



1. The four principals of Beacon Hill Asset Management LLC (“Beacon Hill”), John D. Barry (“Barry”), Thomas P. Daniels (“Daniels”), John M. Irwin (“Irwin”), and Mark P. Miskiewicz (“Miskiewicz”), together implemented a fraudulent scheme that resulted in investors losing more than \$300 million. From at least the beginning of 2002 through October 2002, Beacon Hill and its principals made material misrepresentations to investors and engaged in other fraudulent conduct, concerning critical aspects of its hedge fund operations. The misrepresentations concerned, among other things, the valuation methodology Beacon Hill used for calculating Net Asset Values (“NAVs”); the hedging and trading strategy for its purportedly “market neutral” funds; and the value and performance of these hedge funds.

2. Central to Beacon Hill’s fraud was its method of valuing securities in the hedge funds to show steady and positive returns. Beacon Hill manipulated its valuation procedures for the Master Fund, the core hedge fund that held and traded securities in Beacon Hill’s three feeder hedge funds. The manipulative conduct allowed Beacon Hill to report steady growth and hide losses in these hedge funds during 2002.

3. As the value of these Beacon Hill hedge funds decreased over the summer of 2002, Beacon Hill nevertheless continued to report positive returns. Beacon Hill increasingly inflated the prices of the securities in the Master Fund to maintain the appearance of positive returns. At the same time, contrary to what it was telling investors, Beacon Hill made an increasing and ultimately unsuccessful bet on interest rates rising in an attempt to cover its hidden losses.

4. In addition, Beacon Hill entered into a series of trades between the Master Fund and certain other accounts it managed for two institutional clients (the “managed

accounts”) at prices that defrauded the Master Fund and allowed the managed accounts, whose performances had also declined, to reap substantial profits. Beacon Hill was able to hide the losses resulting from these fraudulent trades by inflating the value of the securities in the Master Fund to an even greater extent.

5. In September 2002, as their scheme started to unravel, three of the four principals liquidated an account in which they were the only investors by selling the securities in their account to the Master Fund without disclosure to investors. Finally, in early October, when Beacon Hill’s prime broker challenged the valuation of the Master Fund and Beacon Hill was forced to admit it had sustained losses, the principals misrepresented the magnitude of the actual losses in an attempt to save Beacon Hill’s operations and make the losses appear to be the result of market conditions. On October 17, 2002, Beacon Hill finally announced the full extent of investor losses, admitting that, as of September 30, the NAVs of its hedge funds had declined 54% from previously reported August 31, 2002 levels, and further acknowledging that it had mis-priced securities in the funds prior to August.

6. By engaging in this conduct, Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz violated various anti-fraud provisions of the federal securities laws. More specifically, they directly or indirectly violated Section 17(a)(1), (2) and (3) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Additionally, through this conduct Beacon Hill violated Sections 206(1), (2) and (3) of the Advisers Act, and defendants Barry, Daniels, Irwin, and Miskiewicz aided and abetted Beacon Hill’s violations of these sections.

### **JURISDICTION**

7. The Commission brings this action pursuant to the authority conferred upon it by Sections 209(d) and (e) of the Advisers Act of 1940, 15 U.S.C. § 80b-9(d) and (e) (“Advisers Act”), Section 20(b) of the Securities Act of 1933, 15 U.S.C. § 77t(b) (“Securities Act”) and Section 21(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(d) (“Exchange Act”), to enjoin the defendants permanently from future violations of the federal securities laws and to obtain other relief. Unless enjoined, defendants will continue to engage in the transactions, acts, practices and courses of business alleged herein, and in transactions, acts, practices, and courses of business of a similar type and object. The Commission also seeks a final judgment ordering the defendants and relief defendants Nancy Daniels, Marie Irwin, Ellen Lynch, Jennifer Tindell and Safe Harbor Asset Management LLC to disgorge ill-gotten gains and pay prejudgment interest thereon, and the defendants to pay civil money penalties pursuant to Section 20(d) of the Securities Act, Section 209(e) of the Advisers Act and Section 21(d)(3) of the Exchange Act. Additionally, the Commission seeks the final distribution of the remaining assets and proceeds of Beacon Hill Master Fund, Ltd., Bristol Fund, Ltd., Milestone Plus Partners L.P. and Milestone Global Advisors, L.P. Finally, the Commission seeks continuing interim and equitable relief while this action is pending.

8. This Court has jurisdiction over this action, and venue is proper, pursuant to Section 214 of the Advisers Act, 15 U.S.C. § 80b-14, Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and Sections 21(d)(3), 21(e) and 27 of the Exchange Act, 15 U.S.C. §§ 78u(d)(3), 78u(e) and 78aa. Many of the transactions, acts, practices and courses of business alleged in this Amended Complaint occurred within the Southern District of New York, including the offer, purchase or sale of investments and the use of

the mails or wires in connection with investments in this district. The defendants, directly and indirectly, singly and in concert, made use of the means and instrumentalities of transportation or communication in, or the instrumentalities of interstate commerce, or of the mails in connection with the transactions, acts, practices and courses of business alleged in this Amended Complaint.

### **DEFENDANTS**

9. **DEFENDANT BEACON HILL ASSET MANAGEMENT, LLC**

(“Beacon Hill”) is a limited liability company organized under the laws of Delaware and located in Summit, New Jersey. Barry, Daniels, Miskiewicz and Irwin (collectively the “principals”), together with a since deceased fifth partner, established Beacon Hill in 1997 as a private investment management firm to provide asset management services to U.S. and foreign investors. The same year, the principals launched both the Bristol Fund and the Safe Harbor Fund.

10. In 1998, Asset Alliance Corporation (“Asset Alliance”) purchased a 50% equity interest in Beacon Hill. Nevertheless, the day-to-day management of Beacon Hill remained the responsibility of the four principals.

11. Defendants Barry, Daniels, Irwin and Miskiewicz formed, were officers of, and were the principals of Beacon Hill. They jointly had day-to-day responsibility for the management and actions of Beacon Hill and its employees. From January 1, 2002 through September 2002, the four principals worked together in a small suite of offices. They conducted frequent meetings, often many in a single day, to collectively discuss and make decisions concerning Beacon Hill. While Barry, Daniels, Irwin and Miskiewicz collectively managed Beacon Hill and its employees, each had a different role in the

operation of Beacon Hill and each had primary responsibility for executing different but complementary parts of the fraudulent scheme.

12. **JOHN (“JACK”) D. BARRY**, 43, was the President of Beacon Hill and Chairman of its Management Board, and was responsible for marketing, sales, client relationships and overall management of the firm. Barry asserted his Fifth Amendment Privilege against Self-Incrimination in the Commission’s investigation.

13. **THOMAS (“TOM”) P. DANIELS**, 46, was the Chief Investment Officer and directed the firm’s overall investment, securities valuations, and risk management. Daniels asserted his Fifth Amendment Privilege against Self-Incrimination in the Commission’s investigation.

14. **JOHN M. IRWIN**, 44, was the Senior Portfolio Manager in charge of the firm’s credit sensitive mortgage portfolio and shared portfolio management responsibilities and all trading decisions with respect to the funds’ investments and security valuations with the Chief Investment Officer. Irwin asserted his Fifth Amendment Privilege against Self-Incrimination in the Commission’s investigation.

15. **MARK P. MISZKIEWICZ**, 40, a certified public accountant, was the Chief Financial Officer and was responsible for Beacon Hill’s financial, accounting and administrative operations, as well as net asset valuation calculations. Miskiewicz asserted his Fifth Amendment Privilege against Self-Incrimination in the Commission’s investigation.

#### **RELIEF DEFENDANTS**

16. **BRISTOL FUND, LTD.** (“Bristol Fund”), is a limited liability company incorporated under the laws of the Cayman Islands. Bristol Fund’s investments were intended for non-U.S. and U.S. tax-exempt investors.

17. **SAFE HARBOR FUND L.P.** (“Safe Harbor Fund”) is a New Jersey limited partnership. Safe Harbor Fund’s investments were offered to U.S. investors.

