

Attachment #2 - Evidence of Misconduct as to Uncorrected Material Misrepresentation of Accounting and Regulatory Evidence by AUSA Hogan and Agent Murphy in Segal Prosecution, Forfeiture and Restitution Proceedings

This document cites specific examples of uncorrected material accounting misrepresentations used to convict Michael Segal of insurance fraud. The document also provides evidence that the US Attorney's office and FBI Agent Murphy knew the accounting presented to the court and now in forfeiture and restitution proceedings -- was impossible, incomplete and inaccurate and known false. This section documents that prosecutors were in possession of exculpatory evidence that proved the "crime" attributed to Michael Segal and Near North Insurance was not possible and was, in fact, indeed, was manufactured by former employees of NNIB who were rewarded and protected when they defected to an insurance competitor.

GOVERNMENT FAILED TO EXERCISE DUE DILIGENCE IN PRESENTING KNOWN INCOMPLETE, INACCURATE, UNCORRECTED ACCOUNTING EXHIBITS

The basic accounting "evidence" presented by the government was devoid of backup documentation or "working papers" that are required under the most basic accounting standards to accept the conclusions presented. The government had all of Near North's accounting records during the two-year+ period prior to trial. The government additionally subpoenaed records from third parties.

Although the government was in possession of all of the underlying accounting records, there was no team of government accountants assigned to analyze those records. Instead, the government simply adopted the unsupported accounting conclusions originated by the Takeover group, who had a significant personal financial interest in the success of the prosecution of Segal and Near North, and other leveraged witnesses. There was no governmental due diligence with respect to the accounting conclusions. Instead, the government took the "ostrich" approach of deliberate avoidance of analysis of the accounting records by government or independent third-party accountants combined with multiple Brady violations.

The prosecutors knew, or should have known through the exercise of due diligence, that accounting conclusions as to the sole material evidence during the time of offense (i.e. the PFTA use reconciliation) was inaccurate and unreliable due to the lack of reconciliation of the underlying numbers.

Segal's prosecution is decidedly different from other financial crimes prosecutions. Normally, the government assembles a team of accountants and auditors to pour over the records of an

enterprise to determine what happened. More revealing is that Segal's alleged financial crime prosecution was not under the financial crime division of the U.S. Attorney's office.

In Segal's case, the Government simply accepted documents from a Takeover Group, employed by business competitor AON, as the foundation for a criminal prosecution. The Government knew better. The Takeover Group was not a group of "whistleblowers." They were agents of a business competitor who were determined to destroy Near North for competitive advantage through the reduction of competition in the Insurance brokerage business. The non-statutory and non-reconciliation accounting "records" produced by this group would have been received with extreme skepticism. Instead, the Government vouched for their veracity at every opportunity.

In closing, the Government argued that Segal's case was "a fiduciary fraud case." In other words, an accounting case. Because there was no direct evidence of misuse of the PFTA and because the government presented no claim of loss, to create fiduciary fraud, prosecutors had to imply misuse of the PFTA through proven false and inaccurate accounting analysis.

THE ONLY COMPLETE AND ACCURATE ACCOUNTING EVIDENCE FURNISHED AT FORFEITURE TRIAL EXPOSES KNOWINGLY FALSE AND UNCORRECTED GOVERNMENT EXHIBITS

There was "true" accounting testimony presented, but not at trial. The real picture was testified to by Lotts/FANCO (CPA and Forensic Accounting Firm) at Segal's forfeiture hearing after the trial. Lotts/FANCO had performed a substantial amount of independent work — \$1,227,535.34 worth to be exact. Testimony at the forfeiture hearing established that Lotts/FANCO had not previously performed accounting work for Segal and Near North — their engagement to forensically reconstruct Near North's accounting records was devoid of any taint that would be associated with a firm that had a pre-existing or ongoing relationship with Near North.

Lotts/FANCO recomputed the PFTA use reconciliations on key dates corresponding to the dates of the government's exhibits themselves — establishing, for example, that on 6/30/2001 (date of loss for prosecution), Near North's PFTA had a surplus of \$5.8 million, as opposed to the \$24 million shortfall urged by non-expert government witnesses and outrageous testimony by AUSA Hogan (proven false by the government's own record) that \$10 million had to be added to a \$34 million shortfall. **Hogan's own accounting exhibits prove his false manufacturing of evidence.**

The prosecutors were not simply content to "present" false accounting evidence through the testimony of their witnesses. In closing arguments, the government not only capitalized on the false testimony used in the trial — they went so far as to embellish it.

