

Section 3-1

THE BASIS OF THE GOVERNMENT'S PROSECUTION OF MICHAEL SEGAL

What is Segal accused of doing?

Segal was accused of Misuse of Premium Fund Trust Account (PFTA)

- Misappropriating funds from the PFTA
 - Creation of a cumulative deficit in the PFTA
 - Hiding the cumulative deficit by borrowing money to fill the deficit
- The prosecution was in possession of all books, records, computers and warehouse access for NNIB for two years prior to trial. And yet, not a single disbursement was presented into evidence drawn against NNIB's PFTA that was not authorized by the Illinois statutes and regulations.
 - The prosecution knowingly misrepresented and concealed the Illinois statutory facts governing PFTAs in an attempt to create a false impression of regulatory non-compliance. In addition, they cherry picked evidence to leave an impression of political taint.
- The prosecution did not result from a complaint or loss from insured, insurer and insurance regulator, but rather from a group of ex-employees who, when rebuffed in their takeover bid, formed an alliance with a competitor to use the US Attorney's office to eliminate NNIB and seek personal gain from NNIB and Segal's destruction.
 - Court documented cybercrime, stolen documents including attorney-client privileged documents, and hacked civil and criminal case legal strategies were ignored in possession of Government witnesses who protected from investigation and prosecution.

Proven fundamental flaws and misrepresentations in the theory of the prosecution

A PFTA is not a conventional trust account subject to impress trust accounting

The determination of whether a broker has sufficient funds in the PFTA is determined by a methodology established by the Illinois insurance regulations. It is a "cash method" accounting computation--the PFTA must contain the premium funds actually received from the customer that have not yet been forwarded to the insurance carrier.

No evidence based on "cash" method accounting was introduced at trial. The government substituted accrual-accounting "estimates" to argue a breach of regulatory compliance--but without "cash" accounting, it is impossible to conclude that any money at all was actually "missing" from the PFTA.

Despite the use of the word 'Trust' in Premium Fund Trust Account, the statutory meaning is that a PFTA is merely an ordinary bank account, or accounts, containing money belonging to the broker, encumbered by a fiduciary obligation to remit insurance premium payments to the carriers when due.

The regulations provide that the insurance brokerage regular bank account be named premium fund trust account and that checks drawn on it indicate this. However, the regulations themselves do not provide for the conventional trust account single entity impress accounting. This naming requirement does not create a "trust" account in the ordinary sense of the word.

The regulations specifically provide for the commingling of the broker's money with the net premium receipts.

Segal 495 F.3d 826, 830 (7th Cir. 2003) commingling inconsistent with a "trust" account. 3113.40(f) – [Ref: Tr.197, Tr.2143, Tr.2163, Tr.1693]

The prosecution alleges that "premium" and "non-premium" funds must be "segregated." However, the "segregation" of the funds is not associated with the deposit of the funds, but rather with the withdrawal of the funds from the PFTA. Illinois law specifically provides that the PFTA is a commingled account, containing both premium funds and funds belonging to the broker.

In absence of specific, unauthorized PFTA transactions, prosecutors present known, nonsupported accounting regarding the PFTA having a cumulative deficit as evidence of using or borrowing PFTA funds

Prosecution known use of incomplete and inaccurate statutory PFTA use reconciliation.

Misappropriation was the leitmotif of the Prosecution's case. The root problem is the disconnect between the Prosecution's misappropriation evidence and the clear language of the Illinois code.

Under the code, there is a misappropriation only if the PFTA balance is less than the amount deposited less lawful withdrawals. *[Ref: 50 Ill.Admin.Code ss3113.40(j)]*

The code definition of misappropriation could not be clearer; cash deposited minus cash withdrawals. Since the code calls for a cash analysis, accrual concepts play no role in deciding whether there is a PFTA deficit *rel non*.

The prosecution completely ignored the code. No rational person would think that cash plus accounts receivable is the same as, or a valid substitute for, the Codes "amount deposited".

- Accounts receivable are not cash or an amount deposited in a bank account. Accounts payables are not the same, or substitute for the codes "lawful withdrawals".
- Accounts payable are unpaid liabilities, and have no connection to withdrawals from a bank account or the balance of that account.

