

40-33

PaulHastings

Paul, Hastings, Janofsky & Walker LLP
75 East 55th Street, New York, New York 10022-3205
telephone 212-318-6000 / facsimile 212-319-4090 / internet www.paulhastings.com

Atlanta
Beijing
Hong Kong
London
Los Angeles
New York
Orange County
San Diego
San Francisco
Stamford
Tokyo
Washington, D.C.

(212) 318-6713
christophertafone@paulhastings.com

January 8, 2004

VIA UPS NEXT DAY AIR

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Attention: Filing Desk

Re: **Excelsior Funds, Inc., Excelsior Tax-Exempt Funds, Inc. and
* Excelsior Funds Trust (the "Funds") ***
Registration Nos. 811-4088, 811-4101 and 811-8490

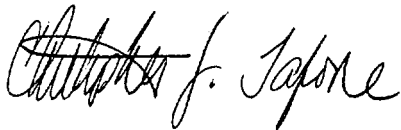
Ladies and Gentlemen:

On behalf of the Funds and pursuant to Section 33 of the Investment Company Act of 1940, as amended, we hereby transmit for filing a copy of a class action complaint that was originally filed on October 22, 2003, in the Superior Court of the State of California, County of Los Angeles, against the Funds (as Doe Defendants), as well as against Janus Capital Corp., et al.

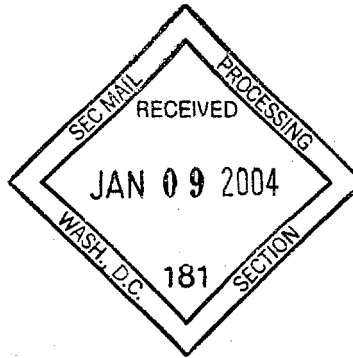
We have enclosed a pre-paid, self-addressed envelope and kindly request that you return a copy of this letter with evidence of filing.

Should you have any questions regarding this matter, please do not hesitate to contact the undersigned at the above number. Thank you.

Very truly yours,



Christopher J. Tafone
of PAUL, HASTINGS, JANOFSKY & WALKER LLP



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811-8490

37269.00001

PROCESSED

JAN 29 2004

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FINANCIAL

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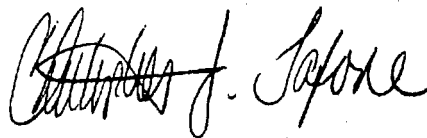
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Very truly yours,



Christopher J. Tafone
of PAUL, HASTINGS, JANOFSKY & WALKER LLP

SUMMONS
(CITACION JUDICIAL)

2:57 p.m. 12/3/03
Karin Umanito
Served in person

NOTICE TO DEFENDANT: (Aviso a Acusado)
IANUS CAPITAL CORPORATION

(Additional Defendants listed on attached page)

YOU ARE BEING SUED BY PLAINTIFF:
(A Ud. le está demandando)
MIKE SAYEGH, on Behalf of the General Public,

FOR COURT USE ONLY
(SOLO PARA USO DE LA CORTE)

You have 30 CALENDAR DAYS after this summons is served on you to file a typewritten response at this court.

A letter or phone call will not protect you; your typewritten response must be in proper legal form if you want the court to hear your case.

If you do not file your response on time, you may lose the case, and your wages, money and property may be taken without further warning from the court.

There are other legal requirements. You may want to call an attorney right away. If you do not know an attorney, you may call an attorney referral service or a legal aid office (listed in the phone book).

Después de que le entreguen esta citación judicial usted tiene un plazo de 30 DÍAS CALENDARIOS para presentar una respuesta escrita a máquina en esta corte.

Una carta o una llamada telefónica no le ofrecerá protección; su respuesta escrita a máquina tiene que cumplir con las formalidades legales apropiadas si usted quiere que la corte escuche su caso.

Si usted no presenta su respuesta a tiempo, puede perder el caso, y le pueden quitar su salario, su dinero y otras cosas de su propiedad sin aviso adicional por parte de la corte.

Existen otros requisitos legales. Puede que usted quiera llamar a un abogado inmediatamente. Si no conoce a un abogado, puede llamar a un servicio de referencias de abogados o a una oficina de ayuda legal (vea el directorio telefónico).

