place your stamp on the original of this document, C-35 for identification?

"A. That's hard for me to say whether I did or not. I know I've stamped a document like that, but my stamp is always in my office and my desk is not locked, so whether or not someone else did it, I don't -- you know, I can't say that I stamped that one. I've stamped a certificate like that."

"Q. Would you look at the second page, sir, that has been marked as C-55A. That's another certificate of insurance, is it not, sir? The insurance company is London & World?

"A. Right.

"Q. The dates are different, are they not?

"A. I have to look at the other one. I can't tell. Yes, the dates are different.

"Q. Down on the right-hand corner over the line marked "Authorized Representative" there's a stamp. Does that appear to be your signature, sir?

"A. It appears to be the same stamp.

"Q. And that stamp is a facsimile of your signature --

"A. Right.

"Q. -- is it not? Did you stamp that document, sir?

"A. I may have. I have no way of knowing. I know I stamped a few documents.

"Q. And you stamped those, sir, even though you are not the authorized representative of London & World?

"A. That's right.

Dasti Never Asked Questions About Insurance Certificates

"Q. You didn't question anyone when they presented you with these documents?

"A. No, I did not.

"Q. And you are the president of the insurance company, are you not?

"A. President of the agency.

"Q. Let me show you what's been marked as C-36. Would you look at that and tell me if you have ever seen it before, sir?

"A. I don't recall. This looks like a policy, but I don't recall whether I saw this or not. I tried to search my memory prior to coming down here and I can't actually state whether I saw a policy or a copy of it.

"Q. That's a policy that purports to be issued by London & World Assurance?

"A. Right.

"Q. Now, after the girls brought these certificates of insurance in to you for your signature or your stamp, do you know what happened to those certificates after you signed or stamped them?

"A. I assumed that they went back to Vernon Valley.

"I Assumed Everything Was Okay"

"Q. Well, how do you know they were going to Vernon Valley if you never looked at the papers when you stamped them?

"A. Well, the girl came in and said she needed something for Vernon Valley, that's why I stamped it. I mean, if somebody walked in off the street and said stamp this, I'm sure I wouldn't stamp it. The only reason I stamped it is because I knew the people I was working with and they were associated with, someone I had been with for 14 years through this time period, and I just assumed everything was okay, just stamp it and go on about my business. I have a lot of duties in my office. I handle stocks, I watch markets with brokers, I watch markets with people for sales, so we retail and whole-sale. I also run an insurance operation, which I get calls on life insurance from



agents and from William Penn Life from time to time. And you know, with our Mayland Properties business, so if a girl came in, which they do a number of occasions, not only that document, but even letters, they come in and they bring me the letter and I just stamp it.

"Q. I take it, then, you handled insurance, or at least some of the insurance for Vernon Valley?

"A. I never handled insurance for Vernon Valley.

"Q. Then why would you send certificates of insurance to Vernon Valley?

"I Shouldn't Have Done It Unless I Read It"

"A. I was asked to stamp this document for Vernon Valley and because Mr. Mulvihill is an associate of Vernon Valley and also Mayhill Agency it was a normal thing for me to assume I should do. That's the only reason I did it. In hindsight, I shouldn't have done it unless I read it.

Now, I understand the document states I'm an agent for the London. I never heard of London & World, Lloyds of London, whatever it is. I have no documents about the company, I have no records, I don't know anything about it. I don't know who the principals are. I don't know who brought the insurance or who paid for it, where the payments went. The only thing I did was stamp a document that I shouldn't have stamped.

"Q. You didn't know, I take it, who the insurance carrier was for Vernon Valley in the late 1970's?

"A. No, I did not, and I don't know who it is now.

"Q. When the girl came in and asked you to stamp it, didn't it enter your mind that you may not have been authorized to stamp it?

"A. It never entered my mind. I just stamped it automatically and the girl just picked it up and went about her business, whoever it was. They never even spoke to me about it or went into detail. Nobody went into any detail with me at all on it.

Didn't Know If London & World Was Licensed

"Q. You testified, sir, that you never heard of London & World Assurance, Limited, until you received our subpoena, is that correct?

"A. That's correct.

"Q. All right. Notwithstanding the fact that your signature or your signature stamp appears on ten or twelve, at least, certificates of insurance?

"A. I stated I never read the document.

"Q. So you wouldn't know, then, would you, whether or not London & World was licensed to transact business in the State of New Jersey, would you?

"A. No, I wouldn't.

"Q. And you wouldn't know whether or not they were an approved surplus lines carrier in the State of New Jersey, would you?

"A. No, I wouldn't."

Mulvihill Gave Him 40,000 Shares of Stock

Dasti was questioned next about his stockholding interests in Vernon Valley Recreation Association and particularly about the 40,000 shares of stock Mulvihill gave him in early 1980:

"Q. Do you own any stock, sir, in Vernon Valley Recreation Association, Inc.?

"A. Yes, I do.

"Q. Are you an officer or a member of the board of directors of that company?

"A. No, I'm not.

"Q. Can you tell me how much stock you own in that company, sir?

"A. I own 10,000 shares.

"Q. Did you ever own substantially more than 10,000 shares?

- "A. I owned 40,000 shares in addition...which I disposed of.
- "Q. When did you acquire that additional 40,000 shares?
- "A. Back in 19 -- let's see. It was over two years ago. February of 19 -- I believe it was February, 1980.
- "Q. Where did you purchase those shares, those 40,000 shares, sir?
- "A. I received them from Mr. Mulvihill.
- "Q. You purchased them from him?
- "A. I received them for services rendered.
- "Q. What services were those, sir?
- "A. Well, I've been with him for 14 years. I performed a lot of duties and services over 14 years for him.
- "Q. Was part of those services the affixing of your signature or signature stamp to the London & World certificates of insurance?
- "A. No, sir, that was never any part of receiving any monetary benefit, signing my signature to any document. I would never do that.
- "Q. Can you tell me when you sold those 40,000 shares?
- "A. I sold 40,000 shares, I believe, in May of 1982.
- "Q. And to whom did you sell them, sir?
- "A. I sold them to First Jersey Securities.
- "Q. That's Mr. Brennan's company?
- "A. Yes, sir. They make a market in the stock.
- "Q. What was the selling price of the stock, sir?
- "A. A half a dollar.
- "Q. You sold all 40,000 shares to First Jersey?
- "A. Yes, sir."

**The London & World "Claims Department"**

Eric Karg testified next about certain unusual aspects in the manner in which insurance liability claims were handled at Vernon Valley. Karg described himself as a claims representative or "independent adjuster" who conducts insurance investigations "with respect to accidents that occur on the property of Vernon Valley." He said that when Canadian Universal was the Vernon Valley surety, it hired and paid him to investigate claims, was billed by him and it paid the claims through him. He also said that he had nothing to do with setting up insurance company reserves for claims when either Canadian or, later, American Universal was the Vernon Valley carrier. However, Karg testified, these customary procedures did not prevail when London & World Assurance purportedly became Vernon Valley's surety. SCI counsel Hart conducted the questioning:

Q. Now, you said you were investigating claims at Vernon Valley since its inception. Do you know Mr. Gene Mulvihill?

A. Yes, I do.

Q. How long have you known Mr. Mulvihill?

A. Since he took over Vernon Valley.

Q. Did there come a time when Vernon Valley switched insurance carriers from Canadian Universal to a company known as London & World Assurance, Limited?

A. Yes, to my knowledge.

Q. When was that?

A. 1977.

Q. I take it you were notified by someone that there was going to be a change in carrier. Who notified you?

A. Mr. Mulvihill.

Q. Did you have occasion to go to London & World after Mr. Mulvihill advised you they were to be the new carrier and offer your services to them?

A. No. No more than I went to Canadian Universal.

Q. Didn't you tell me before that you went to Canadian Universal and were hired by them?

A. By phone.

Q. By phone?

- A. Sent them a resume.
- Q. Did you phone London & World and offer your service after you found --
- A. I did it through Mr. Mulvihill.
- Q. Did you investigate claims during the time that London & World was the carrier?
- A. Yes, I did.
- Q. Who hired you to investigate those claims on behalf of London & World?
- A. Mr. Mulvihill.
- Q. Did Mr. Mulvihill ever tell you anything about the company other than its name? That is, where it was located, for instance?
- A. He told me it was out of the Cayman Islands.
- Q. Did you prepare reports on the claims that you investigated during the time that London & World was the carrier?
- A. Yes.
- Q. To whom did you submit reports that you wrote on those claims?
- A. I made them available to Mr. Mulvihill in my office, if it was necessary, and also to London & World if they desired a copy.
- Q. Did you ever send reports to London & World?
- A. There was never an occasion.
- Q. Unlike when Canadian Universal was the carrier. Your reports went to that insurance company, is that correct?
- A. That's correct.

THE CHAIRMAN: I take it you advised London & World that the reports were available to them in your office?

THE WITNESS: Through Mr. Mulvihill.

THE CHAIRMAN: In what form?

THE WITNESS: Oral.

Q. During the time that London & World was the carrier to whom did you submit bills for your services?

A. To Mr. Mulvihill.

Q. And who paid those bills?

A. Vernon Valley.

Q. Again, that is unlike the arrangement when Canadian Universal was the carrier?

A. Yes, but not unusual.

Mulvihill, Not London & World, Hired Karg to Handle Claims

Q. Did London & World have a claims department?

A. Not to my knowledge.

Q. Do you recall telling us in Executive Session that you were the claims department of London & World?

A. That is correct.

Q. Who hired you to be the claims department of London & World?

A. Mr. Mulvihill.

Q. What did you do as the claims department for London & World?

A. Set up claims, set up reserves, made a complete investigation. If a settlement was warranted, attempted to settle it. If there wasn't any need or any indication that a settlement was warranted, the claim was denied.

COMMISSIONER DELTUFO: You have dealt with a variety of insurance companies?

THE WITNESS: Yes, I have.

COMMISSIONER DELTUFO: You never operated as a claims department for an insurance company yourself until London & World Assurance Company came along, did you?

THE WITNESS: That is correct.

COMMISSIONER DELTUFO: And in terms of dealing with insurance companies on claims, you would deal with representatives of the claims department of that insurance company,

not with the insured, isn't that right?

THE WITNESS: Yes, that is correct.

COMMISSIONER DELTUFO: And you would send records to the claims department of the insurance companies, isn't that correct?

THE WITNESS: That is correct.

COMMISSIONER DELTUFO: And in this instance when London & World was on the risk you dealt with Mr. Mulvihill?

THE WITNESS: That is correct.

COMMISSIONER DELTUFO: You made reports available to Vernon Valley, did you not?

THE WITNESS: If it was necessary, yes.

COMMISSIONER DELTUFO: And checks that were forthcoming in payment of claims came from Vernon Valley, not from London & World Assurance Company, isn't that correct?

THE WITNESS: That is correct. Yes. That is correct, but I don't see anything wrong with that.

BY MR. HART:

Q. How did you set up reserves on claims as they came into your office?

A. On the basis of what the claim was.

Q. Well, did you state in writing what your opinion was as to the reserves that should be placed on a particular case?

A. I had a complete account of all of the claims and I placed a reserve on the claim just the same as an insurance company does.

Q. Did you submit your written reserve estimates to Mr. Mulvihill?

A. Yes, I did.

Q. Once a year?

A. Yes.

Q. But you sent a written reserve on every claim that came in?

A. That is correct.

THE CHAIRMAN: What did Mr. Mulvihill do about the reserves that you set?

THE WITNESS: I have no idea. No more than when I give a value of a case to an insurance company what they do with it.

THE CHAIRMAN: If you'd just answer the question, we'd appreciate it.

THE WITNESS: Sorry.

Q. In a case you mentioned, a minimal case, let's say a thousand dollars, would you consider that a minimal case?

A. Yes, I would.

Q. Such a case would come into your office and you'd write down on a piece of paper as a reserve a thousand dollars?

A. On a card, yes, and put it in the file.

Q. That's the type of case you would not refer to Mr. Mulvihill saying you should set aside a thousand dollars for this case, is that correct?

A. That is correct.

Q. You never set aside that thousand dollars for that particular claim?

A. No.

Q. So it's fair to assume then that a reserve was never set aside for that particular case?

A. I don't know about that.

Q. If you didn't set aside the money and you didn't communicate it to Mr. Mulvihill what the reserves should be on a particular case, how else could he set the money aside?

A. May I answer that question expounding a little bit?

I would give an estimate to Mr. Mulvihill of what I anticipated we could foresee as to the number of claims that we would possibly obtain during the course of the year and



give him a reasonable expectation of what reserves should be set aside and then corroborated that at the end of the year for accounting purposes, I assume, just like an insurance company does as to what the values were. If they were different and if they had to be increased, I would increase them. If they were to be less, I would let him know.

THE CHAIRMAN: It's customary in those situations, however, for an insurance company you're advising (on) reserves you think are necessary, to actually set up a cash reserve in that amount, is it not?

THE WITNESS: I would assume so, but I don't have any affiliation with any insurance company, so I don't really know exactly what they do. I can only tell you what they tell me.

COMMISSIONER DELTUFO: How long have you been in the business?

THE WITNESS: 33 years.

COMMISSIONER DELTUFO: You've come in contact with other insurance companies and their practices?

THE WITNESS: I come in contact with people.

COMMISSIONER DELTUFO: Don't you know that insurance companies set up cash reserves? Yes or no?

THE WITNESS: Yes, I do.

Mulvihill, Not Insurer, Made Claims Decisions

- Q. Who decided, Mr. Karg, whether or not a claim would be settled and paid on one hand or denied and defended on the other during the time that London & World was the insurance carrier?
- A. According to the amount of the claim, myself, or if it was of any great amount of money, Mr. Mulvihill would be taken into account for it.
- Q. Now, that's kind of an unusual arrangement, based upon your experience in the insurance business or the insurance investigating business, isn't it, that the insured would have the right to determine whether or not a claim was to be settled or defended?

A. An insured?

Q. Yes, sir. Isn't that unusual?

A. You might say that.

Q. Wasn't Mr. Mulvihill London & World Assurance, Limited?

A. Was Mr. Mulvihill London & World Assurance, Limited?

Q. Yes, sir, was that his company?

A. Not to my knowledge.

Q. Who paid the claims that were settled during the time that London & World was the carrier?

A. Vernon Valley Recreation Association, Inc., as well as T.R.C., Inc.

THE CHAIRMAN: Who is T.R.C.?

THE WITNESS: That's I believe, the corporation that handles the Alpine Slide.

Q. Isn't it unusual for an insured to make the payments of claims that are settled or judgments rendered against the corporation?

A. May I expound on that?

Q. Please do.

A. Well, for instance, Avis has their own insurance company and I used to do work for Avis and Avis used to send me checks that were payable to the claimant.

THE CHAIRMAN: Well, they were self-insured?

THE WITNESS: They were self-insured, but I assumed they were also insured in excess of the amount that they were self-insured for. I don't know. You're asking me a question with regard to it and I'm trying to give you an answer with regard to it.

THE CHAIRMAN: All right. Now, when you were working in the early '70's for this Canadian insurance company, the insured didn't pay the settlement claims or the verdict claims but rather the company paid out insurance company checks, did they not?

THE WITNESS: Yes, they did.

THE CHAIRMAN: And isn't that the usual thing?

THE WITNESS: Yes.

THE CHAIRMAN: That's the very reason for insurance, is it not, to have the insurance company pay?

THE WITNESS: It's all according to whether or not you have a deductible and what it says the deductible is. If you have a small deductible than I would say that the insurance company has no need to pay. If you have a large deductible -- it's all according -- there's no guarantee on that.

Another "Unusual Circumstance" Involving Claims

COMMISSIONER PATTERSON: Do you know what Vernon Valley had as a deductible?

THE WITNESS: I was initially told it was \$1,000. I really don't know and it never really mattered to me.

COMMISSIONER DELTUFO: Did you come across any claims in excess of a thousand dollars?

THE WITNESS: Yes, I did.

COMMISSIONER PATTERSON: They were paid by whom?

THE WITNESS: They were paid by Vernon Valley Recreation Association, Incorporated, or T.R.C.

COMMISSIONER PATTERSON: If the deductible policy was \$1,000 and Vernon Valley paid more than a thousand dollars?

THE WITNESS: Uh-huh.

COMMISSIONER PATTERSON: Isn't that an unusual circumstance?

THE WITNESS: My understanding, and as it was explained to me, is that Vernon Valley would pay that amount and they would be reimbursed by London & World. Whatever arrangement Mr. Mulvihill had with London & World, I don't know.

THE CHAIRMAN: Where did you get that understanding from, and when?

THE WITNESS: Mr. Mulvihill.

Q. As the claims department for London & World, did you ever have any communications with that company?

A. Yes, I have.

Q. Were your communications written or oral?

A. Oral.

Q. And whom in that company did you speak to?

A. Michael Teschner in Cologne, Germany.

Q. Did you speak to Mr. Teschner since your Executive Session appearance?

A. Yes, I have.

Q. Prior to that you hadn't spoken to any official from London & World?

A. No, I had not.

COMMISSIONER DELTUFO: During the period of your acting as adjuster then you never dealt with anyone from London & World Assurance Company?

THE WITNESS: Directly, no.

COMMISSIONER DELTUFO: Through Mr. Mulvihill, I take it?

THE WITNESS: Through Mr. Mulvihill.

Despite evidence to the contrary, Karg persisted in contending that he did not know Vernon Valley was self-insured through its captive London & World company:

Q. Did you ever represent to anyone that Vernon Valley was self-insured at a time when London & World ostensibly was the carrier?

A. I may have made a joking reference to it, but I couldn't definitely say because I did not know.

Q. Do you recall having a meeting on June the 3rd, 1982? That was approximately a month and a half before your Executive Session testimony. That meeting was with an attorney by the name of Kevin Kelly and an

expert witness that he brought with him to examine the Alpine Slide at Vernon Valley. Do you remember such a meeting?

A. Oh, yes, I do.

Q. The purposes of that meeting was for him to have his investigator examine the Alpine Slide with reference to a death case?

A. That's correct.

Q. During that meeting do you recall being asked by Mr. Kelly's expert who the insurance carrier was for Vernon Valley at the time the death occurred? Do you recall him asking you that?

A. No, I don't remember. I don't recall it, but he probably did.

Q. It wouldn't be an unusual question?

A. It would be an unusual question.

Q. Do you recall telling the expert and Mr. Kelly that Vernon Valley was self-insured at that time?

A. I may have jokingly, as I said, made reference to it since there wasn't any deductible amount and I didn't think the case was worth any -- much more.

COMMISSIONER DELTUFO: You think it was worth more than a thousand dollars?

THE WITNESS: It's all according to whether you determine the fact that there was liability involved.

COMMISSIONER DELTUFO: Do you think it was worth more than a thousand dollars?

THE WITNESS: I'm not so sure.

THE CHAIRMAN: That's what you mean, the deductible feature?

THE WITNESS: The deductible feature, whether it was a thousand, whether it was \$100,000.

THE CHAIRMAN: In a death case?

THE WITNESS: A death case. I have gone out on death cases, Mr. Lane, and there hasn't been any liability.

BY MR. HART:

Q. When Vernon Valley is a defendant in a negligence suit, do you supply the Answers to Interrogatories that are served upon the corporation?

A. I assist with those answers that I know.

Q. Do you provide the information that makes up the answers to the insurance interrogatories?

A. I assist with the answers that I know.

Q. Do you know the answers to the insurance interrogatories?

A. I only put down that which I have been told and that's what I have done.

Q. And who tells you what answers to put down?

A. I put down the answer that I had initially been told, that London & World was the carrier.

Q. Who certifies the Answers to Interrogatories that go out? Who places his signature on the certification page of the interrogatories?

A. It's all according to whom I have that answers the questions.

Q. Does Adam Ringler certify interrogatories in some cases?

A. He has in some cases, yes.

Q. Who is Adam Ringler?

A. He is presently the director of operations for Vernon Valley, to my knowledge.

Q. Would you look, please, at Commission Exhibit C-151, which are excerpts from Answers to Interrogatories in the matter of Basille versus Vernon Valley Recreation Association which was a personal injury suit

arising out of the Alpine Slide.