The government's reliance on false accounting continued post-trial into the forfeiture proceedings, and continues to this day in the government's representations to the court on forfeiture remand by the United States Court of Appeals for the Seventh Circuit.

ACCOUNTING FORENSIC ANALYSIS FUNCTIONS LIKE MEDICAL DNA

"Accounting" was the centerpiece of Segal's trial. "Accounting" is an area of specialized, technical knowledge and skill, conducted according to generally accepted principles in the field and subject to peer review. It is important to point out that in Segal's case, the court ruled that there was no loss or victim, which would have not established the need for the government to manipulate incomplete and inaccurate accounting regulatory data.

Testimony about "accounting" is therefore potentially subject to the requirements of Federal Rules of Evidence, is no different than technical or scientific evidence.

At Segal's trial, different lay witnesses testified to different reconciliation balances in the same account on the same day — sometimes different by millions of dollars. The Government's accounting data was presented by their leveraged lay witnesses. Courts have recognized that "reliability" is an important factor in assessing technical testimony offered by lay witnesses:

In Segal's case, an accounting expert was not called to testify at trial. Segal had pre-trial agreement to put on forensic defense and other witnesses at a cost of \$3 million. Segal was not informed until the end of the Government's case, in chief, that his defense attorney did not prepare and intend to put on these various defense witnesses. Segal was never given an explanation for not calling accounting or regulatory witnesses, but believes in good faith that defense counsel was concerned under the RICO superseding indictment that that allocation of time and expense to utilize these witnesses.

However, Segal's lawyer did call the key forensic accountant, Andrew Lotts (FANCO/records reconstruction) at Segal's subsequent forfeiture hearing. Additionally, following the forfeiture hearing, the accountancy expert has submitted sworn affidavits expanding his testimony at the forfeiture hearing. As a result, the accountancy expert testimony that could have been offered at Segal's trial is not a matter of speculation. The testimony is especially significant because the "accountancy" testimony from Government witnesses was not offered pursuant to Fed.R.Evid. 702 as "expert" testimony. Because defense accountancy expert Andrew Lotts testified at the forfeiture hearing pursuant to Fed.R.Evid. 702 as an "expert" witness, his testimony is worthy of considerable weight.

Lotts' testimony at forfeiture trial establishes that his team did a complete forensic reconstruction of Near North's accounting records, recomputing the accounting components proffered by the Government. Lotts' forensic testimony was able to establish the core accounting evidence recomputed validity which at a minimum presents the knowledge as to the only one finite answer as to the nature of accounting as to Segal's forfeiture. Another difference is that Lotts' work is supported by accounting "work papers" and can be subjected to independent peer-review, while the accounting exhibits proffered by the Government are unsupported by "work papers" and therefore not subject to independent verification.

Forensic Accounting from the record provides further example of Government evidence at the time of offense and forfeiture incomplete and inaccurate illegal gains computations

Forensic Accountant Lotts both identified fatal flaws in the accounting exhibits proffered by the Government's witnesses and offered forensic recomputations of those exhibits. For example: 1) forensic recomputation of consolidated Government Exhibit 72 as of October 31, 1998, reflects a positive \$1.5 million PFTA use reconciliation – in contrast to the negative value urged by Government at trial; 2) use of the proper "consolidated" PFTA use reconciliation with respect to Exhibit 108B, a 9-30-2000 PFTA analysis, demonstrates a positive \$633,350 PFTA reconciliation as opposed to the deficiency of \$6,918,000 urged by the Government at trial; 3) forensic recomputation of the PFTA use reconciliation as of 6-30-2001 using the methodology prescribed by Illinois statutes and regulations shows a PFTA surplus of \$5,852,861.00, as opposed to the \$24 million deficit urged by the Government on that date and the \$10 million proven impossible false AUSA Hogan's non-supported increase; and 4) identification of fatal deficiencies in various Government exhibits which precluded reliance on those exhibits for any purpose.

