

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

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U.S. DISTRICT COURT

JAMES W. SCHACHT, Acting Director )  
of Insurance of the State of )  
Illinois, in his capacity )  
as Conservator of UNITED )  
DIVERSIFIED CORPORATION, )  
as Liquidator of ASSOCIATED )  
LIFE INSURANCE COMPANY, )  
and as Liquidator of UNITED )  
FIRE INSURANCE COMPANY, )

Plaintiff,

vs.

STEPHEN HOFFENBERG,  
MITCHELL BRATER, CHARLES H.  
CHUGERMAN, MICHAEL ROSOFF,  
TOWERS FINANCIAL CORPORATION,  
and TOWERS DIVERSIFIED  
COMPANY,

Defendants.

BOOKETED

JUN 28 1991

No. - - -  
9 IC 4024

JUDGE WINKLE

MAGISTRATE JUDGE LEFKOWICZ DEMANDED

COMPLAINT

Plaintiff, JAMES W. SCHACHT, Acting Director of Insurance of the State of Illinois, in his capacity as Conservator of United Diversified Corporation, and as Liquidator of Associated Life Insurance Company and United Fire Insurance Company, by his attorneys, complains of Defendants, Stephen Hoffenberg ("Hoffenberg"), Mitchell Brater ("Brater"), Charles Chugerman ("Chugerman"), Michael Rosoff ("Rosoff"), Towers Financial Corporation ("Towers Financial") and Towers Diversified Company ("Towers Diversified"), as follows:

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Parties, Jurisdiction and Venue

1. James W. Schacht, Acting Director of Insurance of the State of Illinois ("Director"), is the successor of the duly appointed Conservator of United Diversified Corporation ("Diversified") and Liquidator of Associated Life Insurance Company ("Associated") and United Fire Insurance Company ("United Fire"), pursuant to the Orders of Conservation and Liquidation entered by the Circuit Court of Cook County, Illinois on July 29, 1988 ("Conservation Order"), and March 3, 1989 ("Liquidation Orders"), and by virtue of the laws of the State of Illinois.

2. At all relevant times Diversified was an Illinois corporation with its principal place of business in Des Plaines, Illinois. United Diversified acted as a holding company whose principal business activities were conducted through and for its insurance subsidiaries, namely: Associated and United Fire.

3. At all relevant times Associated was a domestic stock legal reserve insurance company organized under the laws of the State of Illinois with its principal place of business in Des Plaines, Illinois. Associated is a wholly-owned subsidiary of Diversified and was in the business of writing life, accident and health insurance for individuals and groups.

4. At all relevant times United Fire was a domestic stock property, casualty and fire insurance corporation organized under the laws of the State of Illinois with its principal place of business in Des Plaines Illinois. United Fire is a wholly-owned

subsidiary of Associated and was in the business of writing health insurance for individuals and groups as well as various lines of property and casualty coverages.

5. Hoffenberg is a resident of the State of New York, and at all relevant times, was Chairman of the Board of Directors of United Fire, Associated, Diversified, Towers Diversified and Towers Financial. On information and belief, Hoffenberg, through an entity known as the "Hoffenberg Family Trust", at all relevant times owned 100% of Professional Business Broker's Inc., a New York corporation which owned 82.5% of Towers Financial.

6. Brater is a resident of the State of New York, and at all relevant times, was the Vice Chairman of the Board and Chief Operating Officer of Towers Financial and a member of the Board of Directors of United Fire, Associated, and Diversified.

7. Chugerman is a resident of the State of New York, and at all relevant times, was Vice President and Secretary of Towers Financial and a member of the Board of Directors of United Fire, Associated, and Diversified.

8. Rosoff is a resident of the State of New York, and at all relevant times, was Senior Vice President, Chief Legal Officer and Assistant Secretary of Towers Financial and acted as counsel for United Fire, Associated, and United Diversified.

9. Towers Financial is a publicly held Nevada corporation with its principal place of business in New York, New York. Towers Financial is in the business of providing financial services.

10. Towers Diversified is a Delaware corporation with its principal place of business in New York, New York, and a wholly-owned subsidiary of Towers Financial. Towers Diversified was established to acquire certain capital stock of Diversified, representing approximately 82% of its outstanding shares.

11. This Court has jurisdiction over Count IX pursuant to 18 U.S.C. §§ 1964(a) and 1964(c). Additionally, the sum or value of the claims in this case, exclusive of interest and costs, exceeds \$50,000.00, and there is diversity of citizenship between the parties. This Court, therefore, has jurisdiction over the remaining Counts pursuant to 28 U.S.C. § 1332(a).

12. Plaintiff resides in this District. In addition, the claims arose in this District. Venue in the Northern District of Illinois is, therefore, proper under 28 U.S.C. § 1391(a).

#### Factual Background

13. This is an action for money damages against several former members of the Boards of Directors of Diversified, Associated and United Fire (collectively "the Companies") and an attorney for the Companies and their parent companies, Towers Diversified and Towers Financial (collectively "the Controlling Companies"). The defendants initiated, caused and/or permitted on a continuing basis certain transactions, some of which are more fully described below, which caused the Companies to suffer damages in excess of \$4 million, become insolvent and be placed in conservation and/or liquidation.

14. In 1987, Diversified and its insurance company subsidiaries, Associated and United Fire, experienced significant financial difficulties in maintaining the minimum capital and surplus requirements of the Illinois Insurance Code in accordance with statutory accounting practices. On May 21, 1987, the Companies were placed in conservation by an order of the Circuit Court of Cook County, Illinois at the request of the Director and the Attorney General of the State of Illinois.

15. In July, 1987 Diversified retained Towers Financial to assist it in obtaining additional capital financing to infuse into the Companies as part of a rehabilitation plan in lieu of liquidation.

16. Thereafter Hoffenberg and Rosoff, on behalf of Towers Financial, began negotiations to acquire approximately 82% of the outstanding capital stock of Diversified.

17. On October 6, 1987, Towers Financial, through Towers Diversified, purchased approximately 82% of the outstanding capital stock of Diversified.