The name and address of the court is: (El nombre y dirección de la corte es)

LOS ANGELES COUNTY SUPERIOR COURT
111 NORTH HILL STREET
LOS ANGELES, CA 90012

CASE NUMBER: (Número del caso)

80304655

The name, address, and telephone number of plaintiff's attorney, or plaintiff without an attorney, is:
(El nombre, la dirección y el número de teléfono del abogado del demandante, o del demandante que no tiene abogado, es)

Lionel Z. Glancy, Glancy & Binkow LLP, 1801 Avenue of the Stars, Suite 311, Los Angeles, CA 90067
(310)201-9150

DATE: OCT 22 2003
(Fecha)

JOHN A. CLARKE, CLERK

W. Coleman, Deputy
(Delegado)

NOTICE TO THE PERSON SERVED: You are served

1. ☒ is an individual defendant.
2. ☒ as the person sued under the fictitious name of (specify): **DOE 5**
3. ☒ on behalf of (specify): **EXCELSIOR FUNDS, INC.**
under: ☒ CCP 416.10 (corporation)
☐ CCP 416.20 (defunct corporation)
☐ CCP 416.40 (association or partnership)
☐ other:
4. ☐ by personal delivery on (date):

Form Adopted by Rule 202
Judicial Council of California
002(a)(5) (Rev. January 1, 1994)

(See reverse for Proof of Service)
SUMMONS

CCP 416.30

20 'd RECEIVED TIME DEC. 4, '0 8:28AM

PRINT TIME DEC. 4, '0 9:14AMZ-EO-030

SHORT TITLE:

MIKE SAYEGH v. JANUS CAPITAL CORP., ET AL

CASE NUMBER:

- 1 1. JANUS CAPITAL CORPORATION
- 2 2. JANUS CAPITAL MANAGEMENT LLC
- 3 3. JANUS INVESTMENT FUND
- 4 4. EDWARD J. STERN
- 5 5. CANARY CAPITAL PARTNERS LLC
- 6 6. CANARY INVESTMENT MANAGEMENT LLC
- 7 7. CANARY CAPITAL PARTNERS, LTD.
- 8 8. KAPLAN & CO. SECURITIES INC.
- 9 9. BANK ONE CORPORATION
- 10 10. BANC ONE INVESTMENT ADVISORS
- 11 11. THE ONE GROUP MUTUAL FUNDS
- 12 12. BANK OF AMERICA CORPORATION
- 13 13. BANC OF AMERICA CAPITAL MANAGEMENT LLC
- 14 14. BANC OF AMERICA ADVISORS LLC
- 15 15. NATIONS FUND INC.
- 16 16. ROBERT H. GORDON
- 17 17. THEODORE H. SIHPOL III
- 18 18. CHARLES D. BRYCELAND
- 19 19. SECURITY TRUST COMPANY
- 20 20. STRONG CAPITAL MANAGEMENT INC.
- 21 21. JB OXFORD & COMPANY
- 22 22. ALLIANCE CAPITAL MANAGEMENT HOLDING L.P.
- 23 23. ALLIANCE CAPITAL MANAGEMENT L.P.
- 24 24. ALLIANCE CAPITAL MANAGEMENT CORPORATION
- 25 25. AXA FINANCIAL INC.
- 26 26. ALLIANCEBERNSTEIN REGISTRANTS
- 27 27. GERALD MALONE
- 28 28. CHARLES SCHAFFRAN
- 29 29. MARSH & MCLENNAN COMPANIES, INC.
- 30 30. PUTNAM INVESTMENTS TRUST
- 31 31. PUTNAM INVESTMENT MANAGEMENT LLC
- 32 32. PUTNAM INVESTMENT FUNDS
- 33 33. DOES 1-500.

(Required for verified pleading) The items on this page stated on information and belief are (specify item numbers, not line numbers): Named Defendants in this Action

This page may be used with any Judicial Council form or any other paper filed with the court.

Page 3

80 'd RECEIVED TIME DEC. 4. 'C 8:28AM

PRINT TIME DEC. 4. 'C 9:14AM 2-60-020

PROOF OF SERVICE — SUMMONS
(Use separate proof of service for each person served)

1. I served the

- a. ☒ summons ☐ complaint ☐ amended summons ☐ amended complaint
completed and blank Case Questionnaires ☐ Other (specify):

b. on defendant (name):

c. by serving ☐ defendant ☐ other (name and title or relationship to person served):

d. ☐ by delivery ☐ at home ☐ at business

(1) date:

(2) time:

(3) address: _____

e. ☐ by mailing

(1) date:

(2) place:

2. Manner of service (check proper box):

a. ☐ Personal service. By personally delivering copies. (CCP 415.10)

b. ☐ Substituted service on corporation, unincorporated association (including partnership), or public entity. By leaving, during usual office hours copies in the office of the person served with the person who apparently was in charge and thereafter mailing (by first-class mail, postage prepaid) copies to the person served at the place where the copies were left. (CCP 415.20(a))

c. ☐ Substituted service on natural person, minor, conservatee, or candidate. By leaving copies at the dwelling house, usual place of abode, or usual place of business of the person served in the presence of a competent member of the household or a person apparently in charge of the office or place of business, at least 18 years of age, who was informed of the general nature of the papers, and thereafter mailing (by first-class mail, postage prepaid) copies to the person served at the place where the copies were left. (CCP 415.20(b)) (Attach separate declaration or affidavit stating acts relied on to establish reasonable diligence in first attempting personal service.)

d. ☐ Mail and acknowledgment service. By mailing (by first-class mail or airmail, postage prepaid) copies to the person served, together with two copies of the form of notice and acknowledgment and a return envelope, postage prepaid, addressed to the sender. (CCP 416.30) (Attach completed acknowledgment of receipt.)

e. ☐ Certified or registered mail service. By mailing to an address outside California (by first-class mail postage prepaid, requiring a return receipt) copies to the person served. (CCP 413.40) (Attach signed return receipt or other evidence of actual delivery to the person served.)

f. ☐ Other (specify code section):

☐ additional page is attached.