Look at the second page which is the certification page that accompanies those Answers to Interrogatories --

A. Yes.

Q. -- and tell me if that's Adam Ringler's signature on that page?

A. I would say that that was Adam Ringler's signature.

Q. Now, would you look at interrogatory number 17 and read that into the record?

A. "Self-insured for \$100,000."

Q. Read the question for me first, please?

A. "Set forth the amount of coverage."

Q. What is the answer?

A. "Self-insured for \$100,000."

Q. Is that the information that you supplied for Mr. Ringler to certify?

A. That is the information that I gave to our counsel advising him that that's the amount of money that I was under the impression was the policy at that particular time. I did not tell Mr. DeGonge, who is the one that put that there, to put in self-insured. I have never made a comment that we are self -- and referring to "we," I used the word "we," Vernon Valley is self-insured.

COMMISSIONER DELTUFO: You can use the word "we."

THE WITNESS: Okay.

COMMISSIONER DELTUFO: You testified before that there was a thousand dollar deductible?

THE WITNESS: That's what I had been told.

COMMISSIONER DELTUFO: When did you come to the conclusion it was \$100,000?

THE WITNESS: I didn't make that conclusion.

COMMISSIONER DELTUFO: You didn't make that yourself?

THE WITNESS: No, I didn't.

COMMISSIONER DELTUFO: As far as you know it's still a thousand dollars?

THE WITNESS: I have since been in contact with Mr. Teschner and that may not be so.

COMMISSIONER DELTUFO: You were in contact with Mr. Teschner after your appearance in Executive Session of this Commission?

THE WITNESS: Yes, it was just last week, as a matter of fact. He called me --

Karg concluded his appearance with a statement which prompted a final exchange of questions and answers on whether Vernon Valley had violated the insurance requirements of its lease. Karg's concluding testimony:

THE WITNESS: I don't know for what purposes this -- I have been brought here other than for insurance purposes. I have done a lot of work for a number of insurance companies over the course of many, many years. I feel myself quite qualified to place values, true values on cases, to place true reserves on cases. I'm not infallible, I do make mistakes, but by and large I will say that my percentage is sufficiently enough to warrant a credible appearance and a credible answer to many, many questions involving claims.

Whether or not, and I do not know this for a fact, whether or not Vernon Valley is self-insured for a thousand dollars, a hundred thousand dollars or whatever, is, in my opinion, a moot statement. And the reason that I make that, is that under no sets of circumstances has any claim, any claim, from an insurance company from Vernon Valley, or anyone else, never been paid. Every claim submitted to me, whether it be a settlement, whether it be a judgment or whatever, has been paid in full. There is no outstanding claim as a result of Vernon Valley's entry, you might say, into insurance.

The ability to be self-insured, I believe, is predicated on the individual's ability to pay, whether it's a thousand dollars or a hundred thousand dollars, it shouldn't make a bit of difference, and I don't think that any place or any person should be chastised for it. And I don't know exactly what you



gentlemen are looking for with regard to it.

There isn't a soul in this State that drives a car that isn't self-insured, whether it be for \$50, a hundred dollars, 200 or 500 and in some cases a thousand dollars. So what I would like to submit is that I believe that Vernon Valley has met each and every obligation that has been submitted to them on a financial basis, whether it be a settlement, a judgment or any bills submitted to Vernon Valley because everything, every bill goes through my office, and before I make any -- before I close any case, any case, every bill is paid in full and Vernon Valley, T.R.C., has done it, is doing it and will continue to do it, until every case is satisfied that has been placed against them.

COMMISSIONER DELTUFO: You're saying that you believe then that Vernon Valley is a legal self-insurer, aren't you?

THE WITNESS: As a matter of fact, Mr. Del Tufo, I am absolutely positive that they are.

COMMISSIONER DELTUFO: If I were to tell you that the people of the State of New Jersey expected to be backed up by insurance coverage and not by Vernon Valley and there was a provision in the lease agreement to that effect, wouldn't you say that the people of the State of New Jersey are entitled to that?

THE WITNESS: I don't know all the ramifications. I do know, so I have been told, and again I haven't seen any positive proof of it, that Vernon Valley was insured at the time that Vernon Valley was handling all of these claims and is handling all of these claims for up to \$2 million.

#### **CPA Confirms Insurance Coverage Was Inadequate**

Dale Baver, a CPA and a partner in Klatzkin & Company, Vernon Valley's accounting firm, testified at an executive session of the SCI that he had once signed a note attesting to the adequacy of Vernon Valley's insurance coverage and confirming that Eugene Mulvihill handled it "personally." However, in that same private hearing, Baver also conceded that the insurance coverage was inadequate. Baver, the next scheduled witness, was not present to testify. As Chairman Lane noted for the record, "he has indicated to us in advance that he would, on the basis of a claim of

privilege, be unwilling to testify in this matter." As a result, the Commission directed that portions of his executive session testimony be read into the record, with SCI counsel Hart repeating the questions and chief accountant Cayson reciting Bayer's answers from a transcript. At the outset, Bayer during the closed hearing said he supervised his company's audits of Vernon Valley in 1980, 1981 and 1982 and that he worked on such audits "I would guess probably every, almost every year except 1973 and 1974." Prior to 1982, he said, Steven Klein (a more senior partner in the Klatzkin firm) had been "responsible" for the audit. The first excerpt from the executive session transcript concerned a handwritten note by Bayer that generated the following testimony:

"Q. Mr. Bayer, let me show you what's been marked as C-280 through C-284. Would you look at the contents of those files and tell me, just generally speaking, do you recognize what's contained therein? Do these files contain Klatzkin & Company's insurance work papers concerning Vernon Valley Recreation Association?

"A. Yes, they do.

"Q. All right. I would like you to look at the top document in that file, and tell me if you recognize that letter, sir.

"A. This is a letter in response to our insurance inquiry to Davis, Dorland and Company for the audit of April 30th, 1979.

"Q. All right.

"A. It's a general request for insurance coverage and premiums and monies due. This would be their cover letter in response to that, to that request.

"Q. Now, there's a handwritten note on the bottom of that letter, is there not?

"A. Yes, there is.

"Q. Is that note in your handwriting?

"A. Yes, it is.

"Q. Is that your signature at the bottom of the note?

"A. Yes.

"Q. Would you read that note into the record, please?

"A. The note says, 'In a review of insurance coverage attached, plus the fact that G. Mulvihill handles the insurance program personally, it is my opinion that the coverage appears adequate to safeguard the company's assets,' with my signature, dated April 11th, 1979.

"Q. How did you know that Gene Mulvihill handled the insurance matters personally?

"A. I, I don't remember this, this letter or this comment. In reviewing the files in preparation for today, I, of course, saw this. Honestly, I, I cannot remember making this comment in 1979.

"Q. Did Mr. Mulvihill personally handle the insurance matters for V.V.R.A.?

"A. I don't know.

"Q. You would not have put a false notation in the file, would you, sir, back in 1979?

"A. Well, this would have been my understanding in 1979. Again, in reviewing the work papers of that year in preparation for today, I have notations in the review of the internal accounting control. There's -- we use a questionnaire that we review with management. In this case my notations indicate that I reviewed it with Roger Scott. One of the questions that is asked in that internal control questionnaire is, is the insurance coverage reviewed by a responsible official on a periodic basis, looking for adequacy of insurance. I have a notation on there that says, 'R. Scott and G.,' I don't know if it says G.M. or Gene Mulvihill.

"Q. But your notation on that letter doesn't say that insurance is reviewed by Gene Mulvihill. It says it's handled personally, does it not?

"A. That is -- it says the insurance program -- 'handles the insurance program personally.'

"Q. Can you tell me why it would have been necessary to place such a note in the file?

"A. Well, the reason, the reason for this note would have been, as the independent auditors, we are responsible to review for the adequacy of insurance in regards to safeguarding the company's assets for fair

presentation of the financial statements,

"Q. For the fiscal year 1982, did Vernon Valley Recreation Association have adequate insurance coverage in so far as the amount of coverage that was required by the lease between Vernon Valley Recreation Association and the State of New Jersey?

"A. To my knowledge, yes, it did.

"Q. How about for the fiscal year ending April 30th, 1981; did they have adequate insurance insofar as the lease is concerned?

"A. To my knowledge, yes.

"Q. All right. Do you know what the limits were set forth in the lease for liability coverage?"

"A. I believe the lease calls for \$2 million of liability insurance.

"Q. Would it refresh your recollection if I were to tell you it was between 2.1 and \$2.3 million?

"A. I would have to review the document. I assume that that is what it says, yes.

"Q. Would your insurance files for 1981 -- would those files contain information as to the amount of liability coverage for the company in 1981?

"A. In 1981, I don't see any reference to the coverage in reference to liability insurance.

"Q. Okay. How about for 1980; would you look at what's been marked C-281?

"A. I don't see any reference to the limits of insurance coverage for April 30th, 1980.

"Q. Let me ask you this: Would it be unusual or is it unusual that your insurance work papers don't contain a notation as to the liability coverage for the company.

"A. I would have expected them to contain that, yes.

"Q. Your firm issued, did it not, unqualified opinions in the certified financial statements for Vernon Valley Recreation Association for those particular fiscal years?

- "A. In 1980 and 1981, yes, we did.
- "Q. So I assume, to your satisfaction or the satisfaction of your firm, Vernon Valley did have some liability coverage, otherwise there would have been a notation to that effect in the financial statement, would there not?
- "A. Yes, that would be correct.
- "Q. Can you tell me where evidence, where Klatzkin & Company got the evidence of liability coverage from in order to issue the unqualified opinion if it's not contained in the insurance files?
- "A. If it's not contained here, no, I could not tell you.
- "Q. How about for the fiscal year ending in 1979, does that file contain notation or evidence of liability coverage for that particular fiscal year?
- "A. There's a notation in here of a liability policy with the annual premium of \$175,000, but it does not list the amount of coverage."
- "Q. And do I understand correctly, or am I reading this correctly, that this policy number SNJ 10101 is issued by London & World Assurance, Limited?
- "A. That's correct. That's what it would indicate.
- "Q. 175,000 is the amount of the premium; is that correct?
- "A. That would be the annual premium, correct.
- "Q. Did you approve this particular work paper?
- "A. I reviewed it, yes. It says, 'Approved by D.B.'"
- "Q. Now, these particular notes, and the work papers that we have been talking about, do not contain the amount of coverage under this London & World policy. Is that correct?
- "A. That is correct.

"Q. Well, at some point did either you or someone else from Klatzkin & Company verify or attempt to find out the amount of coverage of that London & World policy?

"A. Did we definitely? From these work papers, I could not give you a definite yes."

"Q. Would Klatzkin & Company have issued an unqualified opinion without checking on the insurance, the amount of coverage?

"A. I would not think so, no.

"Q. Now, if I were to tell you that the amount of coverage under that London & World policy is (\$2) million, would that amount comply with the requirements of the state lease?

"A. Well, I believe you told me the requirements of 2.1 million. Under that assumption, it would not.

"Q. To your knowledge, did Klatzkin & Company ever inform the D.E.P. that Vernon Valley's insurance coverage was not up to the requirement of the lease?

"A. To my knowledge, no."

"Q. Do the Klatzkin & Company files contain any letters or notations to the effect that the D.E.P. was notified of insufficient coverage?

"A. I, I did not see any letter to the effect of Klatzkin & Company notifying the state of coverage."

#### **State Labor Department's Role**

Bureaucratic ineptitude in connection with the Vernon Valley lease hold was evident in the State Department of Labor (and Industry) as well as the DEP. The Labor Department's concerns included the issuing of permits for and the inspection of ski lifts and amusement rides. In connection with the latter, which are a feature of Vernon Valley's Action Park, the Labor Department imposes certain liability insurance requirements: 1) that liability coverage be at least \$100,000; 2) that the surety be licensed by New Jersey or be approved by the State as a surplus line insurer, and 3) that applicants for a permit submit proof that they are properly insured. The next witness, Seymour Rubenstein, described in his testimony how Vernon Valley violated all three of these Labor Department requirements. Rubenstein, the assistant director of the Office of Safety Compliance in the Department's Division of Workplace Standards, was questioned by SCI counsel Amitrani, initially on insurance matters:

- Q. These documents are the applications for permits and evidence of insurance for the various rides at Vernon Valley. With your familiarity with the file, is it fair to say that, prior to 1977, the rides at Vernon Valley were insured by Canadian Universal?
- A. Yes.
- Q. And from a period of time approximately 1977 up until 1981 the insurance company was changed to London & World Assurance, Limited?
- A. I believe that in 1978 that was changed to London & World Assurance.
- Q. Mr. Rubenstein, in that pile of documents I'm going to ask you to pick out the third-to-the-last document. Now, that is a certificate of insurance; is that correct?
- A. Yes, it is.
- Q. And the insurance company is London & World Assurance, Limited?
- A. That is the company that is listed here.
- Q. And the name of the insured is listed as Dunehill, Incorporated?
- A. Yes.
- Q. And you know that to be one of the subsidiary companies of Vernon Valley?
- A. I don't know if they're a subsidiary company of Vernon Valley or not, but at that time they registered certain rides with us.
- Q. All right. And it is addressed to the State Department of Labor and Industry. Correct?
- A. Yes.
- Q. And the effective date of insurance begins August 25th of 1977. Correct?
- A. That's what it says.
- Q. Do you know when London & World Assurance, Limited, was incorporated in the West Indies?
- A. No, I do not.

Q. All right, Mr. Rubenstein, that document is the certificate of incorporation from London & World. Would you please read for the Commission the date that it was incorporated?

A. There are two dates. I have to read the whole thing, if you don't mind.

Q. All right.

A. "I, Robert Crosby Bodden, Registrar of Companies at the Cayman Islands, do hereby certify pursuant to the Companies Law, CCAP .22, that all the requisitions of the said law in respect of registration were complied with by London & World Assurance, Limited, an exempted company formed in the Cayman Islands on the 12th day of October, 1977. This company was registered on the 13th day of October, 1977."

Q. All right. So it wasn't registered until October 13th of 1977. Correct?

A. That's what it says.

Q. And going back, October of '77 would be approximately two months after the insurance began for Dunehill, Incorporated. Correct?

A. That's what it would indicate.

Insurance Certificate Also Predates Coverage

Q. All right. I'm again going to ask you to return to Exhibit C-187 and look at the signature on the bottom of the certificate of insurance. It is dated October 5th of 1977. Correct?

A. Yes.

Q. And it is signed by a Joseph Guy Dasti?

A. Yes, sir.

Q. And he signs as the authorized representative. Correct?

A. That's correct.

Q. Now, October 5th of 1977 is approximately one week before London & World was even registered in the Grand Cayman Islands. Correct?



- A. That would be correct.
- Q. Does it appear that there's a discrepancy between when this company was formed and when the effective date of the insurance began?
- A. It would appear so.
- Q. Had your department known of this discrepancy, would they have issued the permits for the amusement rides at Vernon Valley?
- A. Had we known that they were not an acceptable company, we would not have issued the permit.
- Q. All right. If you had seen a discrepancy such as this, would this at least have been a red flag to you that something should be checked further?
- A. If we had seen such a discrepancy, yes.
- Q. But your department did not have the certificate of incorporation?
- A. That's correct. We don't get them.
- Q. As a normal course of business, your department does not get the certificate of incorporation?
- A. That's correct.

London & World Questioned in 1977

- Q. I'm going to ask you to look inside this packet of documents to a letter from a Leon Rennebaum.
- A. Dated October 12, 1977?
- Q. Correct. Who is that letter addressed to?
- A. William H. Ingrund, Dunehill, Incorporated.
- Q. Who is Mr. Leon Rennebaum?
- A. Mr. Leo Rennebaum at that time was chief of our Carnival-Amusement Rides Section.
- Q. Would you please read the letter for us?

A. "Dear William: This will confirm my telephone call to you on October 11th in reference to your insurance. The certificate of insurance shows London & World Assurance, Limited, as the insurance company. This company is not authorized to do business in the State of New Jersey. Please send us another certificate of insurance with an approved insurance company.

"Very truly yours, Leon A. Rennebaum."

Q. As early as October of 1977 your department was having problems authenticating London & World Assurance as an approved insurer. Correct?

A. That's the first time London & World Assurance appears in our files, as I recall, and I -- at that point how we determined they were not an approved insurance company, I can't tell you. I wasn't there. But we did find out and that's the results of it.

Insurance Coverage Still An Issue In 1978

Q. All right. Mr. Rubenstein, I'm now going to show you a document marked C-191, and this, too, is a group of documents pertaining to one of the rides up at Vernon Valley. And on the cover there are two handwritten notes. Correct?

A. Yes.

Q. And the first one is dated May 23rd of 1978?

A. Yes.

Q. Who is that from?

A. It's initialed by A.P.S., who is Arnold Schmidt, one of our principal safety inspectors at the time.

Q. Please read the note of May 23.

A. "Called Debra Evers at 201 635-1500. Will return call with acceptable insurance for both rides."

Q. Is there anything in your files to indicate that Vernon Valley ever responded to Mr. Rennebaum's letter eight months prior to October 12th of 1977 with an approved insurance carrier?

- A. There's nothing in our file and that particular ride for which they had filed was not registered for that year.
- Q. Again on C-191, there's another handwritten note dated May 30th of 1978. That is again from Mr. Schmidt. Would you please read that?
- A. "Called 201 635-1500. Spoke with Gene Mulvihill. States that insurance is good. Will have someone from state office call me."
- Q. All right. I now show you another document marked C-192. This is a handwritten note to Arnold and it's signed, "Joe." Arnold you have already explained is Arnold Schmidt?
- A. Yes, sir.
- Q. Although this note is undated, would it be fair to say this note fits into the sequence of notes between May 23rd and May 30th?
- A. Taken in context, I would say, yes.
- Q. Who is Joe?
- A. Joe was Joe Palizone, who is now a principal safety inspector. At that time he was a safety inspector, I believe. He was called into Trenton to man the telephones or for some other work.
- Q. Would you please read this note for the Commission?
- A. "Arnold. Charles Paulin of the Department of Insurance, 2-5355. He said Dunehill, Incorporated, and T.R.C. International now have insurance through London & World Assurance, Limited, West Indies. They have paid the state taxes and are now approved as a state insurance as of 4/13/78. Joe."
- Q. Is there any indication in your file that this handwritten note was ever followed up by written confirmation either from the Department of Insurance to your office or from your office back to the Department of Insurance?
- A. No.

Q. And based upon this phone call, permits were issued for the amusement rides at Vernon Valley/Great Gorge?

A. Yes.

Amusement Rides Approved for Three Years Without Insurance

Q. Mr. Rubenstein, I now show you a document marked C-193, a letter dated April 6 of 1981 from a C.H. Dunning to Mr. Gene Mulvihill. Who is Mr. Dunning?

A. Mr. Dunning at that time was the chief safety inspector for amusement rides.

Q. And would you please read that letter?

A. It's addressed to Vernon Valley Recreation Association, Incorporated. Attention: Gene Mulvihill, President.

"We have received the certificate of insurance for your rides listing London & World Assurance, Limited, as the insurance carrier. A check with the Commissioner of Insurance office indicated that London & World Assurance, Limited, is not authorized to do business in this state. Our regulations, 12:195-1.14(b) indicates, quote, the policy shall be procured from one or more insurers acceptable to the State Commissioner of Insurance, end quote.

"This is to inform you that all ride operations must cease until you have provided us with adequate and proper insurance coverage.

"Very truly yours, C.H. Dunning, Chief Safety Inspector, Office of Safety Compliance."

Q. Mr. Rubenstein, is there anything contained within the files of Labor and Industry from May of '78 to Mr. Dunning's letter of April of '81 indicating that London & World Assurance was an approved insurer other than the handwritten note about the phone call from Mr. Paulin?

A. I could find nothing in the file.

Q. And as of approximately Spring of 1981 London & World Assurance Company stopped insuring at Vernon Valley. Correct?

- A. We no longer accepted them.
- Q. All right. But for approximately three years, 1978, 1979, 1980, Vernon Valley had obtained permits and operated amusement rides without the legally required insurance based upon that handwritten note?
- A. I can't say without legally required insurance because I don't know that much about London & World Assurance. Based on the evidence we had, certificates of insurance, they were with London & World Assurance.
- Q. There was no other insurance company listed during that period of time except London & World?
- A. That's correct.