18. Immediately following the closing of the purchase, Hoffenberg and the Controlling Companies assumed full and complete control and operation of Diversified and its insurance company subsidiaries.

19. On October 21, 1987, the Illinois Department of Insurance approved Tower Financial's acquisition of control of Diversified and its insurance company subsidiaries. In granting the approval, the Director relied upon Towers Financial's

representation to the Director that it would contribute \$3 million to the surplus of United Fire. On information and belief, Towers Financial never intended to contribute the \$3 million.

20. Following the closing of the acquisition, Hoffenberg, on behalf of Towers Financial, controlled and dominated the Companies as a mere instrumentality of Towers Financial, as further described herein. Hoffenberg, without corporate formalities, appointed Brater and Chugerman to the Boards of Directors of each of the Companies. Similarly, absent corporate formalities, the Boards of Directors of the Companies named Hoffenberg, Brater and Chugerman to Executive Committees and, upon information and belief, Hoffenberg, Brater, Rosoff and Chugerman to Investment Committees which controlled all of the investments for the Companies.

21. Pursuant to Ill. Rev. Stat. Ch. 73, § 622(2) (1987), the corporate powers of Associated and United Fire were to be exercised by, and their business affairs were under the control of, their Boards of Directors.

22. The individual defendants owed the Companies fiduciary duties of loyalty and care of the highest order consistent with the Illinois Insurance Code, the regulations issued thereunder, common law, their oral employment contracts and sound insurance practices. The individual defendants acting on behalf of the Controlling Companies, breached their duties of loyalty and care causing the Companies to lose in excess of \$4 million by engaging in the wrongful conduct described herein.

23. The individual defendants breached the terms of their oral employment agreements with the Companies by engaging in the wrongful conduct described herein.

24. The individual defendants negligently managed the affairs of the Companies as hereinafter alleged.

25. The individual defendants also engaged in secret and fraudulent business transactions which were hidden from the Companies, their officers, policyholders, shareholders and the Director as hereafter alleged.

26. Upon assuming control of the Companies, Hoffenberg took certain of their checks with him to New York, then signed and issued a series of checks drawn on a United Fire account, as the sole signator, contrary to Illinois law. Upon being advised that Illinois law required at least two signatures on checks over \$5,000 disbursing insurance company funds, Hoffenberg attempted to circumvent the law by writing checks drawn on Diversified bank accounts holding Associated and United Fire funds. Many of the checks were issued for the benefit of Hoffenberg and the Controlling Companies.

27. In violation of Illinois law, Hoffenberg failed to provide vouchers supporting the disbursements by check. When repeatedly asked by the officers of the Companies and representatives of the Director to provide vouchers and/or supporting documentation for the checks, Hoffenberg refused and still refuses to provide this information.

28. In violation of Illinois law, Hoffenberg, on behalf of the Controlling Companies, began a transfer of the investments and cash of the Companies, including all of their bonds, into various brokerage accounts in the State of New York. The funds were used to purchase additional securities which were held in various names, concealed and moved from one brokerage firm to another within the State of New York.

29. Even though representatives of the Director and Daniel Peyton, the Chief Financial Officer of the Companies, asked Hoffenberg to return the securities to Illinois, Hoffenberg refused to do so until ordered to return the securities by the Circuit Court of Cook County, Illinois.

30. The investments in the securities were imprudent and contrary to sound insurance business practices. The Companies lost approximately \$2 million as a result of these investments.

31. In violation of Illinois law, Hoffenberg signed and issued at least two checks totalling \$1,100,000 to the Controlling Companies or their affiliates. These checks were either illegal dividends or constituted waste of the Companies funds.

32. Hoffenberg caused Associated and United Fire to issue or deliver insurance policies at a time when he knew that Associated and United Fire were insolvent or impaired in violation of Section 144.1 of the Illinois Insurance Code. (Ill. Rev. Stat. Ch. 73 § 756.1 (1987)).

33. Hoffenberg knowingly caused Associated and United Fire to file false and misleading annual statements for 1987 and quarterly statements for the first quarter of 1988 with the Illinois Department of Insurance in violation of Section 139(2) of the Illinois Insurance Code. (Ill. Rev. Stat. Ch. 73, ¶ 751(2) (1987)).

34. Through the defendants' failure to provide the Illinois Department of Insurance with complete and accurate information, defendants artificially prolonged the operation of the Companies by the Controlling Companies beyond the point of insolvency.

35. Each of the above described transactions constituted waste of the Companies' assets and lacked any legitimate business purpose. Brater, Chugerman and Rosoff, acting on behalf of the Controlling Companies, failed to properly supervise the activities of Hoffenberg. Moreover, they negligently, and in breach of their fiduciary duties, approved (or failed to review) the above described transactions which were contrary to law, fraudulent, blatantly unsafe, unsound and dangerous to the economic well-being of the Companies. Brater, Chugerman and Rosoff failed to take corrective action to cure the violations of law and overall mismanagement.

36. As a consequence of the above described conduct, the Director filed a petition for the conservation of the assets of the Companies on July 29, 1988. The petition alleged, inter alia, that Associated and United Fire were insolvent; they failed to establish and maintain books and records which were sufficient

for the determination of their financial condition; and that they violated the laws of the State of Illinois by: failure to meet the minimum capital and surplus requirements; failure to maintain adequate policyholder Security Deposit Accounts; failure to comply with the laws relating to the proper registration and location of securities, failure to obtain the requisite approval for transfer or sale of securities and failure to obtain the appropriate signatures, authorizing the transfer or sale of securities. The Director also alleged that Diversified was insolvent and that its books and records were in such a condition that its financial condition could not be ascertained with a reasonable degree of certainty. On September 1, 1988, the Director filed a verified complaint for liquidation against Associated and United Fire, alleging, inter alia, similar misconduct.