3. The "Notice to the Person Served" (on the summons) was completed as follows (CCP 412.80, 415.10, and 474):

a. ☐ as an individual defendant.

b. ☐ as the person sued under the fictitious name of (specify):

c. ☐ on behalf of (specify):

under: ☐ CCP 416.10 (corporation)
☐ CCP 416.20 (defunct corporation)
☐ CCP 416.40 (association or partnership)

☐ CCP 416.60 (minor)
☐ CCP 416.70 (conservatee)
☐ CCP 416.90 (individual)

☐ other:

d. ☐ by personal delivery on (date):

4. At the time of service I was at least 18 years of age and not a party to this action.

5. Fee for service: \$

6. Person serving:

a. ☐ California sheriff, marshal, or constable.

b. ☐ Registered California process server.

c. ☐ Employee or independent contractor of a registered California process server.

d. ☐ Not a registered California process server.

e. ☐ Exempt from registration under Bus. & Prof. Code 22350(b).

f. Name, address and telephone number and, if applicable, county of registration and number.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

(For California sheriff, marshal, or constable use only)
I certify that the foregoing is true and correct.

Date:

Date:

(SIGNATURE)

(SIGNATURE)

pc2(c)(6) (Rev. January 1, 1994)

RECEIVED TIME DEC. 4. '88 8:28AM

PRINT TIME DEC. 4. '88 9:14AM 2-80-030

1 LIONEL Z. GLANCY #134180
2 PETER A. BINKOW #173848
3 MICHAEL GOLDBERG #188669
4 GLANCY & BINKOW LLP
5 1801 Avenue of the Stars, Suite 311
6 Los Angeles, CA 90067
7 Telephone: (310) 201-9150
8 Facsimile: (310) 201-9160

9 BRIAN BARRY #125631
10 LAW OFFICES OF BRIAN BARRY
11 1801 Avenue of the Stars Suite 307
12 Los Angeles, CA 90067
13 Telephone: (310) 788-0831
14 Facsimile: (310) 788-0841

15 *Attorneys for Plaintiff Mike Sayegh*

16 SUPERIOR COURT OF THE STATE OF CALIFORNIA
17 COUNTY OF LOS ANGELES

18 MIKE SAYEGH, on Behalf of the General
19 Public,

20 Plaintiff,

21 v.

22 JANUS CAPITAL CORPORATION, JANUS
23 CAPITAL MANAGEMENT LLC, JANUS
24 INVESTMENT FUND, EDWARD J. STERN,
25 CANARY CAPITAL PARTNERS LLC,
26 CANARY INVESTMENT MANAGEMENT
27 LLC, CANARY CAPITAL PARTNERS,
28 LTD., KAPLAN & CO. SECURITIES INC.,
BANK ONE CORPORATION, BANC ONE
INVESTMENT ADVISORS, THE ONE
GROUP MUTUAL FUNDS, BANK OF
AMERICA CORPORATION, BANC OF
AMERICA CAPITAL MANAGEMENT
LLC, BANC OF AMERICA ADVISORS
LLC, NATIONS FUND INC., ROBERT H.
GORDON, THEODORE H. SHIPOL III,
CHARLES D. BRYCELAND, SECURITY
TRUST COMPANY, STRONG CAPITAL
MANAGEMENT INC., JB OXFORD &
COMPANY,

29 *[Caption Continues On Next Page]*

ORIGINAL FILED

OCT 22 2003

LOS ANGELES
SUPERIOR COURT

Case No.

BC304655

PRIVATE ATTORNEY GENERAL
COMPLAINT ON BEHALF OF THE
GENERAL PUBLIC FOR:

1. VIOLATIONS OF BUSINESS AND
PROFESSIONS CODE §17200
(Restitution and Injunctive Relief)

JURY TRIAL DEMANDED

PRIVATE ATTORNEY GENERAL COMPLAINT

RECEIVED TIME DEC. 4, 2003 8:28AM

PRINT TIME DEC. 4, 2003 9:14AM 2-80-030

1 ALLIANCE CAPITAL MANAGEMENT
2 HOLDING L.P., ALLIANCE CAPITAL
3 MANAGEMENT L.P., ALLIANCE
4 CAPITAL MANAGEMENT
5 CORPORATION, AXA FINANCIAL INC.,
6 ALLIANCEBERNSTEIN REGISTRANTS,
7 GERALD MALONE, CHARLES
8 SCHAFFRAN, MARSH & MCLENNAN
9 COMPANIES, INC., PUTNAM
10 INVESTMENTS TRUST, PUTNAM
11 INVESTMENT MANAGEMENT LLC,
12 PUTNAM INVESTMENT FUNDS, and
13 DOES 1-500.