18. **SAFE HARBOR ASSET MANAGEMENT LLC (“SHAM”)** is a limited liability company organized under the laws of New Jersey and located in Summit, New Jersey. The company is the general partner of Safe Harbor Fund. Beacon Hill Asset Management LLC and Barry own 99% and 1% respectively of Safe Harbor Asset Management LLC.

19. **MILESTONE PLUS PARTNERS L.P.** (“Milestone”) is a Delaware limited partnership. Its general partner is Milestone Global Advisors L.P., a Delaware limited partnership. The general partner of Milestone Global Advisors L.P. is Milestone Fund Manager, Inc., a Delaware corporation.

20. **BEACON HILL MASTER, LTD.** (“Master Fund”) is a company incorporated under the laws of the Cayman Islands. It became operational on January 2, 2002. Under the terms of its Articles of Association, the assets of the three “feeder funds,” Bristol Fund, Safe Harbor Fund and Milestone, were transferred to the Master Fund and each feeder fund participated *pro rata* in the Master Fund’s trading profits and losses.

21. **NANCY DANIELS** is the wife of Tom Daniels, one of the principals of Beacon Hill.

22. **MARIE IRWIN** is the wife of John Irwin, one of the principals of Beacon Hill.

23. **ELLEN LYNCH** is the wife of Mark Miszkiewicz, one of the principals of Beacon Hill.

24. **JENNIFER TINDELL** is the wife of Jack Barry, one of the principals of Beacon Hill.

## **FACTS**

### **Beacon Hill's Investment Management Business**

25. In 2002, Beacon Hill was the investment manager of three hedge funds, Bristol Fund, Safe Harbor Fund, and Milestone (the “feeder funds”). Beacon Hill conducted the trading activities of these feeder funds through, and held their assets in, the Master Fund (the three feeder funds and the Master Fund will be collectively referred to as the “Funds”). Beacon Hill was the investment manager of the Master Fund. Beacon Hill also was retained as the investment manager of three “managed accounts” and managed those accounts in a similar fashion to the Funds, often making investments in the same types of securities.

26. For the Master Fund, Beacon Hill invested primarily in U.S. agency mortgage-backed securities called Collateralized Mortgage Obligations, or “CMOs”, most of which were “inverse floaters.” Like other fixed-rate instruments, mortgage-backed securities typically increase in value as interest rates decline. However, for mortgage backed securities this effect may be partly or fully offset by an increase in mortgage prepayments, which often accompanies declining interest rates. Beacon Hill made representations (as described in detail below) that it hedged the interest rate risk by shorting (among other things) Treasury securities and managed the prepayment risk by

adjusting the duration of the short Treasury positions. All of the securities Beacon Hill invested in traded over-the-counter; none were exchange-traded.

27. In marketing itself, Beacon Hill represented that it was a relative value arbitrageur, which exploited the structural inefficiencies associated with the mortgage-backed securities market and avoided speculation on the direction of interest rates. Beacon Hill also emphasized that its investment strategy was designed to produce steady annualized returns of 12-18%. In particular, Beacon Hill highlighted its steady performance history. Throughout 2002, it emphasized that its Funds had reported losses in only three months since 1997.

28. Beacon Hill's financial incentives were directly linked to the amount of assets under management and the performance of the feeder funds and the managed accounts. Beacon Hill received management and incentive fees from each of the feeder funds based on the aggregate NAV of each fund and any appreciation in NAV each quarter. Further, under the terms of the purchase agreement with Asset Alliance in 1998, Asset Alliance was required to pay the Beacon Hill principals an "earnout" payment in each of the following four years based upon increases in net assets under management and investment returns. In addition, if Beacon Hill failed to maintain a certain level of performance as determined by a formula in its agreement with Asset Alliance, a "clawback" provision required Beacon Hill to pay back to Asset Alliance up to half of the prior earnout.

### **Representations Regarding Valuation Methodology**

29. Specific provisions for valuing Beacon Hill's Funds for NAV purposes were contained in various documents, including the Master Fund's Articles of Association, Beacon Hill's Investment Management Agreement with the Funds, and the offering memoranda provided by Beacon Hill to investors in the feeder funds. The Investment Management Agreement was signed by Barry on behalf of Beacon Hill.

30. The Master Fund's Articles of Association, which were dated December 2001, and the Bristol Fund's Memorandum and Articles of Association, dated March 1997, required Beacon Hill to value securities "based on the broadest and most representative market for [each] security." They also defined a hierarchy of methods for valuing the securities: (1) for exchange-traded securities, the last sales price; (2) for over-the-counter ("OTC") securities, the most recently quoted bid price provided by one or more principal market makers unless the investment manager believed that the values so obtained did not fairly indicate market value of any security, in which case the investment manager could rely on the value obtained from a reputable broker-dealer; and (3) if market quotations were not readily available for a security, the security was to be valued at its "fair value as determined in good faith in accordance with the procedures adopted by the Investment Manager."

31. The Bristol Fund offering memoranda, dated March 1997 and June 2002, provided a similar hierarchy of methods for valuing the securities, although for OTC securities, they required Beacon Hill to use the "mid-market price of one or more principal market makers unless, in the opinion of the Investment Manager, the value so obtained does not fairly indicate the market value of any security, in which case the

Investment Manager may value the security based upon the value of other securities believed to be comparable and valuation models used by the Investment Manager.” The Safe Harbor Fund offering memoranda, dated November 1997 and October 2002, contained virtually identical provisions.

32. Thus, under all of these provisions, Beacon Hill in the first instance was required to value its portfolio using prices from market makers. It could not turn to other valuation methods except under the specified limited circumstances described above.

33. The valuation methods that Beacon Hill actually used from its inception, through September 2002, differed substantially from the methods it told investors it used. Thus, these representations about valuation methods were materially false and misleading when made. For the same reason, the representations in the Bristol Fund and Safe Harbor Fund offering memoranda that Beacon Hill would use “valuation models” only when it believed that market maker prices did not fairly indicate market values were also materially false and misleading. In addition, Beacon Hill’s routine use of its internal valuation methodology each month (discussed below) rendered false the statement in the Master Fund and Bristol Fund Articles of Association that it would turn to “reputable broker-dealers” to obtain prices when principal market maker quotes did not reflect market values.

34. Beacon Hill failed to disclose to investors that it did not use market maker or broker-dealer prices and that it used its own materially different valuation methodology for its regular month-end calculations of NAVs. Beacon Hill owed a fiduciary duty to the Funds, and these were material facts necessary to make the statements Beacon Hill made to investors not misleading.

35. While Beacon Hill was permitted to adopt fair value procedures and use them in good faith when market prices were not readily available, such prices were unavailable for only a small portion of the Master Fund’s securities. One document disseminated to investors by Beacon Hill—the Master Fund’s March 31, 2002 Financial Statements—describes fair value procedures that the Master Fund ostensibly used “in the absence of readily ascertainable market values.” It stated that in those circumstances the estimated fair value for the Master Fund’s mortgage-backed securities had been established by “using prices furnished by investment services firms (such as brokers, dealers or other entities).” The Financial Statements also stated that Beacon Hill used “an Option Adjusted Spread (“OAS”) model to value mortgage-backed securities . . . The OAS model takes into account current interest rates and prepayment speeds to determine future cash flows which are then discounted to arrive at the current value. The Investment Manager compares the model’s valuation to quotes from brokers to ensure the valuation is reasonable.” But Beacon Hill never used an OAS model to value mortgage-backed securities for its NAV calculations. Nor did Beacon Hill use prices furnished by investment services firms for any month other than the month completing its fiscal year-end audit. As to its valuations for the month of its year-end audit, Beacon Hill’s use of third-party prices for its audit was not done in good faith.