#### Improper Disbursements

37. To protect policyholders and shareholders, the Illinois Insurance Code requires that certain procedures be followed in dealing with the funds of insurance companies. Specifically:

- (a) Ill. Rev. Stat. Ch. 73, ¶ 745 (1987) requires that books, records, accounts and vouchers must be prepared so that the company's financial condition and financial statements may be readily verified;
- (b) Ill. Rev. Stat. Ch. 73 ¶ 752 (1987) requires that vouchers must be maintained for disbursements in excess of \$100;

(c) Ill. Admin. Code tit. 50, § 904.30 (1987) requires at least two authorized signatures on checks in excess of \$5,000.

38. In violation of these laws and regulations issued thereunder, Hoffenberg issued a series of checks, for which he was the only signator and provided no supporting documentation. These checks were drawn from United Fire and Diversified accounts as follows:

COMPANY: United Fire Insurance Company

<u>Check #</u>	<u>Date</u>	<u>Amount</u>	<u>Payee</u>
100111	11/06/87	\$50,000.00	United Air Fleet
100110	11/13/87	25,000.00	Jeff Epstein
100108	11/20/87	25,000.00	Corporate Risk
100107	11/30/87	8,000.00	Mintz, Fraade & Zieger PC
100064	12/01/87	50,000.00	United Air Fleet
100066	12/01/87	25,000.00	Jeff Epstein
100527	12/03/87	17,000.00	GAB Services, Inc.
100106	12/11/87	75,000.00	United Air Fleet
100105	12/24/87	6,266.75	Sonnenschein Carlin Nath & Rosenthal
100068	01/05/88	25,000.00	Jeff Epstein
100104	01/06/88	50,000.00	United Air Fleet
100070	01/06/88	1,196.21	American Express
100071	01/06/88	3,479.80	American Express
100069	01/08/88	4,019.78	American Express
100072	01/14/88	1,625.22	Ford Motor Credit Company
100102	01/21/88	1,800,000.00	Merrill Lynch, Pierce, Fenner & Smith, Inc.
101378	01/29/88	24,595.01	MTH Consulting
100103	02/01/88	25,000.00	Jeff Epstein
100073	02/04/88	25,000.00	United Air Fleet
100074	02/08/88	87,570.00	EAF
100075	02/10/88	32,058.12	United Air Fleet
100077	02/17/88	36,000.00	Bear Stearns
100076	02/18/88	20,837.84	American Express

COMPANY: United Diversified Corporation

<u>Check #</u>	<u>Date</u>	<u>Amount</u>	<u>Payee</u>
7266	01/04/88	6,009.00	Wellesley
7062	02/23/88	29,695.54	United Air Fleet
7063	03/01/88	25,000.00	Jeff Epstein
7064	03/01/88	10,880.00	United Air Fleet
7065	03/02/88	20,000.00	Jeff Epstein
7452	03/04/88	25,000.00	Jeffrey Epstein
7453	03/04/88	5,000.00	Robert Biegen
7066	03/07/88	31,210.00	Sonnenschein Carlin Nath & Rosenthal
7072	03/07/88	11,380.13	American Express
7470	03/10/88	20,000.00	United Air Fleet
7450	03/10/88	629.50	Stephen Juncker
7071	03/15/88	90,819.00	EAF
7067	03/15/88	11,690.97	American Express
7070	03/15/88	100,000.00	TFC Management Inc.
7068	03/16/88	3,401.98	American Express
7069	03/16/88	1,854.27	United Air Fleet
7451	04/01/88	5,000.00	Mintz, Fraade & Zeiger
7454	04/06/88	15,000.00	Parker, Chapin, Flattau & Klipl
7455	04/06/88	20,000.00	Jeff Epstein
7457	04/13/88	19,060.00	GAB Business Services, Inc.
7458	04/21/88	10,000.00	Certilman, Haft, Balin, etc.
7459	04/21/88	1,000.00	Certilman, Haft, Balin, etc.
7468	05/03/88	25,000.00	Jeff Epstein
7469	05/02/88	5,590.00	Robert Biegen
7460	05/05/88	15,000.00	Gerry Gilbert Company Advertising
7467	05/11/88	10,000.00	Shea & Gould
7707	05/31/88	10,000.00	Gerry Gilbert Company
7466	06/01/88	50,000.00	Ben Barnes, Esq.
7465	06/10/88	1,000,000.00	Towers
7726	06/24/88	10,000.00	Parker, Chapin, Flattau & Klipi
7719	04/13/88	932.00	Mid-State Financial Corp.
7720	07/01/88	58,732.60	Rodman & Renshaw
7708	07/20/88	26,296.65	Manett Phelps Rothenberg & Evans

39. As a result of the lack of documentation the financial statements of the Companies could not be verified.

40. The checks were issued primarily for the benefit of Hoffenberg or the Controlling Companies and not for the benefit of the Companies.

41. Among the checks benefiting Hoffenberg individually are checks payable to American Express for personal expenses and to Wellesley College for, upon information and belief, tuition for a Hoffenberg relative.

42. Among the checks that benefited the Controlling Companies were checks payable to United Air Fleet and EAF for an amount in excess of \$522,000. To conceal the nature of these transactions, Hoffenberg directed that these checks be recorded on the books of the Companies as "travel expenses, airline miscellaneous or broker deposits." Subsequently Hoffenberg directed that these checks be recorded as management fees. In fact, the checks were issued to pay for the rental of a private airplane and its maintenance costs which were the obligations of the Towers Organization and Towers World Airways Inc., affiliates of the Controlling Companies. On information and belief, Towers Financial guaranteed the rental obligations on a lease between Towers World Airways Inc. and EAF Aircraft Sales, Inc.

43. Other disbursements included a series of checks payable to Jeff Epstein or Jeff Epstein & Co. totaling \$215,000. At different times Hoffenberg claimed that the expenditures were for broker's fees on investment advice associated with an investment in the capital stock of Emery Air Freight ("Emery"). Within a period of shortly over six months the Companies lost

approximately \$2 million on the Emery investment.

44. Although often requested to provide the vouchers supporting the issuance of the above described checks, Hoffenberg refused and continues to refuse to provide same.