14 Defendants.

15 Plaintiff makes the following allegations upon information and belief, except as to the
16 allegations specifically pertaining to plaintiff and his counsel, based on the facts alleged below,
17 and predicated upon the investigation undertaken by and under the supervision of plaintiff's
18 counsel. Plaintiff believes that further substantial evidentiary support will exist for the
19 allegations set forth below after a reasonable opportunity for discovery.

20 I.

21 INTRODUCTION

22 1. This is a civil action brought by Mike Sayegh against Defendants named herein
23 who engaged in the improper schemes discussed herein relating to "market timing" and "late
24 trading" of mutual fund shares. Plaintiff, for himself and all other members of the general
25 public, brings an action for monetary damages for Defendants' violations of Business and
26 Professions Code §17200, et. seq.

27 II.

28 JURISDICTION AND VENUE

1 This Complaint is filed and these proceedings are instituted pursuant to §17200
2 of the California Business and Professions Code (hereinafter "17200"), for restitution and
3 injunctive relief due to violations of §17200, et seq., by the Defendants and their co-
4 conspirators.

5 3. Jurisdiction and venue as to each Defendant is proper in this judicial district

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 1

1 pursuant to the provisions of §17200 and §§395(a) and 395.5 of the California Code of Civil
2
3 Procedure. Each Defendant either maintains an office, has an agent or transacts
4 business, directly or indirectly, in the County of Los Angeles. Plaintiff's cause of action arose
5 in part within the County of Los Angeles, and numerous of the transactions at issue took place
6 in this County. Many of the unlawful acts hereinafter alleged had a direct effect on investors
7 within the State of California and, more particularly, within the County of Los Angeles. The
8 trade and commerce hereinafter described is carried on, in part, within the State of California,
9 and, more particularly, within the County of Los Angeles. Plaintiff also resides in the County of
10 Los Angeles.

11 4. In connection with the acts alleged in this complaint, Defendants, directly or
12 indirectly, used the means and instrumentalities of interstate commerce, including, but not
13 limited to, the mails, interstate telephone communications and the facilities of the national
14 securities markets.

15 III.

16 SUMMARY OF ACTION

17 This action charges Defendants with engaging in an unlawful and deceitful course of
18 conduct designed to improperly financially advantage certain co-Defendants to the detriment of
19 others. Plaintiff owned shares of Janus mutual funds, which were improperly traded as
20 described herein. As part of Defendants' unlawful conduct, the Fund Defendants, as defined
21 below, in clear contravention of their fiduciary responsibilities and disclosure obligations, failed
22 to properly disclose that select favored customers were improperly allowed to engage in "market
23 timing" and "late trading" of their mutual fund shares. Such trading practices, as more fully
24 described herein, improperly allow a short-term, in-and-out mutual fund investor to exploit
25 short-term moves and inefficiencies in the manner in which the mutual funds price their shares,
26 to the detriment of unsuspecting long-term investors. As a result, Defendants are liable to
27 Plaintiff and the general public pursuant to §17200 of the California Business and Professions
28 Code.

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 2

PARTIES

5. Plaintiff Mike Sayegh is a resident of the City of Beverly Hills and County of Los Angeles. Pursuant to §17200, plaintiff brings this action on behalf of the general public of the State of California.

FUND DEFENDANTS

Janus Defendants

6. Each of the Janus Funds are mutual funds that are regulated by the Investment Company Act of 1940, that are managed by defendant Janus Capital Management LLC, as defined below, and that buy, hold, and sell shares or other ownership units that are subject to the misconduct alleged in this complaint.

7. Defendant Janus Capital Corporation was registered as an investment adviser under the Investment Advisers Act of 1940 (the "Investment Advisers Act") and managed and advised the Janus family of mutual funds ("Janus Funds") until April 1, 2002. During this period, Janus Capital Corporation had ultimate responsibility for overseeing the day-to-day management of the Janus Funds. Janus Capital Corporation is located at 100 Fillmore Street, Denver, Colorado.

8. Defendant Janus Capital Management, LLC ("Janus Capital Management") is registered as an investment adviser under the Investment Advisers Act and managed and advised the Janus Funds since April 1, 2002. Janus Capital Management has ultimate responsibility for overseeing the day-to-day management of the Janus Funds. Janus Capital Management replaced Janus Capital Corporation as the investment advisor to the Janus Funds on April 1, 2002. Janus Capital Management is located at 100 Fillmore Street, Denver, Colorado. (Hereinafter, advisers to the Janus Funds - both Janus Capital Management and Janus Capital Corporation - shall be referred to as Janus Capital Management).