It is significant that Andrew Lotts, forensic expert witness, was subjected to extensive cross-examination by the Government's cross-examination tended to highlight the strength of the accounting positions put forward by Mr. Lotts. The only true "expert" testimony in the entire proceeding exculpated Segal and Near North with respect to the Government's core allegation of a scheme to defraud based on a deficiency in the balance of the PFTA and the sole accounting evidence to establish any illegal proceeds for forfeiture.

GOVERNMENT PROSECUTORS WITHHOLD EXCULPATORY MATERIAL EVIDENCE AS TO ACCOUNTING

At the end of 2000, Segal and Near North had a strategic plan to borrow, or enter into a convertible debenture relationship, with its two lead insurance carrier vendors, AIG and Fireman's Fund. There was a strong interest by the carriers in Near North's technology for niche marketing and expansion by acquisition of wholesale brokers as clearly supported in Government's Exhibit 101. They used Pricewaterhouse Coopers to do an independent audit and due diligence report. The PwC report necessarily presented a favorable picture of Near North, because, based upon that report, both AIG and Fireman's Fund each loaned Near North approximately \$10 million. **Although the Government obtained this report pretrial through its broad subpoenas to AIG and Fireman's Fund, the report was never disclosed to the defense.** The Government, however, alluded to the report on numerous occasions during trial, demonstrating a familiarity with its contents. Unfortunately, the PwC report remains successfully concealed by the Government.

The record is clear that Pricewaterhouse did an extensive independent due diligence analysis and did not rely on the government's accounting data provided by takeover prejudiced witnesses, even though the government's investigative record presents contact and trial testimony as to the Pricewaterhouse review, but no turnover of the actual report. More revealing, is that Pricewaterhouse recommend the termination of the key Government agent witness, Tom McNichols, who was the undisclosed member appointed by the Takeover group to the CFO position at NNIB.

The due diligence report that was not made available to NNIB by PwC, was refused when requested to AIG and Fireman's Fund. The government ordered both AIG and Fireman's Fund not to talk to Segal. The government substituted proven invalid accrual-accounting "estimates" and proven meaningless loan deposits having no accounting nexus to argue pecuniary misconduct. The PwC report, was relied upon by AIG and Fireman's Fund, would not support the incomplete and inaccurate accounting facts and the misrepresentation by the Takeover group and the government to misrepresent \$35M risk of loss and loan accounting analysis, the basis for the forfeiture illegal gains computation.

The PwC Due Diligence Report proves knowledge to prosecutors and their withholding of exculpatory and true and accurate accounting exhibits and subsequent reuse and non-correction of the true accounting.

FORFEITURE REMAND FILINGS AND NEGOTIATIONS CONTINUE WITH THE USE OF UNCORRECTED, FALSE AND IMPOSSIBLE CALCULATIONS

At the forfeiture stage of the proceedings and negotiations, and even after the seizing of hundreds of millions of dollars, AUSA Hogan continues the unlawful misconduct to continue his animus of Segal. Hogan continues to misrepresent the law in his own filings and district and appellate court rulings to withhold from Segal his personal assets.

During the 6+ years of forfeiture remand hearings, AUSA Hogan continued with his due process violations, misrepresenting the trial records and his own filings in making known false statements to interfere with the appellate court's remand instructions. One of the reasons for his intransigence may be attributed again for Segal's June 2010 filing with the Department of Justice which cast Hogan in a negative light. After the initial letter was received by the DOJ, Hogan openly voiced his displeasure to Segal's attorney Edward Joyce during a conversation at a forfeiture remand hearing. One can infer that AUSA Hogan's continued involvement in the forfeiture hearings, a job usually handled by the financial division of the Northern District of Illinois US Attorney's office, only further illustrates the continued ill will of this agent of the Government. In addition, since the record and accounting evidence continues to be misrepresented and not corrected, Hogan's concerning protection of these due process violations can also be inferred.

FALSE ACCOUNTING EVIDENCE DRIVES FORFEITURE PROCEEDINGS AND RESTITUTION FILINGS

The Government's theory of Segal's guilt is that over a period of decades, Segal misused money from a trust account. Throughout this period, the trust deficit increased continually until it reached a maximum deficit of \$35M in June of 2001. Finally, the government alleges that Segal borrowed \$30M in an effort to "put back" the stolen money. The evidence to support this theory is known and proven to be false from the Government's own exhibits on their face. It is also not corrected throughout the proceedings including forfeiture.