36. In addition, in many other documents and communications, Beacon Hill falsely represented to investors that it used independent third-party pricing sources for NAV calculations. Thus, for example, in various due diligence questionnaires completed by Beacon Hill and submitted to investors as late as September 2002, Beacon Hill falsely stated that “prime brokers” or “numerous dealers” provided pricing; that “OTC” and

“illiquid positions” were marked “utilizing prices received from the repo market,” using “three market makers,” or “through repo or broker price”; and that pricing sources utilized for NAV calculations were “IDC, passport and repo” or were “3 brokers.” Barry and Daniels made similar misrepresentations as to the use of independent third-party pricing in communications with numerous investors, frequently representing that Beacon Hill used repo prices (that is, broker-dealer prices obtained in connection with repo-ing out the Fund’s securities) and IDC (Interactive Data Corporation) prices as its third-party pricing sources. For example, in an email to one investor in July 2002, Barry wrote that “since the [mortgage-backed securities] market is OTC, we have always received month-end pricing data from our 6-8 repo counterparties. Since a repo is a collateralized loan we have always believed that this is the most responsible source of pricing information. We roll our repo position at the end of each month in order to receive this data. This information is then sent to Beacon Hill and [our administrator] electronically to calculate the NAV....”

37. All of these representations made to investors as to Beacon Hill’s use of third-party pricing sources were false. At no time did Beacon Hill use multiple broker or market maker prices for calculating the NAV of the Master Fund or its feeder funds. Nor did Beacon Hill use repo or IDC prices for its month-end valuations. Instead, for each month except the month in which the year-end audit occurred, Beacon Hill used the same undisclosed internal valuation model that it had used from the inception of the Funds.

38. Each of Beacon Hill’s four principals knew or was reckless in not knowing that the representations Beacon Hill made to investors as to its valuations of the Funds’ NAVs were false and misleading. Daniels, Barry, Miskiewicz and Irwin each

knew or recklessly disregarded facts indicating that their activities, together with the activities of their fellow principals, would and did cause Beacon Hill's representations to investors to be materially false and misleading. They together launched the Funds and as the principals of Beacon Hill they collectively controlled the content of the documents sent to investors in the name of Beacon Hill. Daniels and Barry each made misrepresentations to investors in 2002 concerning the use of third-party prices for calculating NAV. Further, both Daniels and Barry reviewed and approved false responses sent to investors in the various due diligence questionnaires. As the CFO of Beacon Hill, Miskiewicz was responsible for all Beacon Hill accounting matters, including the misrepresentations in the Master Fund's audited Financial Statements for year-end March 31, 2002. In addition, Miskiewicz had access to the pricing sheets reflecting Beacon Hill's internal valuations, and supervised the calculation of NAV using these prices. He knew or was reckless in not knowing that Beacon Hill's valuation methodology was materially different than the representations in the financial statements. Daniels and Irwin, as the senior portfolio manager who priced the portfolio with Daniels, also knew or were reckless in not knowing that Beacon Hill's valuation methodology was materially different from the representations made by Beacon Hill as to the use of third-party pricing sources.

**The Two Manipulative Valuation Methodologies Beacon Hill Actually Used**

39. Instead of calculating NAVs as it had represented to investors, Beacon Hill manipulated the process used to determine the NAVs of the funds.

40. For all months in 2002, except March (the month that the annual audit was done in 2002), Beacon Hill used an undisclosed valuation process (its “internal valuation methodology”).

41. Beacon Hill’s internal valuation methodology consisted of two steps: first, Beacon Hill developed computer-generated “hedge-adjusted” prices; second, either Daniels, the chief investment officer, or Irwin, the senior portfolio manager, made manual adjustments to those prices.

42. For the hedge-adjusted pricing, Beacon Hill used a computer program to calculate the net profit or loss on the hedge. The computer program then changed the prices of the mortgage-backed securities in the Master Fund to adjust the value of the long-side portfolio in the opposite direction, but in approximately the same amount, as the change in the value of the hedge. During the summer of 2002, as interest rates declined, with resulting losses in the Master Fund’s hedged Treasury short positions, the hedge-adjusted pricing methodology had the effect of hiding those losses by increasing the value of the mortgage-backed securities in the Master Fund.

43. The hedge-adjusted prices were subject to further adjustment by Daniels or Irwin. Daniels or Irwin made these adjustments on “pricing sheets” that contained the list of securities in the Master Fund with hedge-adjusted prices. Daniels or Irwin then personally adjusted the prices for these securities. The pricing spreadsheets that Daniels and Irwin used to adjust prices allowed them to monitor the impact of those adjustments on the net value of the portfolio by automatically calculating the change in market value for both the specific securities and the portfolio resulting from the manual adjustments.

Beginning at least in 2002, these manual adjustments were increasingly made to raise artificially the value of the securities in the Master Fund.

44. Beacon Hill's final adjusted prices, reflecting both the hedge-adjusted pricing changes and the manually adjusted prices, were then sent to the fund administrator to prepare the NAVs for the Funds. The inflated NAVs that were produced as a result of the internal valuation process were subsequently reported to investors by Beacon Hill.

45. The manual adjustments, coupled with the use of the hedge-adjusted pricing, enabled Beacon Hill to issue misleading reports of stable, positive returns month to month. Besides overstating the NAVs for the Funds, the internal valuation methodology used by Beacon Hill was materially different than the representations made to investors.

46. For March 2002, when the annual audit was done, Beacon Hill obtained multiple dealer prices and Bloomberg prices, and then deliberately selected individual prices that, in aggregate, allowed Beacon Hill to match the portfolio value generated by its own internal valuation methodology. To arrive at this result, Daniels went through a series of selection procedures, each reflected in a separate spreadsheet that highlighted both the price Daniels selected for each bond and the individual and aggregate market value of the bonds. For March 2002, the third-party prices Daniels selected initially created a total market value for the Master Fund's portfolio that was \$8.454 million higher than the market value generated by Beacon Hill's internal valuations. In each subsequent selection, Daniels chose different third-party prices to narrow the aggregate market value difference between the third-party prices he selected and Beacon Hill's

internal prices. The final selections generated an aggregate market value that was almost identical to that generated by Beacon Hill's internal prices (the difference was less than \$10,000). The final, carefully selected, prices were submitted to Beacon Hill's outside auditor and transmitted by Beacon Hill to the fund administrator for March-end NAV calculations.

### **Beacon Hill Inflated Prices**

47. As early as June 2002, Beacon Hill's Funds began to incur sizeable losses, which grew dramatically through July and August. Moreover, at least two of the Beacon Hill principals knew that the Master Fund was suffering substantial losses in June. In an email dated June 25, 2002, Irwin wrote to Daniels, "I JUST WANTED TO LET YOU KNOW, [one of the Beacon Hill traders] THINKS HE IS UP \$2MILLION THIS MONTH." In a response sent on the same day, Daniels replied to Irwin, "that's good now it means [we're] only down 18 mm on the month."

48. Despite knowing that the Master Fund was losing money, Daniels and Irwin caused Beacon Hill to report a positive performance for the month ending June 30, 2002. Thus, Daniels or Irwin manually adjusted prices to increase the NAV for the portfolio for the month-end June 30 valuations by \$2.6 million above the already inflated prices that Beacon Hill's hedge-adjusted pricing method had calculated.

49. In July and August 2002, Beacon Hill and its principals made even greater manual adjustments, even though they knew that the Funds were suffering increasing losses. In July, the net aggregate adjustments made by Daniels and Irwin were \$6.87 million, while in August, the aggregate adjustments totaled \$5.16 million. Each month's aggregate adjustments were in addition to the inflated prices generated by the hedge-

adjusted computer program to overcome increasing losses on the portfolio's hedged positions. The manual price adjustments accounted for a substantial part of the reported positive returns of the Funds. Particularly in July and August, these adjustments corresponded to virtually the entire positive returns reported by the Funds.

50. The manipulation of the prices in the portfolio resulted in a substantial and increasing disparity between Beacon Hill's marks and those of independent pricing sources such as Bear Stearns and IDC. By July and August, the disparity between Beacon Hill prices and Bear Stearns prices doubled (growing from more than 7% at month-end June to more than 14% at month-end August) and the disparity between Beacon Hill prices and IDC prices more than tripled (growing from less than 3% at month-end June to more than 10% at month-end August).

51. Beacon Hill's internal data during the summer of 2002 provided warnings to the principals that the internal valuations of the CMOs in the Master Fund portfolio were increasingly inflated.