#### **State Insurance Department's Role**

Charles J. Paulin of the Surplus Lines Office of the Insurance Department's Financial Examinations Division, was an examiner-in-training in 1978 when an insurance premium tax payment was accepted as proof of insurance, even though such a tax payment is not proof that a premium was paid. As the next witness, he reviewed this incident with SCI counsel Amitrani:

- Q. What were your duties back in May of 1978?
- A. At that time I reviewed surplus line agents' filings and made office visits to the surplus line agents in the field.
- Q. During May of 1978 do you recall a telephone conversation with someone from the Department of Labor and Industry about either Vernon Valley or London & World Assurance Company?
- A. I don't recall the date, but I do recall a phone call from Labor and Industry.
- Q. Is there any reason why a phone call from Labor and Industry would have stuck out in your mind or you would have remembered that?
- A. Yes, because I had spent a month over at Labor and Industry in 1977.
- Q. All right. And what was the nature of the conversation?

- A. Evidently, this person calling had information from Vernon Valley concerning a tax filing. Because Vernon Valley is not a surplus line agent, there would be no reason to have any other information until this person gave me specific names.
- Q. What type of information would you have within your office that would enable you to answer this particular person?
- A. We have what they call direct placement filings, and those fall under New Jersey Statutes 17:22-664, which states that any person or company may procure any insurance from any company as long as they file the necessary forms and pay the three percent state surplus lines tax.
- Q. All right. Mr. Paulin, I'm going to show you what's been marked C-196. Is this the filing that you are speaking of?
- A. Yes, it's a copy there. I have the original with me.
- Q. And would there be any other information contained within your office whereby you would be able to answer somebody as to whether somebody is an approved insurance company?
- A. Yes. We have the Annual Commissioner's Report, which is always December 31 of the previous year.
- Q. All right. Mr. Paulin, I'm going to show you what's been marked C-292 and C-293. These are the reports to which you are referring, for the years 1977 and 1978?
- A. That is correct.
- Q. And in May of 1978, which one of those books would you have been using?
- A. We'd be using the 1977 Commissioner's Report.
- Q. Going back to the other document marked C-196, that document shows that Dunehill paid \$11,500 on a premium. Correct?
- A. Yes, that's what it states.
- Q. And the amount of tax that they paid was \$345 on that premium?

A. Correct.

Q. Now, your department only received a check for the tax of \$345. Correct?

A. Right.

Q. So C-196 is not proof that a premium was actually paid, was it?

A. That is correct.

Q. It is only proof that a tax was paid. Correct?

A. That is correct.

Q. If a company wanted to create the illusion of having been insured, could they have paid this tax and filed this document?

A. Most certainly.

Q. And the payment of \$345 in tax comes from the insured, not the insurance company. Correct?

A. Right.

Q. And it is not proof that the insurance meets any particular needs concerning amusement rides. Correct?

A. That is correct.

Q. And nor is it your responsibility to know what the particular requirements were for amusement rides. Correct?

A. That is right.

"I Don't Want to Close Those Rides"

Q. Mr. Paulin, during the course of the conversation with this individual from the Department of Labor and Industry, did he ever make any comment to you to the effect of "I don't want to have to go up there and close those rides"?

A. The person was very perturbed and disturbed and he, as I recall, it's five years ago, he said something to the effect that he would hate to have to go up to Vernon Valley and close them up, and at that time I told him to do whatever he had to do.

Q. That response of his, that he would hate to have to go up and close those rides, was that in response to you telling him that London & World Assurance Company was not an approved insurance company?

A. I don't recall. I, I don't recall.

Q. Do you recall if you went to these books that you have, these Commissioner's Reports?

A. Uh-huh, yes, I did, right.

Q. Did you go to them at that time?

A. Certainly.

Q. Now, you have reviewed both of those books for 1977 and 1978 prior to coming in to testify today. Correct?

A. Yes.

Q. And is London & World Assurance Company listed anywhere as an approved insurance company within those books?

A. It is not.

The Handwritten Note on Tax Payment

Q. Mr. Paulin, I'm going to read to you what has already been marked C-192. It is a letter, handwritten note, that was in the files of the Department of Labor and Industry. It reads: "Arnold: Charles Paulin of Department of Insurance 2-5337 called. Said Dunehill and T.R.C. International now have insurance through London & World Assurance, Limited, West Indies. They have paid the state taxes, are now approved as state insurance as of 4/13/78."

Mr. Paulin, did you make such a statement?

A. I don't recall. I don't see how I could have.

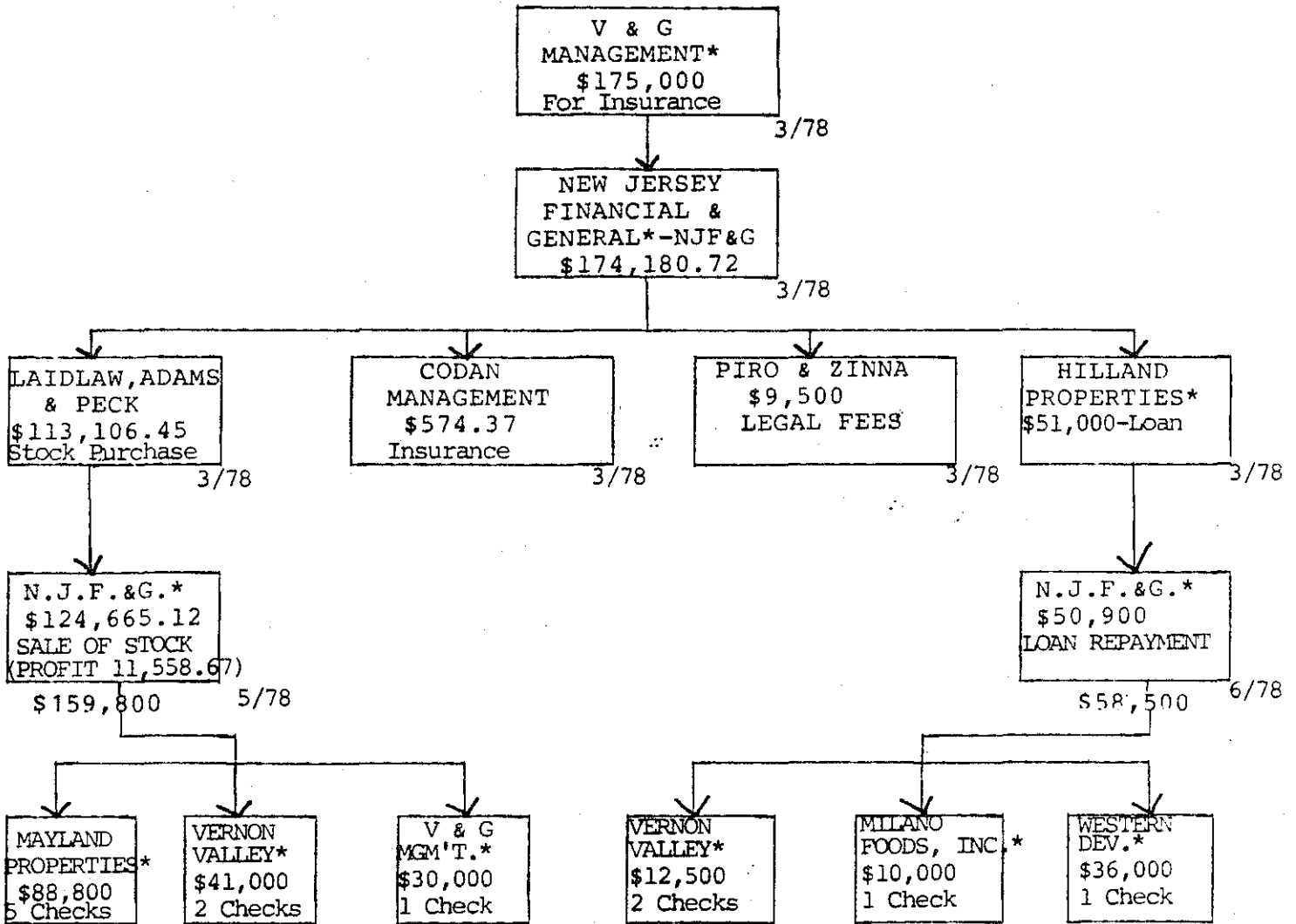
**Tracing Mulvihill's \$175,000 "Premium" Check\***

SCI Chief Accountant Julius Cayson returned as a witness to explain, by means of a chart, how the Commission traced most of

\*See Chart, next page.



N.J.F. & G.\* PREMIUM TRACE



\*MULVIHILL - RELATED CORPORATIONS

the proceeds of a purported \$175,000 premium payment to London & World Assurance back to companies connected to Eugene Mulvihill and/or Vernon Valley. The information on the chart was obtained from the books and records of Mulvihill's New Jersey Financial and General Company. According to Cayson, the books and records were maintained by Mulvihill's secretary, Debra Evers. SCI counsel Coppola laid the groundwork for Cayson's review of the chart:

- Q. And for the time period that the books covered, who was the accountant for New Jersey Financial and General?
- A. Prior to Elliot Goldberg, it was the firm of Klitzkin & Company, specifically, Steven Klein.
- Q. All right. There are a number of companies designated on that diagram. Can you tell us what connection, if any, Gene Mulvihill has to those particular companies?
- A. Any company represented with the asterisk, these are what we call Mulvihill-related companies; that is, we have direct evidence that he either has a proprietary interest, be it 51 percent of the stock, or a hundred percent of the stock, or some financial interest.
- Q. It's entitled New Jersey Financial and General Premium Trace. Could you please explain what's shown on the diagram?
- A. Yes. There's been prior testimony that the \$175,000 from V & G Management was a payment for a premium for the London & World Assurance Company. Now, that check was made out to the New Jersey Financial and General Company in the amount of \$175,000 and the check emanated from the V & G Management Company, which operated the Vernon Valley/Great Gorge ski area.
- Q. Was the date of the check March 13th, 1978?
- A. Yes, it was.
- Q. And was it made out to New Jersey Financial and General and signed by Gene Mulvihill?
- A. Yes, it was.
- Q. Please continue.
- A. This is what's called a premium trace. We're trying to trace the \$175,000. We are attempting to trace the \$175,000 out of V & G into New Jersey Financial and General and

to the various payees as they are indicated. So what happened was that \$113,106.45 was sent to Laidlaw, Adams & Peck. And that was charged to a stock purchase account. \$574.37 went for insurance. A legal fee of \$9500 went to a firm of Piro & Zinna, and \$51,000 went to Hilland Properties, which we identify as a Mulvihill-related company.

THE CHAIRMAN: Let me ask a question. Those four items -- do they amount to that \$175,000?

THE WITNESS: They amount to \$174,180.72.

THE CHAIRMAN: You have traced insurance premium money on a check drawn from V & G for 175,000. Is that correct?

THE WITNESS: And identified as the premium payment for London & World.

EXAMINATION BY MR. COPPOLA:

Q. That Codan Management Company, do you know where that is incorporated?

A. Cayman Islands.

Q. Continue.

A. Laidlaw, Adams & Peck was a stock purchase in March of 1978. Subsequently the stock was sold and the proceeds were \$124,665.12, resulting in a profit of \$11,558.67.

On the other side, a check was made out to Hilland Properties for \$51,000 and then Hilland Properties repaid New Jersey Financial and General \$50,900. So we have the \$50,900 at this level and \$124,665.12 emanating from the original 175,000.

THE CHAIRMAN: Of the purported premium payment?

THE WITNESS: That's right, sir.

A. From the \$124,665 there were disbursements to Mayland Properties for 88,800; Vernon Valley 41,000; V & G Management for 30,000, and that comes to 159,800. Now, of course, the 159,800 is more than 124,665. What we're saying is that other funds came in but the bulk of the funds going out to these particular entities, which were all

Mulvihill-related entities, emanated from the stock sale by Laidlaw, Adams & Peck of \$124,665.

We go to the other side. When the 50,900 comes in from Hilland Properties, that goes back to Vernon Valley, 12,500; Milano Foods, Inc., 10,000; and Western Development, \$36,000, all Mulvihill-related companies.

\$12,500 To a Mulvihill-Financed Restaurant

Q. Can I ask you a question about Milano Foods?

A. Yes.

Q. Is that also known as Tino's Restaurant in New York City?

A. Yes.

Q. Is there anyone associated with that who is a London & World officer or authorized representative?

A. Yes, sir.

Q. Explain that.

A. The records of the New York State Liquor Authority indicate that the two principals in Tino's Restaurant on E. 58th Street is one Augustino Scarpa and the other individual is Eugene Mulvihill, the sole person putting up any money. And, as I said, the records of the New York State Liquor Authority indicate that the holding corporation for the Tino's Restaurant is Milano Foods, Inc.

Q. All right. During the course of the S.C.I.'s investigation did you come into possession via subpoena of a document now marked C-159 for identification? It is a London & World insurance policy insuring or naming as the insured Vernon Valley for the time period January, '79 to January, '80, wherein Augustino Scarpa is listed on the insurance policy as the president of London & World insurance.

A. Yes, we did.

Q. Did you also come across documents during the course of the investigation, specifically performance bonds wherein Augustino Scarpa was designated as the authorized representative of London & World?

A. Yes.

Q. Please continue.

A. That actually completes it. What we're saying, in effect, is that on the basis of the evidence presented to this Commission, there is no credible evidence presented at all from any source which would indicate that this \$175,000 went to any organization by the name of London & World Assurance, Incorporated and that, in fact, the money wound up back into the pockets of entities controlled by Eugene Mulvihill.

Q. For what period of time did the books and records cover from New Jersey Financial and General?

A. From 1976 to 1980.

Q. Do the books show any payment at all to London & World during that particular period of time?

A. Not one dime.

#### **How \$175,000 Insurance Check Was Disbursed**

Debra Evers, the next scheduled witness, was not present because, as the Commission noted for the record, "she has indicated to us in advance that, on the basis of a claim of privilege, she would be unwilling to testify in this matter." Therefore the Commission authorized reading for the public hearing record from transcripts of Evers' prior testimony at SCI executive sessions in September and November, 1982. SCI counsel Coppola said that such testimony was being presented on the issue of "whether a \$175,000 check drawn on the account of V & G Management, allegedly for payment of an insurance premium, was ever utilized for that purpose." Counsel Coppola also said that Evers' testimony would reveal that a trace of the insurance premium shows that money going to New Jersey Financial and General was invested with a stock broker and returned with a profit to New Jersey Financial and General and was then "disbursed to other Mulvihill-related companies."

Debra Evers testimony on the purported \$175,000 premium check to London & World Assurance was critical since she not only was secretary/treasurer and bookkeeper of New Jersey Financial and General, of which Mulvihill was president, but she also served Mulvihill and various Mulvihill companies in a secretarial or bookkeeping capacity. She testified in executive session that she was the corporate secretary of Vernon Valley Recreation Association, of Stonehill Development, the condominium company of which Mulvihill was a director, and of the former V & G Management Co., which once managed Vernon Valley/Great Gorge. She also was bookkeeper for the Mulvihill-owned Mayland Properties, Inc. In addition, she submitted to the State Department of Labor and

Industry as vice president of Dunehill, Inc., that Mulvihill company's various applications for amusement rides that were accompanied by London & World "certificates of insurance."

With Counsel Coppola reciting the questions put to Debra Evers at her executive session appearances, and with SCI Special Agent/ Accountant Chris Klagholz repeating Evers' answers, the following testimony about the various disbursements from the \$175,000 insurance premium check was read into the hearing record:

"Q. What is the main business activity of that corporation?

"A. New Jersey Financial and General receives money from Arizona Title and holds it. They lend it to Mayland Properties or at one time they lent monies to other companies. We use it as an inter-company account to try to keep a better control over who owed who money. At the present time it really doesn't do much of anything.

"Q. Do you maintain the checkbooks for New Jersey Financial and General?

"A. Yes."

"Q. What I would like to do is to trace with you a series of transactions involving that corporation and to do that I would like to show you what's been marked as C-134 for identification. What is that item?

"A. It's a receipts and disbursements and I believe the general numbering of New Jersey Financial and General.

"Q. Can you tell me who makes the entries in that?

"A. I do."

"Q. Will you turn to the cash receipts book of March of 1978?

"A. I have got it.

"Q. On line 4 on the page for March of 1978, can you tell what's depicted on that line?

- "A. A receipt from V & G Management for a hundred and seventy-five thousand dollars.
- "Q. What's V & G Management?
- "A. V & G Management was the company that existed to manage Vernon Valley/Great Gorge. It's no longer in existence."
- "Q. What was the date that that hundred seventy-five thousand dollars was received?
- "A. March 13th.
- "Q. Of '78?
- "A. Right.
- "Q. Does the cash receipts book reflect whether that \$175,000 was deposited?
- "A. Yes."
- "Q. Let me show you what was marked as C-86 for identification. I believe I showed you that the last time you were here.
- "A. Yes.
- "Q. Do you recall that check?
- "A. Yes.
- "Q. Do you recognize the signature on that check?
- "A. Yes.
- "Q. Whose signature is that?
- "A. Gene Mulvihill.
- "Q. Do you recognize the endorsement on the check?
- "A. It's my handwriting.
- "Q. It was endorsed by --
- "A. By New Jersey Financial and Management."
- "Q. Can you tell me does that check represent the entry on line 4 of the cash receipts book?

"A. Yes.

"Q. For March of 1978?

"A. Yes.

"Q. Let me show you what's been marked as C-135. Can you look at that and tell me what it is, if you know?

"A. I would say there is an excellent chance that this is the actual deposit receipt."

"Q. Can you tell me what is reflected in the notes on that receipt?

"A. It was the date, the amount, it came from V & G and underneath there is a notation that says, 'Insurance premium.'

"Q. What's the date?

"A. March 13th, '78.

"Q. What's the amount?

"A. A hundred and seventy-five thousand dollars.

"Q. Would that be the hundred and seventy-five thousand dollars we have been talking about these last few minutes?

"A. Yes."

"Q. That indicates that you understood it to be a payment of insurance premium in that amount of a hundred seventy-five thousand dollars?

"A. I assume so if that's what I wrote here.

"Q. Can you tell me who told you that was an insurance premium, who gave you the information to make that notation on the receipt?

"A. No. I might have asked someone from Vernon Valley or I might have asked Mr. Mulvihill. I don't remember who exactly told me that. I can see I didn't carry that forward as that in my receipt journals. Since I wasn't sure, I put it in the inter-company loan account. If I knew for sure it was specifically something, I would have called it that in my receipts.



"Q. New Jersey Financial and General is not and never was an insurance company?

"A. No.

"Q. Nor was it ever an insurance agent, broker or intermediary?

"A. No.

Disbursements From Insurance Check

"Q. Would you turn, please, to the cash disbursements section of the book for March of 1978?

"A. Okay.

"Q. Is there an entry on March the 7th, 1978?

"A. Yes.

"Q. What is that entry?

"A. It's a disbursement to Laidlaw, Adams & Peck for \$113,106.45.

"Q. Does the book reflect the purpose of that transaction?

"A. Stock purchase.

"Q. Is there any entry for March the 29th of 1978?

"A. Yes, to Hilland Properties.

"Q. What is the amount of that disbursement?

"A. \$51,000.

"Q. Is the purpose reflected in the book?

"A. It just says Hilland, which is an inter-company.

"Q. How about another disbursement on March the 29th, is there an additional disbursement?

"A. Codan Management, \$574.37.

"Q. So that was an insurance premium paid by New Jersey Financial and General to a company known as Codan Management, then; is that right?

"A. Right.

"Q. Can you tell me who Codan Management is or where they are located?

"A. No. Actually I don't remember writing that check although it's my handwriting.

"Q. Would it refresh your recollection if I were to tell you that Codan Management is located in the Cayman Islands, British West Indies?

"A. No.

"Q. Let me show you what's been marked as C-137, C-138 and C-139. Would you look at them and tell me if you recognize them, please?