Instead of following the code, the Prosecution merely showed that the total of cash and accounts receivable was less than accounts payable.

In absence of specific, unauthorized PFTA transactions, prosecutors present known, nonsupported accounting regarding the PFTA having a cumulative deficit as evidence of using or borrowing PFTA funds

No cumulative deficit is possible in a PFTA account

The sole evidence offered for a PFTA deficit is Pater's inaccurate and incomplete premium ratio charts based upon the incomplete and inaccurate statutory prescription as to the reconsolidation *as to the use* of the bank account and not to the bank account itself.

Financial statements that contain financial account numbers would be admissible, however all PFTA exhibits as to reconciliation under the statute requirements cannot support any approach to a 1341 money loss.

The Prosecution relies on the misrepresented theories and facts of the regulatory statute *to infer* bank account negative use reconciliations, same as a negative bank account reconciliation.

There can be no trust account or trust account accounting but for the statutory regulation.

The record proves there can be no cumulative deficit as to a PFTA use. Customers are structurally incapable of experiencing a loss.

The Prosecution argued at trial that if NNIB failed to pay the carriers for insurance for which NNIB had received payment from the customers that the customers would experience a loss. Under Illinois law, even if NNIB had defaulted on its obligation to pay carriers, the customers would have been entitled to the insurance that they had paid for.

See *Scott v. Assurance Co. of America*, 625 N.E.2d 439, 442, (Ill.App.1993) (interpreting 215 ILCS 5/500-115(b), which provides that customer payments to an insurance broker are deemed received by the carrier).

Government witness Pater confirmed this interpretation of Illinois law. [Ref: Tr.650].

Prosecutors attempt to misrepresent facts of the record to give false and impossible impressions that collected premiums were used or delayed for payment

Carriers were paid on time

In Segal's original appeal of his criminal conviction, the Prosecution cited trial testimony that NNIB "had to hold checks to carriers until there was money in the PFTA to pay them," citing to Tr.2560-65. Segal I, Brief of the United States, p.10 trial record contains no accounting evidence of bank balance accounting.

- The government further argued that "by the late 1990's NNIB was chronically late paying carriers and was holding up checks cut to carriers until it could accumulate sufficient funds to send them out," citing Tr.1821-23. Id. at 30. which was adopted by the appellate court.
- No evidence of cancellation and no evidence from insurers.

- All government witnesses stated all carriers within the 30-45 day billing cycle
- Record support that NNIB advanced funds for premium payments to avoid cancellation in the millions of dollars" (Tr's to be filled in)
- All government accounting balance sheet exhibits showed positive millions of dollars positive cash and CDs, which cannot support prosecutor's allegations of using other people's money

NNIB's responsibility to maintain funds in the PFTA to cover carrier billings does not accrue until the funds are actually received from the customer. *[Ref: Tr.6064]*

Section 3-2

**EX-EMPLOYEES WHO CONSPIRED TO
OBTAIN STOCK AND TAKE CONTROL OF
NNIB ARE SOLE SOURCE OF
GOVERNMENT'S ACCOUNTING
EVIDENCE.**

Segal's prosecution was not the result of a federal or state concern about the conduct of Segal's Illinois Insurance Brokerage activities.

- No complaints were received by regulators.
- Prosecution does not present one victim at trial
- Prosecution does not present one delayed premium payment
- Prosecution does not present one notice of cancellation for paid premium

“There have been no complaints against NNIB or Mr. Michael Segal...”

-Brett Gerger, Asst. Chief Examiner, Illinois Dept of Insurance.

- Affidavit obtained despite government prosecutor leverage and pressure of DOI.
- Documented records show takeover group member ex-employee Gallagher calls to Illinois DOI alleging regulatory violations.