52. One of the analytical tools Beacon Hill used was an option adjusted spread ("OAS") analysis. The OAS reflects the incremental rate at which investors are compensated for investing in a risky investment instead of the risk-free rate provided by Treasury bonds. Thus, when prices assigned to most mortgage-backed securities generate a negative OAS, the negative OAS serves as a warning that the assigned price is too high: investors are unlikely to invest in bonds that contain greater risk than, and are priced to give a negative spread to, Treasuries.

53. Over the summer of 2002, Beacon Hill's daily and monthly portfolio pricing reports reflected a dramatic increase in the number of bonds in the Master Fund

showing negative OAS numbers. Thus, in June 2002, approximately 15% of the mortgage-backed securities had negative OAS numbers; by August, more than 90% of the CMOs had negative OAS numbers.

54. A second set of internal data, known as effective duration reports (“EDRs”), also provided the Beacon Hill principals with information that should have raised serious doubts as to the legitimacy of Beacon Hill’s valuations and hedging strategy. The duration numbers contained in these EDRs showed a stark increase in the number of bonds with large, even nonsensical, negative durations. These negative duration numbers, which strongly suggested that the Master Fund’s portfolio was over-hedged, should have served as a major warning that Beacon Hill’s valuations were highly questionable.

55. Indeed, in late August, one Beacon Hill employee was so concerned about the OAS and duration numbers that he contacted Miskiewicz to warn him about the data. Miskiewicz assured the employee that he would raise the matter with the other principals.

56. Despite the data indicating that they were pricing the securities too high, Daniels and Irwin continued to increase manually the prices of many of those bonds, resulting in even larger negative OAS numbers. Miskiewicz continued to report these valuations to the administrator for the purposes of calculating month-end NAVs.

57. Moreover, during this period, Beacon Hill and its principals failed to systematically compare the Beacon Hill valuations with the third-party pricing data to which it had ready access. Throughout 2002, Beacon Hill had daily access to Bear Stearns and IDC prices. Each day, Beacon Hill electronically downloaded Bear Stearns

pricing marks (which covered more than 80% of the CMOs in the portfolio), and it had similar access to a substantial number of IDC prices. Yet Beacon Hill failed to compare or adjust its own valuations in any systematic way when it calculated month-end NAVs, even when its OAS and duration numbers strongly indicated Beacon Hill's marks were increasingly inflated. It was not until mid-September 2002, after having been explicitly warned by one of their employees that the Funds were suffering major losses, that two of the principals, Daniels and Miskiewicz, began systematically comparing Beacon Hill marks with Bear Stearns and IDC marks.

58. Beacon Hill's valuations of the Master Fund securities were not only inflated compared to Bear Stearns and IDC marks, they were inflated compared to the values Beacon Hill assigned to the same bonds in its other accounts. From June through August 2002, approximately 15% of the CMOs in the Master Fund were also in the managed accounts. Of these bonds, virtually all were marked at higher prices in the Master Fund than in the managed accounts, which were subject to greater oversight and which generally required all prices to be within 2% of IDC prices. Moreover, the differences between the prices that Beacon Hill assigned to the bonds in the Master Fund and the managed accounts grew through the end of August.

59. In addition, numerous Beacon Hill marks in the Master Fund were materially different than the prices at which Beacon Hill contemporaneously traded those securities. Thus, on a number of occasions in the last two weeks of July 2002, Beacon Hill's hedge-adjustment computer program placed values on CMOs in the Master Fund that were substantially higher than the prices Beacon Hill had just paid for the bonds.

60. As a result of the overstated prices for many of the CMOs in the portfolio, Beacon Hill and its principals materially and increasingly overstated the NAV of the Master Fund. By the end of August 2002, Beacon Hill's overvaluations exceeded 50% of the portfolio's NAV. There were similar overstatements of the NAVs of the feeder funds during the same period.

61. Beacon Hill later admitted, in an October 17, 2002 announcement to investors, that its internal pricing of the CMO portfolio resulted in overstating the NAVs of the Funds before August 31, 2002: "Using a combination of Interactive Data Corporation (IDC) prices, valuations from our prime broker, and dealer quotations, we have calculated ... the Fund had losses of approximately 54% from the reported NAV as of August 31, 2002." Beacon Hill reported further that "[u]tilizing these pricing inputs, the analysis of the portfolio reflects that a portion of the Fund's losses occurred prior to August 31, 2002."

62. Each of Beacon Hill's four principals knew or was reckless in not knowing that Beacon Hill was materially inflating the prices of its CMOs, thereby inflating the NAVs of the Funds. Daniels, Barry, Miskiewicz, and Irwin each knew or recklessly disregarded facts indicating that the CMO prices and, thus, the Funds' NAVs were inflated. Daniels was responsible for pricing the CMOs and manually increased the prices even when many signs indicated the prices already were too high. He continued to make adjustments that resulted in reporting positive returns when he knew the Funds actually were losing money. Irwin was responsible for pricing the portfolio in Daniels' absence. He knew the pricing process and had access to all of the pricing-related data that indicated Beacon Hill's prices were too high. He also knew that the Funds were

sustaining losses at the same time that Beacon Hill was reporting positive performance. Miskiewicz was warned that prices were too high, but he ignored the warnings or did nothing to ensure that the prices reflected market value. He knew or was reckless in not knowing that Beacon Hill's valuation prices differed from its transaction prices, and that multiple prices existed for the same bonds in different accounts. Throughout this period, Miskiewicz continued to authorize the inflated NAV valuations. By virtue of his overall responsibilities for Beacon Hill, Barry knew or was reckless in not knowing of the inflated valuations by Beacon Hill. Indeed, in September, when Barry had specific knowledge of problems related to Beacon Hill's valuation and prepayment models, he nevertheless continued to misrepresent to investors that the Funds were performing positively and without problems. As discussed later, all of the principals failed to stop or disclose the overpricing when they learned of it, and even affirmatively misrepresented pricing and valuations to investors and others.

### **Misrepresentations Concerning the Value and Performance of the Funds**

63. The false information concerning the value and performance of the Funds was reported to investors through monthly reports, weekly estimates, and oral conversations between and among the principals of Beacon Hill and investors in the Bristol Fund and the Safe Harbor Fund.

64. For example, ATC, fund administrator, at Beacon Hill's direction and only upon explicit approval from Beacon Hill each month, sent monthly statements to investors entitled Safe Harbor Fund, L.P. Monthly Summary Statement and Bristol Fund, Ltd. Monthly Shareholder Statement. Each investor in the Safe Harbor Fund received a monthly statement from ATC that included a market value for the prior and current

month, any subscriptions or redemptions for that month, and the exact dollar return for the fund that month. Each investor in the Bristol Fund also received a monthly statement from ATC that included a current market value, any subscriptions or redemptions for that month, and the number of shares owned by that investor. As a result of the defendants' actions, the monthly statements for 2002 materially misrepresented the NAVs. Further, none of these statements informed investors that prices for securities in the Master Fund were based on an internal valuation methodology that included hedge adjusted prices followed by unsupported manual price adjustments.

65. Beacon Hill also directly sent monthly performance reports to investors in the Bristol Fund and the Safe Harbor Fund. Both reports were on Beacon Hill letterhead and were signed by Barry. Thus, the Safe Harbor Fund Performance Report – August 2002 represented that the fund had a .72% net return that month. Earlier reports contained positive net returns for April through July, gradually declining from 1.47% to 0.81%. The Bristol Fund Performance Report – August 2002 contained similar results for these months. Each of these monthly performance reports for 2002 materially misrepresented the NAVs. None of Beacon Hill's monthly performance reports for 2002 informed investors that prices for securities in the Master Fund were based on a hedge adjusted pricing process that included unsupported manual price adjustments.

66. In addition to the monthly reports, Beacon Hill emailed weekly performance estimates to various investors. As with the monthly reports, the weekly performance estimates emailed to investors were inaccurate and misleading. Moreover, Beacon Hill continued to send out weekly estimates containing false and misleading performance reports as late as September 23, 2002, just days before it first announced a

25% loss. Thus, the Bristol Fund Estimate for the week ending Friday, September 20, 2002, falsely stated, “The estimate for the week ending Friday, September 20 is flat. The month to date estimate remains +35bp. The estimated NAV is 1914.28.” An estimate for the week ending September 23, 2002 reported that the week and month were “flat.” These estimates, and earlier ones, were provided to investors at a time when the principals of Beacon Hill knew or were reckless in not knowing that there were significant losses on the hedge, that record prepayments were dramatically and adversely affecting the value of the CMOs, and that the securities were significantly over-priced.