#### Improper Investments

45. The Illinois Insurance Code and regulations issued thereunder set forth the requirements for purchasing and selling securities and the manner of and location for holding same. The procedure for the making of loans is also set forth therein. Specifically:

- (a) Ill. Rev. Stat. Ch. 73, ¶ 137.12a(c), precludes an insurance company from investing an amount in excess of 10% of its capital and surplus in the common stock of any one corporation.
- (b) Ill. Rev. Stat. Ch. 73, ¶ 736.1 (1987), requires that directors must authorize or ratify investments or loans;
- (c) Ill. Rev. Stat. Ch. 73, ¶ 745 (1987), requires that books, records, accounts and vouchers must be prepared so that the company's financial condition and financial statements may be readily verified. Further, securities must be kept within the state;
- (d) Ill. Rev. Stat. Ch. 73, ¶ 752 (1987), requires that vouchers be maintained for disbursements in excess of \$100;
- (e) Ill. Admin. Code tit. 50, § 904.10 (1987), requires that securities be registered, issued to, and carried in the name of the insurance company;
- (f) Ill. Admin. Code tit. 50, § 904.20 (1987), requires that the transfer or sale of securities be approved by the Board of Directors and have at least two authorized signatures;

- (g) Ill. Admin. Code tit. 50, § 904.30 (1987), requires at least two authorized signatures on checks in excess of \$5,000.

46. In violation of these laws, Hoffenberg, for the benefit of the Controlling Companies, transferred all of the bonds of Associated and United Fire, valued in excess of \$2.5 million, to brokerage accounts in the State of New York. These transfers were completed by Hoffenberg alone, without the requisite documentation and approvals. While the bonds remained under Hoffenberg's control in the brokerage accounts, the interest earned on the bonds was used for the benefit of Hoffenberg and the Controlling Companies and the Companies were deprived of the interest.

47. The individual defendants permitted the above described bonds to be placed in margin accounts, permitting those acting on behalf of Associated and United Fire to borrow from the brokerage firms in violation of Illinois law.

48. On January 21, 1988, Towers Financial contributed \$1.8 million to the capital of United Fire in satisfaction of the requirement imposed by the Director when he approved the acquisition of the Diversified capital stock by Towers Financial. On the same date, Hoffenberg, as the sole signator, wrote a check from a United Fire account in the identical amount to Merrill, Lynch, Pierce, Fenner and Smith, Inc. The funds were then transferred to an account in the name of United Fire Insurance Company with the brokerage firm of Guinan and Company, Inc. in the State of New York, contrary to law. Within the

following five days, 531,300 shares of Emery were acquired in the account at a cost in excess of \$4,000,000. Contrary to law, the individual defendants failed to prepare any documentation authorizing the purchase. To acquire the shares of Emery Air Freight, an amount in excess of \$2,000,000 was borrowed from Guinan and Company, Inc.

49. The \$4 million investment in Emery stock, contrary to law, exceeded 10% of the capital and surplus of United Fire which at the time of the purchase was negative according to regulatory accounting practices.

50. The individual defendants used the bonds owned by Associated and United Fire as collateral for additional purchases of Emery stock on margin. The individual defendants failed to prepare the requisite documentation authorizing the transactions.

51. To conceal the wrongful acquisitions of Emery stock and the resulting loans, the individual defendants, without approval of the Companies' Boards of Directors and contrary to law, caused the stock to be transferred between accounts in the following brokerage houses in the State of New York: Rodman and Renshaw, Inc.; Kuhns Brothers and Laidlaw, Inc.; McKinley Allsopp Inc.; Guinan and Company, Inc.; Ernst & Company; Bear Sterns and Company, Inc.; Edward A. Viner and Company, Inc. and Fahnestock and Company, Inc. The securities were held in the name of United Fire, Associated, Tower Financial-Associated Life Insurance Company and/or Tower Financial-United Fire Insurance Company.

52. Only \$1.8 million of the investment was recorded on the books of United Fire. The margin loan was never recorded. In a further effort to conceal the improper use of the \$1.8 million invested in Emery Stock, Hoffenberg advised the Chief Financial Officer of United Fire that the \$1.8 million was invested in a money market account.

53. On information and belief, the purchase of the Emery stock was part of a plan by Hoffenberg and the Controlling Companies to acquire control of Emery.

54. Within approximately six months of the initial purchase, the individual defendants authorized the sale of all of the Emery stock at a loss. Hoffenberg and Brater have advised the Companies that substantially all of the \$1.8 million used for the Emery investment was lost together with the interest earned on the Associated and United Fire bonds.

55. Contrary to law, the purchase and sales of Emery stock were not authorized by the Boards of Directors of the Companies or any duly authorized committee of the Boards of Directors.

56. Contrary to law, the loans utilized to acquire Emery stock were not authorized by the Boards of Directors of the Companies. Similarly, the Emery stock was neither registered in the name of the Companies nor located within the state.

57. The investment in Emery stock is departure from traditional insurance company investment practices. The investment was made by the individual defendants with reckless disregard for the risk factors associated with the investment and

without regard to the need for investment earnings required by an insurance company to pay underwriting losses.

58. After the Conservation Order was entered, approximately \$95,000 remained in a brokerage account with Ernst & Company ("Ernst") in the name of Associated. Rosoff fraudulently notified Ernst that the funds in the account were the property of Towers Diversified and directed Ernst not to deliver the funds to the Director, the duly appointed Conservator of Associated. Ernst, following Rosoff's direction, has refused to turnover to the Director the balance of the account.

59. In October 1988, \$56,830.53 was in an account maintained in the name of Associated with McKinley Allsopp, Inc. A check in the aforesaid amount was made payable to Associated by Broadcourt Capital Corp., the firm through which McKinley Allsopp, Inc. cleared its transactions. The check was mailed to Associated to the attention of Hoffenberg at the offices of the Controlling Companies. The funds were never delivered to the Conservator for Associated and, on information and belief, the check was fraudulently converted to the use of one of the Controlling Companies.