Nov 29 05 02:07p J1 Dept. of Insurance 312-814-6741 p.2
 Nov 29 05 02:04p Producer Regulatory Unit (2. 558-2081 p.2

Chayx

COUNTY OF _____)
 STATE OF ILLINOIS) SS

United States of America v. Michael Segal
 No. 02 CR 0112

AFFIDAVIT

I, Brett Gerger, being first duly sworn upon oath, deposes and states:

1. I am employed at the Illinois Division of Insurance, previously known as the Illinois Department of Insurance ("DOI"), as Assistant Chief Examiner Producer Regulatory Section.

2. I am thoroughly familiar with the records maintained by the DOI regarding consumer complaints. It is the DOI's practice to maintain a record of each consumer complaint that it receives. The DOI maintains records of consumer complaints from 1989, to the present.

3. On November 29, 2005, I reviewed the files to determine whether there had been any customer complaints against New North Insurance Brokerage ("NNIB") or Mr. Michael Segal with respect to NNIB's Premium Fund Trust Account or credit write-offs. As of November 29, 2005, there have been no customer complaints against NNIB or Mr. Michael Segal with respect to NNIB's Premium Fund Trust Account or credit write-offs.

4. This Affidavit is based upon my personal knowledge and, if sworn as a witness, I would testify competently to the same.

Further your affiant sayeth naught.

Dated: *November 29, 2005* *Brett Gerger*

Subscribed and sworn to before me on November 29, 2005.

Tanya S. Kowalski
 Notary Public

NOTARY SEAL
 Tanya S. Kowalski
 Notary Public, State of Illinois
 My Commission Exp. 04/12/2009

NOV 29 '05 12:59 312 814 6741 PAGE.02

[Reference-Affidavit: Brett Gerger, Assistant Chief Examiner, Illinois Department of Insurance]

Original source of accusations and evidence

A takeover group of ex-employees, motivated by personal greed to gain control over Near North and interfere with pending stock plans for 60 executives and, when that failed, to destroy the company through prosecution and then pick up the pieces for personal gain as members of giant competitor AON created the case.

- The "theory of the case" and the sole foundational "accounting" evidence was developed by this group of NNIB ex-employees who had been rebuffed by Segal in their takeover bid and then handed it to prosecutors as they walked out the door to become members of AON. [Ref: Exhibit 216]
- The ex-employees **takeover group, while still employed at NNIB**, became affiliated with NNIB's business competitors to reap substantial business gains in the wake of NNIB's destruction.

- Takeover parties Barry, Walsh, and Gallagher received substantial, unorthodox stock grants and legal indemnities from AON.
- Flurry of phone calls between Berry and Walsh takeover Government agents (including during the time of arrest with AON president) and with AON chairman and president and FBI provide unmistakable evidence of AON's involvement with the group and Segal's arrest.
- Takeover group continued to work with prosecution as private agents.

Although Segal and NNIB vigorously advanced a complaint and included in a civil suit illegal hacking involving the takeover group possession and distribution of hacked materials including attorney-client privileged information, the U.S. Attorney's office used its prosecutorial discretion to not prosecute the confessed hacker.

As a consequence, the full relationship between the hacker, the takeover group, the FBI, and AON has never been fully revealed.

Original source of accusations and evidence

Some of the hacked email contents were provided to the press and used to interfere with exculpatory evidence. Segal filed a pre-trial motion by Albert Alschuler, University of Chicago constitutional law professor, seeking to enjoin the government and its witnesses from leaking case materials. Although the motion was supported by clear evidence of coordination between the U.S. Attorney's office, the Takeover group, and the press, by the time the motion was heard by the court, the court found that the time was past when such a communications limitation would have been effective.

Segal's arrest was known prior to even Segal being informed. During the arrest, takeover group leader Berry received a phone call from FBI agent confirming Segal's arrest. Co-leader of the takeover group Walsh called every media outlet where NNIB had offices to tip them off regarding the coming public announcement of Segal's arrest.

Original source of accusations and evidence

In short, a few prosecutors were incorrectly used and misled to change the competitive landscape in the insurance brokerage business

Prosecution acknowledged the barest outline of a conspiracy plan to take control of NNIB using allegations of regulatory violations as justification. The Government admits control was requested.

The Takeover Group plan proposed to gain control of NNIB for itself by empowering the group to take “any and all steps” without the consent of Segal.