9. Defendant Janus Investment Fund is the registrant and issuer of the shares of the Janus Funds. Janus Investment Fund is located at 100 Fillmore Street, Denver, Colorado.

1 **Bank of America Defendants:**

2 10. Each of the Nations Funds are mutual funds that are regulated by the Investment
3 Company Act of 1940, that are managed by defendant Banc of America Capital Management,
4 LLC, and that buy, hold, and sell shares or other ownership units that are subject to the
5 misconduct alleged in this complaint.

6 11. Defendant Bank of America Corporation ("Bank of America") is a bank and
7 financial holding company that is incorporated in Delaware with its principal place of business
8 in Charlotte, North Carolina. Bank of America is the ultimate parent of the Nations Funds
9 family of mutual funds ("Nations Funds").

10 12. Banc of America Advisors, LLC ("BAA") was registered as an investment
11 adviser under the Investment Advisers Act and managed and advised the Nations Funds until
12 January 1, 2003. During this period, BAA had ultimate responsibility for overseeing the day-to-
13 day management of the Nations Funds. BAA Advisors is located at One Bank of America
14 Plaza, Charlotte, North Carolina 28255.

15 13. Defendant Banc of America Capital Management, LLC ("BACAP"), is registered
16 as an investment adviser under the Investment Advisers Act. BACAP manages and advises the
17 Nation Funds. BACAP has the ultimate responsibility for overseeing day-to-day management
18 of the Nations Funds. BACAP is located at One Bank of America Plaza, Charlotte, North
19 Carolina 28255. BACAP replaced Banc of America Advisors, LLC, as the investment adviser
20 to the Nations Funds on January 1, 2003.

21 14. Defendant Nations Funds, Inc. is the registrant and issuer of the shares of the
22 Nations Funds. Nations Funds, Inc. is incorporated in Maryland.

23 15. Defendant Robert H. Gordon ("Gordon") is the President of defendant BACAP,
24 and since March 31, 2003, President of Nations Funds, and was an active participant in the
25 unlawful schemes alleged herein.

26 16. Defendant Theodore C. Sihpol, III ("Sihpol") is a broker in the high-net worth
27 group of Banc of America Securities LLC in Manhattan, New York, and was an active
28 participant in the unlawful schemes alleged herein.

1 17. Defendant Charles D. Bryceland ("Bryceland") is the manager of the Banc of
2 America Securities branch at which Sihpol worked and was Sihpol's superior. Bryceland was
3 an active participant in the unlawful schemes alleged herein.

4 **Bank One Defendants**

5 18. Each of the One Group Funds are mutual funds that are regulated by the
6 Investment Company Act of 1940, that are managed by defendant Banc One Investment
7 Advisors ("BOLA") and that buy, hold, and sell shares or other ownership units that are subject
8 to the misconduct alleged in this complaint.

9 19. Defendant Bank One Corporation ("Bank One Corp.") is a multi-bank holding
10 company registered under the Bank Holding Company Act of 1956 with its principal place of
11 business at 1 Bank One Plaza, Chicago, Illinois.

12 20. Banc One Investment Advisors ("BOLA") is registered as an investment adviser
13 under the Investment Advisers Act.

14 21. Defendant The One Group Mutual Funds is the registrant and issuer of the shares
15 of the One Group Funds. Its principal place of business is located at 1111 Polaris Parkway,
16 Columbus, Ohio.

17 **Strong Capital Management Defendants**

18 22. Each of the Strong Funds are mutual funds that are regulated by the Investment
19 Company Act of 1940, that are managed by defendant Strong Capital Management, Inc. and that
20 buy, hold, and sell shares or other ownership units that are subject to the misconduct alleged in
21 this complaint.

22 23. Strong Financial Corporation is the ultimate parent of all of the Strong
23 defendants. Through its subsidiaries, Strong Corporation markets, sponsors and provides
24 investment advisory, distribution and administrative services to mutual funds. Strong
25 Corporation maintains its headquarters at 100 Heritage Reserve, Menomonee Falls, Wisconsin
26 53051.

27 24. Strong Capital Management, Inc. ("Strong Capital Management") is registered as
28 an investment adviser under the Investment Advisers Act and managed and advised the Strong

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 8

RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4, 2007 8:41AM 002-80-030

1 Funds throughout the Class Period. During the Class Period, Strong Capital Management, Inc.
2 had ultimate responsibility for overseeing the day-to-day management of the Strong Funds.
3 Strong Capital Management is located at 100 Heritage Reserve, Menomonee Falls, Wisconsin
4 53051.