#### Funds Transferred to Affiliates

60. The Illinois Insurance Code provides standards for transactions between insurance companies, their affiliates and entities employed to provide management services. Specifically:

- (a) Ill. Rev. Stat. Ch. 73, ¶ 639 (1987), prohibits payment of dividends and other

distributions without sufficient surplus;

- (b) Ill. Rev. Stat. Ch. 73, ¶ 736.2 (1987), prohibits investments or loans to entities in which any officer or director has a financial interest;
- (c) Ill. Rev. Stat. Ch. 73, ¶ 743.20 (1987), provides that material transactions with affiliated companies be fair and reasonable, the books and accounts of the affiliate be maintained to clearly and accurately disclose the nature of the transactions, and transactions with affiliates must be reasonable in relation to surplus;
- (d) Ill. Rev. Stat. Ch. 73, ¶ 743.20(a) (1987), requires that the Director be notified prior to distribution of dividends or any other transaction which might render the company's surplus unreasonable;
- (e) Ill. Rev. Stat. Ch. 73, ¶ 753.1 (1987) requires all management contracts and service agreements be filed with the Department of Insurance;
- (f) Ill. Admin. Code tit. 50, § 904.30 (1987) requires at least two authorized signatures on checks in excess of \$5,000.

61. On June 1, 1988, Hoffenberg, as the sole signator, fraudulently issued a Diversified check in the amount of \$1,000,000 to "Towers." Said check cleared through the bank account of Diversified. None of the officers of the Companies are aware of the purpose for the check. Hoffenberg failed to provide a voucher or other documentation for the check. Hoffenberg has refused and continues to refuse to provide information regarding the purpose of the check and refused and

continues to refuse to identify the entity that cashed the check. There is no legitimate business purpose for said check.

62. On March 15, 1988, Hoffenberg, as the sole signator, fraudulently issued a Diversified check in the amount of \$100,000 on an account in the name of Diversified to TFC Management, an affiliate of Towers Financial. The check cleared Diversified's bank. Hoffenberg refused and continues to refuse to provide a voucher or other documentation for the check. Hoffenberg refused and continues to refuse to provide an explanation for the transfer of \$100,000.

63. Payments to "Towers" and TFC Management are not proper dividends because (a) they were not approved by the Directors of the Companies; (b) they were not approved by the Director; and (c) the Companies lacked sufficient surplus to pay dividends.

64. The payments to "Towers" and TFC Management were not proper payments of management fees since contracts for management services between the Companies and "Towers" and TFC Management were not approved by the Director.

65. The nature of the transactions involving the payments to "Towers" and TFC Management cannot be determined. The payments were neither fair and reasonable nor reasonable in relationship to surplus.

COUNT I  
Claim For Fraud Against Hoffenberg  
And The Controlling Companies

66. The Director realleges and incorporates by reference Paragraphs 1 through 65 inclusive as though fully set forth herein.

67. With the intent to derive the use, enjoyment and profits from the Companies and with the intent to injure the Companies, Hoffenberg devised a fraudulent scheme wherein he could, under the guise of acting for the Companies, acquire the assets of the Companies for his own personal gain or use, or the gain or use of Towers Financial or Towers Diversified.

68. In order to accomplish this fraudulent scheme, while acting in his capacity as Chairman of Towers Financial, Towers Diversified, Diversified, Associated and United Fire, Hoffenberg caused Towers Financial and Towers Diversified to gain control of the Companies. At the time of gaining control over the Companies, Hoffenberg represented to the Department of Insurance and the Companies that the Controlling Companies would infuse surplus into United Fire, thereby rehabilitating the ailing Companies.

69. Hoffenberg concealed his actual intentions of not infusing surplus into United Fire but converting the assets of the Companies to himself for his own personal gain or use or to Towers Financial or Towers Diversified for their gain or use.

70. The Department of Insurance reasonably relied on Hoffenberg's representation that he would infuse capital into

United Fire.

71. In order to accomplish this scheme, Hoffenberg transferred securities and cash valued in excess of \$6 million from the Companies, resulting in their insolvency and causing them to be placed in conservation and/or liquidation. These transfers were accomplished by improperly removing the Companies' bonds from the State of Illinois and either transferring funds to the Controlling Companies or their affiliates or using the funds for the benefit of Hoffenberg or the Controlling Companies.

72. Hoffenberg made these transfers and issued checks knowing that the funds were not being used on behalf of the Companies, intending to transfer the funds to himself for his own personal gain or use, or to Towers Financial or Towers Diversified for their gain or use.

73. The Companies reasonably relied on the assurance of Hoffenberg that he was acting in the best interests of the Companies.

74. In an effort to conceal the fraud, Hoffenberg hid and refused to identify where securities and funds were transferred and concealed the purposes of the transfers of funds and securities.

75. By concealing their intent not to infuse the necessary surplus into United Fire, Hoffenberg and the Controlling Companies fraudulently obtained the approval of the Director for the acquisition of the Diversified stock and the continued operation of the Companies and the depletion of their assets.

76. By mailing fraudulent financial statements which Hoffenberg and the Controlling Companies knew did not disclose the Companies insolvency or the effect of the illegal transfers of funds, investments and loans, the Companies suffered from the defrauding of the Illinois Department of Insurance which permitted the Controlling Companies to operate the Companies beyond their insolvency and to be further drained of their assets.

77. As a direct and proximate result of each of these fraudulent acts, the Companies have been damaged.

78. Malice is the gist of this action.

79. The fraudulent actions of Hoffenberg and the Controlling Companies merit the imposition of punitive damages.

WHEREFORE, the Director prays that this Court enter judgment against Hoffenberg, Towers Financial, and Towers Diversified and award Diversified, Associated and United Fire compensatory and punitive damages in an amount to be determined at trial, plus interest, costs and such other and further relief as this Court deems appropriate.

COUNT II  
Claim For Conversion Against Hoffenberg  
And The Controlling Companies

80. The Director realleges and incorporates by reference Paragraphs 1 through 79 inclusive as though fully set forth herein.