"A. C-137 is a check that I sent to Laidlaw, Adams & Peck for -- to obviously pay for that stock.

"Q. The check is in the amount of \$113,106.45, dated March 13th, 1978?

"A. Right. Check dated March 29 is to Hilland Properties for \$51,000 and it was a loan to Hilland Properties.

"Q. The third one?

"A. Dated April 2nd, 1978, for \$574.37 to Codan Management Cayman Limited.

"Q. Are these three checks representative of the information contained in the cash disbursements book for March of 1978 that we talked about a few moments ago?

"A. Yes.

"Q. Do you recognize what's been marked as C-150?

"A. Yes. My bank statement for New Jersey Financial and General for the month of March, 1978.

"Q. Opening balance?

"A. \$8,193.31.

"Q. How many deposits were made that month?

"A. Four.

"Q. What was the total, roughly, of those four deposits?

"A. \$206,242.29.

- "Q. The disbursements for the month amounted to what, approximately?
- "A. \$196,606.45. In my book it was a hundred and eighty-four but checks came in from a prior month that totalled 196.
- "Q. As I understand it, there is 200,000 in the bank that month?
- "A. Right.
- "Q. And including part of that, the major part of it being a hundred and seventy-five thousand dollar deposit, with that amount of money, obviously had you not had the hundred and seventh-five thousand dollar deposit that month, you wouldn't have been able to draw that 163,000 the next day or what have you, isn't that correct, without getting further money?
- "A. That's correct.
- "Q. You didn't get further money?
- "A. Right. That's why it's so obvious.
- "Q. We agree, then, without that hundred and seventy-five thousand dollars all three of those checks could not have been written?
- "A. Unless I got the money from somewhere else. Sounds picky."
- "Q. Would you turn back, please, for a minute to the cash receipts book for May of 1978?
- "A. Okay.
- "Q. Specifically lines three and six. What do they show?
- "A. They show a receipt from Laidlaw, Adams & Peck 20,000 on May 18th and the second one for \$104,665.12 on May 24th."
- "Q. Can you tell me from the records that you have in front of you from the cash receipts book what was that total of a hundred and twenty-four and some-odd thousand dollars credited to?
- "A. Credited to what I call margin, meaning when you have a credit in your stock account you

can draw money and that was excess money that we had and I drew it.

"Q. Did anyone instruct you to credit that to a margin account?

"A. To call it specifically margin, that's probably my own thought to call it margin. It's not a sensible term, I realize now, but that's what I called it then.

"Q. What would you have called it today?

"A. Today, stock proceeds.

No Record of Premium Payment to London & World

"Q. Is there anywhere in your records there or in the exhibits that I have shown to you where you can show this Commission that the hundred and seventy-five thousand dollars that V & G paid to New Jersey Financial and General in March of 1978 went towards the payment of insurance premium to London & World Assurance, Limited?

"A. Did I disburse any money to London & World?

"Q. Is there anywhere in there that indicates that hundred and seventy-five thousand dollar check, specifically this check that was marked as C-86 --

"A. I took those funds and disbursed them?

"Q. Is there anywhere you can show this Commission that these funds were disbursed to a company known as London & World Assurance, Limited for the purposes of paying a liability insurance premium on behalf of Vernon Valley Recreation Association, Incorporated? Or any form of insurance.

"A. No.

Did She Use Dasti's Signature Stamp?

During Joseph Guy Dasti's executive session testimony at the SCI, he indicated that, in addition to himself, others in Mulvihill's Chatham office may have used his signature stamp to affix his name as "authorized representative" to London & World certificates of insurance. He stated, as previously noted, that "my stamp is always in my office and my desk is not locked," indicating thus its general availability.

Debra Evers, however, contradicted Dasti's testimony during her executive session appearance at the SCI. She claimed she never used his signature stamp in processing London & World insurance certificates out to various state agencies. Counsel Coppola and Accountant Klagholz read the following excerpt from Evers' executive session testimony:

"Q. Mr. Dasti never asked you to fill out a certificate of insurance for him?

"A. No.

"Q. Let me show you a certificate of insurance that's been filled out. It's been marked as C-35 for identification. Would you look at that and tell me if you have ever seen that document?

"A. I might have.

"Q. Can you tell me, do you recognize the signature stamp on the bottom right-hand corner?

"A. It's Joseph Dasti's.

"Q. Does he have a signature stamp in his office?

"A. Yes.

"Q. Have you ever used that signature stamp?

"A. Did I ever stamp his name? Never.

"Q. Did he ever request you to use it?

"A. No. He keeps it locked in his drawer. Nobody has access to it but him.

"Q. Did you ever see anyone other than Mr. Dasti use his signature stamp?

"A. No. I'm sure he would not allow that.

#### **SCI's Probe of London & World Assurance**

SCI Special Agent Raymond Schellhammer testified next, about the numerous steps the Commission took in an effort to verify the existence and validity of London & World Assurance, Ltd., as a liability insurance carrier. Schellhammer recalled that the Commission contacted both the Police and the Insurance Departments of the government of the Cayman Islands and he read into the hearing record two letters to SCI counsel James A. Hart, the attorney who headed the SCI investigative team.

One letter was from E.J.E. Stowers, Grand Cayman police commissioner, dated January 4, 1983, which confirmed that London & World "does not occupy office accommodation on the island." The other letter, dated January 5, 1983, came from Insurance Superintendent John Darwood of the Cayman Islands. Darwood's letter, which revealed that London & World never applied for an insurance license, stated in part:

"From the information disclosed, it seems that such criminal activity as may have taken place occurred mainly in New Jersey and mainly before our insurance laws became effective. Since the company has never applied for an insurance license here, this office has very little knowledge of its affairs."

SCI Sends Agent to Cayman Islands

Counsel Hart questioned Agent Schellhammer about his visit to the Cayman Islands on March 21 and 22, 1983, on an assignment by the Commission to inquire into the status and activities, if any, of London & World on the islands:

- Q. And while you were there, did you have a meeting with Superintendent Darwood, the Superintendent of Insurance?
- A. Yes, I met both with Superintendent John E. Darwood and Deputy Superintendent Steve E. Butterworth.
- Q. Could you tell the Commission what you learned at that meeting?
- A. Yes, sir. They reaffirmed that London & World has never been a licensed insurance company on the Cayman Islands. They indicated, as is represented in the letters, that London & World Assurance, Limited, was and is an exempt company within the provisions of the corporation law of the Cayman Islands.
- Q. Did they tell you what an exempt company is?
- A. Yes, sir. It is a company incorporated upon the islands which can operate in whatever area the corporation deems it proper to operate for their own benefit.
- Q. Did you speak to Commissioner Superintendent Darwood about the insurance laws of the Cayman Islands?

- A. Yes, sir, I did.
- Q. What did he tell you about the insurance laws?
- A. He informed me that during 1979 legislation was worked upon and passed which was to become the insurance law for the Grand Cayman. The law became effective on March 16th, 1980, and required certain things of insurance companies that were operating on the island or from the island.
- Q. Did the insurance law also require certain things from exempt companies that had been doing insurance business?
- A. That's correct, sir. The Attorney General of the Cayman Islands indicated that not only were companies presently doing insurance business required to register, but that companies that were at risk for any insurance liability in a previous period of time would also be required to file the data that was required under the law.
- Q. Did Superintendent Darwood tell you whether or not London & World had ever registered pursuant to that law with the Department of Insurance?
- A. Yes, he affirmed his statement that they had not registered as an insurance company.
- Q. Did Darwood advise you that, in order for London & World to write any insurance after June 16th, 1980, the company would have had to have been licensed in the Cayman Islands?
- A. That's correct, sir.
- Q. Did he tell you whether or not they were licensed in the Cayman Islands?
- A. They were not licensed in the Cayman Islands.
- Q. Did he tell you that the licensing requirement of the law also applied to the writing of performance bonds as well as the writing of liability insurance?
- A. It would have applied to the issuance of any type of insurance or surety.

Q. While you were in the Cayman Islands did you have occasion to go to the Barclays Bank Building in George Town, Grand Cayman?

A. Yes, sir, I did.

Q. Why did you go there?

A. Documents that were in the possession of the Commission indicated that the London & World Assurance, Limited, would be housed in the Barclays Bank Building. In addition, there was an address of Cardinal Avenue, George Town. It happens that Barclays Bank is located on Cardinal Avenue in George Town.

Q. What did you observe when you got to that bank building?

A. In the lobby of the bank building was a directory posted on the wall. It indicated that on the upper floors the offices of W.S. Walker and Company and Cayhaven could be found.

Q. Was there any listing on the directory that London & World Assurance was housed in that building?

A. No, sir, there was not.

Q. What is the significance of Cayhaven?

A. The proper name is Cayhaven Corporate Services, Limited. Cayhaven is the registered office for Codan Management. Codan Management is the registered office of London & World.

Q. All right. Do you recall the chart that was exhibited a short time ago? Mr. Cayson testified that a five-hundred-seventy-four-dollar check was drawn to Codan Management from New Jersey Financial and General?

A. Yes, sir.

Q. Is that the same Codan Management?

A. As far as I understand it, it is.

Q. Were there any signs or indicia on the outside or the inside of the bank building



indicating that London & World Assurance, Limited, had offices within that building?

A. There was nothing, sir.

Q. Did you speak to anyone from Codan Management?

A. Yes, sir, I did.

Q. Who did you speak to from Codan Management?

A. I interviewed Mr. Malcolm S. Davies, who is the managing director of Cayhaven. I explained, when I made an inquiry, was I not speaking to the wrong people, that I wanted to speak to someone either from London & World or Codan. He said that London & World had the registered office at Codan and Codan had the registered office at Cayhaven, so I was in the right place.

Q. Did Mr. Davies answer any of the questions that you posed to him that day?

A. A few of them.

Q. Did he give you a reason for not answering other questions?

A. Yes, sir, he did.

Q. What was the reason?

A. He told me that the information was protected and that he was not at liberty to give me that information.

Q. Did the insurance law of the Cayman Islands prohibit him from giving you information on London & World Assurance, Limited?

A. Not the insurance law so much as the corporation law, the Privacy Act.

Q. This Commission has received documents indicating that persons with the name of Alice Mae Co, and Averill Bleasdale and Margaret White were the original subscribers of the London & World Company. Did you learn anything about those persons from Mr. Davies?

A. If I might explain, sir, that a management corporation such as Cayhaven or Codan provides, at the request of individuals who

might request their services, the placement of shareholder nominees on record in the Cayman Islands so that that organization might incorporate. Mr. Davies would tell me that there were at that time people working for or still working for that company, meaning Cayhaven, but he would not explain to me whether those people were the nominees for the incorporation of London & World Assurance, Limited.

THE CHAIRMAN: Are you saying that that company down in the Cayman Islands, that management group, just provided names of incorporators for the benefit of anybody that might inquire?

THE WITNESS: Sir, if I was of a mind to set up a corporation down there and I communicated with them by letter or by telephone, they would provide the shareholder nominees and the stocks would be placed in their names as bearer.

BY MR. HART:

- Q. Does Cayhaven or Codan run the business of the corporation that they provide the shareholders for?
- A. As best I could learn from speaking with the police, the Commissioner, the Superintendent of Insurance, and from what I could glean from Mr. Davies, they don't function as the business operation. They are a management service.

Agent Schellhammer was also asked about other actions by the SCI to determine whether London & World was a valid insurance company:

- Q. Did the Commission take any steps by way of contacting Vernon Valley Recreation Association during the course of the investigation to determine whether or not London & World was an existing or a bona fide insurance company?
- A. Yes, sir.
- Q. What did the Commission do?
- A. On three separate occasions the Commission has communicated with McCarter & English, the attorneys representing Vernon Valley

Recreation Association. On the three occasions, which were a letter dated November 15th, 1982, December 9th, 1982, and January 17th, 1983, we requested that we be authorized by Vernon Valley to review the books and gather information in the Cayman Islands concerning London & World Assurance, Limited.

Q. Did Vernon Valley ever provide this Commission with such an authorization?

A. No, they did not, sir.

THE CHAIRMAN: Now, as I understand it, those letters were addressed to the law firm representing --

THE WITNESS: Yes, sir, they were addressed to counsel representing Vernon Valley.

THE CHAIRMAN: What response did you get?

THE WITNESS: We received no response to them.

#### **Surplus Lines Insurance Tax Problems**

The next witness was Jerry M. Porcelli, assistant chief examiner of the State Insurance Department's Surplus Line Examining Office. He was questioned about the manner in which Eugene Mulvihill, on behalf of Vernon Valley and other Mulvihill - connected companies, submitted state insurance tax payments in connection with purported liability coverage by London & World. SCI counsel Hart initially asked Porcelli to describe how the Insurance Department through his office regulates insurance companies that are not licensed to write insurance in the State of New Jersey:

Q. Companies that are not licensed to write insurance in New Jersey nevertheless can write insurance in this state if they are approved by your department. Is that right?

A. Yes, that's right.

Q. Can a company that is not licensed and not approved by your department write insurance in the state of New Jersey?

A. Yes, they can, under certain conditions.

Q. Could you tell us how that works?

A. Right. The assured would have to go

directly to the insurance company and he cannot go with any broker or agent licensed in the State of New Jersey.

Q. So, for example, if I were to desire insurance and I couldn't get it from a licensed company and I couldn't get it from an approved unlicensed company, I could go directly to the unapproved insurance company and purchase insurance for property here in New Jersey?

A. Yes, you can.

Q. But I'd have to go directly to the company, I couldn't go through a broker or an agent?

A. That is right, you cannot go through a broker or an agent.

Q. When one does go directly to such a company, is there a tax or penalty of some sort that the insured must pay in order to get such insurance?

A. Yes, it's a three percent tax on the premium.

Q. The tax is figured as a three percent of the premium figure?

A. Yes, it is.

Q. If the insurance that's purchased is liability insurance and it's purchased from an unlicensed, unapproved company, where does that tax get paid to?

A. Tax is paid to the State of New Jersey.

Q. What about if the insurance is fire insurance; who is the recipient of that three percent tax payment?

A. State Fire Relief Association.

#### Got Anonymous Mailing of Insurance Certificates

Porcelli testified that prior to 1980 he had never encountered an insurance company by the name of London & World:

Q. I take it sometime in 1980 you came across the name London & World Assurance, Limited?

A. Yes, that's true.

Q. Could you explain how that came about?

A. Around April of 1980 I received four certificates of insurance in the mail. There was no address name or otherwise, just anonymously addressed to myself, Surplus Line Examining Office, Trenton, New Jersey.

Q. What was the name of the insurance company on those four certificates of insurance?

A. London & World Assurance, Limited.

The witness identified the certificates as certifying coverage of \$100,000 bodily injury liability and \$50,000 property damage liability for 1980 for Waterhill, Inc., Western Formula, Inc., Dunehill, Inc., and T.R.C. International. The certificates had been addressed to the State Department of Labor & Industry. After receiving the certificates in the mail, Porcelli said he went to an address in Westfield that was listed on the insurance certificate for Dunehill:

Q. Why did you go to Westfield, New Jersey, to that office?

A. Well, as I explained before, we collect taxes in the State of New Jersey for policies that are issued on surplus lines. Not knowing that I received any taxes on that particular item, I decided to go to Westfield to find out who these people were.

At Westfield, Porcelli was referred to an officer at Vernon Valley or to a 215 Main Street, Chatham, address, as listed on three of the certificates. At Chatham he was introduced to Eugene Mulvihill:

Q. Did you speak to Mr. Mulvihill about these certificates of insurance?

A. Yes, I did.

Q. What did you tell him and what did he tell you?

A. I explained that I received these certificates in the mail and since London & World Assurance, Limited, is not a licensed company I was seeking to find out if he had placed insurance with this company or somebody in his organization.

Q. What did Mr. Mulvihill reply?

A. He said he had went directly to the company because he couldn't get insurance elsewhere in the market. I proceeded to explain under our law there's a three percent tax due from the assured.

Q. Did you provide Mr. Mulvihill with blank tax returns so he could file them to pay the three percent tax?

A. Not at that time. I didn't have them with me. Subsequently, when I went back to my office a few days later, I did send Mr. Mulvihill some tax returns and ask him to complete them and send the three percent tax to the State of New Jersey or to the Fire Relief Association if it was fire insurance.

Q. What was the date of this meeting with Mr. Mulvihill?

A. It was on May 9th, 1980.

Mulvihill's Insurance Tax Checks and Tax Returns

Q. Did you receive anything back from Mr. Mulvihill after you sent him the blank tax returns?

A. Yes, I did. I first received a check for \$3000 made out to the State of New Jersey with no tax returns. I proceeded to contact Mr. Mulvihill by phone indicating that we have to have the tax returns completed and submitted to the department.

Q. Would you look, please, at Commission Exhibits 222, 223, and 224 and could you tell me what those are, please?

A. These are direct placement tax returns which are usually filed by an insured when they go directly to a unauthorized, unapproved surplus line company.

Q. Are those the tax returns Mr. Mulvihill sent back to you?

A. Yes, they are.

Q. Now, how many tax returns did you receive from Mr. Mulvihill?

A. I have received three.

- Q. Shouldn't you have received four, one for each of the companies listed on the four certificates of insurance?
- A. Yes, I should have received four.
- Q. Did you take any steps to check with Mr. Mulvihill concerning a fourth tax return?
- A. No, not at that time.
- Q. Could you tell me why you didn't check with him?
- A. I just don't know, really, why. At the time I was operating by myself and it didn't occur to me to look into the matter any further.

Although Porcelli had questioned Mulvihill about the four insurance certificate sent to him anonymously, he soon began to receive tax returns reflecting liability coverage from 1978 through 1980 for Vernon Valley, which created further problems. His testimony continued:

- Q. Would you look at Exhibit 222? What's the name of the insured on that tax return?
- A. Vernon Valley Recreation Association.
- Q. What type of coverage is indicated on the tax return?
- A. The problem here is that they didn't indicate what type of coverage, it just showed the total forty-five-thousand-dollar premium.
- Q. Is the type of coverage supposed to be listed on that tax return?
- A. It should have been identified.
- Q. What's the amount of coverage?
- A. The amount of cover is \$1 million.
- Q. What's the term of the policy?
- A. One year, January 2nd, 1979.
- Q. The name and the address of the insurer?
- A. London & World. The address is George Town, Great Cayman, British West Indies.

- Q. Does the tax return indicate the amount of the premium paid for that million-dollar policy?
- A. Forty-five-thousand-dollar premium.
- Q. What would the three percent tax be on the forty-five-thousand-dollar premium?
- A. \$1,350.
- Q. Is that total indicated on the tax return?
- A. Yes, it is.
- Q. Does Mr. Mulvihill's signature appear at the bottom of that return over the words "Chairman of the Board"?
- A. A signature appears. I could not determine if it's Mr. Mulvihill's.
- Q. Immediately above the signature are the words "I declare under penalty of perjury I have examined this return to the best of my knowledge and believe that matters and information set forth herein are true, correct and complete." Is that right?
- A. Yes, they appear there.
- Q. Now, looking at Exhibit 223, for the most part, it contains the identical information as did 222 that we were just talking about other than the term and the expiration of the policy. Is that correct?
- A. That is true.
- Q. What's the premium shown on the tax return?
- A. 45,000.
- Q. And the tax due?
- A. \$1,350.
- Q. Does that tax return describe the type of insurance?
- A. It does not describe the type of insurance?
- Q. Does it indicate that the insurance is liability and fire?
- A. No, it doesn't indicate that.



Q. Would you look, please, at Exhibit 224, and again the information is pretty much the same as it is on 222 and 223, other than the term and the expiration of the policy. Is that right?