Takeover Group member McNichols reluctantly testifies to group’s intent to gain control of NNIB.

McNichols drafted a letter to Segal, dated April 20, 2001 and signed by McNichols, Ludwig, Walsh, and Berry, captioned NNNG Management Operations Plan. Tr2580-92. It's purpose was to bring NNIB into compliance with the law, and its first proposal was to put control of NNIB into an executive committee, consisting of the signers, that would report to Segal but be free to act without his approval. *Id.* The plan called

[Reference-US v Segal, No. 05-1602, 05-4756 (7th Cir.)]

9). The Executive Committee is further empowered to take any and all steps necessary to accomplish the goals and fulfill the directives set forth in this Management Operation Plan without further action by or consent of the sole director and shareholder.

[Reference-Exhibit 214-A]

14 Q. And in about that time, the managing directors that you have
15 identified began to want to participate in management to a
16 greater degree than they had.
17 A. Yes.
18 Q. And they wanted a shift of control from Mr. Segal to them.
19 A. Yes, they wanted a remediation plan.
20 Q. And I don't want to dwell on this, but the remediation plan
21 that they wanted when they had control of the company would take
22 three years, and this was in the spring of 2001, correct?
23 A. Correct.

[Reference-Tr 2699; McNichols cross by Cognetti]

Original source of accusations and evidence

In short, a few prosecutors were incorrectly used as a tool to change the competitive landscape in the insurance brokerage business

McNichols further testifies that Takeover Group plan identified their roles after takeover.

Tr. 2657-58; McNichols cross by Reidy

Q. And so who had been designated as the Chief Executive Officer?

A. I believe that would have been Matt Walsh.

Q. And who would have been designated as the president?

A. That would have been, I'm assuming, Dana Berry.

Q. And the chief planning officer?

A. I don't know that there was an announcement of that yet.

Q. Okay. So there might not have been one of those yet. And with respect to the Chief Operating Officer?

A. I believe that would have been Jeff Ludwig.

Q. And you were the Chief Financial Officer?

A. There had not been any announcement for that yet.

Q. Okay. So did you hold as of March 2001 the position of Chief Financial Officer?

A. Yes, I was the Chief Financial Officer.

Q. So if you stayed in your position, then you would be this person on the committee?

A. Yes.

Though prosecution portrays Takeover Group as whistleblowers, testimony and the record indicates otherwise.

McNichols admits Takeover Plan did not include self-reporting of supposed PFTA issue to Illinois Department of Insurance. Instead, plan called for group to continue to conceal the alleged deficit and earn it down of time.

Tr. 2657; McNichols cross by Reidy

Q. Now, in this plan, which is Government Exhibit 214A of March 2001, there wasn't any part of this plan to go to the Illinois Department of Insurance, was there?

A. No.

Q. And so your plan was to continue to operate Near North with a premium fund trust deficit for two to three years until you could make that deficit up, right?

A. Yes.

Q. And to work diligently to try and get that deficit down, right?

A. Yes.

Original source of accusations and evidence

Prosecution shows that the group knew this conduct would be illegal.