81. During the period of October, 1987 through July, 1988

Hoffenberg, while acting in his capacity as Chairman of Towers Financial, Towers Diversified, Diversified, Associated and United Fire, caused the transfer of securities and cash in excess of \$6 million from assets or accounts properly belonging to the Companies.

82. Through these transfers, Hoffenberg and the Controlling Companies intentionally converted and disposed of the cash and interest earned on the securities for the benefit or use of Hoffenberg and/or the Controlling Companies.

83. As a direct and proximate result of these improper acts by Hoffenberg and the Controlling Companies, the Companies have been damaged in excess of \$4 million.

WHEREFORE, the Director prays that this Court enter judgment against Hoffenberg, Towers Financial, and Towers Diversified and award Diversified, Associated and United Fire compensatory and punitive damages in an amount to be determined at trial, plus interest, costs and such other and further relief as this Court deems appropriate.

#### COUNT III

##### Claim For Breach Of Fiduciary Duty Against Hoffenberg

84. The Director realleges and incorporates by reference Paragraphs 1 through 83 inclusive as though fully set forth herein.

85. As a Director of the Companies, Hoffenberg was a fiduciary and owed certain statutory duties to the Companies as well as a duty to the Companies to exercise the highest degree of

honesty, care, good faith and loyalty in handling the business and affairs of the Companies.

86. Beginning in October, 1987 through the present, Hoffenberg, in breach of his fiduciary duties and in violation of Illinois law:

- (a) Issued a series of checks drawn on accounts of Diversified and United Fire for his personal use or the use of Towers Financial or Towers Diversified;
- (b) Caused the Companies to transfer bonds out of Illinois, make a series of imprudent investments and loans resulting in a loss of considerable sums of money;
- (c) Transferred \$1.1 million from United Fire and Diversified to affiliates of the Controlling Companies;
- (d) Caused the Companies to violate the Illinois Insurance Code and Regulations issued thereunder as hereinabove alleged.
- (e) Concealed the true financial condition of the Companies from the Companies and from the Director and allowed the Companies to operate while they were insolvent.

87. These breaches of fiduciary duty were fraudulent, in conflict with the interest of the Companies and constituted waste and mismanagement of the Companies' assets.

88. As a direct and proximate result of Hoffenberg's breaches of fiduciary duties, the Companies were damaged.

89. The actions of Hoffenberg in breaching his fiduciary duties were done willfully, wantonly and with malice, entitling the Companies to punitive damages.

WHEREFORE, the Director prays that this Court enter judgment against Hoffenberg and award Diversified, Associated and United Fire compensatory and punitive damages in an amount to be determined at trial, plus interest, costs and such other and further relief as this Court deems appropriate.

COUNT IV  
Claim For Breach Of Fiduciary Duty Against Brater,  
Chugerman and Rosoff

90. The Director realleges and incorporates by reference Paragraphs 1 through 89 inclusive as though fully set forth herein.

91. As directors, counsel and members of the investment and executive committees of the Companies, Brater, Chugerman, and Rosoff, were fiduciaries and owed certain statutory duties to the Companies as well as a duty to the Companies to exercise the highest degree of honesty, care, good faith and loyalty in handling the business and affairs of the Companies.

92. Beginning in October 1987 through the present, Brater, Chugerman and Rosoff, breached the fiduciary duties each owed to the Companies in the conduct, direction, supervision and control of the business and affairs of the Companies in that each knew or should have known:

- (a) Hoffenberg issued a series of checks drawn on accounts of Diversified and United Fire for his personal use or the use of Towers Financial or Towers Diversified;
- (b) They allowed the transfer of bonds out of Illinois and a series of imprudent

investments and loans to be made with the Companies' funds, resulting in a loss of considerable sums of money;

- (c) Hoffenberg transferred \$1.1 million from United Fire and Diversified to affiliates of the Controlling Companies;
- (d) Hoffenberg caused the Companies to violate the Illinois Insurance Code and Regulations issued thereunder as hereinabove alleged;
- (e) The true financial condition of the Companies was being concealed from the Companies and the Director; and
- (f) The Companies continued to operate while they were insolvent.

93. In breach of their fiduciary duties, Brater, Chugerman and Rosoff failed to prevent the Companies from participating in the above described transactions, ratified the transactions and violated the Illinois Insurance Code and Regulations issued thereunder.

94. Brater, Chugerman and Rosoff breached their fiduciary duties by failure to disclose the acts leading to the Companies' financial impairment including the fraudulent and preferential transfers.

95. These breaches of fiduciary duties were fraudulent, in conflict with the interests of the Companies and constituted waste and mismanagement of the assets of the Companies.

96. As a direct and proximate result of the defendants' breach of fiduciary duties, the Companies were damaged.

97. The actions of the defendants in breaching their fiduciary duties were done willfully, wantonly and with malice,

entitling the Companies to punitive damages.

WHEREFORE, the Director prays that this Court enter judgment against Brater, Chugerman and Rosoff, and award Diversified, Associated and United Fire compensatory and punitive damages in an amount to be determined at trial, plus interest, costs and such other and further relief as this Court deems appropriate.

COUNT V  
Claim For Breach Of Fiduciary Duty Against  
Towers Financial And Towers Diversified

98. The Director realleges and incorporates by reference Paragraphs 1 through 97 inclusive as though fully set forth herein.

99. As the corporate parents of the Companies, exercising control and domination over the Companies such that they were mere instrumentalities, the Controlling Companies had a statutory duty to deal fairly and reasonably with their subsidiaries and as fiduciaries owed a duty to the Companies to exercise the highest degree of honesty, care, good faith and loyalty in handling the business affairs of the Companies.