Segal's prosecution was grounded on Illinois Producers Statute and Administrative Code Regulations referred to PFTA regulations. The Government defined by ignoring the Illinois state regulations at the Department of Insurance that a PFTA reconciliation as cash + accrued accounts receivable - accrued accounts payable. If the result is negative, the Government called it a "PFTA deficit", "PFTA trust deficit", "out of trust deficit" and continued to misrepresent evidence as to **negative cash accounting to falsely support a claim of taking and using other peoples' money from a trust account.**

It is clear that the statute does not contain the word "trust" nor does the regulation refer to a PFTA deficit, but rather a PFTA use reconciliation, which is different from any bank account reconciliation or bank account deficit. The PFTA must contain the premiums actually received

from the customers that have not yet been forwarded to the insurance carrier within the agreed billing cycle between 30-45 days. No evidence based upon cash accounting was introduced at trial. It is accepted that if insurance carriers are not paid within the contracted 30-45 days from the inception date the carrier unilaterally cancels for non-payment.

An Illinois Insurance Producer's PFTA is not a trust account (as to department regulation and Illinois case law). Instead, it is a comingled account prescribed by the Illinois Dept. of Insurance that permits both customer premium payments and other brokerage revenue and funds. Because it is a comingled account, it cannot, as a matter of law, be a "trust" account. Furthermore, "trust" or "impress" accounting principles cannot be applied to a comingled account.

Because of the finite nature of accounting and regulatory evidence, the government's criminal element allegations are not only in dispute, but proven known to be false, impossible, and not corrected in a continuous pattern in multiple ongoing Government filings.

By forensic reconstruction from the record, the accounting underlying the alleged \$35M shortfall, performed strictly according to GAAP and Illinois statutory requirements recomputed the \$35M deficit as a \$5.8M surplus. Government prosecutors continue to not correct the false accounting evidence that is the sole material support, other ongoing filings in the Skilling remain and the ongoing forfeiture remains.

Government Prosecutors Create Exhibit 550 that is Proven to Misrepresent the Accounting Effects as to Insurance Companies Warrants and Loans

The loans, alleged by the government as being taken out to resolve and provide known false proof of an implied, non-cash "deficit", to prove pecuniary misconduct, did nothing of the sort. The government knew that the evidence was false from their own exhibits 550 and 99. The loans were not funded until November 16, 2001. Given that 1) between June 30, 2001 and September 30, 2001, there was no substantial cash infusion into NNIB's PFTA as to non-operating revenue; and 2) NNIB continued to meet its premium obligations subsequent to June 30, 2001; there was a PFTA surplus of \$7.7M. September 30, 2001, Government Exhibit 99.

Not only did the forensic recomputation of the PFTA statute for June 2001 demonstrate via the "statutory" methodology that there was no PFTA deficit, in like manner, the government's own financial exhibits from September 2001, using the government's methodology, shows an even larger PFTA surplus in September of 2001. There was no "hole" to "plug." Somehow, with no massive infusion of cash between June 30, 2001 and September 30, 2001, the Governments Exhibits establish that NNIB's PFTA use "deficit" was reduced by \$47.7M, so as to create a \$7.7M surplus in the PFTA which is supported by the Government's own Exhibit 550 and proven to be false.

The Government continues to misrepresent its facts, theories and evidence by withholding true accounting evidence analysis which provides further support of government's knowledge of false evidence

The government never presented even one check drawn on the PFTA bank account that was not permitted under regulations 3313.30 H1-6 to an improper recipient. There was no direct evidence of any check drawn on the operating account, which was in turn funded by other than NNIB's portion of the comingled PFTA bank account. There was no customer who did not receive the insurance for which they paid. There was no carrier who was not paid on time and in full. Ultimately, the district court ruled that there was no economic loss associated with Segal's use of the PFTA. The reason there was no loss was not because Segal "stole" the money and then "put it back." Instead, **there never was any missing money**. It was there all the time.