Tr 5281; Government-Closing

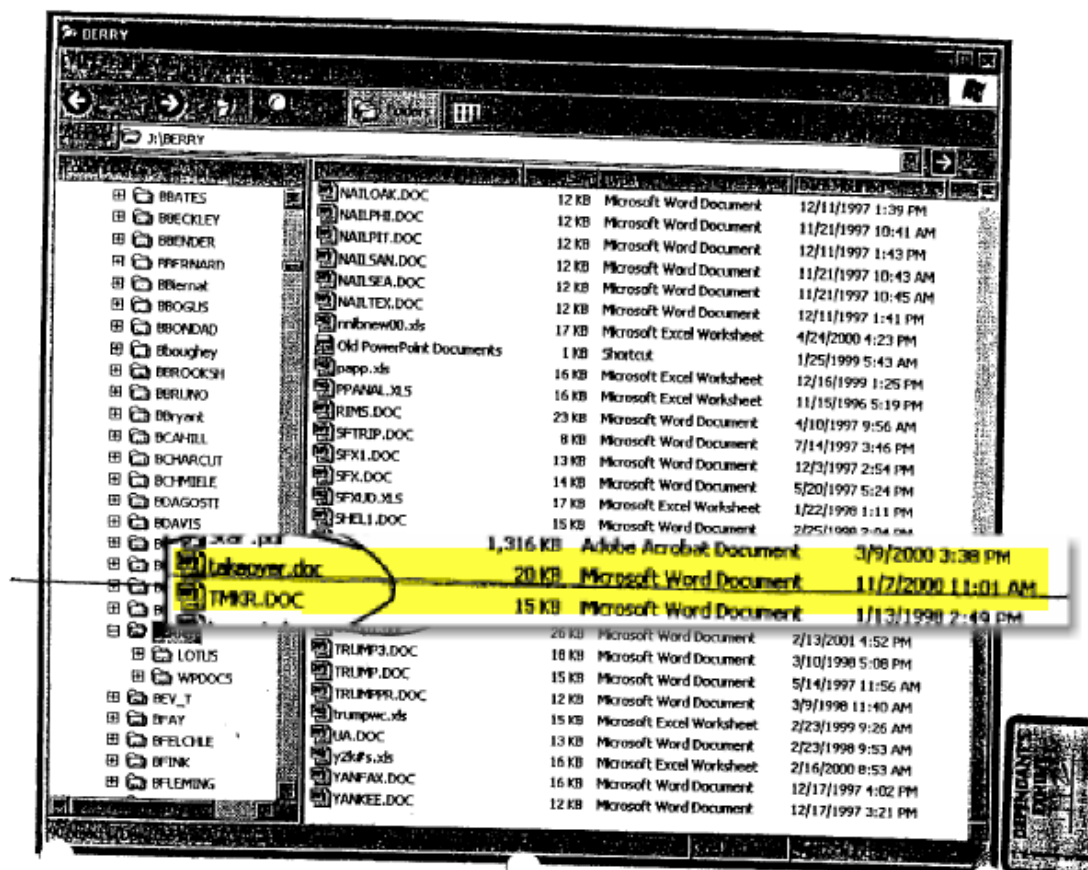
We have evidence from April of '01, where the managing directors at the time -- Walsh, Berry, Ludwig, Gerber -- all admitted that they knew what was going on at Near North was wrong, and that they were perpetuating, acting on its behalf, to help perpetuate that criminal activity.

Thus, their concern about the activity was only a concern so long as Segal was in charge. In exchange for \$5M and control, they were perfectly happy to continue to operate NNIB 'illegally'?

More plausibly, they knew there was no actual shortfall and created the phantom crisis to facilitate acceptance of their plan by Segal.

The Takeover Group had a takeover plan as early as November of 2000.

Document labeled 'Takeover.doc' from November 2000 found on Group member Dana Berry's computer. (Highlighted and enlarged)



[Reference-Exhibit 172]

The Takeover Group had a takeover plan as early as November of 2000.

Sample of Takeover Group plan from November 2000 found on Group member Dana Berry's computer. (Highlighted and enlarged)

Group plan identifies sum to be extorted

TAKEOVER.DOC, 11-7-2000 11:01am, FOUND IN DANA BERRY'S PERSONAL DIRECTORY

Assumptions: Annual Brokerage Rev. = \$80m (does not include Title, IFG, Envision, ATMG)
Trust at Zero balance

\$80 m Revenue x 1.5 (multiple) = \$120,000,000

Give 20% to management group (\$24,000,000) equal split

Group includes: Matt Walsh, Dana Berry, Jeff Ludwig, Mike Mackey, Devra Gerber and Tim Gallagher

Note: If he will do it, we should include Mr. B. as he would be helpful on sales strategy.

5-year employment contracts. Ownership to vest 20% per year.

Key Man life insurance policy on MS

Five-year growth and sale plan: (VERY CONSERVATIVE ESTIMATE)

Grow current revenues to \$100,000,000 by year 5.

