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PE Firm Was Behind 'Blatant' $100M Fraud, Insurer Says

By **Ryan Boysen**

Law360, New York (October 17, 2017, 7:26 PM EDT) -- Insurer Confie Seguros Holding II Co. is urging an Illinois federal court to greenlight its securities fraud suit against the owners of an auto insurance network, brushing aside motions to dismiss and calling the $100 million scheme “so blatant” that Hollywood would reject it as "too outrageous" if it were a movie script.

Confie says Illinois-based Affirmative Insurance Holdings Inc. and J.C. Flowers & Co., a private equity firm that allegedly controlled AIH through its debt and equity investments in the company, conspired to trick Confie into buying the brokerage network in 2015 for $100 million.

The brokers in the network exclusively sold risky, nonstandard auto insurance policies backed by AIH subsidiary Affirmative Insurance Co., an entity that was not part of the deal. Just months after Confie purchased the brokerage network, AIH filed for bankruptcy and AIC was liquidated by the Illinois Department of Insurance. Confie says it was left with a worthless brokerage network and forced to spend tens of millions of dollars placing the broker’s policies with other insurers on unfavorable terms.

AIH and Flowers have moved to dismiss the suit, saying it doesn’t contain enough facts to sustain the fraud claims and calling it merely a case of buyer's remorse for an investment that Confie knew was risky. But on Monday, Confie fired back, saying in a response to Flowers’ motion to dismiss that “the audacity of this fraud is so blatant, that if the story were a movie script it would likely be rejected as too outrageous to be believable.”

“Based on a fair reading of the complaint, there is no question that [AIH] fraudulently induced Confie to purchase AIH’s network of managing general agencies,” Confie says in its response.

Confie is suing Flowers, AIH director Eric Rahe and several other individuals associated with both companies for alleged multiple violations of the Securities Exchange Act and common law fraud.

Confie is one of the nation’s largest personal and commercial insurance brokers, and admits in the response that it is “as defendants have pointed out several times … a sophisticated and experienced purchaser of insurance-related businesses.”

In the run-up to Confie’s purchase of the brokerage network, AIC had been struggling. In 2014, Flowers was forced to inject $30 million to keep AIC’s Risk Based Capital Ratio at 200 percent, the bare minimum mandated by the Illinois Department of Insurance for most insurers, and the IDOI continued to watch the company closely throughout 2015, according to Confie's complaint.

Confie purchased the brokerage in June 2015 through a Stock and Asset Purchase Agreement, agreeing to pay roughly $85 million for the brokerage itself and to inject $20 million into the ailing AIC to keep its Risk Based Capital Ratio above 200 percent. As part of the deal, Confie required a signed certification from AIC's CFO indicating that the $20 million would be enough to push the ratio above 200 percent and avoid liquidation by IDOI.

Confie says in the response that it "makes no effort to pretend as if it thought AIC were a healthy company," which is why "Confie would only consummate the sale if it received the sworn promise that AIC would have enough cash to survive for at least one or two years, which would have given Confie an adequate amount of time to plan around AIC's possible demise."

Confie alleges AIC's CFO lied on the certification at Flowers' behest, and says that shortly after the deal closed, Confie realized that AIC's RBC Ratio was still well short of 200 percent even with the $20 million infusion.

IDOI placed AIC into receivership in September 2015 and AIH filed for bankruptcy one month later, leaving Confie to "sift through the smoking ashes" of the company and "try to salvage some value from its purchase," the response says. Confie filed its suit in July.

"Confie knew which questions to ask to determine whether the risk of losing AIC was acceptable," the response continues. "Unfortunately, AIH flat-out lied. No amount of sophistication can unring the bell once a seller of securities decides to simply lie to trick a buyer into a purchase."

Flowers says Confie was well aware of the risk it was taking in purchasing the brokerage network, having bought a different brokerage network from AIH in 2013. That fact was "curiously omitted from Confie's complaint," Flowers says in its motion to dismiss.

Flowers says AIH's Form 10-K, an annual performance report filed with the U.S. Securities and Exchange Commission, noted there was "substantial doubt about the company's ability to continue as a going concern" in 2014.

Flowers says the "alleged misrepresentations" don't rise to the standards required by the Exchange Act to prove fraud, and also says Confie can't prove that Flowers "controlled" AIH, among other things, and that the suit should therefore be tossed.

Confie maintains that it's pled plenty of facts in its complaint to sustain the fraud and Exchange Act violations claims, calling its suit a "textbook case of securities fraud."

None of the parties involved responded to requests for comment on Tuesday.

Confie is represented by Michael C. Kasdin, Seth E. Darmsdadter and Matthew R. Lasky of Michelman & Robinson LLP.

Flowers is represented James B. Heaton of Bartlit Beck Herman Palenchar & Scott LLP.

Eric Rahe is represented by Jason M. Rosenthal of Honigman Miller Schwartz and Cohn LLP and Joseph S. Allerhand, Amanda K. Pooler, Paul Dutka and Andrew Blumberg of Weil Gotshal & Manges LLP.

The case is Confie Seguros Holding II Co. v. J.C. Flowers & Co. LLC et al., case number 17-cv-05166, in the U.S. District Court for the Northern District of Illinois.

--Editing by Jill Coffey.