A. Yes, that's true.

Q. The premium is again listed as \$45,000?

A. That's right.

Q. And the tax again is listed as \$1,350?

A. Yes. There's something else here, though, I should point out.

#### Payments To Fire Relief Association

The witness then observed that two of the tax returns contained the notation, "less paid to the Fire Relief Association" -- \$5,265.75 in one year and \$6,265.75 in the second year. The testimony on this development follows:

Q. Assuming the amounts were right, would that satisfy the three percent surplus lines tax?

A. It would have if this was fire insurance, yes.

Q. Do you have any idea whether or not it was fire insurance?

A. Not from their tax return. I can't determine that.

Q. Did Mr. Mulvihill show you the London & World policies when you met with him in his office?

A. No, he did not.

Q. If he had shown them to you, would you know that they were not fire insurance?

A. Yes.

#### Did Not Question Vernon Valley Submissions

Q. Now, all of those tax returns named Vernon Valley Recreation Association as the insured. Is that right?

A. That's right.

Q. The four certificates that you received in the mail and you spoke to Mr. Mulvihill about were for companies other than Vernon Valley Recreation Association?

A. That's true.

Q. Did you ever ask Mr. Mulvihill why he sent in tax returns in the name of Vernon Valley when you had questioned him about these four other companies, those being Dunehill, Waterhill, Western Formula and T.R.C.?

A. No, I did not ask him specifically why.

Was Insurance Premium \$175,000 or \$45,000?

Counsel Hart showed Porcelli a 1979 insurance policy by London & World covering Vernon Valley risks. The exhibit raised a question as to whether Mulvihill had failed to submit an adequate tax return for the premium listed on the policy:

Q. All right. What is the expiration date listed on that tax return?

A. Expiration date is January 2nd, 1979.

Q. Now, if you look at the policy I showed you, which was C-158, what is the expiration date on the policy?

A. The expiration date is January 2nd, 1979.

Q. That's the same as the tax return?

A. Yes, I said so.

Q. So the tax return goes with the policy we're talking about?

A. I would say so, yes.

Q. All right. Does the policy indicate what the premium was that London & World charged for the policy?

A. Yes, it does.

Q. What is the amount of the premium?

A. \$175,000.

Q. So the policy shows a premium of 175,000 and the tax return shows a premium of 45,000?

- A. Yes, it does.
- Q. What would be the effect of underreporting the amount of the premium of \$130,000?
- A. There would be less tax due to the State of New Jersey.
- Q. So if the premium, in fact, was \$175,000, the State of New Jersey would have additional tax monies coming to it?
- A. Yes, it would have.
- Q. That would also mean, would it not, that the individual who swore to the truthfulness of Exhibit 222, the tax return, was not being truthful when he placed the information in the return that the premium was only \$45,000?
- A. I would say that is true.

Other Insurance Premiums Were Under-Reported

- Q. Would you look, please, now, at what's been been marked Exhibit 159. That purports to be another insurance policy issued by London & World Assurance, Limited. What is the name of the insureds under that policy?
- A. Vernon Valley Recreation Association, Great Gorge, Inc., and E.T.A.L.
- Q. Does that policy set forth the amount of the premium?
- A. Yes.
- Q. What is it?
- A. \$140,000.
- Q. What is the term of the policy?
- A. Term of the policy is January 2nd, 1979, to January 2nd, 1980.
- Q. All right. Now look at Exhibit 223, the second tax return. The term that's listed on that tax return is what?
- A. The term is one year, expiring December the 15th, 1979.

- Q. In effect, then, but for a couple of weeks we're talking about the calendar year 1979 that each of these documents purportedly covered. Is that correct?
- A. That's correct.
- Q. The premium listed on the policy is 145,000, the premium listed on the tax return was 45,000. The effect of underreporting the amount of that premium I'm assuming would be to decrease the amount of taxes paid to the State of New Jersey. Isn't that correct?
- A. That is correct.
- Q. And if, in fact, the premium was underreported, the state would have additional monies coming to it?
- A. Yes, they do.
- Q. There's an endorsement to that policy C-159. Does that endorsement include T.R.C. International as a named insured?
- A. It does include T.R.C. International, Inc., as a added insured.
- Q. Would you look, please, at Commission Exhibit C-160 which also purports to be a London & World liability insurance policy. Is the entity insured under that policy also Vernon Valley Recreation Association?
- A. Yes.
- Q. What's the term on the policy?
- A. Term is December 15th, 1979 to December 15th, 1980.
- Q. What's the amount of the premium?
- A. \$105,000.
- Q. Now, looking at Exhibit 224, which is the third tax return, for the one-year period from December 15th of '79 to December 15th of '80, that's the same period covered by the policy. Right?
- A. Yes, it is.

Q. And the tax return shows a premium of \$45,000, so here again the state would have additional tax monies coming to it because of the underreporting of the premium on the tax return. Is that correct?

A. That is correct.

The Fire Department Checks

Porcelli was asked to clarify the listing in the insurance tax returns of payments by Mulvihill to the Firemen's Relief Fund. He said Mulvihill sent him copies of checks made out to the Vernon Valley Fire Department of Vernon Township:

Q. What did you do when you received those checks?

A. When I reviewed the checks and the tax returns and came to a conclusion that something was wrong, I couldn't figure out why there would be a forty-five-thousand-dollar premium on a tax return and adding up the \$4,050 in tax and yet I had a group of checks that totalled up to over \$11,000.

Q. It would appear from the cancelled checks that Vernon Valley had paid more than they owed based upon the tax returns?

A. That is true.

Q. Did you communicate with Mr. Mulvihill about that discrepancy?

A. Yes, I did.

Q. All right. Would you look, please, at Exhibit 231 and tell me what that is?

A. This is the letter dated November 7th, 1980, when I wrote to Mr. Mulvihill and I have indicated that I made a review and I just didn't understand the particular items whereby he had sent the tax returns with \$45,000 in each tax return adding up to a tax of \$4,050 and I have checks adding up to 11,531, and I questioned why Mr. Mulvihill was paying that amount to the Fire Relief Association.

Q. Did you request in your letter a meeting with Mr. Mulvihill to discuss the discrepancy?

- A. Yes, I did.
- Q. Did you receive a response from Mr. Mulvihill?
- A. I received a telephone call from Mr. Mulvihill which indicated that he couldn't be available at that time.
- Q. Did he explain to you in any way at any time, either over the phone, or by letter, or by personal meeting, why he had apparently overpaid the tax that was due?
- A. He never explained, no.
- Q. When you first met with Mr. Mulvihill in the Chatham office, did he tell you at that time that he had already paid the tax that was due?
- A. No, he did not.
- Q. In fact, you had to explain to him what the tax was and that it was due?
- A. Yes, I did.
- Q. Can you tell me from looking at Exhibits 225 to 230 the dates of the checks that were presented to you by Mr. Mulvihill as proof that he paid the tax?
- A. You cannot determine by the check face if these are tax amounts or not. It's just made out to the Vernon Township Fire Department.
- Q. I understand that. Can you make out the dates that are on those checks?
- A. The dates? Yes, one date is August 11th, 1980; one date is July 18th, 1979; one check has October 19th, 1979. The other dates are difficult for me to read although it's 1980 and one is 1979.
- Q. So most of those checks were written prior to your meeting with Mr. Mulvihill? In fact, as much as a year prior. Is that correct?
- A. That is correct.
- Q. He didn't tell you at the meeting that he had already paid the tax?

A. He never indicated that he had paid the tax, no.

Q. You just mentioned a few moments ago, I think, the answer to this next question. Is there any way from looking at the checks that one can tell whether or not they were payment of the tax or whether they were a charitable contribution or a payment for services rendered by the Vernon Township Fire Department?

A. There's no way of telling, no.

"Authorized Representative" Was not Authorized

The four certificates of insurance Porcelli received in the mail, as noted in previous testimony on such certificates, contained the signature of Joseph Guy Dasti as the "Authorized Representative" of London & World. Porcelli's testimony on this issue follows:

Q. Is there any way that an individual named Joseph Guy Dasti could be an authorized representative of London & World Assurance Company in the State of New Jersey?

A. No, it cannot be.

Q. Why is that?

A. Because, number one, you won't have an authorized agent in the state of New Jersey for a company that is not licensed or approved as an unauthorized company.

Q. Did you ever check the files of the Department of Insurance to determine whether or not there was an individual by the name of Joseph Guy Dasti who was licensed to write insurance in the state of New Jersey?

A. Yes, we did check our license division.

Q. And what were the results of your check?

A. We found that this gentleman is licensed as a life and health agent.

Q. So he can't write liability insurance from any company in the state of New Jersey. Is that right?

A. That is correct.

London & World Performance Bonds Questioned

Q. Could you tell us what a performance bond is?

A. Performance bond is issued to usually a contractor who is, has a contract with either a municipality or a private concern, and the performance bond purpose is that in case the contractor does not complete the contract properly or within the time frame, then the insurance company has to turn around and pay for the completion of the job.

Q. They're generally used in the construction industry. Is that right?

A. That is correct.

Q. Is your department responsible for regulating the use of performance bonds in the State of New Jersey?

A. If they are issued by a licensed company, yes.

Q. Now, look at the four bonds that are in front of you, Mr. Porcelli, and I'm assuming now during your career you have had occasion to see many performance bonds. Is that correct?

A. I have seen some performance bonds, yes.

Q. The bonds that you have seen, how do they compare appearance-wise with the bonds that you have in your hand right now?

A. Well, they appear to be similar in context.

Q. Do performance bonds generally have a date on them?

A. Yes, they usually do.

Q. Do those performance bonds have any dates?

A. These performance bonds have dates, although there's no year on these performance bonds.

Q. Let's take them one at a time. What's the top exhibit you have there? What's the date on that bond?



- A. February 28th.
- Q. What's the year?
- A. There's no year shown.
- Q. How about the next exhibit?
- A. The date is February 28 with no year shown.
- Q. How about the next one?
- A. The next one there's no date shown at all when it was signed, sealed or dated.
- Q. How about the fourth one?
- A. The fourth one, no date shown ...
- Q. Who is the surety on each of those four performance bonds?
- A. Surety on the four, London & World Assurance, Limited.
- Q. And the entity purchasing those bonds from London & World is Stonehill, Incorporated. Is that correct?
- A. That is correct.
- Q. All right. Aren't performance bonds generally preprinted forms that would contain the name of the surety, that is the insurance company, printed at the top of the page?
- A. Usually, yes.
- Q. These particular performance bonds have no such name of the surety printed on them, do they?
- A. No, they do not, other than on the bottom; they're signed by an individual.
- Q. But the name of the company is not printed on the paper. Is that correct?
- A. No, it is not.
- Q. All right. In fact, these four are typewritten, they're not even printed forms. Is that correct?

- A. They're not printed, they're typewritten, yes.
- Q. They don't contain any seals or ribbons or any other indicia that a normal performance bond would they have, do they?
- A. They do not have any ribbons or seals or anything.
- Q. Did you search the records of the Department of Insurance in order to determine whether or not the three percent surplus lines tax was paid on these performance bonds?
- A. We searched the records. We didn't find any place where the payment of taxes were made on these performance bonds.
- Q. Who would owe the tax on those performance bonds?
- A. The insureds. Stonehill of Vernon Inc., which is the insured here.
- Q. In your experience, Mr. Porcelli, have you ever come across the situation where a municipality has allowed a construction company to self-insure a construction project?
- A. No, not in my experience.
- Q. Have you taken any steps to ascertain the bona fides of London & World Assurance, Limited?
- A. Yes, I did.
- Q. Would you tell us what steps you have taken?
- A. At the time I tried to verify if London & World was a company. What steps I took was I went to Best's Statistical Reporting Service. Secondly, I contacted an attorney in New York, called LeBoeuf, Lamb & Levy. They are attorneys for Lloyd's of London in the United States and they're also attorneys for many alien companies. And, thirdly, I checked with the National Association of Insurance Commissioners in Milwaukee, Wisconsin, a Mr. Jim Ryan, who at the time was executive director. Each case I found no place where London & World had any -- was anything.

Q. To this date have you been able to determine whether or not London & World is actually an insurance company?

A. To this date I still don't know if they're in existence or not.

#### **Firemen's Relief Tax Payments Denied**

Robert G. Baldwin, the 1981-82 chief of the Vernon Township Fire Department, was the next witness. He recalled that he served as treasurer for four years through 1980 of the Vernon Township Firemen's Relief Fund. He testified on the issue of whether Vernon Valley had made tax payments to this fund as part of its surplus lines insurance tax obligations. Chief Baldwin was questioned by SCI counsel Hart:

Q. Are you aware of a New Jersey statute that requires the payment of a three percent tax to the Firemen's Relief Fund when a company purchases insurance from a surplus lines carrier?

A. I know of it.

Q. Can you tell me, during the time you were the treasurer of the Firemen's Relief Fund, did you ever receive any tax payments from Vernon Valley Recreation Association or a company known as V & G Management?

A. Most of that was generally sent into the state office and distributed to the fire companies from the state office.

Q. Did you ever receive any funds from the state office?

A. Yes, from the state office I did, yes.

Q. Did you receive any such funds from the state office initially paid by Vernon Valley Recreation Association or V & G Management Company?

A. It's grouped into one lump sum and given to us. It's not, it's not handed to us by way of designated -- it's not given to us and, in other words, we're not told.

Q. You're not told who paid the money?

A. Exactly.

- Q. Okay. At the request of this Commission, did you check the records that you might have to determine whether or not there were any such payments made directly to the Firemen's Relief Fund by Vernon Valley or V & G?
- A. I didn't know. I didn't have any records to check because they were all turned over to Mr. Labar (his successor).
- Q. Let me show you what's been marked as Exhibit C-232. Do you recognize that? What is that?
- A. It's a letter addressed to you on the donations that Vernon Valley donated to the fire department from '79 to '81.
- Q. The contents of that letter are based upon the records of the Vernon Township Fire Department. Is that correct?
- A. That's correct.
- Q. Would you look, please, at Exhibit 225, which is a copy of a check made out to the Vernon Township Fire Department in the amount of \$5000, dated July 18, 1980. Looking at that check and looking at the letter that you sent to the State Commission of Investigation, can you tell me whether, or can you tell me for what purpose that check was received by the fire department from Vernon Valley Recreation Association?
- A. Donation from the V & G Management Corporation to the fire company for operating expenses and so forth.
- Q. Does your letter indicate that it was connected in some way with a country-western show?
- A. Yes, it does.
- Q. Would you explain what that is?
- A. Well, they more or less assist us in the form of a donation. In offering our annual western show, we use their facilities and so forth and they give us a nice donation in those regards.

Q. So this five-thousand-dollar check was a donation and was not payment of any tax due to the Firemen's Relief Fund. Is that correct?

A. Not that I know of. This was a donation.

Q. All right. Would you look, please, at Exhibit 226, which is a copy of a check made out to the fire department in the amount of \$420, dated August 11, 1980. Does your letter reflect a purpose for which the department received that check?

A. Yes.

Q. What was the purpose of the department's receipt of that check from Vernon Valley?

A. To stand by and help out at one of their festivals.

Q. That again was not payment of a three percent surplus lines tax, was it?

A. Not that I know of.

Q. Your letter shows that the fire department received a total of 14 checks from Vernon Valley between July the 2nd, 1979, and August the 28th of 1981. Did the fire department receive any of those checks for the purpose of a payment of the three percent surplus lines tax?

A. No, I don't believe so.

COMMISSIONER PATTERSON: Mr. Hart, were these checks that you are talking about now the same checks a previous witness testified to?

MR. HART: That's correct, Mr. Patterson.

COMMISSIONER PATTERSON: And he testified that copies of these checks were sent to him by Vernon Valley as an indication that they had paid the three percent tax on the excess lines. Is that right?

MR. HART: That's correct.

#### **Further Firemen's Relief Fund Testimony**

Bruce LaBar, who succeeded Baldwin as treasurer of the Vernon Firemen's Relief Fund, testified next:

Q. Are you aware of a state statute that requires the payment to the Firemen's Relief Fund of a three percent tax on fire insurance premiums where the insurance has been purchased from a surplus lines carrier?

A. Yes.

Q. In your capacity as treasurer of the Vernon Township Firemen's Relief Fund, have you ever received payment of such a tax from any source?

A. Yes.

Q. Did you ever receive any checks which purported to be payment of the three percent tax from Vernon Valley Recreation Association or V & G Management Company?

A. No.

Q. Would you look at Commission Exhibit C-223 and tell me what that is, please?

A. It's a letter.

Q. To whom is that letter addressed, Mr. LaBar?

A. No one in particular.

Q. Who sent that letter?

A. I did.

Q. Would you read that letter into the record?

A. "To the best of my knowledge during the time period of '77 to present the Vernon Township Firemen's Relief Association has never received for deposit any checks issued by Vernon Valley Recreation Association, Inc."

#### **State Firemen's Relief Association Comment**

SCI counsel Hart concluded the second day of testimony by reading into the hearing record a letter from the New Jersey State Firemen's Association in East Orange:

MR. HART: Letter is dated February 23rd, 1983. It's addressed to Mr. James A. Hart, Esq., State Commission of Investigation. Re: V & G Management, McAfee, New Jersey.

"Dear Mr. Hart:

"As per our telephone conversation of this morning, February 23rd, 1983, please refer to our letter dated November 8, 1982. Our research to this date indicates that we have received no funds for the above-captioned organization nor do we have any knowledge of funds being received by them.

"You indicated you were in touch with Mr. Jerry Porcelli. If any monies arrive at this late date it would be still in the surplus lines examining office.

"If you feel that we could be of further service please let us know." And it's signed by Louis Pulasty, Treasurer.

**THE TESTIMONY -- THIRD DAY  
WEDNESDAY, MARCH 30, 1983**

**Transition Statement**

SCI Commissioner Robert J. DeLufo opened the concluding session of the Commission's public hearing with the following statement:

We will continue with further testimony on Vernon Valley's efforts to deceive the State of New Jersey about insurance coverage at its ski resort and amusement park leasehold in Sussex County. Before this final day of our hearing concludes, we also will take additional testimony on the failure of the State to make certain that it was adequately protected against death, injury and property and damage claims as required by the insurance provisions of the State's lease with Vernon Valley.

**Performance Bonds Faked**

The SCI's investigation of Vernon Valley's utilization of London & World Assurance, Ltd., for liability insurance purposes led to the disclosure that fake performance bonds with London & World as the indicated surety were foisted on Vernon Township by a Vernon Valley subsidiary. The subsidiary was Stonehill of Vernon, Inc., and the performance bonds related to a condominium project Stonehill was building in the township.

The first witness of the day was John L. Kurlander, a consultant for both Vernon Valley and its Stonehill company and the president of Stonehill between February, 1978, and the summer of 1982. Kurlander, who was one of the required signers on the performance bonds as the corporate president, recalled these documents during questioning by SCI counsel Morley:

Q. I would like you to look at Exhibit C-137, a performance bond naming Stonehill of Vernon as principal, Vernon Township as obligee and London & World Assurance Company, Limited, as surety; is that correct?

A. Yes.

Q. Now, there is a signature, two signatures on the bottom of that performance bond. The first signature appears below the typed words Vernon Valley Development. Do you recognize that signature?

A. Yes, that's mine.



- Q. Do you recall who asked you to sign your name to it?
- A. No, I don't.
- Q. Did you sign your name to it in the course of your responsibilities as president of Stonehill?
- A. Yes.
- Q. Who normally would have given you things for you to sign in your capacity as president of Stonehill?
- A. Either Roger Scott, Mr. Mulvihill or his secretary.
- Q. His secretary's name is?
- A. Mary Meyers.
- Q. Will you also look now at C-136, another performance bond. The parties named thereon are the same parties as were named on C-137 and this one is in the amount of \$131,400; is that correct?
- A. Yes, it is.
- Q. Once again there is a signature at the bottom under the typed words Stonehill of Vernon, Incorporated; is that your signature?
- A. Yes, it is.
- Q. Once again, do you recall who asked you to sign it?
- A. No, I don't.
- Q. Would it also be your supposition that it was either Mr. Scott, Mr. Mulvihill or Miss Meyers?
- A. Yes, it would be.
- Q. Would you take a look now at C-135. This is another performance bond naming the same parties as the other two, and it's in the amount of \$72,900. Is that correct?
- A. Yes, it is.

Q. Is that your signature below the words Stonehill of Vernon, Incorporated?

A. Yes, it is.

Q. Would it be accurate again to say that you probably signed it at the request of either Mr. Scott, Mulvihill or Miss Meyers?