67. Further, Beacon Hill regularly provided false information concerning the value of the assets in the feeder funds to various hedge fund data providers, including, among others, TASS Research and MarHedge, for dissemination to potential investors and other market participants.

68. Daniels, Barry, Miskiewicz and Irwin each was responsible for the content and/or dissemination of the false and misleading NAV information sent to investors and other market participants. Each knew or was reckless in not knowing that the NAVs reported to investors were falsely overstated and that the valuations of the CMO portfolio were artificially inflated. Each also knew or was reckless in not knowing that the failure to disclose the actual method used to price the portfolio was an omission of a material fact necessary to prevent the reported NAVs from being misleading. The false NAVs were disseminated to investors and others in various documents published by and on behalf of Beacon Hill. These documents were the result of the collaborative efforts of the four principals.

**Beacon Hill Failed To Disclose A Material Change  
In Its Hedging And Trading Strategy**

69. In 2002, Beacon Hill diverged from a fundamental and well-advertised strategy—market neutrality—without informing investors. From its inception, Beacon Hill advertised itself as engaging in a market-neutral, zero net duration hedging strategy, which it defined as meaning Beacon Hill did not speculate on interest rate changes. In its marketing materials, responses to due diligence questionnaires, and meetings with investors, Beacon Hill consistently asserted that it followed such a strategy. Contrary to these representations, however, throughout most of 2002, Beacon Hill abandoned its proclaimed market neutral strategy.

70. For the first few months of 2002, Beacon Hill's internal duration data reflected that the Master Fund portfolio was hedged to benefit from a decline in interest rates. For example, in February and March, the duration data implied that the Master Fund would gain or lose more than 15% of the value of its portfolio for every 100 basis point move in interest rates, a sensitivity to rates that is far from market neutral.

71. Only in May did Beacon Hill's internal duration data show a market neutral fund. For that month, the EDRs showed that Master Fund would gain or lose less than 1% of its portfolio value for every 100 basis point move in rates.

72. Beginning at least as early as July and continuing through September 2002, Beacon Hill made an undisclosed and increasing bet that interest rates would rise. Thus, the duration implied by the internal effective duration reports for July indicated that the portfolio would lose or gain more than 30% of its value for each 100 basis point move in rates. The data for August showed even greater volatility.

73. In October 2002, Beacon Hill admitted that it had deliberately over-hedged the portfolio. In its October 7, 2002 email to investors announcing a 25% decline in the previously reported August 31, 2002 NAV, Beacon Hill attributed the decline to an incorrect hedge in September. At the same time, Beacon Hill admitted that it had deliberately over-hedged the portfolio, anticipating that interest rates would rise. In an Beacon Hill memorandum sent to the Master Fund's Board of Directors, Beacon Hill stated that it had "hedge[d] the portfolio to the average rise in rates that we have experienced during past refinancing waves, the average of which has been 70bps.... we hedged the duration of the portfolio to within 10% of neutrality."

74. While Beacon Hill's admission that it deliberately over-hedged was limited to September 2002, Beacon Hill's trading records and effective duration reports show that the over-hedging began months earlier and that Beacon Hill failed to adjust materially its hedge as interest rates declined, as it should have done to remain market neutral as advertised.

75. Instead of taking corrective action to maintain market neutrality in response to the shortening duration of the long side of the portfolio, Beacon Hill chose instead to maintain the approximate size and duration of its Treasury and swap positions over the summer of 2002. Similarly, Beacon Hill did not lengthen the duration of its mortgage-backed securities to reduce effectively the over-hedged short position. Beacon Hill's goal was to place and win an undisclosed bet on interest rates. Its failure to inform investors of this bet was a material omission.

76. In addition, throughout 2002 Beacon Hill made repeated material misrepresentations to investors about the net duration of the Master Fund's portfolio.

Contrary to the duration numbers described above, from February through August 2002, Beacon Hill sent certain investors monthly reports, styled as a Portfolio Composition Report, which falsely reported that the funds' net duration ranged from +0.46 years to – 0.47 years, consistent with a market neutral fund that would gain or lose less than 1% of its value for every 100 basis point change in rates. Accurate reporting of the net duration information would have shown investors that, except for month-end May 2002, Beacon Hill was not hedging its portfolio as it had represented it would. Further, accurate representations of the net duration for the Master Fund would have disclosed that, at least beginning in July, Beacon Hill was actually making a bet that interest rates would increase.

77. Beacon Hill also falsely represented its investment strategy to investors in various Due Diligence Questionnaires. For example, in a Due Diligence Questionnaire for the Bristol Fund dated May 1, 2002, Beacon Hill stated, “Our returns are not based on any interest rate speculation.” Similarly, in another Due Diligence Questionnaire prepared in September 2002, Beacon Hill stated that “our daily goal is to manage our portfolios to a ‘zero’ duration, or zero interest rate exposure.” Each of the principals of Beacon Hill knew or was reckless in not knowing that these representations were false.

78. Further, after telling investors that the Funds did not speculate on interest rates, Beacon Hill failed to disclose that it had changed its investment strategy. This was a material fact that Beacon Hill needed to disclose to make its prior statements not misleading. In addition, Beacon Hill had a fiduciary duty to the Funds as their investment adviser, and, therefore, was required to disclose to the Funds' investors the material change in strategy.

### **Trading Between Managed Accounts And Master Fund**

79. Beacon Hill was the manager of two “managed accounts,” Beacon Hill/HSBC Managed Trust (“HSBC”), set up by Lehman Bros., and Lyxor Master Fund (“Lyxor”), set up by Societe Generale. Both funds were closely monitored by their respective institutional managers.

80. In July and August 2002, during the same period that the Master Fund was suffering significant losses, Beacon Hill reported performance results for the two managed accounts that were substantially smaller than the previous six months, including reporting a small loss suffered by the HSBC in July.

81. During this period and continuing through the beginning of October 2002, Beacon Hill engaged in a series of trades between its managed accounts and the Master Fund that substantially improved the performance of the managed accounts during this period. As financial adviser to the Master Fund, Beacon Hill was required to disclose all conflicts of interest to the Funds’ investors. These trades constituted a conflict of interest for Beacon Hill that was not disclosed.

82. Thus, in July, for example, Beacon Hill sold a number of bonds from the two managed accounts to the Master Fund at prices that were favorable to the managed accounts and detrimental to the Master Fund. As a result of the transactions, Beacon Hill was able to generate substantial profits for the managed accounts, which improved their reported performance for the month. While the Master Fund suffered commensurate losses in these transactions, Beacon Hill was able to hide these losses by manually adjusting the prices of securities to increase the aggregate net valuation of the portfolio.

83. For example, on July 22, 2002, Beacon Hill sold two bonds from HSBC to the Master Fund at prices substantially higher than the purchase prices it had paid just twelve days earlier. In addition, HSBC had purchased each bond at a price below IDC's valuation and sold it to the Master Fund at a price above the IDC mark for the corresponding date. Beacon Hill generated profits to HSBC of more than \$1.1 million from the sales of the two bonds.

84. At least nine other sales to the Master Fund in June and July generated profits to HSBC of up to \$3.6 million and to the Lyxor Fund of up to \$4.9 million. The managed accounts had purchased the bonds from the market approximately three to seven weeks before selling the bonds to the Master Fund. In each case, the managed accounts had purchased the bonds below the prices IDC had placed on the bonds and sold them to the Master Fund at prices substantially higher than the recent purchase price. All of the sales prices to the Master Fund were above the prices that IDC had placed on the bond on or about the sales date.

85. On one of the days that these sales were being made to the Master Fund, a Beacon Hill employee approached Daniels, who had issued the instructions for the trades, to inquire about the prices at which trades were being made. Daniels advised the employee that the sales were to proceed at the prices he had set.

