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Defense lawyer: Suit is 'madness'

Savannah health system suit says investment firm's referral to SEC-sanctioned hedge fund manager cost it \$6 million

By Greg Land, Staff Reporter

A suit filed by Savannah's St. Joseph's/Candler Health Care System says the nonprofit's investment arm lost at least \$6 million to a North Carolina hedge fund manager, some of whose assets were placed in receivership by order of a federal judge earlier this year. Now, the local investment firm that steered the health system to the fund manager, Montford Associates, is being sued over allegations that it took \$130,000 from fund manager Stanley Kowalewski in exchange for recommending that the system invest with him.

Kowalewski is not named in the new suit.

Montford's attorney, McKenna Long & Aldridge partner Bruce P. Brown, said the suit was baseless and noted that his client, Montford founder and principal Ernest "Ernie" Montford, had himself invested more than \$200,000 in the fund.

"This is madness, victims suing victims," said Brown, describing the action as "an unfounded and misguided lawsuit."

According to the complaint filed Wednesday in Fulton County Superior Court, St. Joseph's/Candler and its wholly owned subsidiary, Geechee Reinsurance LLC, invested more than \$40 million in two funds Kowalewski set up in 2009 on the advice of Ernie Montford.

In January, the U.S. Securities and Exchange Commission filed a complaint against Kowalewski in U.S. District Court in Atlanta charging fraud related to his management of another fund into which he had funneled investors' money. The suit asked for an emergency injunction and the appointment of a receiver. The SEC complaint said Kowalewski diverted \$16.5 million of investors' funds into "self-dealing transactions," including spending millions on luxury homes for himself and his family, and paying himself millions more in administrative fees and salary.

In January, U.S. District Judge Timothy C. Batten Sr. signed an order granting the injunction and appointing a receiver to take charge of the remaining assets of the fund, and in June Kowalewski signed a consent order agreeing to keep the receiver in place and to refrain from "employing any device, scheme or artifice to defraud" or to obtain money "by means of any untrue statements of a material fact," among other provisions.

The Fulton County suit details a relationship between St. Joseph/Candler and Montford going back to 1997, when Ernie Montford began "providing investment management consulting services" to the predecessor entity of the health group.

By 2007, Montford provided consulting services "for all of [St. Joseph/Candler]'s investment accounts" in return for a percentage of its holdings. Between 1997 and 2008, Montford was paid about \$1.35 million in fees; in 2009 and 2010, Montford earned \$261,883, according to the suit.

Among the duties Montford provided was to seek out investment managers, one of whom was Kowalewski. In 2007, according to the complaint, Montford recommended the health system place its investments with a fund Kowalewski managed, Columbia Partners Absolute Return Fund, a "fund of funds" that "placed investment proceeds with multiple third-party hedge fund managers to create a mix of investments in order to minimize the risk and volatility that might occur in investing in just one hedge fund."

In 2009, Kowalewski left Columbia and set up his own company, SJK Investment Management, in Greensboro, N.C.

"As part of establishing SJK in 2009," says the complaint, "Kowalewski paid Montford Assoc. a \$130,000 'consulting fee' for Montford Assoc. and Ernie Montford to encourage their clients, including [St. Joseph's/Candler] and Geechee, who were investors in the Columbia Partners Absolute Return Fund, to transfer their investments from the Columbia Partners Absolute Return Fund to the newly formed SJK Absolute Return Fund.

"Neither Montford Assoc. nor Ernie Montford ever disclosed the \$130,000 'consulting fee'" to the health system, it says.

Upon Montford's advice, St. Joseph/Candler transferred its investments into two SJK funds, the SJK Absolute Return and SJK Long/Short Equity Fund; by December 2010, the health system had invested about \$40.8 million in the funds.

"Unbeknownst to [St. Joseph's/Candler], in late 2009, SJK and Kowalewski formed the SJK Special Opportunities Fund," a "purported investment fund that was controlled by Kowalewski," says the complaint. Between December 2009 and January 2011, Kowalewski diverted \$16.6 million from the other two SJK funds in the new fund, it says.

"[St. Joseph's/Candler] was never told about the existence of the Special Opportunities Fund or that money it had invested in the SJK Absolute Return Fund was being diverted to the Special Opportunities Fund," according to the complaint.

"Between December 2009 and January 2011, the Special Opportunities Fund was used by Kowalewski and SJK for numerous self-dealing transactions, including purchasing Kowalewski's personal home for \$2.8 million, purchasing homes for parents and brother-in-law, purchasing a beach vacation home for \$3.9 million, and paying SJK approximately \$10 million in administrative and incentive fees, which Kowalewski used to pay himself approximately \$8 million," says the complaint. He also bought two boats and two jet skis, it says.

The complaint says that, "upon information and belief," Montford knew by at least November 2010 that Kowalewski was under investigation by the SEC, but never notified St. Joseph's/Candler. It was only when he was charged in federal court that the health system became aware of Kowalewski's alleged misconduct.

The suit cites a report from the court-appointed receiver indicating that "less than \$6 million of the more than \$16 million of investors' money that Kowalewski and SJK diverted to the Special Opportunities Fund is expected to be recovered."

"As the fund's largest investor, St. Joseph's/Candler "stands to lose more that \$6 million. Indeed, according to the latest account statements ... the value of [St. Joseph's/Candler]'s holdings in the SJK Absolute Return Fund declined from \$37.9 million to \$27 million, a loss of \$10.9 million, immediately after the fraud of Kowalewski and SJK was revealed," it says.

The complaint, filed by Parker, Hudson, Rainer & Dobbs partner Robert M. Brennan, associate Rajesh Shah, and Savannah attorney Leonard J. Panzitta, charges Montford with fraud, violation of the Georgia Uniform Securities Act, breach of contract, breach of fiduciary duty and professional negligence.

In addition to the fees paid Montford in 2009 and 2010, the suit says the health system also is entitled to recover "all damages, both direct and consequential," arising from its role in steering St. Joseph's/Candler's investments to Kowalewski.

Brown said in an email, "Montford denies the allegations. Montford, like the plaintiffs, was a victim of SJK's fraud. Montford invested over \$200k of his own money in SJK's funds, and would never have done so—or advised others to do so—had he had any idea that SJK was a fraud. This is madness, victims suing victims—an unfounded and misguided lawsuit."

Brennan declined to comment on the pending litigation, and Kowalewski's attorney, Thomas R. Todd Jr. of Atlanta, did not reply to telephone or email requests for comment.

The case is St. Joseph's/Candler Health System v. Ernest V. Montford, No. 2011CV202904.

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