100. Beginning in October, 1987 and through the present, the Controlling Companies breached the fiduciary duties each owed to the Companies in the conduct, direction, supervision and control of the business and affairs of the Companies in that each knew or should have known:

- (a) Hoffenberg issued a series of checks drawn on accounts of Diversified and United Fire for his personal use or the

use of Towers Financial or Towers Diversified;

- (b) They allowed the transfer of bonds out of Illinois and a series of imprudent investments and loans to be made with the Companies' funds, resulting in the loss of considerable sums of money;
- (c) Hoffenberg transferred \$1.1 million from United Fire and United Diversified to affiliates of the Controlling Companies;
- (d) Hoffenberg caused the Companies to violate the Illinois Insurance Code and Regulations issued thereunder as hereinabove alleged;
- (e) The true financial condition of the Companies was being concealed from the Companies and the Director; and
- (f) The Companies continued to operate while they were insolvent.

101. In breach of their fiduciary duties, the Controlling Companies failed to prevent the Companies from participating in the above described activities, violating the Illinois Insurance Code and Regulations issued thereunder.

102. These breaches of fiduciary duties were fraudulent, in conflict with the interests of the Companies and constituted waste and mismanagement of the assets of the Companies.

103. As a direct and proximate result of the Controlling Companies' breach of fiduciary duties, the Companies were damaged.

104. The actions of the Controlling Companies in breaching their fiduciary duties were done willfully, wantonly and with malice, entitling the Companies to punitive damages.

WHEREFORE, the Director prays that this Court enter judgment against Towers Financial and Towers Diversified and award Diversified, Associated and United Fire compensatory and punitive damages in an amount to be determined at trial, plus interest, costs and such other and further relief as this Court deems appropriate.

COUNT VI  
Claim For Negligence Against Brater And Chugerman

105. The Director realleges and incorporates by reference Paragraphs 1 through 104 inclusive as though fully set forth herein.

106. As directors of the Companies, Brater and Chugerman owed a duty to the Companies to exercise reasonable business judgment in the handling of the business and affairs of the Companies.

107. Beginning in November, 1987 through July, 1988, Brater and Chugerman, in breach of their duties, negligently allowed Hoffenberg to issue a series of checks drawn on accounts of Diversified and United Fire for his personal use or the use of Towers Financial and Towers Diversified.

108. These acts constitute negligent management of the Companies.

109. As a direct and proximate consequence of the Defendant's negligence, the Companies have been injured.

WHEREFORE, the Director prays for a judgment against Brater and Chugerman, awarding Diversified, Associated and United Fire

compensatory damages, interest, costs and such other and further relief as this Court deems appropriate.

COUNT VII  
Claim For Negligence Against Hoffenberg, Brater,  
Chugerman And Rosoff

110. The Director realleges and incorporates by reference Paragraphs 1 through 109 inclusive as though fully set forth herein.

111. As members of an executive or investment committees formed to make decisions regarding the investments of the Companies, the individual defendants owed a duty to the Companies to comply with the Illinois Insurance Code and to exercise reasonable business judgment in making investment decisions.

112. Beginning in October 1987 through July, 1988, the individual defendants, in breach of their duties, negligently invested the funds of the Companies in securities that were inappropriate investments for the Companies. The investment in these securities was imprudent and caused the Companies to lose approximately \$2,000,000.

113. As a direct and proximate result of these breaches, the Companies have been damaged.

WHEREFORE, the Director prays for a judgment against Hoffenberg, Brater, Chugerman and Rosoff awarding Diversified, Associated and United Fire compensatory damages, interests, costs and such other and further relief as this Court deems appropriate.

COUNT VIII  
Claim For Breach Of Contract Against Hoffenberg,  
Brater, Chugerman And Rosoff

114. The Director realleges and incorporates by reference Paragraphs 1 through 113 inclusive as though fully set forth herein.

115. As employees or agents of the Companies, the individual defendants formed oral contracts with the Companies whereby the individual defendants agreed not to convert the Companies' funds to their own use or the use of the Controlling Companies. Under such oral contracts, the individual defendants were to perform their duties for the benefit of the Companies and were required to exercise a high degree of care in the performance of their duties.

116. At all times when such oral contracts were in effect, the Companies performed all the conditions, covenants and promises required of them in accordance with the terms of the contracts.

117. In breach of these contracts the individual defendants either took, or allowed the taking, of funds from the Companies for the personal gain or use of Hoffenberg or the Controlling Companies.

118. As a result of these breaches of contract, the Companies have been damaged.

WHEREFORE, the Director prays for a judgment against the Hoffenberg, Brater, Chugerman and Rosoff awarding Diversified, Associated and United Fire compensatory damages, interest, costs

and such other and further relief as this Court deems appropriate.

COUNT IX  
Claim For Violation Of RICO Against Hoffenberg

119. The Director realleges and incorporates by reference Paragraphs 1 through 118 inclusive as though fully set forth herein.

120. This Count is brought against Hoffenberg pursuant to the provisions of 18 U.S.C. §§ 1962(a) and 1962(c).

121. Hoffenberg is a "person" within the meaning of 18 U.S.C § 1961(3).

122. Towers Financial and Towers Diversified are "enterprises" within the meaning of 18 U.S.C § 1961(4). In addition, the combination of Towers Financial and Towers Diversified constitute an enterprise within the meaning of 18 U.S.C § 1961(4). At all relevant times, these enterprises were engaged in, and the activities of such enterprises affected, interstate and foreign commerce.

123. At all times relevant hereto, Hoffenberg was associated with these enterprises within the meaning of 18 U.S.C § 1962(c).

124. Beginning in October of 1987, Hoffenberg conducted, and participated in the conduct of the above enterprises' affairs through a pattern of racketeering activity. Hoffenberg embarked on a series of schemes with the common purpose of acquiring the assets of the Companies for himself or for the Controlling

Companies in which he had an interest.