5 **Alliance Defendants**

6 25. Each of the Alliance Bernstein Funds are mutual funds that are regulated by the
7 Investment Company Act of 1940, that are managed by defendant Alliance Capital Management
8 L.P., and that buy, hold, and sell shares or other ownership units that are subject to the
9 misconduct alleged in this complaint.

10 26. Defendant Alliance Capital Management Holding L.P. ("Alliance Holding") is a
11 publicly-traded holding company which provides investment management services through
12 defendant Alliance Capital Management L.P. ("Alliance Capital Management"). Alliance
13 Holding is incorporated in Delaware with its principal place of business located at 1345 Avenue
14 of the Americas, New York, New York 10105. Alliance Holding is the ultimate parent of the
15 Alliance Bernstein Funds and the parent company of, and controls, Alliance Capital
16 Management and Alliance Bernstein Registrants. As of March 31, 2003, Alliance Holding
17 owned approximately 30.7 percent of the outstanding shares of Alliance Capital Management.

18 27. Defendant Alliance Capital Management is registered as an investment adviser
19 under the Investment Advisers Act and managed and advised the Alliance Bernstein Funds at
20 times relevant hereto. During this period, Alliance Capital Management had ultimate
21 responsibility for overseeing the day-to-day management of the Alliance Bernstein Funds.
22 Alliance Capital Management is located at 1345 Avenue of the Americas, New York, New York
23 10105.

24 28. Defendant Alliance Capital Management Corporation ("Alliance Corporation") is
25 a wholly-owned subsidiary of defendant AXA Financial, Inc., and the general partner
26 of defendants Alliance Holding and Alliance Capital Management. Alliance Corporation owns
27 100,000 partnership units in Alliance Holding, and a 1 percent general partnership interest in
28 Alliance Capital Management. Alliance Corporation is located at 140 Broadway, New York,

1 New York 10005.

2 29. Defendant AXA Financial, Inc. ("AXA") - a unit of Europe's second-largest
3 insurer, AXA SA - is an international financial services organizations which provides financial
4 advisory, insurance and investment management products and services worldwide. AXA is a
5 Delaware corporation and maintains its principal place of business at 1290 Avenue of the
6 Americas, New York, New York 10104. AXA controls Alliance Capital Management by virtue
7 of its general partnership interests through Alliance Corporation and its 55.7 percent economic
8 interest in Alliance Capital Management as of March 31, 2003.

9 30. Defendants AllianceBernstein Registrants are the registrants and issuers of the
10 shares of the AllianceBernstein Funds, and were active participants in the unlawful scheme
11 alleged herein.

12 31. Defendant Gerald Malone was at all relevant times a Senior Vice President at
13 Alliance Capital Management and a portfolio manager of several AllianceBernstein Funds
14 and Alliance hedge funds, and was an active participant in the unlawful scheme alleged herein.

15 32. Defendant Charles Schiaffran was at all relevant times a marketing executive at
16 Alliance Capital Management who sold Alliance hedge funds to investors and was an active
17 participant in the unlawful scheme alleged herein.

18 **Putnam Defendants**

19 33. Each of the Putnam Funds, is a mutual fund that is regulated by the Investment
20 Company Act of 1940, managed by defendant Putnam Investment Management LLC, as defined
21 below, and that buy, hold, and sell shares or other ownership units that are subject to the
22 misconduct alleged in this complaint.

23 34. Marsh & McLennan Companies, Inc. ("Marsh & McLennan") is the ultimate
24 parent of defendants bearing the Putnam name. Marsh & McLennan is a New York City-based
25 professional services firm that, through its subsidiaries, operates in the insurance, investment
26 management and consulting industries. Marsh & McLennan is headquartered at 1166 Avenue of
27 the Americas, New York, New York 10036.

28 35. Putnam Investments Trust ("Putnam Investments") is a subsidiary of Marsh &

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 7

DEC-01-2003 THU 11:24 AM
DEC-03-2003 WED 03:11 PM

FAX NO.
FAX NO.

P. 14
P. 13

1 McLennan and operates as Marsh & McLennan's investment management arm, catering to
2 individual and institutional investors and offering an array of investment products and services.
3 Putnam Investments is headquartered at One Post Office Square, Boston, Massachusetts.

4 26. Putnam Investment Management LLC is registered as an investment advisor
5 under the Investment Advisers Act and managed and advised the Putnam Funds during the
6 Class Period. Putnam Investment Management has ultimate responsibility for overseeing the
7 day-to-day management of the Putnam Funds. Putnam Investment Management is
8 headquartered at One Post Office Square, Boston, Massachusetts. Putnam Investment
9 Management is a subsidiary of Putnam Investments.