86. On September 24, 2002, three of the four Beacon Hill principals, Daniels, Irwin and Miszkiewicz, were notified via email that the Lyxor Fund's market value had declined by approximately \$2.5 million in the preceding four days.

87. The same day and the following day, Daniels commenced a series of transactions between the Lyxor Fund and the Master Fund that generated more than \$1.4 million in profits for the Lyxor Fund.

88. Thus, on September 24, Daniels sold one bond from the Lyxor Fund to the Master Fund at 103.50. On October 1, Daniels arranged for the Lyxor Fund to repurchase the bond back from the Master Fund at 99.06. Eight days later, Beacon Hill sold the bond from the Lyxor Fund to a third party at 101.82.

89. On September 25, Daniels sold two bonds from the Master Fund to Lyxor at 99.00 and 98.9375 respectively. Five days later, Daniels arranged for the Master Fund to repurchase the same bonds from the Lyxor Fund at 104.50 and 103.75 respectively.

90. The profits generated by these trades had a significant impact on the valuations and performance of the managed accounts. For example, for month-end July, HSBC had reported net assets of more than \$34 million. The profit generated by the two sales to the Master Fund on July 22 (approximately \$1.1 million) by themselves constituted more than 3% of the total assets under management in the HSBC fund at month-end July. Without the profit generated by these trades, HSBC's performance for the month would have been considerably worse than the loss (-0.09%) that Beacon Hill reported for the month. Similarly, the September-October trades back and forth between the Lyxor Fund and the Master Fund, involving just three bonds, generated profits that constituted more than 1.4% of the assets in the Lyxor Fund during this period. Compared to the average reported monthly performance of approximately 1.3% for the Lyxor Fund in 2002, the transactions in these bonds produced significant returns. The transactions

improved, to a material degree, the managed accounts performance for these months, at the expense of the Master Fund.

91. Beacon Hill initiated other trading between the Master Fund and the managed accounts during July, August and September. Unlike the sales by the managed accounts to the Master Fund, each of these trades were sales by the Master Fund to the managed accounts. In each of these sales by the Master Fund, Beacon Hill sold the bonds from the Master Fund to the managed accounts at prices below the corresponding marks placed on the bonds by IDC.

92. Neither the trading between the Master Fund and the managed accounts, nor the conflicts of interest involved in that trading, was disclosed to investors in the Funds.

#### **The Principals' Self-Dealing With The Master Fund**

93. Three of the four principals of Beacon Hill, Daniels, Barry and Irwin, established and maintained their own personal account at Beacon Hill, Asset Risk Management, LLC (“ARM”), although Daniels put his account in his wife’s name. This fund invested primarily in asset-backed bonds, some of which were also held by the Master Fund. Beacon Hill was the manager of ARM.

94. In late July, during the same period that Beacon Hill sold bonds at inflated prices from the managed accounts to the Master Fund, Irwin (on behalf of himself, Daniels and Barry) arranged for Beacon Hill to sell two bonds from the Master Fund to ARM, each at a price substantially below the valuations that Beacon Hill had placed on the bonds. When they subsequently sold the two bonds back to the Master Fund in

September, the three Beacon Hill principals made almost \$500,000 from the earlier purchases.

95. Thus, on July 19, 2002, Irwin directed the sale of one bond from the Master Fund to ARM at 78.00. Both before and after the sale to ARM, Beacon Hill valued the bond for Master Fund NAV calculations at prices substantially higher than the sale price to ARM. Prior to the sale, Beacon Hill had consistently priced the bond, for Master Fund month-end NAV calculations, at marks for the bond ranging from 93.00 (March) to 94.138 (May). After the July 19 sale to ARM, the Master Fund NAV marks ranged from 95.1949 (July) to 98.12 (August). When, on September 20, Irwin directed ARM to sell the bond back to the Master Fund, he did so at a price (91.09) that was far more consistent with the NAV valuations Beacon Hill had initially placed on the bond, and that generated a profit to ARM of more than \$350,000.

96. Also on July 19, 2002, Irwin sold a second bond from the Master Fund to ARM. The sale price of 82.50 was below the valuation of 84.53 that Beacon Hill had consistently assigned to the bond in each of the four preceding months and that Beacon Hill continued to assign to the bond at month-end July. On September 20, Irwin directed ARM to sell the bond back to the Master Fund at 89.50, resulting in a profit to ARM of more than \$120,000.

97. These trades constituted a conflict of interest for Beacon Hill that was not disclosed by the principals to the Funds' investors, in violation of Beacon Hill's fiduciary duties.

### **Beacon Hill's Financial Incentives to Commit Fraud**

98. The fraudulent manipulation of Beacon Hill's valuations in 2002 was motivated, at least in part, by significant financial incentives and disincentives that the four principals shared as a result of the Asset Alliance purchase agreement. For the year ending on September 30, 2002, the principals of Beacon Hill together stood to earn approximately \$26 million from Asset Alliance or to be required to pay Asset Alliance approximately \$7 million, based in large part on the performance of the Bristol Fund and Safe Harbor Fund. To maximize their earnout for this period, Beacon Hill needed to generate total performance returns (for most of its funds) of 18.75% and increase assets under management (as determined by an agreed-upon formula) by \$333 million. At the same time, if Beacon Hill's growth in net assets and returns, among other things, did not meet a certain level of performance projected for 2002 when the prior earnout was paid, the applicable "clawback" provision would require the principals of Beacon Hill to pay back to Asset Alliance up to approximately \$7 million of the earlier earnout.

99. Despite their knowledge that the Master Fund was suffering losses at least as early as June and continuing through September, Beacon Hill and its principals hid the losses and continued to stress to investors Beacon Hill's historical and current purported positive performances.

100. Beacon Hill's marketing efforts were successful, as investors poured large amounts of money into the feeder funds while withdrawing relatively small amounts. For the six months from April through September 2002, inflows into the feeder funds were approximately \$350 million, of which \$250 million was deposited from June through September. Redemptions during the same period totaled only approximately \$22 million.

By hiding losses in the Funds and falsely emphasizing steady positive performance, the principals of Beacon Hill successfully increased Beacon Hill's assets under management to meet one of the two requirements for the maximum earnout from Asset Alliance.

101. Indeed, despite specific knowledge of losses and growing problems with Beacon Hill's internal data, in early-September 2002, with Beacon Hill's reported numbers and representations indicating that the principals were on target to reach the performance goal, Barry and Miskiewicz approached Asset Alliance in an unsuccessful attempt to persuade Asset Alliance to increase the earnout for the period ending September 30, 2002. The principals argued that they were entitled to the increase as a result of their successes in increasing assets and generating larger than anticipated management fees.

#### **Beacon Hill's Responses to Warnings of Growing Losses**

102. Contemporaneous with the preparation and issuance of the valuations used for the August 30, 2002 NAV, the principals of Beacon Hill knew that the Funds were suffering enormous losses. Despite this information, the principals of Beacon Hill continued to mislead investors, Bear Stearns and Asset Alliance about the net valuation and performance of the Funds. In addition, the principals attempted to cover up their fraud.

103. As already noted, in late August, an employee had expressed concern to Miskiewicz about some of the OAS and duration numbers generated by Beacon Hill's computer programs. Miskiewicz had told the employee that he would speak to the other principals. The same employee again approached Miskiewicz in mid-September to

warn him of large losses in the Master Fund arising from the continuing fall in interest rates.

104. Following those warnings, Miskiewicz and Daniels directed the employee to begin comparing Beacon Hill's prices with those of Bear Stearns and IDC. By October 3, 2002, the employee provided Miskiewicz with a spreadsheet showing that the value of the Master Fund portfolio declined by more than 50% when using IDC and Bear Stearns instead of Beacon Hill's internal prices.

105. The principals of Beacon Hill were aware of these price comparisons and the magnitude of the valuation problem when they falsely announced a 25% loss to investors on October 7.