A. Yes, that's correct.

Bonds Were Supposed to Protect The Township

Q. Okay. With respect to the three performance bonds that you just identified as having signed as president of Stonehill, have you ever seen performance bonds other than those three before?

A. Not that I recollect, no.

Q. Do you know what a performance bond is?

A. Yes.

Q. What's your understanding of the meaning or the purpose of a performance bond?

A. These were to make sure that the work was performed by the company at the town's request. In other words, the town wanted to make sure the roads were put in and so forth, and they needed a bond to guarantee it that if we defaulted or if we didn't do the work that there would be a recourse back to, I guess, the bonding company to make sure that it was performed.

Q. Other than placing your signature on these three performance bonds, did you play any role in the obtaining of the bonds on behalf of Stonehill?

A. No.

Q. Did you read them before you signed them?

A. No.

Q. Will you look at them again, at the three performance bonds, and is it correct that there is another signature other than your own on each of those bonds?

A. Yes.

Q. Do you know whose signature that is?

A. Michael Teschner's.

Q. Do you know Michael Teschner?

A. No, I don't.

Q. With respect to the surety company named on those bonds, London & World Assurance, Limited, have you personally ever had any communication with London & World?

A. No.

Q. Have you ever had occasion to direct somebody at Vernon Valley or at Stonehill to communicate on behalf of either one of those entities with London & World?

A. No.

Q. In the course of operating Stonehill of Vernon, do you know who was responsible for obtaining performance bonds that you would sign?

A. No, not specifically.

He Was a Figure-Head President

Q. Did you personally make any executive decisions as president of Stonehill?

A. No; it went to the higher echelon, Mr. Mulvihill.

Q. Did Stonehill have any employees other than yourself?

A. No.

Q. Do you know who the other officers of Stonehill were, if any?

A. I believe Roger Scott was a vice-president and I believe Wes Smith for a short period of time was an officer. He might have been secretary or vice-president. I am really not sure.

Q. Do you know who any of the directors of the corporation were?

A. No, I don't.

Q. Were you a director of the corporation as well as president?

A. Not that I know of.

THE CHAIRMAN: You don't know whether or not you were a director?

THE WITNESS: Right.

Q. Did you ever attend a board of directors meeting?

A. Not that I know of.

Q. And it's your understanding that Mr. Mulvihill was really running Stonehill of Vernon and you were a figure-head president, in effect. Would that be accurate?

A. Yes.

#### Bonds Came From Mulvihill's Office

The next witness, Wesley Smith, an executive of a New York developing company, was general manager of Vernon Valley Recreation Association from July, 1979, until early 1981. He also was the designated assistant secretary for Vernon Valley's condominium developer in Vernon Township, the Stonehill corporation. Questioned by SCI counsel Hart, he gave additional details on the London & World performance bonds that Stonehill gave to the township:

Q. Will you look, please, at Commission Exhibits C-135, 136, 137 and 138 and tell me if you recognize those documents, please, Mr. Smith? What are those documents?

A. Those are performance bonds that were issued to the township as part of the requirement passed down by the planning board for certain aspects of the Stonehill Development.

Q. Each of those bonds is signed by John Kurlander as an officer of Stonehill, Incorporated. Can you tell me who John Kurlander is?

A. John Kurlander served as president of Stonehill Corporation.

Q. Those bonds are also signed by an individual with the name Michael Teschner on behalf of London & World Assurance, Limited. Do you know who Michael Teschner is?

A. No, sir.

Q. Do you know who signed Michael Teschner's name to each of those performance bonds?

A. Michael Teschner. I don't know.

Q. You are assuming it was Michael Teschner?

A. That's the name I see in front of me.

COMMISSIONER PATTERSON: You never saw him sign it?

THE WITNESS: I don't know Michael Teschner.

COMMISSIONER PATTERSON: You don't know what his handwriting looked like?

THE WITNESS: No, sir.

Q. Do you know an individual by the name of Mary Meyers?

A. Yes. Mary Meyers is a secretary to Mr. Mulvihill.

Q. Can you tell me what role, if any, you played in obtaining the performance bonds for London & World Assurance, Limited?

A. When the planning commission would come to an approving resolution, part of my duty was to see that whatever requirements were satisfied; whether performance bonds, letters of credit or cash deposits were required, I would request the performance bond from the Chatham office and would initiate the request through Mr. Roger Scott of the company for either the letters of credit or a cash deposit.

Q. This Chatham office that you made the request to, is that at 215 Main Street, Chatham?

A. Yes.

Q. Is that Mr. Mulvihill's office address?

A. Yes.

Q. Did you speak to Mr. Mulvihill personally about obtaining these bonds for London & World?

A. I would initiate the request either by a telephone call to Mr. Mulvihill or Mary

Meyers, perhaps Debbie Evers or it would be in a memo or letter that I would initiate and mail to that office.

Q. I take it you would receive the performance bonds from that office then in the mail a short time later; would that be correct?

A. Either in the mail or someone from the Chatham office would be coming up and it would be hand-delivered.

Q. When you received those bonds from the Chatham office, was Michael Teschner's signature already affixed to those bonds?

A. To the best of my memory, yes.

Q. What is Mr. Mulvihill's connection with Stonehill, Incorporated?

A. If I recall, Mr. Mulvihill was on the board of directors of the Stonehill Corporation. The Stonehill Corporation for all intents and purposes, as I recall, was a wholly-owned subsidiary of Vernon Valley Recreation Association with Mr. Kurlander as the designated president. Mr. Mulvihill is a major stockholder in Vernon Valley Recreation.

Q. Do you recall Vernon Township requiring a communication from London & World setting forth Mr. Teschner's authorization to execute performance bonds on behalf of London & World?

A. I recall that a request did come from the township or the township attorney at that time. I passed that information over to Mr. Kurlander and I don't know what happened to it from that point.

Since Smith, in describing his duties as general manager at Vernon Valley, had stated that he supervised group ski sales and ski schooling, the Commission asked him what he knew about the "mandatory lessons" ploy that Vernon Valley used to divert income from ski revenues on which its state rent was calculated:

BY MR. HART:

Q. If group attendees did not desire lessons, they didn't have to take them; is that right?

- A. That's correct.
- Q. Suppose a group was coming to its slopes, the package they had was simply a lift ticket; when they got to the slopes, some of the members of that group desired a lesson. Would they have to pay extra to get that lesson?
- A. They would go to -- or the group leader would go to the special activities office and make an arrangement for ski school lesson if a prior arrangement had not been made, and there would be an additional charge on a group rate discounted basis.

Also, the Commission questioned Smith about the man-made lake that Vernon Valley had constructed on Hamburg Mountain, in violation of its lease with the State. He recalled an early morning alarm over a break in the dam at that Lake:

BY MR. HART:

- Q. How did you become aware of the existence of that lake?
- A. I first became aware of the existence of that lake after having received a phone call very early in the morning, four-thirty, five o'clock, that there was some water coming down the mountain and the night watchmen weren't exactly sure where it was coming from. I went to the area and followed the water to find that there had been some erosion around an overflow pipe, a small break in the dam and there was a small stream bed, but part way down the mountain where the stream went under one of the ski slopes in a pipe, the pipe was blocked which caused the water to run down the ski slope...

THE CHAIRMAN: Have you fixed a time for that approximately?

THE WITNESS: I seem to recall it was in the fall, and I don't remember whether it was the fall of '79 or the fall of '80.

- Q. Whom did you notify about the water running over the dam and coming down the mountain, if anyone?
- A. One of supervisors from the mountain.

Q. Did you ever speak to an individual named Charles O'Brien about the water coming over the dam or through the dam and down the mountain?

A. Later that morning.

Q. Who is Charles O'Brien?

A. Charles O'Brien is the president of Vernon Valley Recreation Association and serves as the mountain manager and outdoor supervisor.

Q. Was Mr. O'Brien surprised when you told him about water coming down the mountain from that lake?

A. Not that I recall, no.

**"They Didn't Look Like Performance Bonds"**

Margaret O'Dowd, assistant municipal clerk for Vernon Township since 1978, was the next witness. She said at the outset that her duties included maintaining files on performance bonds which were posted in connection with construction projects in the township. SCI counsel Morley questioned her about the London & World performance bonds that Stonehill had posted:

Q. Could you describe for us briefly what the process is once you have received a performance bond that's being posted by a developer?

A. I would turn it over to the township attorney for review and he would give his recommendation as approving or disapproving.

Q. Upon the completion of a project which is covered by a performance bond, what must take place in order for a bond to be released?

A. The developer or the owner would request that the bonds be released and the engineer would then go out and inspect the area to see that all the requirements were met in accordance with the bond and based upon the engineer's recommendation the bond would be released.

Q. Is it your experience as assistant clerk of the township that developers are anxious to get bonds released once they have completed projects?

A. Yes, it is. It's money that's there and they usually want it back.



- Q. I will ask you to look at please, Exhibits C-135, 136 and 137. Each is a performance bond naming Stonehill of Vernon as the principal, Vernon Township as the obligee and the London & World Assurance Company, Limited, as the surety. Each is signed by John Kurlander on behalf of Stonehill of Vernon and a Michael Teschner on behalf of London & World Assurance Company, Limited; is that correct?
- A. That's correct.
- Q. Were these performance bonds obtained from your files in Vernon Township?
- A. Yes, they were.
- Q. They were, in fact, posted by Stonehill of Vernon with the township?
- A. Yes.
- Q. Now, in the course of your five years or so as assistant municipal clerk, is it correct that you have had occasion to handle and process other performance bonds?
- A. At least over 50.
- Q. Looking at these performance bonds, at the time that you received them was there anything remarkable about them as compared to the other performance bonds that you had processed?
- A. Well, there was no seal, first of all. There is no indication of -- usually bonds that I received have insurance papers backing it which this didn't.
- Q. Are there dates on these three performance bonds?
- A. There are dates but no year.
- Q. On C-135 and 136 each one says "signed, sealed and dated 28th day of February," but no year; is that correct?
- A. Yes.
- Q. On 137 in the same space "signed, sealed and dated" and simply a blank space?
- A. Right.

Q. Now, you have already testified that the three performance bonds were unusual, looked unusual to you, looked different to you from others you have processed. Did you express any reservations about those bonds to any official in the township?

A. When I turned them over to the township attorney, I said they didn't look like bonds that I had been normally receiving.

Q. These bonds were, in spite of your reservations, processed and accepted; is that correct?

A. Yes, they were.

Q. Would you look now at Exhibit C-248. This is a letter dated February 20, 1980. It's on the letterhead of the then attorney for Vernon Township who is no longer the township attorney; is that correct?

A. That's correct.

Q. And it refers to Stonehill bond in the amount of \$6720 dated February 15, 1980; is that correct?

A. Yes.

Q. The letter is addressed to the Township Committee of Vernon Township. Would you read into the record the second paragraph of that letter?

A. "The bond, however, should have attached to it or added to it the address of the bonding company and certification that the gentleman who signed the bond, that is Michael Teschner, whose name should also be typed on the bond, is authorized to execute the bond on behalf of bonding company."

Q. There is a copy indicated on that letter; it's indicated that a copy was sent to a person named Wes Smith. Do you know who Wes Smith is?

A. Yes. He worked for Vernon Valley.

Mulvihill's Partner Vouches for London & World

It should be noted here that during the testimony of Stonehill's "figure-head president," John Kurlander, he recalled

an incident that was to become significant in Assistant Township Clerk O'Dowd's testimony. The incident involved Tino's, a New York City restaurant financed by Mulvihill but operated by Agostino Scarpa. Kurlander recalled that he ate at that restaurant once at Mulvihill's suggestion and met the operator, who identified himself only as "Tino." Kurlander also recalled Mulvihill saying he was part owner of Tino's "when he mentioned that I ought to try it out." The name of Mulvihill's restaurant partner, Scarpa, figured in Assistant Township Clerk O'Dowd's testimony. She was asked if she ever received any formal certification that Michael Teschner was authorized to execute a London & World performance bond, as the then township attorney's letter had requested:

Q. Do you know whether there was any evidence of the type requested in that letter submitted to the township?

A. I don't believe so. I probably would have attached it to the back of it if there was.

Q. Will you look at Exhibit C-134. Have you ever seen that letter before?

A. Yes.

Q. That is a letter typed on a piece of stationary that has printed on it London & World Assurance Company, Limited; is that correct?

A. Right.

Q. Is there an address for London & World on the letterhead?

A. 2 World Trade Center, New York, New York.

Q. Is there a line that appears before the words "2 World Trade Center?"

A. Care of Davis, Dorland Intermediaries.

Q. The address, is that printed in the same face as London & World Assurance, Limited?

A. No.

Q. Is it, in fact, typed onto the stationary?

A. Yes, it is.

Q. Is there a date on that letter?

A. No, there is not.

Q. The letter is addressed to Vernon Township; is that correct?

A. Yes.

Q. Would you read the contents of that letter?

A. "Gentlemen, please be advised that Michael Teschner is an officer of London & World Assurance, Limited, and is authorized to execute bonds on behalf of the company. The main office of the company is located in the Barclays Bank Building, Georgetown, Grand Cayman.

Q. It's signed by an individual on behalf of London & World Assurance, Limited; is that correct?

A. Yes.

Q. What is the name of the person who signed the letter?

A. Agostino Scarpa.

Stonehill Never Requested Release of Performance Bonds

Normal business practice would dictate that Stonehill request a release of the letters of credit and performance bonds once they were no longer needed. However, although the letters of credit had finally expired, Stonehill never initiated the required release procedures, a lapse that in itself suggested the actual worthlessness of the bonds. Ms. O'Dowd's testimony on this issue:

Q. Do your files -- have you searched your files to see if Stonehill of Vernon has made any request for the release of the bonds?

A. Yes, I did. They didn't.

Q. Is there any evidence in your files that Stonehill of Vernon had taken any steps to obtain any reports or inspections which would be necessary as a preliminary step to release the bonds?

A. I don't believe so.

Q. Did you check your files for that kind of evidence.

A. Yes.

Q. Did you find anything like that?

A. No.

**The "Assistant Secretary of the Corporation"**

Mary Meyers, a secretarial employee at Vernon Valley companies, was the next scheduled witness but she did not appear because, as the Commission stated for the record, "she has indicated in advance that she would, on the basis of the claim of privilege, be unwilling to testify." As a result, the Commission authorized that her prior testimony at SCI executive sessions be made a part of the public hearing record. This was accomplished by SCI counsel Hart reading certain questions that had been put to Meyers at the executive sessions and by SCI Special Agent Wendy Bostwick reading Meyers's answers to those questions.

According to her prior testimony, Mary Meyers worked for six years for Mulvihill and various Mulvihill companies and, as she confirmed, was sometimes referred to as "the assistant secretary of the corporation."

Questioned About Signatures

Meyers was questioned primarily about the signatures that appeared on various London & World documents that she processed. The issue was whether she had forged certain names and her responses at the SCI on September 9, 1982, had repercussions. She was summoned back in November so the SCI could obtain samples of her handwriting and she returned in January to recant. Following are relevant portions of the transcript of her testimony at the SCI in September, as read by counsel Hart and Agent Bostwick:

"Q. Do you know an individual by the name of Joseph Peterson associated with London & World?

"A. No, I never heard of that.

"Q. How about Michael Teschner; do you know that name?

"A. I've heard that name. Michael is -- I don't know if he's associated with London & World. I know Michael.

"Q. You know Michael Teschner?

"A. Well, I --

"Q. Where do you know him from?

"A. He's called the office. I don't know, you know, more than that. He speaks to Mr. Mulvihill.

"THE CHAIRMAN: You mean you don't know him as a person? But you know the name?

"THE WITNESS: Through calling, yeah.

"Q. Is he a business associate of Mr. Mulvihill?

"A. I think they do business.

"Q. Do you know what type of business Mr. Teschner is in?

"A. I have no idea.

"Q. Did you ever correspond with the London & World Assurance, Limited, down in the Grand Cayman Islands, the British West Indies?

"A. I don't remember if I did.

"Q. Did you ever receive any letters from them?

"A. I don't remember.

"Q. How did you come to know London & World was the insurance carrier for Vernon Valley?

"A. I just remember hearing the name.

"Q. Who did you hear the name from?

"A. I guess from Vernon Valley.

"Q. Did you hear it from Mr. Mulvihill, perhaps?

"A. Maybe I did. I don't know.

"Q. Is Mr. Mulvihill associated in any way with London & World Assurance, Limited?

"A. I don't know.

"Q. Was he responsible for the formation of that company?

"A. I don't know.

Denies Writing Teschner's Name

"Q. Miss Meyers, let me show you what's been marked as C-20 for identification. Would you look at that and tell me if you have ever seen it before? That purports to be an insurance policy issued by the London & World Assurance Company.

"A. I may have. I don't remember seeing it.

"Q. Do you recognize the signature on the bottom of the first page?

"A. It says 'Michael Teschner.'

"Q. Have you ever seen Michael Teschner's signature before.

"A. No.

"Q. Did you write that name 'Michael Teschner' on the bottom of that page?

"A. No.

"Q. Did you ever write Michael Teschner's name on anything?

"A. I may have. I don't remember.

"Q. Under what circumstances?

"A. I can't say whether I did or I didn't because I can't remember. I doubt very much if I did because I don't, you know, sign his name unless I am authorized.

"Q. Well, has Mr. Teschner ever authorized you to sign his name?

"A. Not that I remember.

"Q. Let me show you what was marked as C-36 which, again, purports to be another insurance policy of Vernon Valley issued by the London & World Assurance Company. Have you ever seen that document?

"A. I don't remember. I may have.

Also Denies Signing Peterson's Name

"Q. And the signature at the bottom of the first page which purports to be that of a Joseph Peterson, do you recognize that signature?

"A. No, I don't.

"Q. Did you sign that name Joseph Peterson there?

"A. No.

"THE CHAIRMAN: Does it look like your handwriting?

"THE WITNESS: No. I never heard of Joseph Peterson.

"Q. Did you ever sign the name Joseph Peterson

--

"A. No.

"Q. -- on any document?

"A. No, I don't even know Joseph Peterson.

"Q. How about on Exhibit C-38, again, we have Michael Teschner's name. Did you sign his name there?

"A. No. I never signed it. I don't remember seeing it.

#### Handwriting Exemplars Obtained

After portions of Meyers's transcript were read into the record, including a detailed description by Meyers of her processing of London & World insurance certificates and other documents to State agencies, counsel Hart made the following statement:

I would like the record to reflect that in view of some of the answers that Mary Meyers provided in that transcript in her appearance in Executive Session, she was recalled to executive session on November 17, 1982, for the purpose of this Commission obtaining from her handwriting exemplars. Those exemplars were obtained on November 17, 1982, and the next witness has testimony to give regarding the exemplars that were taken from Mary Meyers.

#### **Handwriting Expert Testifies**

Sergeant Glenn A. Owens served with the Union County Sheriff's Criminal Identification Bureau from 1959 through 1971 and with the Union County Prosecutor's office since 1971. He is in charge of fingerprint and handwriting identification at the prosecutor's office and, as he testified, spends more than half his working time on handwriting analysis. He has attended academic courses on handwriting analysis, is a graduate of the U.S. Secret Service School and has testified "several hundred times" as an expert witness in state, county and municipal court trials. He was questioned by SCI counsel Amitrani:



- Q. Sergeant Owens, I am going to show you C-160, the London & World Assurance policy. That document contains ten signatures of Michael Teschner, correct?
- A. That's correct.
- Q. I am now going to show you four exhibits, C-135 to C-138. They are performance bonds. Do each of those exhibits contain a signature of Michael Teschner?
- A. That's correct.
- Q. Sergeant Owens, you were asked by this office to examine those documents concerning the authenticity of the signature of Michael Teschner, correct?
- A. I was.
- Q. And, more specifically, you were asked to look at those signatures to determine if they had actually been made by a Mary Meyers; is that correct?
- A. That's correct.
- Q. Now, pertaining to the exemplars from Mary Meyers, some are samples of her handwriting she gave after she knew that it was going to be compared to other writings, correct?
- A. That's correct.
- Q. And concerning the exemplars of Michael Teschner, they were all signatures that he made not knowing that they would be used for comparison purposes?
- A. That's correct.
- Q. Sergeant Owens, were you able to form an opinion as to the authenticity of the Michael Teschner signatures on the exhibits or on the London & World Assurance policy and on the four performance bonds?
- A. I was.
- Q. What is your opinion as to the authenticity of Michael Teschner's signature?