Mr. B. to lead initiative to sell NNNNG for minimum multiple of 1.5x's revenue or higher depending on hard market conditions.

If sold for \$150,000,000 minimum: Segal walks away with \$120,000,000
Each of us walks with \$5,000,000

[Reference-Exhibits 101, 113]

Phone Records show Takeover Group had more than 250 calls with President of AON and FBI, presenting a clear picture of collaboration in destroying NNIB

Samples of phone logs showing contacts between Berry, Walsh, AON CEO Pat Ryan, and AON President O'Halleran before and during Segal's arrest. Multiple contacts months prior to takeover group leaving employ of NNIB.

- Segal was told by high profile client that Ryan called for business after arrest and when client stated he did not like what he heard about the ex-employees, Ryan basically stated he did not know them
- Three business days after Segal's arrest, the arrest complaint was faxed to another large client, Jupiter Corporation, and related hacked email informing NNIB's lawyers as such, a subsequent Walsh letter to client attempting to explain exculpatory position

<u>DATE</u>	<u>TIME</u>	<u>FROM</u>	<u>TO</u>
04/12/01	5:43 p.m.	Tim Gallagher	AON Main Number
04/18/01	10:36 a.m.	Dana Berry	AON Main Number
04/18/01	10:39 a.m.	Dana Berry	AON Main Number
07/26/01	4:36 p.m.	Dana Berry	AON Main Number
07/27/01	7:42 a.m.	Dana Berry	Pat Ryan (direct) (CEO of AON)
07/27/01	1:51 p.m.	Dana Berry	Eric Brandfonbrenner at Grippo Elden
07/30/01	7:34 a.m.	Dana Berry	Pat Ryan (Direct) (CEO of AON)
08/02/01	5:40 p.m.	Dana Berry	Pat Ryan (Direct) (CEO of AON)
08/04/01	11:23 a.m.	Dana Berry	Pat Ryan (direct, his Lake Geneva Wisconsin Home (Unlisted number)
02/21/01	-	Matt Walsh (called from Hotel in New York)	AON Main Number

<u>DATE</u>	<u>TIME</u>	<u>FROM</u>	<u>TO</u>
01/26/02	11:26 a.m.	FBI (using NNIB courtesy phone, picture available)	Matt Walsh cell phone
01/26/02	11:28 a.m.	Matt Walsh	Tim Gallagher
01/26/02	11:32 a.m.	FBI (using NNIB courtesy phone, picture available)	Dana Berry cell phone
01/26/02	11:54 a.m.	Dana Berry	Michael O'Halleran AON President/at home
01/26/02	11:56 a.m.	Dana Berry	Michael O'Halleran
01/26/02	11:58 a.m.	Dana Berry	Matt Walsh cell phone
01/26/02	12:03 p.m.	FBI (using NNIB courtesy phone, picture available)	Matt Walsh cell phone
01/26/02	12:03 p.m.	Matt Walsh	FBI cell phone
01/26/02	12:03 p.m.	Dana Berry	Eric Brandfonbrenner direct at Grippo Elden
01/26/02	12:07 p.m.	FBI (using NNIB courtesy phone, picture available)	Dana Berry cell phone

McNichols, who became prosecutor's undisclosed private agent and key witness in presenting accounting evidence, was initially hired by takeover group as a consultant in 1999.

Takeover Group member Mackey contacts McNichols.

Tr.2486, McNichols direct by Kendall

Q. Who contacted you originally about coming to Near North then?

A. Mike Mackey.

Q. And when was that?

A. That would have been in early 1999, early to mid 1999.

McNichols meets with takeover group members

Tr.2486-88, McNichols direct by Kendall

Q. Who were the people that you met with in mid '99?

A. I met with Devra Gerber, Jeff Ludwig, Matt Walsh, Dana Berry, Don Kendeigh.

Q. Did I miss anybody that you met with that day?

A. Don Kendeigh.

Q. Okay. Don Kendeigh. Thank you. What about Don Kendeigh, what was his position when you met him?

A. I don't believe he had the title of Chief Financial Officer, but he was the highest ranking accounting person in the department.