10 37. Putnam Investment Funds is the registrant and issuer of each the Putnam Funds
11 except for the following funds, which are the registrants and issuers of their own shares or units,
12 respectively: Putnam American Government Income Fund, Putnam Arizona Tax Exempt
13 Income Fund, Putnam Asset Allocation: Balanced Portfolio, Putnam Asset Allocation: Growth
14 Portfolio, Putnam California Tax Exempt Income Fund, Putnam Capital Appreciation Fund,
15 Putnam Capital Opportunities Fund, Putnam Convertible Income-Growth Trust, Putnam Florida
16 Tax Exempt Income Fund, Putnam Massachusetts Tax Exempt Income Funds, Putnam
17 Michigan Tax Exempt Income Fund, Putnam Minnesota Tax Exempt Income Fund, Putnam
18 Money Market Fund, Putnam Municipal Income Fund, Putnam New Jersey Tax Exempt Income
19 Fund, Putnam New Opportunities Fund, Putnam New Value Fund, Putnam New York Tax
20 Exempt Income Fund, Putnam New York Tax Exempt Opportunities Fund, Putnam Ohio Tax
21 Exempt Income Fund, Putnam Pennsylvania Tax Exempt Income Fund, Putnam Tax Exempt
22 Income Fund, Putnam Tax Exempt Money Market Fund, Putnam Tax Smart Equity Fund,
23 Putnam Tax-Free High Yield Fund, Putnam Tax-Free Insured Fund and Putnam U.S.
24 Government Income Trust. Putnam Investment Funds is located at One Post Office Square,
25 Boston, Massachusetts.

26 38. Defendants Janus Capital Corporation, Janus Capital Management, Janus
27 Investment Fund, the Janus Funds, Bank of America, Banc of America Advisors, Banc of
28 America Capital Management, Nations Funds, Inc., the Nations Funds, Bank One Corporation,

1 Banc One Investment Advisors, The One Group Mutual Funds, the One Group Funds, Strong
2 Financial Corporation, Strong Capital Management, Inc., the Strong Registrants, the Strong
3 Funds, Alliance Holding, Alliance Capital Management, Alliance Corporation, AXA Financial,
4 Inc., AllianceBernstein Registrants, the AllianceBernstein Funds, Marsh & McLellan, Putnam
5 Investments, Putnam Investment Management and the Putnam Funds are referred to collectively
6 herein as the "Fund Defendants."

7 **CANARY DEFENDANTS**

8 39. Defendant Edward I. Stern ("Stern") is a resident of New York, New York. Stern
9 was the managing principal of Canary Capital Partners, LLC, Canary Investment Management,
10 LLC and Canary Capital Partners, Ltd. (collectively, "Canary"), and was an active participant in
11 the unlawful scheme alleged herein.

12 40. Defendant Canary Capital Partners, LLC is a New Jersey limited liability
13 company with offices at 400 Plaza Drive, Secaucus, New Jersey. Canary Capital Partners, LLC
14 was an active participant in the unlawful scheme alleged herein.

15 41. Defendant Canary Investment Management, LLC is a New Jersey limited
16 liability company, with offices at 400 Plaza Drive, Secaucus, New Jersey. Canary Investment
17 Management, LLC was an active participant in the unlawful scheme alleged herein.

18 42. Defendant Canary Capital Partners, Ltd. is a Bermuda limited liability company.
19 Canary Capital Partners, Ltd. was an active participant in the unlawful scheme alleged herein.

20 **OTHER DEFENDANTS**

21 43. Defendant Kaplan & Co. Securities, Inc. is a broker dealer located in Boca
22 Raton, Florida, which Canary approached after hearing that it provided late trading.

23 44. Defendant Security Trust Company ("STC") is a provider of corporate trust
24 services to retirement plans, third-party administrators and various industrial clients. It became
25 Canary's partner in a wide-ranging late trading and timing venture. STC is headquartered in
26 Phoenix, Arizona.

1 45. Defendant JB Oxford & Company is a provider of discount and online brokerage
2 services, with offices located at 9665 Wilshire Boulevard Third Floor, Beverly Hills, California
3 90212.

4 46. The true names and capacities of defendants sued herein as Does 1 through
5 500 are other active participants in the widespread unlawful conduct alleged herein whose
6 identities have yet to be ascertained. Such defendants were secretly permitted to engage in
7 improper trading activities at the expense of ordinary mutual fund investors, such as
8 Plaintiff and the other Janus Funds, Nations Funds, One Group Funds, Strong funds and
9 Alliance Bernstein Funds mutual fund holders, in exchange for which these John Doe defendants
10 provided remuneration to the funds' managers. Plaintiff will seek to amend this complaint to
11 state the true names and capacities of said defendants when they have been ascertained.

12 **IV.**

13 **BACKGROUND**

14 47. From 1999 to 2003, Canary engaged in two fraudulent schemes and benefitted to
15 the extent of tens of millions of dollars at the expense of mutual fund investors. Both schemes
16 involved the complicity of mutual fund management companies that violated their fiduciary
17 duties to their customers in return for substantial fees and other income for themselves and their
18 affiliates.