- A. I found that the ten signatures on the World Assurance policy and the four Michael Teschner signatures on the performance bonds were forgeries.
- Q. Were you able to form an opinion after having examined the exemplars of Mary Meyers as to who made the signatures of Michael Teschner?
- A. I was. It was my conclusion after examination that Mary Meyers was the writer of the Michael Teschner signature.

At this point Sergeant Owens gave a detailed explanation of his analysis of the Teschner signatures, noting particularly how he was able to penetrate Meyers's attempt to confuse the issue by disguising some of her handwriting. Sergeant Owens concluded:

I must say that everything was in agreement and my firm conclusion was that Mary Meyers had signed and forged the Michael Teschner signature in the World Assurance policy and the signatures of Michael Teschner in the performance bonds.

Mary Meyers Admits She Forged Teschner's Name

After Sergeant Owens was excused, Counsel Hart addressed the Commission:

I would like to make a proffer of proof at this time. Shortly after Mary Meyers gave the handwriting exemplars to this Commission the Commission was contacted by her attorney who requested that she be allowed to reappear in Executive Session to correct what he termed certain inaccuracies in her testimony of September 22, 1982. She was granted that opportunity and she reappeared before the Commission on January 5, 1983. In her September 22 testimony she had denied knowing Michael Teschner as a person. She denied knowing what business he was in. She denied signing Michael Teschner's name on the London & World Assurance policies and she denied signing Joseph Peterson's name on the London & World Assurance policies.

On January 5 she testified that she did, in fact, know Michael Teschner as a person; she did know he was a businessman and investor. She admitted she did sign his name on the London & World Assurance policies and she said she was not certain whether or not she signed Joseph Peterson's name on the policies. I would like to offer the transcript in evidence, the transcripts of

Miss Meyers in evidence.

THE CHAIRMAN: They will be marked in evidence.

**Who Was Michael Teschner?**

SCI Special Agent Bruce Best testified next, about the Commission's efforts to both identify and locate Teschner. Agent Best was questioned on this subject by counsel Hart:

Q. Mr. Best, throughout the investigation the name Michael Teschner kept coming up. Can you tell me what steps the Commission took to identify or locate Mr. Teschner?

A. Yes, sir. The Commission determined through the Securities and Exchange Commission that Mr. Teschner was living in Aspen, Colorado. Sometime in mid-October the Commission sent a registered letter to Mr. Teschner's Aspen, Colorado, address. No response was received to that letter, in which he was asked to contact the Commission with regard to London & World Assurance, Limited.

On November 2, 1982, I placed a phone call to Mr. Teschner and I reached him in Aspen, Colorado. At that time he declined to answer any questions concerning London & World and he referred all questions to his attorney, Dr. Klasmeyer of Cologne, Germany.

Q. Did the Commission get in touch with Dr. Klasmeyer?

A. Yes, sir. On November 19 the Commission received a letter from Dr. Klasmeyer indicating that he would like to receive questions concerning London & World Assurance, Limited, from the Commission. He indicated, too, that he would respond to those questions in writing.

Q. Did he indicate that he, Dr. Klasmeyer, would respond or Michael Teschner would respond?

A. He indicated that he would contact or that he would be in touch with Michael Teschner and he would respond to the questions in writing.

Q. Did the Commission in fact send questions to Dr. Klasmeyer?

- A. Yes, sir.
- Q. Do you recall when that was?
- A. That was, I believe, on December 3, 1982.
- Q. Can you describe the information that was sought in the questions set forth in that letter?
- A. There were 24 questions sent to Dr. Klasmeyer, some were several parts, requesting information concerning London & World Assurance, Limited, concerning Michael Teschner's position with London & World and concerning their insurance program. Also requested was Gene Mulvihill's association or relationship with London & World and their insurance program, if any, involving the Vernon Valley Recreation Association.

Teschner Never Responded To SCI

- Q. Did the Commission ever get a response to those inquiries from Dr. Klasmeyer?
- A. No, sir, there was no response.
- Q. To this day do we have a response from him?
- A. To this day there has been no response.
- Q. In your effort to further identify Mr. Teschner did you contact the United States Immigration and Naturalization Service?
- A. Yes, sir, I did.
- Q. Did they provide you with any documents on Mr. Teschner?
- A. Yes, sir, they did.
- A. Yes, they did.
- Q. Did these contain an employment and educational history of Mr. Teschner?
- A. They did.
- Q. What type of business has Mr. Teschner been involved throughout his lifetime?
- A. Mr. Teschner's educational background and training is in the area of hotel and restaurant administration.

Q. Do those documents contain any indication that Mr. Teschner has any training, education or experience in the insurance industry or the insurance business?

A. No, sir, they do not.

Teschner Visited New Jersey

Q. During the course of your investigation, Mr. Best, did you have occasion to go to the offices located at 215 Main Street, Chatham?

A. Yes, I did.

Q. Can you tell us what's located at that address?

A. Located at that address is Seaboard Planning Corporation, T.R.C. International and a few other corporations which are owned and operated by a Mr. Gene Mulvihill.

Q. Did you learn the names of the employees working in that office?

A. Yes, sir. In addition to Mr. Mulvihill there was Mary Meyers working at that office, also Debra Evers and Joseph Guy Dasti.

Q. Did you or any members of the Commission staff ever notice any unusual motor vehicles parked at or near 215 Main Street, Chatham?

A. Yes, sir. On November 10, 1982, Special Agent Raymond Schellhammer observed a sports vehicle, a 500 SL Mercedes-Benz, parked across the street from that address. It was unusual in that it had West Germany plates on it.

Q. Did you ascertain to whom that vehicle was registered?

A. Yes, sir. Through Interpol, Washington, D.C., it was determined from West Germany that the vehicle was registered to Mr. Michael Teschner, born in Hamburg, West Germany, now in U.S. under passport.

Q. And did it indicate he was living in Aspen, Colorado?

A. Yes, it did.

- Q. Between November 10, 1981, and December the 1st, 1982, how many times was that car observed at or near 215 Main Street, Chatham?
- A. By S.C.I. personnel it was observed on three different occasions, and by members of the Chatham Police Department on several other occasions.

Teschner Was An Action Park Stockholder

- Q. Would you look, please, at Exhibit 264, which is a registration statement of Vernon Valley Recreation Association filed with the New Jersey Bureau of Securities in September of 1979.
- A. Yes.
- Q. Does it contain a listing of companies affiliated with Vernon Valley Recreation Association?
- A. Yes, sir, it does.
- Q. One of the companies listed there is T.R.C. International, is that right?
- A. That's correct.
- Q. T.R.C. International, is that the Alpine Slide at Action Park, Vernon Valley?
- A. That's the company that runs the Alpine Slide.
- Q. Who are the officers listed on this schedule for T.R.C.?
- A. Gene Mulvihill is listed as president, treasurer, secretary and director; and Michael Teschner is listed as owning more than 10 percent of the common stock of the company. There's a Barbara Ramon also listed as owning more than 10 percent of the common stock of the company.

The All-But-Indecipherable "Power of Attorney"\*

- Q. Now, I'd like you to look, Mr. Best, at Commission Exhibit C-7. Now, Mr. Best, is the chart that is just placed on the easel a blowup of the document you have in your

\*See Exhibit, p. 212.

hand, Exhibit C-7?\*

A. Yes, sir, it is.

Q. Would you tell us what that exhibit is, please?

A. This is an alleged power of attorney that was sent to the Commission by the attorney for Vernon Valley Recreation Association, Mr. Daniel Rabinowitz, on October 6, 1982.

Q. Did Mr. Rabinowitz send the original or a Xeroxed copy to the Commission?

A. The Xeroxed copy was sent.

Q. Was Mr. Rabinowitz contacted by the Commission and asked for the original?

A. Yes, sir, he was.

Q. Was the original produced?

A. The original was not produced.

Q. What reason was given for not producing the original?

A. The reason given was that Mr. Mulvihill did not possess the original of the power of attorney.

Q. Can you read that power of attorney into the record, please?

A. Yes, sir. "I hereby grant Gene Mulvihill power of attorney to handle all transactions and business concerning London & World Assurance, and to sign and handle business in my behalf." And it's signed Michael Teschner.

Q. Can you tell me this, Mr. Best, how long did it take the first time you looked at that document to figure out what it said?

A. Quite a while.

Q. It's undated, is it not?

A. Yes, it is.

\*See Exhibit, next page.

MEMO . . . . .

London and World Assurance, Ltd.

I hereby grant Gene  
Ch. Laible, power of Attorney  
to handle all transac-  
tions business concerning  
London and World Assurance  
and to sign and handle  
business in my behalf.

KiderTee



Q. It's unwitnessed?

A. Yes, it is. It's unwitnessed.

Insurance Memo Signer Was Mulvihill's Restaurant Partner

The name of Agostino Scarpa, the operator of a Mulvihill-financed restaurant in New York, kept surfacing during the SCI inquiry as having a connection with the so-called London & World Assurance, Ltd. SCI Special Agent Best was asked about Scarpa, as follows:

Q. Would you look, please, at Commission Exhibit C-134 and tell me what that is?

A. This is a letter that was sent to the Township of Vernon from London & World Assurance, Limited, with regard to performance bonds for the -- on behalf of the Stonehill Company associated with the Vernon Valley Recreation Association.

Q. Could you read that exhibit into the record, please?

A. Yes, sir. It's a memo form and it's headed London & World Assurance, Limited. Typed in is care of Davis, Dorland Intermediaries, 2 World Trade Center, New York, New York, 10007. It begins Vernon Township, Vernon, New Jersey. "Gentlemen: Please be advised that Michael Teschner is an officer of London & World Assurance, Limited, and is authorized to execute bonds on behalf of the company. The main office of the company is located in the Barclays Bank Building, Georgetown, Grand Cayman. Very truly yours, London & World Assurance, Limited." And it's signed Agostino Scarpa.

Q. Did you take any steps to ascertain who Agostino Scarpa is?

A. Yes, sir. Our accountants determined through the books of New Jersey Financial and General that Agostino Scarpa was the president of Milano Foods. Milano Foods does business as Tino's Restaurant in New York City.

Q. Did the Commission check with the State Liquor Authority in New York concerning Milano Foods or Tino's Restaurant?

A. Yes, sir. The Commission did check and it was found that in addition to Mr. Agostino Scarpa being president of Milano Foods, Mr. Gene Mulvihill was listed as the treasurer of Milano Foods, there were 10 shares of stock that were issued and the fees paid to the State liquor authority were paid by personal check of Mr. Gene Mulvihill. Mr. Mulvihill also paid for the Milano food purchase of Tino's restaurant, with a \$30,000 check.

Q. Did the Commission send registered letters to Mr. Scarpa requesting that he contact us so we could speak to him?

A. Yes, the Commission did send letters, and to those letters there was no response.

#### **Vernon Valley Principals Refused to Testify**

SCI Commissioner Robert J. DeLufo made a brief statement for the record on the absence of Vernon Valley's key officers from the public hearing:

COMMISSIONER DELTUFO: Good afternoon. As has been announced several times during these proceedings, we have sought to have certain witnesses testify here about issues which have been raised and these witnesses have, as indicated by the Chairman, declined to appear on the basis of the claim of privilege. In their absence we have read into the hearing record portions of prior testimony taken of these witnesses in Executive Session of the Commission. For today's hearing we did request the appearance of certain principals of Vernon Valley for testimony about their company's conduct. These principals are Gene Mulvihill, chairman of the board, and Roger Scott, chief executive officer. Mr. Mulvihill and Mr. Scott will, however, not be here because they have informed us, on the basis of the claim of privilege, they would be unwilling to testify.

#### **Passing the Buck on Lease Administration**

The next witness, Russell Cookingham, director of DEP's Fish & Game Division, was questioned at length about who in State government had the basic responsibility for administering the Vernon Valley lease. Although he conceded at the outset that his division was primarily responsible, he sought to disavow that responsibility in connection with certain facets of the lease,

particularly the insurance requirements. As it turned out, according to Cookingham's responses to SCI Counsel Hart's questions, he did little or nothing to assure that the lease was adequately monitored and maintained:

Q. Can you tell me what the duties are of the Division of Fish and Game insofar as administration of that lease is concerned?

A. Principal duty is to make sure that the money is collected in a timely fashion; secondly, is to make sure the land is used properly in accordance with the lease.

Q. What do you do personally in the administration of that lease?

A. I'm the man in charge of the people who carry out the responsibilities to take care of the lease.

Q. Can you tell me how the rent is calculated?

A. Five percent of all the ski totals. We derive five percent of the ski totals, two percent of the other activities on our property, that are conducted on our property.

Q. Are you familiar with the insurance clause in the lease?

A. I am, yes.

Q. Do you know an individual by the name of Charles Lloyd?

A. I do.

Q. Who is Mr. Lloyd?

A. He was my chief accountant for a period of time, approximately 1977 to 1980.

Q. Did Mr. Lloyd have any responsibilities insofar as administering the lease is concerned?

A. Yes, he was responsible for keeping all my accounts, income derived from all sources.

Q. Was he responsible in any way for verifying compliance with other terms of the lease, such as the insurance requirements?

- A. This he did cooperatively with the legal people in Green Acres. Legal people. We never had our own lawyer, legal staff. We've always had lawyers -- we always relied on department lawyers for legal aspects of implementation of leases of any kind.
- Q. Mr. Lloyd told us, Mr. Cookingham, that he in fact did not do anything concerning administration of that lease other than collect the rent checks and have a clerk record them on payment cards. Can you tell me again how long he worked for you?
- A. About three to four years. I can't remember the exact dates.
- Q. During that three-to-four-year period didn't you realize Mr. Lloyd was not doing anything to administer the lease other than collect the rents?
- A. There was a -- I became aware of it, yes, and it was a concern to me because there was a period of time, around '79 and '80, when we were working cooperatively with the Green Acres to carry out the mandates of the lease, and as far as the insurance coverage is concerned, I think the first year that we actually took over the insurance coverage ourselves or the policies went to us was in 1981.

"We Didn't Have a Handle on the Situation"

- Q. How long had Mr. Lloyd been working as your chief accountant before you realized he wasn't doing any administering of the lease other than collecting rents?
- A. I was aware in 1979 that things -- I was concerned in 1979 that we didn't really have a handle on the situation completely. And Green Acres was in the process of turning over the lease, the operation of the area to us, which they had handled up to that point in time.
- Q. What steps --
- A. And there was communication back and forth over the procedures, and there were several different people involved, including several different lawyers, several of whom left my employment. One was Mr. O'Brien who left my employ at that time. As I understand, at the time we were working with them to

develop a procedure for administering the responsibility of the lease.

Q. Were you involved in the meeting concerning the transfer of the responsibility of the lease to Fish and Game?

A. I delegated this to my personnel.

Q. You didn't attend any of the meetings, I take it?

A. I don't recall attending any. I probably discussed it over the telephone with some of the principals.

Vernon Valley Audit Proposed in Mid-1980

Q. I'd like you to look at Exhibit 270, please. You said a few moments ago that responsibility was finally transferred in 1981. Would you look at Exhibit 270 and tell me what that document is?

A. Yes, this is a memorandum from Mr. Stout to Mr. Lloyd on 7/8/80.

Q. Mr. Stout was the chief at the Land and Facility Management section of Green Acres? And Mr. Lloyd was your supervisor of administration, is that correct?

A. That's right.

Q. Would you look at the last paragraph of the second page of that letter and read it into the record, please?

A. "This office does not have sufficient information to determine whether Vernon Valley is in compliance with the terms and conditions of its agreement with Department. I, therefore, recommend that the Division of Fish, Game and Wildlife as the agency responsible for administering the leased property request an audit of the lease by the Division of Fiscal & Support Services. This office will then assist the Division in resolving any problem that may exist."

Q. At least as late as or early as July 8, 1980, the Division of Fish and Game had responsibilities for administering that lease. You testified a few moments ago that

Fish and Game assumed responsibilities for administering the lease sometime in 1981. This memo in July of 1980 --

- A. That was the insurance you asked me about. As far as the insurance policy is concerned, the first time that the insurance policy has been turned over directly to us for control was about 1981.

Who Was Responsible for Insurance?

Q. Who was administering the lease in July of 1980, Green Acres or Fish and Game?

A. To the best of my knowledge Green Acres was as far as the insurance is concerned.

Q. Would it surprise you if I told you Mr. Lloyd testified that he thought the attorneys for the Division of Fish and Game should be handling the administration of the lease insofar as insurance is concerned?

A. I'm not knowledgeable to that, no.

Q. Did you have any attorneys on your staff at the time Mr. Lloyd was working for you?

A. Yes.

Q. Did those attorneys do any administering of the lease?

A. Only to help advise me as to if things were not going proper in terms of collecting revenue income. I had two different attorneys over a short period of time and in both cases they were instructed to keep on top of this program and advise me.

Q. Did they keep on top of the program and advise you?

A. In part.

Q. What did they tell you about the insurance coverage that Vernon Valley had?

A. Well, I was aware that there were some problems with the insurance under the new management of Vernon Valley/Great Gorge and I was under the impression it was being worked on by Green Acres to try to resolve it.

He Knew In 1979 About Insurance Problems

- Q. Well, you were aware as early as 1979, were you not, from communications from Jeanne Donlon at Green Acres that there already were insurance problems?
- A. Why sure.
- Q. And the problems were they were concerned about the legitimacy of the insurance carrier, London & World?
- A. That is right.
- Q. And she was attempting over a period to get a certified financial statement from London & World from Vernon Valley Recreation Association. After responsibilities were transferred to the Division of Fish and Game did any of your staff follow up on some of the problems Jeanne Donlon had with verifying the bona fides of London & World Assurance, Limited?
- A. When we took over the insurance policy, to the best of my knowledge, it was assigned to a different insurance company. That's the first year that we directly administered -- we had access to the policy.
- Q. You realize, do you not, even if they had a new carrier the State could be possibly held liable on any accidents that occurred during the time London & World was the carrier?
- A. I would assume this, yes. I would assume it.

No Follow-Up on London & World Validity

- Q. Did you take any steps to follow up on Mrs. Donlon's work in attempting to verify the bona fides of London & World?
- A. No, I did not.
- Q. Mrs. Donlon testified in Executive Session and at this public hearing that the responsibility for administering the lease, the total responsibility, including the responsibility for administering the insurance aspects, was turned over to the

Division of Fish and Game sometime in late 1979 or early 1980. Was she mistaken when she told us that?

- A. 1979 was when there was correspondence between us and Green Acres suggesting that we assume all the responsibility for the lease....

To the best of my knowledge, this is the first formalized memorandum from Green Acres to Mr. Lloyd setting up a part of a procedure on the administration of the lease. This one's dated 7/8/80. We had other correspondence. We had taken over the collection of the fees and all that, but as far as a formalized agreement, to the best of my knowledge, this is the -- which was to be worked out between the two agencies. This is the document I have in front of me.

- Q. You said a few minutes ago that you became aware at some point that Mr. Lloyd was not administering the total aspect of the lease, is that correct?

- A. I suspect. I was concerned about it. I suspected it, yes.

- Q. When you say that they review the C.P.A. audit, are you referring to the annual reports?

- A. Yes.

- Q. That Klatzkin & Company sent into the Department?

- A. Yes.

THE CHAIRMAN: You realize, I take it, that a good job was not done in this situation we have been investigating?

THE WITNESS: I sure do.

- Q. Mr. Cookingham, this Commission has determined that Great Gorge revenue amounting to some \$4 million was not reported to the Division of Fish and Game for the fiscal years 1979, '80 and '81. In retrospect, do you think it would be a good idea to have a financial audit done on a periodic basis of the Vernon Valley books?

- A. I certainly do, and I always have felt that way.