#### **The Liquidation Of The ARM Portfolio**

106. Within days of Miskiewicz being warned by an employee that the Master Fund was suffering large losses, the principals of ARM abruptly liquidated most of the ARM portfolio by selling the nine largest bonds to the Master Fund. On September 20, 2002, Irwin (on behalf of himself, Daniels and Barry) directed the trades of the asset-backed securities to the Master Fund.

107. One Beacon Hill employee, having learned of the liquidation, went to Miskiewicz to complain about the principals selling their own bonds and not those in the Master Fund. Miskiewicz promised to discuss the matter with the other principals. However, Miskiewicz allowed the liquidation of the ARM securities and the principals' undisclosed self-dealing with the Master Fund to continue.

108. The three principals of ARM received a total of approximately \$16 million from the liquidation of the ARM portfolio in September 2002. Those proceeds were

transferred out of ARM's brokerage account at Bear Stearns on October 1, 2002. Soon after, all of the recipients of the ARM proceeds invested all or a substantial amount of the monies they received from the ARM liquidation in their wives' names in the Victory Fund (another fund in which all four of the Beacon Hill principals had an ownership interest).

109. The defendants never notified investors in the Master Fund of the above self-dealing transactions. The transactions were in violation of their fiduciary duty to investors and constituted further fraudulent activity. Daniels, Barry, and Irwin knew of or were reckless in not knowing of the self-dealing transactions and directly benefited from the transactions. Miskiewicz knew of or was reckless in not knowing of this self-dealing and allowed it to occur.

#### **False Weekly Estimates And Misleading Assurances**

110. During September 2002, when the Beacon Hill principals were well aware of the valuations problems and bet on interest rates, Beacon Hill continued to assure investors that all was well. However, beginning with the week ended September 20, Beacon Hill stopped sending out the weekly reports that it had routinely sent to investors. These weekly reports contained an estimate of the Funds' performance for the week and the month. Daniels now limited the distribution of these reports to those investors who specifically complained and wanted them. The reports distributed in September to investors did not reflect the severe problems that the Funds were experiencing.

111. In addition to these misleading weekly estimates, Beacon Hill spoke to a number of fund managers in September who called or came to meet with the principals. These managers, representing funds that had invested in the Beacon Hill Funds, were assured that everything was fine.

### **Misrepresentations to Bear Stearns**

112. On September 19, 2002, Miskiewicz met with representatives of Bear Stearns. Miskiewicz told Bear Stearns that the Master Funds' current valuation was approximately \$750 million, when he knew that the Master Fund had suffered huge losses and there were serious questions about this valuation. Miskiewicz later repeated this misrepresentation in a call with Bear Stearns on October 1, 2002. In neither the meeting nor the call did Miskiewicz disclose any problems that Beacon Hill had been experiencing with its hedging models or with the valuation of the Master Fund.

### **Beacon Hill's Attempted Cover-up**

113. By the beginning of October 2002, Beacon Hill was facing not only a financial crisis, but also questions about its portfolio valuations from Bear Stearns, its prime broker. On October 1, in response to Miskiewicz's misrepresentation to Bear Stearns of the net valuation of the Master Fund, Bear Stearns sent Beacon Hill a spreadsheet listing each of the securities in the Master Fund that it had custody of, and showing that Bear Stearns' prices resulted in a net valuation of approximately \$250 million. Bear Stearns insisted that Beacon Hill address the apparent and substantial discrepancy in the net value of the Master Fund.

114. On October 3, Miskiewicz received a detailed spreadsheet comparing, as of September 30, 2002, Beacon Hill's prices for each of the securities in the Master Fund portfolio with those of IDC and Bear Stearns. This spreadsheet showed that using these independent pricing marks, the portfolio suffered a loss in net valuation of more than 50% from the previously reported August 30, 2002 NAV of \$750 million.

115. On or about October 3, Daniels and Barry contacted a few institutional managers to warn them that the Funds had sustained large losses. One of those managers was assured by Daniels and Miskiewicz that there was no danger of a 50% melt-down, in spite of the internal price comparisons that showed a 50% loss if independent prices were used for the securities in the Master Fund.

116. Miskiewicz discussed the losses with the other principals. They decided to announce to investors that the Funds had lost (as of September 30) about 25% of their net valuation since August, despite their knowledge that the actual losses were in excess of 25%.

117. One employee approached Miskiewicz to warn him about announcing a loss of only 25% when Beacon Hill's internal analysis showed losses of more than 50% when using third-party prices. When Miskiewicz explained that the principals did not believe the losses were so great and that they expected to make some of the losses back when interest rates turned, the employee cautioned Miskiewicz that things would blow up if they insisted on reporting losses lower than the funds actually experienced. The employee suggested that someone would go to jail.

118. On October 7, 2002, Beacon Hill's staff was formally told that Beacon Hill was going to announce a loss of approximately 25% in the net valuation of the Funds.

### **Beacon Hill's Fraudulent Loss Announcement**

119. On October 7 Beacon Hill issued the first of its two loss announcements: "In September the 10-year Treasury yield reached the lowest yield on record causing expectations of increased refinancings. The September 27<sup>th</sup> Refi Index has confirmed

that September was the largest month in recorded history for refinancing. The result was that our 'short' Treasury hedge increased in price while asset prices remained stable. This adverse hedge movement caused the majority of the loss." The announced loss was 25%.

120. Beacon Hill's announcement contained at least two misrepresentations or omissions to investors, of which the Beacon Hill principals were fully aware. First, Beacon Hill's internal analyses, as well as the Bear Stearns pricing spreadsheet, did not support the announced loss of only 25% but showed that the losses were much higher. Second, Beacon Hill failed to disclose that the losses resulted from its prior use of highly inflated CMO valuations, as the price comparison spreadsheets made clear.

### **The Collapse of the Cover-Up**

121. The principals' attempts to hide the extent of the losses in the Funds failed. On October 10, Bear Stearns notified the Commission that Beacon Hill valued the Master Fund portfolio far in excess of Bear Stearns' valuation of it and that Bear Stearns was concerned about the discrepancy.

122. On October 17, 2002, Beacon Hill finally informed investors in the Bristol Fund and the Safe Harbor Fund that the losses were approximately 54%, more than double what Beacon Hill had previously reported (but consistent with Beacon Hill's undisclosed internal pricing comparisons). Following the announcement, the Beacon Hill principals declined to meet with the Commission, and, subsequently, asserted their Fifth Amendment Privilege against Self-Incrimination.

### **Relief Defendants**

123. All of the relief defendants are sued in this action to enable the Court to provide complete interim and final relief on the Commission's claims against the defendants.

124. Relief defendants Master Fund, Bristol Fund, Safe Harbor Fund, Milestone, and Milestone Global Advisors either possess or have control over assets or proceeds directly and indirectly related to the underlying violations of the federal securities laws alleged against the defendants.

125. Safe Harbor Asset Management ("SHAM") obtained monies as a result of the illegal conduct of the principals of Beacon Hill, its 99% owner.

126. Relief defendants Jennifer Tindell, Nancy Daniels, Marie Irwin, and Ellen Lynch received monies illegally obtained by their husbands, defendants Barry, Daniels, Irwin, and Miskiewicz.

127. Daniels gave substantial monies to his wife during 2002 that were the direct or indirect proceeds of his illegal conduct. For example, Daniels invested in the ARM portfolio under his wife's name. While the investment in the ARM account was in Nancy Daniels' name, Beacon Hill treated Tom Daniels as the owner. Daniels deposited \$8.4 million from the ARM liquidation into his wife's new bank account on or about October 1, 2002. The same or next day, \$8.4 million was transferred from Nancy Daniels' account into other funds in which the principals of Beacon Hill had a financial interest, \$3.4 million into Victory Fund, L.P. and \$5 million into Victory Macro Fund, L.P. (most of this \$5 million was subsequently transferred into Victory Fund, L.P.). The investments were in her name. As a result, Daniels unjustly enriched his wife and she

has no claim to the proceeds that he transferred to her and any assets acquired with those proceeds.