McNichols becomes the Prosecution's key witness and source of evidence. Prosecution reminds the jury that McNichols, a member of the takeover group, is critical witness and source of evidence.

Tr.5307; Closing by Prosecution

I want to back up a minute to Heitzman and Marcotte and Tom McNichols. I want to talk to you about McNichols. I think McNichols was a very important witness in this case. He had a lot to say, put in a lot of documents that were critical.

- McNichols provides five exhibits at time of offense that serve as the entire basis of prosecution's accounting evidence.
- McNichols, an agent of the takeover group, wears wire to obtain evidence or interfere with exculpatory evidence.
- Prosecution has more than 700 hours of wire transcripts (including the taping of defense attorneys) and does not put a single minute into evidence.
- Government has knowledge of inappropriate application of trust regulations in takeover group evidence yet proceeds in spite of this.
- Prosecutors have legally implied knowledge of McCarren-Ferguson as to congressional mandate defining insurance regulations under jurisdiction of state, not federal government
- The prosecution relied solely upon false and inaccurate accounting summaries prepared by a takeover group of former employees working for a competitor.
- No Government accountant reviewed or testified to the evidence as to its accuracy.
- The Government's own witnesses testified as to the inappropriateness of the prosecution's evidence (see section 5-False Evidence.)

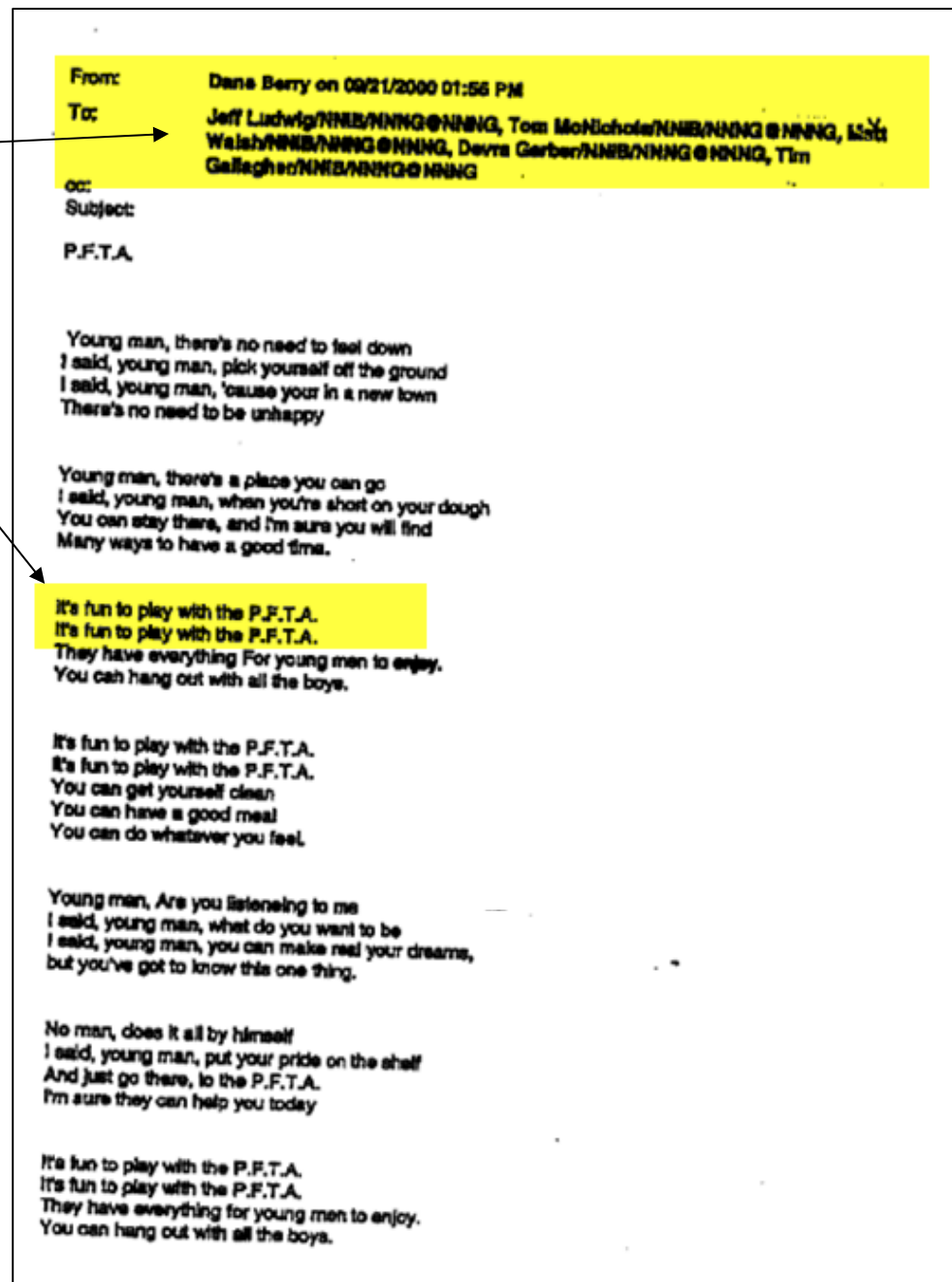
Takeover Group email distribution shows inclusion of newly hired McNichols