Q. This Commission has also found that for the years from 1978 to the present that Vernon Valley has diverted seven-ninths of group lift revenue, which is a reportable category to your Division. They diverted seven-ninths of that group to a nonreportable category thereby not reporting some \$3.8 million to your division. Did Vernon Valley ever make you or your division aware that they were making such an allocation?

A. Never.

#### Chief Accountant's Financial Summary

The SCI's Chief Accountant Julius Cayson was recalled to testify on Vernon Valley's indebtedness to the State -- including unpaid interest -- as a result of its fiscal and corporate machinations at its leasehold. Executive Director O'Halloran questioned him, using a chart\* that had been featured during the first day's testimony:

Q. You have previously testified with regard to Exhibit C-4, a chart which showed the interest due on the rent from Vernon Valley Recreation Association. I'd like that chart, please.\* You explained in some detail, Mr. Cayson, what is outlined and portrayed on that chart. Have you as well prepared a statement of unpaid rent, interest and other charges which reflects as Exhibit C-294 the information shown on chart C-4?

A. Yes, sir, I have.

Q. What is Exhibit C-294, Mr. Cayson?

A. Exhibit 294 really is a condensation of the figures that are portrayed here. In addition, there's another item here about the timber, the charges for timber.

Q. What you have done then is to translate the numbers and the figures from the chart to the C-294 Statement. Could you characterize that as a final statement of the amounts due from Vernon Valley to the State of New Jersey?

A. Yes, I could, yes.

\*See Chart (repeated), next page.

**VERNON VALLEY - GREAT GORGE  
INTEREST DUE ON RENT - AS INDICATED**

<u>YEAR</u> <sup>1</sup>	<u>UNREPORTED GROUP LIFT REVENUE</u>	<u>RENT DUE AT 5%</u>	<u>MONTHS OUTSTANDING AT 12/31/82</u>	<u>INTEREST</u> <sup>2</sup>
1978	\$ 696,323	\$ 34,816	52	\$ 22,633
1979	645,544	32,277	40	17,132
1980	776,828	38,841	28	15,041
1981	777,309	38,865	16	8,201
1982	878,618	43,931	4	2,171
	<u>\$3,774,622</u>	<u>\$188,730</u>		<u>\$ 65,178</u>

**GREAT GORGE RENT PAYABLE BY V.V.R.A.**

<u>YEAR</u> <sup>1</sup>	<u>LIFT REVENUE</u>	<u>RENT DUE AT 5%</u>	<u>MONTHS OUTSTANDING AT 12/24/81</u>	<u>INTEREST</u> <sup>2</sup>	<u>TOTAL INTEREST PAYABLE</u>
1979	\$1,164,193	\$ 58,210	28	\$ 30,898	
1980	1,445,634	72,282	16	17,275	
1981	1,764,174	88,209	4	5,537	
	<u>\$4,374,001</u>	<u>\$218,701</u>		<u>\$ 53,710</u>	<u>\$118,888</u>

<sup>1</sup> FOR FISCAL YEAR ENDED 4/30; PAYMENT DUE 8/31 OF YEAR INDICATED  
<sup>2</sup> COMPUTED AT PREVAILING PRIME RATE BY FINANCIAL PUBLISHING CO. BOSTON, MA.

AVERAGE PRIME RATE --

8-31-78 to 12-31-78	10.451220
12-31-79	12.665068
12-31-80	15.200137
12-31-81	18.832878
12-31-82	14.824658

- Q. Would you please explain it in some detail?
- A. On C-294 -- First item one is unpaid rent Great Gorge for the years '79, '80 and '81 and that's depicted there. There was \$1.1 million in '79. At five percent is \$58,210 and that was outstanding for 28 months. That is the rent due on April 30, 1979, and that point until December 23, 1981, was 28 months. The interest on that is \$30,898.

I'd like to make a statement on the interest rate, Mr. Executive Director. There's been some misunderstanding on the part of some of the people about why we use the prime rate and what was the prime rate. I might add that Mr. Cookingham's office permitted Great Gorge to pay on installments in their rent in 1977 and they charged them 10 percent interest.

- Q. In the year 1977?
- A. Yes. It just so happens that during the hearing break I checked with the State library. The prime rate in 1977 was 6.82. We used the average prime rate as by the Financial Publishing Company. We didn't make this up ourselves. This is the most prestigious financial publishing company in the county and they, of course, get all the record. I want that for clarity. There was some question about why we used the prime rate. The point being is that they were charged greater than the prime rate by Fish and Game in 1977.
- Q. And did they pay it?
- A. They paid it.
- Q. Okay.
- A. Therefore, going down the total unreported revenue by Great Gorge -- in other words, the rent payable by Vernon Valley was \$4,374,001, at five percent, that's \$218,701. The interest on that is 53,710 or \$118,000 when you add the other. I'll get to that again. So, therefore, item one is the \$218,000 in rent plus the interest of \$53,710.
- Q. That refers only to the unpaid rent of Great Gorge?

- A. That's correct.
- Q. What else have you included in C-294?
- A. Item three was the unreported group lift and that's five percent of the \$3,774,622 which gives you \$188,730, and the interest on that is 65,178. As I testified yesterday, this item -- rather this item was outstanding for 52 months. So, therefore, the interest rate was as calculated here and that comes to \$65,178.
- Q. On C-294 item number four you're talking of outstanding interest for 140 months?
- A. That's right.

Also Triple Penalty on Timber Cutting

- Q. What else have you included in your calculation on the C-294 statement?
- A. We have the fair market value of the timber removed in connection with the man-made lake, and the silviculturist testified that was \$4,200. And, incidentally, there's a penalty of triple the fair market value of the timber and that cost comes to \$12,600.
- Q. What is your grand total taking into account all these five items that you just mentioned?
- A. That five would be \$538,919 less payment made by the lessee after the inquiry began was \$233,128, which would leave a net due as of December 31, 1982, today is March 30, 1983, so there is --
- Q. There's three additional months?
- A. That is right, sir. So there's \$305,971 due to the State of New Jersey as of today plus unpaid interest for another three months at whatever rate they so choose to charge.

Vernon Valley Avoided \$800,000-Plus Insurance Premiums

COMMISSIONER PATTERSON: Mr. Cayson, looking at this in terms of what Vernon Valley/Great Gorge did not pay in terms -- not in terms of who they were suppose to pay it to, in this case the State, if I recall your

testimony of yesterday correctly, there is no evidence that we could find that they ever paid any premium due London & World, is that correct?

THE WITNESS: That's correct, sir.

COMMISSIONER PATTERSON: Had they paid such premiums do you have any estimate of what they would have had to pay?

THE WITNESS: Yes. They were uninsured during '77, '78, '79 and '80 and three months in 1981. By best estimate they would have to pay \$950,000 in premiums.

COMMISSIONER PATTERSON: So while they -- that's another roughly \$900,000 they saved paying by the methods that they used to insure themselves?

THE WITNESS: I want to add, sir, I would give them credit for the amounts paid to the Dover Insurance Company.

COMMISSIONER PATTERSON: How much was that?

THE WITNESS: That was \$120,000. So we net out to approximately -- I have a figure of approximately \$830,000.

### Closing Statement

Commission Chairman Arthur S. Lane concluded the three-day hearing with a statement summarizing the proceedings and indicating areas in which the SCI would propose reforms. He cited many specific instances in which Vernon Valley violated the State's lease, as listed in the introduction to this report, and also declared that State entities responsible for administering the lease "had displayed a lack of vigilance in adequately safeguarding public property rented out for commercial use." As the Chairman stated:

The testimony at these hearings showed that no one connected with the State's monitoring of the Vernon Valley lease knew until after the S.C.I.'s investigation uncovered it that Vernon Valley had failed to make timely, accurate and complete payments of rent and was cheating the State out of additional rent by means of the continuing ski-lesson operation. These same State guardians of the Vernon Valley leasehold also failed to assure that the State was indemnified against potential death and injury claims. No one at the State government was alert or

concerned enough to make at least a periodic inspection of Vernon Valley's activities, or a periodic audit of its financial operations, either of which might have revealed this company's misconduct some years ago.

Chairman Lane also expressed the Commission's reaction to the failure of Vernon Valley principals to explain their conduct:

The Commission is appalled by the refusal of a number of individuals closely associated with the Vernon Valley company to appear at these hearings. Testimony by such persons, and they include key officers of the company and the certified public accountant who audited Vernon Valley books, not only would have enabled them to give their side of the story, but the Commission would have also been able to question them directly about the practices that ensued. The Commission has been the target of much corporation propaganda outside of these hearings and we would have certainly liked to have had the opportunity to question or otherwise consider those attacks in an orderly, face-to-face manner at these proceedings.

Despite the refusal of some witnesses to appear here, we have recorded a voluminous amount of testimony from almost 40 witnesses, including the prior Executive Session testimony of some of the absentees, upon which to base our recommendations for proscribing the improprieties and irregularities connected with this State lease and the Vernon Valley leasehold. We have already referred investigative findings to the Attorney General for prosecutorial evaluation, but beyond saying that certain additional matters will be turned over to that office and/or the United States Attorney, we cannot, of course, comment further.

The Commission suggested general areas of probable reforms:

We can suggest certain directions that our reform proposals will take, based on this public hearing record. There can be no question but that the State, in any present or future situations involving the rental of public property to private companies, must be required to obtain absolute proof of actual insurance protection by a bona fide

State registered and approved insurance provider. There certainly should be statutory provisions for periodic financial and operational audits by the State of any such corporate leaseholds. And, in light of the testimony revealing how State personnel in an irresponsible manner passed the buck instead of assuming an obligation to monitor compliance with the lease at issue here, the Commission certainly hopes to suggest how that such an important responsibility can be more centralized and made less vulnerable to bureaucratic carelessness, mistakes and lack of awareness.

We emphasized at the outset of these hearings that in any rental of State property for private commercial use, each party to the lease must assume an extraordinary obligation to the true owners of such property, the public. The Commission certainly will propose statutory and regulatory changes that will more effectively advance and protect the public's interests in such leaseholds. However, there can be no guarantees that by statutory or regulatory mandate all State officers and employees will respond with 100 percent diligence and effectiveness to the challenges thrust upon them. We realize the difficulties inherent in oversight when one is faced with shrewd and purposeful multi-corporate machinations and manipulations of the type demonstrated by Vernon Valley and its principal, Mr. Mulvihill. But oversight can and should be better than we have seen here. We note that considerable attention has been paid of late to the reorganization of various areas of State government. This Commission hopes that, in the light of this laudable restructuring effort, State government will also attempt to develop additional personal motivations that are sorely needed to improve the ability and willingness of State entities and employees to better perform their duties and more faithfully carry out their obligations to the public.

#### RECOMMENDATIONS IN DETAIL

##### Transmittal Notice

The SCI's recommendations on the subject of the lease of State property to Vernon Valley Recreation Association were transmitted

on May 26, 1983, to Governor Thomas H. Kean and to the Legislature via Senate President Carmen A. Orechio and Assembly Speaker Alan J. Karcher. These transmittal letters, signed by Chairman Arthur S. Lane, stated:

"This Commission respectfully submits the enclosed draft of recommendations based on its public hearings March 28-30, inclusive, on the subject of the lease of State property to Vernon Valley Recreation Association. This transmittal is in accordance with the statute governing the Commission's operations, N.J.S.A. 52:9M-1 et seq., which states in Section 9M-4:

The Commission shall, within 60 days of holding a public hearing, advise the Governor and the Legislature of any recommendations of administrative or legislative action which they may have developed as a result of the public hearing.

"Under that provision the deadline for transmitting these recommendations is May 31. This time frame prevents us from including our full report on the public hearing with this enclosure. Although that report may contain more details, the enclosed draft represents the Commission's essential proposals for strengthening substantially the statutory and regulatory requirements and controls with regard to the lease of State property to Vernon Valley Recreation Association.

"The Commission is prepared to cooperate fully in any discussions of these recommendations and in connection with any subsequent decisions to implement them."

X X X

#### **Recommendations In Detail**

#### **I. Yearly Independent Audit of State Leases Which Require Rent Based Upon a Percentage of Lessee's Gross Revenues**

##### COMMENT

Since June, 1968, the State of New Jersey has leased tracts of public land in Sussex County to Vernon Valley Recreation Association, Inc. The rent due the State under this lease is five percent of gross revenues derived from the lessee's ski lifts. At no time has the State ever conducted a full independent financial audit of Vernon Valley's operations. As a result, the State did not learn until the SCI began its investigation that Vernon Valley, by failing to report certain revenues and by diverting other revenues, had withheld \$526,319 in rent and interest lawfully due the State.

An annual financial audit would have uncovered the failure on the part of the lessee to make full and timely rental payments. Consequently, the Commission recommends that all State agencies,



which are responsible for administering any leases in which rents are based upon a percentage of the lessee's gross revenues, require annual financial audits of the lessee's operations. Such a procedure would uncover discrepancies as they arise and would deter such financial machinations as occurred in the case of Vernon Valley.

Whether such audits should be conducted by State employees or independent certified public accountants must be determined on the basis of cost-effectiveness. Of particular importance, however, is the caveat that any accounting firm that is hired to conduct an audit must truly be independent of the lessee.

## **II. More Stringent Liability Insurance Safeguard When State Acts As A Landlord**

### COMMENT

The New Jersey Department of Environmental Protection (DEP) lease with Vernon Valley provides that the lessee obtain "public liability insurance" and that "said public liability be extended to insure the interest of" the Department of Environmental Protection. Such ambiguous language permitted the lessee to obtain insurance from a carrier unlicensed and unapproved by the State. It was only after considerable investigative difficulty that the SCI determined that Vernon Valley's alleged carrier was only a "paper" company, incorporated in the British West Indies, and without assets. From 1977 until March of 1981, Vernon Valley falsely represented to the DEP that the State's interest was insured by this company, known as London & World Assurance, Ltd.

The SCI recommends a statutory enactment requiring that, whenever the State rents property to private concerns, the lessee must obtain public liability insurance naming the State as an additional insured from an insurance company licensed and admitted to conduct business in the State of New Jersey. Further, there should be a statutory requirement that proof of such insurance be supplied to the State in the form of a copy of the policy itself as opposed to a Certificate of Insurance. Lastly, the statute should mandate that a carrier notify the State at least thirty days prior to cancellation of a policy.

## **III. Also Require Subdivisions of State Government To Utilize Only Companies Licensed By The State For All Insurance Transactions, Including Performance Bonds**

### COMMENT

The Commission's investigation revealed that on at least three occasions performance bonds were submitted to Vernon Township by Stonehill, Inc., a wholly-owned subsidiary of Vernon Valley Recreation Association, for the purpose of insuring the proper completion of certain construction projects. The surety on the bonds once again was the fictitious British West Indies company

London & World Assurance. The township accepted the bonds, having no reason to question them.

The SCI recommends, therefore, that all subdivisions of State government, including counties and municipalities, also be required by statute to utilize only companies licensed and approved by the State in all insurance transactions, including performance bonds. In addition, the SCI recommends that the State Department of Insurance forward copies of its annual report to all municipalities within the State. This report contains an up-dated list of all insurance companies licensed to conduct business in New Jersey.

#### **IV. Centralized Control Of All Leases Of Public Property Leased To Private Concerns**

##### COMMENT

As previously noted, the SCI believes that when State government rents public property to private enterprise, its primary obligation as a landlord is to safeguard a continuing public ownership interest in the property. The SCI's inquiry revealed that State government's management and administration of the Vernon Valley lease was marked by bureaucratic carelessness, apathy and lack of vigilance. The absence of any directives assigning responsibility within the Department of Environmental Protection for administration of the Vernon Valley lease resulted in a "pass-the-buck" attitude. Certain essential records were not maintained and those records that were kept were inadequate and inaccurate.

Therefore, the Commission recommends that every DEP lease be specifically and unequivocally assigned to a specific division, bureau or section for administration. Employees responsible for such lease administration must be fully advised about their obligation to assure that all provisions of the lease are enforced. In particular, DEP's Division of Fish and Game, which has jurisdiction over thousands of acres of public property, must establish and scrupulously maintain a bookkeeping and filing system for the purpose of documenting not only rent receipts but also evidence of compliance or non-compliance by the tenant with the various terms and conditions of a lease.

The SCI has been unable to determine the quantity or the quality of administration of all other leases to which the State is a party as landlord, chiefly because there is no central location within State government where leases are catalogued and maintained. There is, therefore, no effective oversight of this governmental function. At present, the Bureau of Real Property Management, Division of Real Property, Department of the Treasury, assists many State departments in the preparation of public land leases. Such assistance, however, occurs on a "hit-or-miss" basis, with no statutory or regulatory mandate that requires such assistance.

The Commission recommends a statutory requirement that all leases of public property be approved and monitored by the Bureau of Real Property Management. The establishment of such a procedure would accomplish several objectives: 1) it would establish a central repository for all leases of public property by the State, and 2) it would force each lease administering agency to effectively enforce the rental contracts under its jurisdiction. Such a system should also assure uniformity in the terms and conditions as well as the administration of leases, with each affected agency following similar guidelines and procedures.

**V. Enlarge DEP Staff Of Conservation Officers, Provide More Appropriate Inspections and Enforcement Equipment, and Conduct Training Program On State Lease Conditions and Requirements.**

COMMENT

Testimony at the Commission's public hearing confirmed that a single DEP conservation officer was responsible for patrolling an area of approximately 250 square miles which encompassed the acreage leased to Vernon Valley. At no time was this employee instructed about provisions of the lease or the responsibilities of the lessee with regard to the State-leased property, nor was he properly equipped to patrol and surveil the huge tract of land for which he was responsible. There also was no formal procedure for reporting unusual occurrences to responsible supervisors or senior DEP officials. As a result of these deficiencies, Vernon Valley was able to remove valuable timber and to construct dams, dikes, and a spillway without prior authorizations or subsequent inspections. Testimony revealed that the resulting 10-acre lake represents a potential hazard to life and property in the area.

The Commission recommends that the DEP increase its staff of conservation officers to permit more effective surveillance of public property. Furthermore, appropriate equipment should be available to enable conservation officers to patrol areas inaccessible by normal transportation means. Lastly, DEP also should establish a clear line of authority and responsibility so that questionable activities on public lands can be reported, investigated and immediately resolved.

The SCI realizes, of course, the fiscal restraints currently confronting State government. However, the Commission believes that commercial enterprises to whom public property is leased should share with the cost of safeguarding the public interest in that property. Therefore, the dollar amounts of future State rentals should include a factor reflecting the State's cost of monitoring leases. In addition, future leases should include both special assessments for uses that require added inspection or other monitoring burdens by the State, and heavy penalties for violations of lease provisions. A survey of all other fees for use of public lands and of penalties for misuse of State property should be conducted to determine if they can be increased to help defray the cost of protecting the taxpayers' interest in public property leaseholds.

**VI. Criminal Penalties For Unauthorized Construction of Dams**

COMMENT

The Safe Dam Act, N.J.S. 58:4-1 et seq., provides for a system regulating the construction, repair and inspection of reservoirs and dams. It further provides for a civil penalty of up to \$5,000 for any violation of the Act, including failure to obtain advance approvals and permits.

Because of the hazardous conditions inherent in the impounding of large amounts of water, including risk to life as well as property, the Commission recommends the imposition of criminal sanctions for failure to abide by the mandates of N.J.S. 58:4-1 et seq. Such violations should at the least be characterized as crimes of the fourth degree, subjecting violators to fines of up to \$7,500 and/or imprisonment of up to 18 months.

**VII. Termination Of The Vernon Valley Recreation Association Lease**

COMMENT

Under the terms of the State lease, dated June 6, 1968, the Vernon Valley leasehold could continue until the year 2018. The investigation and public hearing conducted by the SCI revealed gross and willful violations by Vernon Valley of numerous covenants of its lease. These breaches were so serious that the SCI referred the entire matter to the Office of the Attorney General for prosecutorial consideration.

In view of the grievous nature of the misconduct by Vernon Valley Recreation Association, Inc., and certain of its officers in ignoring its responsibilities as a tenant on public lands, the SCI recommends that the DEP take immediate steps -- as provided for by section 14 of the lease -- to terminate the lease and remove Vernon Valley Recreation Association, Inc. from State property.