125. These schemes to defraud the Companies, their policyholders, creditors and the minority shareholders of Diversified through the operation, establishment and conduct of the business affairs of the Companies by the Controlling Companies was an ongoing course of regular business conduct beginning in or about October of 1987 and continuing until the Director took control of the Companies in July of 1988. The refusal to turnover assets and records of the Companies continues to this date. These schemes to defraud the Companies, their policyholders, creditors and Diversified's minority shareholders were accomplished through five types of schemes, each involving numerous acts of mail and wire fraud, in violation of 18 U.S.C. §§ 1341 and 1343 on at least the following occasions:

- (a) From November of 1987 through July of 1988, Hoffenberg wrote a series of checks transferring the funds of United Fire and Diversified through the U.S. mail to various entities for his own benefit as for the benefit of the Controlling Companies as herein alleged;
- (b) In a series of stock transactions, Hoffenberg transferred the bonds and/or cash from the Companies through the U.S. mail and telephone wires which he used to purchase Emery stock for his own benefit or for the benefit of the Controlling Companies as herein alleged;
- (c) In two separate transactions, Hoffenberg fraudulently transferred \$1,100,000 of the Companies' funds through the U.S. mail to affiliates of the Controlling Companies as herein alleged;
- (d) Hoffenberg caused Associated and United Fire to send through the U.S. Mail

fraudulent annual statements for 1987 and quarterly statements for the first quarter of 1988; and

- (e) Hoffenberg fraudulently represented to the Director through the U.S. mail that Towers Financial would infuse \$3 million of surplus into United Fire.

126. The conduct described above constitutes a "pattern of racketeering activity" within the meaning of 18 U.S.C. §§ 1961(1) and (5).

127. Hoffenberg committed at least two acts of wire and mail fraud in connection with the transactions described above.

128. Hoffenberg ceased making the above described improper disbursements and transfers of funds only when the Director took control of management for the Companies. Hoffenberg continues to retain certain funds properly belonging to the Companies and refuses to turn over those funds to the Director.

129. As a result of the foregoing, the Companies, their policyholders, creditors and the minority shareholders of Diversified were injured in their business and property in an amount to be determined.

WHEREFORE, the Director prays for a judgment against Hoffenberg and award Diversified, Associated and United Fire compensatory damages under 18 U.S.C. § 1964, in an amount to be determined at trial, trebled, plus interest, costs and attorneys fees and such other relief as this Court deems appropriate.

COUNT X  
Claim For Prohibited And Voidable Transfers Against  
Hoffenberg, Brater, Chugerman And The Controlling Companies

130. The Director realleges and incorporates by reference Paragraphs 1 through 129 inclusive as though fully set forth herein.

131. Section 204(1) of the Insurance Code provides that "no company shall make any transfer of or create a lien upon any of its property with the intent of giving to or enabling any creditor or policy holder to obtain a greater percentage of his debt than any other creditor of the same class". Ill. Rev. Stat. Ch. 73 ¶ 816(1) (1987)

132. Section 204(3) of the Insurance Code (Ill. Rev. Stat. Ch. 73, ¶ 816(3) (1987)) provides in relevant part, that "Every director, officer, employee, stockholder, member, or any other person, acting on behalf of such company who, within two years prior to the filing of a complaint against such company under this Article, shall knowingly participate in the making of any transfer or the creation of any lien prohibited by Subsection (1) and every person receiving any property of, or cash surrender from such company . . . shall be jointly and severally liable therefore and shall be bound to account to the director as rehabilitator, liquidator, or conservator as the case may be."

133. In violation of Section 204(3) of the Insurance Code, Hoffenberg, Brater and Chugerman, with knowledge that the assets of the Companies were insufficient to pay their creditors in full, knowingly participated in the making of such voidable

transfers when they allowed Hoffenberg to transfer the funds and securities of Diversified, Associated and United Fire enabling the Controlling Companies and other creditors to obtain a greater percentage of the debt of Diversified, Associated and United Fire.

134. In violation of Section 204(3) of the Illinois Insurance Code, the Controlling Companies received the property of Diversified, Associated and United Fire. The receipt of such property was the result of a transfer prohibited by Section 204(1) of the Illinois Insurance Code.

135. Pursuant to Section 204(3) of the Illinois Insurance Code the transfer of cash and securities as hereinabove alleged is prohibited and voidable and, Hoffenberg, Brater, Chugerman and the Controlling Companies having participated in the transfer are jointly and severally liable to the Companies for the value of the assets transferred.

WHEREFORE, the Director prays that this Court enter judgment against Hoffenberg, Brater, Chugerman, Towers Financial and Towers Diversified, jointly and severally, and award Diversified, Associated and United Fire compensatory damages in an amount to be determined at trial, plus interest, costs and such other and further relief as this Court deems appropriate.

COUNT XI

Claim For Breach Of Contract Against Towers Financial

136. In October 1987, the Companies entered into an oral contract with Towers Financial whereby the Towers Financial would

use space in the premises usually occupied by the Companies in Des Plaines, Illinois as Towers Financial's branch office.

137. Towers Financial agreed to pay the Companies its proportionate share of the expenses for use of the premises in addition to any expenses advanced by the Companies on behalf of Towers Financial.

138. Towers Financial occupied the premises through July, 1988.

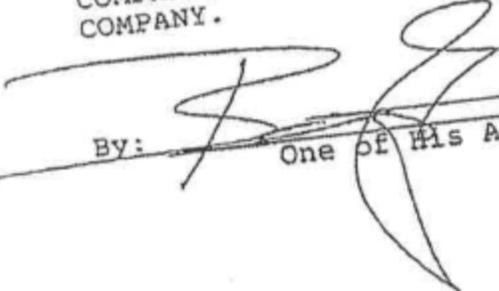
139. At all times when the oral contract was in effect, the Companies performed all the conditions, covenants and promises required of them in accordance with the terms of the oral contract.

140. Although a bill has been submitted to Towers Financial in the amount of \$190,729.96 for use and occupancy of the premises, Towers Financial refused and continues to refuse to pay the bill.

WHEREFORE, the Director prays for a judgment against Towers Financial and award Diversified, Associated and United Fire the sum of \$190,729.96, plus costs and interest.

DATED: June 27, 1991

JAMES W. SCHACHT, Acting Director of Insurance of the State of Illinois, In His Capacity as Conservator of UNITED DIVERSIFIED CORPORATION, and as Liquidator of UNITED FIRE INSURANCE COMPANY, and ASSOCIATED LIFE INSURANCE COMPANY.

By:  One of His Attorneys

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