The fact of the loan deposits proves, the fact of the deposit, nothing more. The government did not show that any of the \$30M was used to replace collected premiums that had been misappropriated. In fact, the government did not show how any of the \$30M was spent. The government's only witness on the \$30M loans, admits the analysis did not include disbursements and did not have any idea how much of the money that went into the PFTA was spent in order to make up for a deficit in that PFTA, if any. She could have performed that analysis but the government did not ask her to do so.

The Government's pivotal point as to the due process interference with actual innocence of Segal/NNIB under Skilling harmless error analysis is the false evidence to support a risk of loss. The pecuniary criminal elements as to NNIB deferring elected premiums and putting back through loans over decades into the cumulative amount of \$35M is proven mathematically impossible. **Three government witnesses and forensic testimony clearly states in the record, undisputed, that insurance carriers will unilaterally cancel insurance if not paid within the 30-45 day billing cycle. The government presents not one transaction reflecting a delayed premium payment or a notice of cancellation of a paid premium.**

This proof is separate from the false government exhibits that the laws of nature, mathematics, invalidate any risk of loss as to deferring or taking and putting back collected premiums.

DUE PROCESS INTERFERENCE AND FAILURE TO CORRECT THE KNOWN FALSE EVIDENCE IN THE SKILLING "HARMLESS ERROR" ANALYSIS FILING, FORFEITURE REMAND AND RESTITUTION FILINGS AND ARGUMENTS

The government's own record and exhibits proves their own knowledge of the impossible and false accounting evidence they presented and especially in the current forfeiture and restitution proceedings. Segals' forensic evidence is no different than medical DNA in exposing the false evidence and its ongoing use by prosecutors. The theory of the case and the

foundational "accounting" evidence was developed by a group of NNIB employees whose attempts to take control and substantial ownership of NNIB was rebuffed by Segal. The Takeover group drummed up the idea of a PFTA deficit, supported by specious off-balance-sheet reconciliation estimates, coupled with omission and commission of accounting data to force Segal into believing that the company had regulatory compliance problems. Government prosecutors knowingly adopted the false accounting and regulatory theory and interfered with exculpatory evidence to continue to punish Segal for pursuing the prosecutor misconduct, especially the attorney client privilege issues protecting their own exposures.

Rather than address the specific question asked by the appellate court in the forfeiture filings, the Government took the district court on a series of irrelevant side trips.

More importantly, the Government sought, through:

- 1) reliance on known false accounting evidence uncorrected;
- 2) creation of new false accounting evidence uncorrected;
- 3) new theories of ownership of assets, to paint a false picture of Segal and NNIB.

The overarching strategy used by the Government is to:

- 1) misrepresent assets personally owned by Segal as the property of NNIB, thereby forfeiting them as "RICO enterprise" property as opposed to personal forfeiture;
- 2) refuse to acknowledge Segal's personal infusions of cash into NNIB, which, depending upon the timeframe examined, comprise \$18-22M million in funds flowing from Segal to NNIB thereby reducing Segal's "net" proceeds "from" NNIB by that amount;
- 3) misrepresent the source of funds used to pay off NNIB debt as "Government" money, rather than "NNIB money." The sheer number of false facts and false theories is somewhat overwhelming.

Government presents false arguments and ignores money Segal put into NNIB

The 7th Circuit instructed a remand "for a determination of what portion of the \$30 million was not reinvested in the enterprise, but rather went to benefit Segal personally.

That answer can only come about after the finite accounting record determination of how much Segal personally received and did not reinvest into NNIB in proceeds.

The ruling and intent of the appellate remand was to avoid double counting, and since money is fungible, the personal benefits to Segal must be based on both a flow of proceeds into Segal and a flow of proceeds back out to NNIB.

During the forfeiture filings, the Government presents multiple false arguments and attempts not to recognize the money put into NNIB by Segal. Their facts and theories keep changing, making it hard to follow.

Despite the record, government repeatedly ignores Segal's loan and states NNIB took out the loan, which is known to be false. In government's recent filing and affidavits submitted by LaSalle Bank officer stating they looked to Near North to repay the loan, this is incomplete, inaccurate, and in opposition to the record. It was believed the affidavit was leveraged and drafted in ambiguous language prior to the trustee's payment of the loan.