Email describing a 'song' that takeover group composed on nature of their manipulation of the P.F.T.A.

Found on Dana Berry's computer and indicating key prosecution witness McNichols was part of group.

Email was sent to takeover group including Ludwig, Walsh, McNichols, Gerber, Gallagher just two weeks after McNichols was hired.

"It's fun to play with the PFTA"



PWC report and replacement of McNichols as CFO

Tom McNichols joined Near North in 1999 and became its Chief Financial Officer in October of that year. McNichols was a 'key member of the management Takeover Group that tried unsuccessfully to take ownership and control of Near North away from Segal, eventually becoming a private agent for the FBI. McNichols left Near North five days before Segal's arrest.

Following the receipt of the Due Diligence report prepared by Pricewaterhouse Coopers, AIG and Firemen's Fund insisted that Tom McNichols be replaced as Near North's CFO. The fact that AIG and Firemen's Fund insisted on the replacement of McNichols is documented in both FBI 302 statements and in trial testimony:

Tr. 2962:10-19 (Cappel - direct by Hogan)

Q. Did (the loan documents require that there be a new CFO?

A. Yes. . . . I don't know if the documents themselves required the new CFO. I can't remember that, But I know the lenders in the discussions with them required there to be a new CFO.

Tr. 2706:7-11 (McNichols - cross by Cognetti).

Q. Did you learn that when IGA -- AIG, excuse me-- Fund loaned Near North 10 million -- \$20 million that they wanted to put in a new CFO?

A. Yes, I did.

AIG and Firemen's Fund did not simply pull a requirement that Near North replace the CFO as a condition for loaning money to Near North out of thin air -- they based it on hard information. Their source of information was a Due Diligence Report prepared by Pricewaterhouse Coopers. Pricewaterhouse would not make such a recommendation without documenting failures of accounting process, management competence, or fiscal integrity on the part of McNichols.

Such specific negative independent information concerning McNichols' competence and/or integrity would have been valuable impeachment material which the defense could have used at trial to discredit McNichols' testimony.

The Y2K accounting software conversion created severe anomalies in NNIB's insurance payables and receivables

NNIB's accounting system conversion created problems as to omission and commission of off-balance sheet accounting components

Testimony and affidavits demonstrate that computer conversion creates issues and anomalies that utterly invalidate the theoretical foundation of the prosecution's non-statutory estimate of PFTA compliance.

Based on our analysis of NNIB's accounting records, and review of contemporaneous correspondence, there was a major breakdown in the accuracy of NNIB's accounting records when in 1998 NNIB decided to convert to a new agency management and accounting package from its existing Harte System. The conversion did not go well and detail was lost from the Harte System with only beginning balances coming forward. At the same time many duplicate entries suddenly appeared as part of the automation process.

[Reference- Affidavit: Supplemental Affidavit of Andrew R. Lotts, Vice-President and CPA Fanco Data Systems, 11/28/05]