128. Barry gave substantial monies to his wife during 2002 that were the direct or indirect proceeds of his illegal conduct. For example, \$3.268 million from Barry's interest in the ARM liquidation was transferred into Barry and Tindell's joint bank account on or about October 1, 2002. The same day, a \$2 million check was written on that account to Victory Macro Fund, L.P. The account listed Tindell as the investor. The \$2 million later was transferred to Victory Fund, L.P. in Tindell's name. As a result, Barry unjustly enriched his wife and she has no claim to the proceeds that he transferred to her and any assets acquired with those proceeds.

129. Irwin gave substantial monies to his wife during 2002 that were the direct or indirect proceeds of his illegal conduct. For example, \$4.8 million from Irwin's interest in the ARM liquidation was transferred into his and his wife's bank account on or about October 1, 2002. On or about October 3, 2002, \$4 million was transferred from that account into Marie Irwin's new bank account. On or about November 4, 2002, Marie Irwin wrote a \$2 million check to Victory Fund, L.P. The investment was in her name. As a result, Irwin unjustly enriched his wife and she has no claim to the proceeds that he transferred to her and any assets acquired with those proceeds.

130. Miskiewicz gave substantial monies to his wife during 2002 that were the direct or indirect proceeds of his illegal conduct. For example, in the first six months of 2002, after receiving compensation from Beacon Hill, Miskiewicz made transfers of at least \$200,000 to his wife. As a result, Miskiewicz unjustly enriched his wife and she

has no claim to the proceeds that he transferred to her and any assets acquired with those proceeds.

### **COUNT ONE**

Violations of Section 17(a) of the Securities Act by Defendants Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz

131. Paragraphs 1 through 130 are repeated and re-alleged as if fully set forth herein.

132. Defendants Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz, in the offer or sale of securities, directly or indirectly, by the use of means or instruments of transportation or communication in interstate commerce, or by the use of the mails: (a) employed devices, schemes or artifices to defraud; (b) obtained money or property by means of untrue statements of material facts or omissions to state material facts necessary in order to make the statements made, not misleading; or (c) engaged in transactions, practices or courses of business which operated or would operate as a fraud or deceit upon purchasers of securities.

133. Defendants knew or were reckless or negligent in not knowing of the conduct described in the allegations.

134. By reason of the foregoing, defendants Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz violated Section 17(a) (1), (2), and (3) of the Securities Act.

### **COUNT TWO**

Violations of Section 10(b) of the Exchange Act, and Rule 10b-5 Thereunder, by Defendants Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz

135. Paragraphs 1 through 134 are repeated and re-alleged as if fully set forth herein.

136. Defendants Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz, in connection with the purchase or sale of securities, directly or indirectly, by use of the means or instruments of interstate commerce, or of the mails, or of a facility of a national securities exchange: (a) employed devices, schemes and artifices to defraud; (b) made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (c) engaged in acts, transactions, practices and courses of business which operated or would operate as a fraud or deceit upon investors.

137. Defendants knew or were reckless in not knowing of the conduct described in the allegations.

138. By reason of the foregoing, defendants Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

### **COUNT THREE**

Violations of Section 206(1) and (2) of the Advisers Act by Defendant Beacon Hill;  
Aiding and Abetting of the Violations by Defendants Barry, Daniels, Irwin, and  
Miskiewicz

139. Paragraphs 1 through 138 are repeated and re-alleged as if fully set forth herein.

140. Beacon Hill acted as an investment adviser to the Funds. For compensation, Beacon Hill engaged in the business of advising the Funds and their shareholders, directly and through publications and writings, as to the value of securities and as to the advisability of investing in, purchasing, or selling securities. As an investment adviser, Beacon Hill also was a fiduciary to the Funds.

141. Beacon Hill, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce: (1) employed devices, schemes or artifices to defraud a client or prospective client; and (2) engaged in transactions, practices or courses of business which operated as a fraud or deceit upon a client or prospective client.

142. Beacon Hill knew or was reckless or negligent in not knowing of the conduct described in the allegations. By reason of the foregoing, Beacon Hill violated Sections 206(1) and (2) of the Advisers Act.

143. As the principals and primary actors of Beacon Hill, defendants Barry, Daniels, Irwin, and Miszkiewicz each were aware that they were participating in Beacon Hill's violations, and they knowingly or recklessly, and substantially, assisted the violations. By reason of the foregoing, defendants Barry, Daniels, Irwin, and Miszkiewicz aided and abetted Beacon Hill's violations of Sections 206(1) and (2) of the Advisers Act.

#### **COUNT FOUR**

Violations of Section 206(3) of the Advisers Act by Defendant Beacon Hill; Aiding and Abetting of the Violations by Defendants Barry, Daniels, Irwin, and Miszkiewicz

144. Paragraphs 1 through 143 are repeated and re-alleged as if fully set forth herein.

145. Beacon Hill, through its principals, defendants Barry, Daniels, Irwin, and Miszkiewicz, acted as an investment adviser to the Funds. For compensation, Beacon Hill engaged in the business of advising the Funds and their shareholders, directly and through publications and writings, as to the value of securities and as to the advisability

of investing in, purchasing, or selling securities. As an investment adviser, Beacon Hill also was a fiduciary to the Funds.

146. Beacon Hill acted as an investment adviser to the Funds in connection with the sales and purchases of securities between ARM and the Master Fund.

147. Beacon Hill, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, acted as principal for ARM (the account of Beacon Hill's principals) and knowingly sold securities to and purchased securities from its client, the Master Fund (and, thus, the feeder funds), without disclosing in writing before the transactions were completed the capacity in which Beacon Hill was acting and obtaining the Master Fund's or feeder funds' consent to the transactions.

148. By reason of the foregoing, Beacon Hill violated Section 206(3) of the Advisers Act.

149. As the principals and primary actors of Beacon Hill, defendants Barry, Daniels, Irwin, and Miszkiewicz each were aware that they were participating in Beacon Hill's violations, and they knowingly or recklessly, and substantially, assisted the violations. By reason of the foregoing, defendants Barry, Daniels, Irwin, and Miszkiewicz aided and abetted Beacon Hill's violations of Sections 206(3) of the Advisers Act.

## **COUNT FIVE**

### Relief Defendants

150. Paragraphs 1 through 149 are repeated and re-alleged as if fully set forth herein.

151. Relief defendants Jennifer Tindell, Nancy Daniels, Marie Irwin, and Ellen Lynch were unjustly enriched through the monies that they received from their husbands and for which they did not give adequate consideration. These monies derived directly or indirectly from the illegal conduct of their defendant husbands.

152. Relief defendant SHAM was unjustly enriched through the monies it received that derived directly or indirectly from the illegal conduct of Beacon Hill and the principals, and for which it did not give adequate consideration.

153. Relief defendants Master Fund, Bristol Fund, Safe Harbor Fund, Milestone, and Milestone Global Advisors have control over assets or proceeds directly or indirectly related to the underlying violations of the federal securities laws by Beacon Hill and its four principals.

#### **PRAYER FOR RELIEF**

154. WHEREFORE, the Commission respectfully requests that this Court:

155. Enter an order permanently enjoining defendants Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz from future violations, and aiding and abetting future violations, of Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a); Section 10(b) of the Exchange Act, 15 U.S.C. §§ 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; and Section 206 of the Advisers Act, 15 U.S.C. § 80b-6;

156. Enter an order directing defendants, Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz to disgorge any ill-gotten gains realized from the conduct alleged herein and to pay prejudgment interest thereon;

157. Enter an order directing defendants Beacon Hill, Barry, Daniels, Irwin, and Miskiewicz to pay civil penalties pursuant to Section 20(d) of the Securities Act, 15

U.S.C. § 77t(d); Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3); and Section 209(e) of the Advisers Act, 15 U.S.C. § 80b-9;

158. Enter an order directing relief defendants Jennifer Tindell, Nancy Daniels, Marie Irwin, Ellen Lynch, and Safe Harbor Asset Management to disgorge any ill-gotten gains realized from the conduct alleged herein and to pay prejudgment interest thereon;

159. Enter an order directing the final distribution and disposition of the remaining assets and proceeds of relief defendants Master Fund, Bristol Fund, Safe Harbor Fund, Milestone and Milestone Global Advisors; and

160. Enter an order granting such further and other relief, as the Court may deem just and equitable.

Respectfully submitted,

Dated: June 15, 2004

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