For example, Government argues a \$2M loan is not supported in the record.

The Government argues the records are messed up, which is contrary to the true, record finite accounting.

The evidence is developed in two forms of "reinvestment in the enterprise." The first is money which never left the enterprise, which Judge Castillo determined was \$15M. However, no court has addressed the issue of money Segal received and at the same time, turned around and loaned to the enterprise.

The Seventh Circuit panel noted that "Segal did not leave detailed records of his crimes" and that his accounting system was "lackluster." Near North's accounting difficulties had nothing to do with the district court's determination as precisely made clear in the record.

The record is clear that Lott forensically re-computes all the books and records, and is also clear that there never was any issue but the general ledger insurance receivables/payables and cash reconciliations which was reconstructed and reconciled. **Lott's affidavits make it clear about the loans, through a reconstruction of Near North's records furnished in an affidavit recognizing loans from Segal in the amount of \$10, \$2 and \$1 million.**

Forfeiture remand record accounting supporting government's interference proceeds reinvested in the enterprise. The District Court, on remand, focused its attention exclusively on the outflow of funds from NNIB to Segal. The Government argued that various funds received by Segal, totaling \$18M represented the funds received by Segal from NNIB.

Segal disputed many of those amounts. Without determining which amounts were correct and which were not correct, the district court simply excluded \$3M from the government's total, finding that the benefit to Segal was \$15M.

Segal, made multiple filings asking the court to strike arguments in the Government's Evidentiary Submission in Support of Forfeiture Judgment ("Evidentiary Submission") because those arguments (1) fail to reference any part of the record, (2) inaccurately reference or summarize the record, (3) rely on evidence outside of the record, or (4) disregard or ignore the Seventh Circuit's remand order directing this Court to determine what portion of the \$30 million was not reinvested in the enterprise, but rather went to benefit Segal personally.

In 2004, the District Court found that \$30 million was improperly withdrawn from the "PFTA" of Near North Insurance Brokerage, Inc. ("NNIB") based upon the government's impossible and known false accounting exhibit calculations and that the funds must be treated as proceeds of racketeering activity. On August 2, 2007, the Seventh Circuit agreed, but held that since Segal forfeited NNIB as part of his sentence, the Government recovered the racketeering proceeds that had been retained by the company, and that recovering these proceeds from Segal a second time would be double counting. *U.S. v. Segal*, 495 F.3d at 839. The Seventh Circuit thus remanded this case for a determination of "what portion [if any] of the \$30 million was not reinvested in the enterprise, but rather went to benefit Segal personally."

The Government asked the Seventh Circuit to reconsider its ruling, maintaining that double counting was appropriate. The Seventh Circuit denied the Government's petition for rehearing on December 17, 2007. Thereafter, the parties appeared before this Court to determine how the case should proceed.

On February 20, 2008, Segal's Position Paper asked the District Court, consistent with the Seventh Circuit's ruling, to determine on the basis of the existing record what racketeering proceeds were "not reinvested in the enterprise but rather went to benefit Segal personally." Segal reviewed the record, crediting every item of Government evidence that tended to show the use of funds for his personal financial benefit. Although the overwhelming majority of his income was legitimate income, Segal treated every dollar that he or members of his family received from NNIB as forfeitable proceeds. The record revealed that, at most, Segal could have personally benefitted from the PFTA in the amount of \$1,598,626. As explained in numerous briefs since, including those regarding the remanded forfeiture issue, that figure should be reduced to zero because of the credits to which Segal is entitled because of the millions of dollars he invested in NNIB. Segal demonstrated in his briefs through references to the record that he personally invested at least \$17 million into NNIB during the relevant time period, and thus, Segal never could have received any personal benefit.

The Government has never filed a response brief which addressed the issue posed by the Seventh Circuit – *i.e.* what amount of the racketeering proceeds were "not reinvested in the enterprise but rather went to benefit Segal personally." Instead, the Government reasserts that "ample evidence" exists to show that Segal personally benefitted from the \$30 million – in spite of the Appellate Court and district Court's ruling of \$15 million -- that was ordered forfeitable **without ever citing to anything in the record**. Government prosecutors continued to ignore the appellate court's ruling as to net proceeds and the government's accounting record evidence.