19 48. The first scheme was Canary's "late trading" of mutual fund shares. As described
20 in greater detail below, the daily price of mutual fund shares is generally calculated as of 4:00
21 p.m. EST. Orders to buy, sell or exchange mutual fund shares placed at or before 4:00 p.m. EST
22 on a given day receive that day's price. Conversely, orders placed after 4:00 p.m. EST are
23 supposed to be priced using the following day's price. Canary agreed with certain financial
24 institutions that orders Canary placed after 4 p.m. on a given day would illegally receive that
25 day's price (as opposed to the next day's price, which the order would have received had it been
26 processed lawfully). This allowed Canary to capitalize on post- 4:00 p.m. information while
27 those who bought their mutual fund shares lawfully could not.

28 49. The second scheme involved "timing" of mutual funds. "Timing" is an

1 investment technique involving short-term, "in and out" trading of mutual fund shares. The
2 technique is designed to exploit inefficiencies in the way mutual fund companies price their
3 shares. This practice is by no means limited to Canary. It is widely acknowledged
4 that timing injures to the detriment of long-term shareholders. Because of this detrimental
5 effect, mutual fund prospectuses typically state that timing is monitored and the funds work to
6 prevent it. Nonetheless, in return for investments that will increase fund managers' fees,
7 fund managers enter into undisclosed agreements to allow timing.

8 50. In fact, certain mutual fund companies have employees (generally referred to as
9 the "timing police") who are supposed to ferret out "timers" and put a stop to their short-term
10 trading activity. Nonetheless, the mutual fund managers arranged to give Canary and other
11 market timers a "pass" with the timing police, who would look the other way rather than attempt
12 to shut down their short-term trading.

13 51. The mutual fund prospectuses created the misleading impression that mutual
14 funds were vigilantly protecting investors against the negative effects of timing. In fact, the
15 opposite was true: managers sold the right to time their funds to Canary and other hedge fund
16 investors. The prospectuses were silent about these arrangements.

17 52. As a result of "late trading" and "timing" of mutual funds, Canary, the
18 mutual fund companies and their intermediaries profited handsomely. The losers were
19 unsuspecting long-term mutual fund investors. Canary's excess profits came dollar-for-dollar
20 out of their pockets.

21 A. Late Trading

22 53. Canary's practice of late trading exploited the unique way in which mutual funds
23 set their prices. Mutual funds are valued once a day, usually at 4:00 p.m. EST, when the New
24 York market closes. The price, known as the Net Asset Value or "NAV," generally reflects the
25 closing prices of the securities that comprise a given fund's portfolio, plus the value of any cash
26 that the fund manager maintains for the fund. A mutual fund stands ready to buy or sell (the
27 mutual fund industry refers to sales as "redemptions") its shares at the NAV with the public all
28

1 day, any day — but unlike a stock, the price of a mutual fund does not change during the course
2 of the day. Accordingly, orders placed at any time during the trading day up to the 4:00 p.m.
3 cutoff get that day's NAV, but an order placed at 4:01 p.m. or thereafter receives the next day's
4 NAV. This is the rule of "forward pricing," which became law in 1968.

5 1. The Purpose of "Forward Pricing"

6 54. This system assures a level playing field for investors. Mutual fund investors do
7 not know the exact price at which their mutual fund orders will be executed at the time they
8 place the orders (unlike stock investors), because NAVs are calculated after the market closes.
9 Orders placed on or before 4 p.m. on a given day are filled at the NAV determined that day
10 while orders placed after 4 p.m. are filled at the NAV calculated the next day. Thus, all investors
11 have the same opportunity to assemble "pre-4:00 p.m. information" before they buy or sell. And
12 no investor has (or at least is supposed to have) the benefit of "post-4:00 information" prior to
13 making an investment decision. The importance of this protection becomes clear when, for
14 example, there is an event after 4:00 p.m. (like an unexpectedly positive corporate earnings
15 announcement) that makes it highly probable that the market for the stocks in a given fund will
16 open sharply higher the next day. Forward pricing ensures fairness: those who bought the fund
17 during the day, before the information came out, will enjoy a gain. Those who buy shares in the
18 fund after the announcement are not supposed to share in this profit. Their purchase order
19 should receive the NAV set at the end of the next day, when the market will have digested the
20 news and reflected its impact in higher prices for the stock held by the fund and, therefore, a
21 higher NAV for the fund.

22 55. An investor who has the ability to avoid forward pricing and buy at the prior
23 NAV enjoys a significant trading edge. He or she can wait until after the market closes for
24 significant news such as the above-earnings announcement to come out, and then buy the fund
25 at the old, low NAV that does not reflect the impact of the new information. When the market
26 goes up the next day, the lucky investor would be able to sell and realize an arbitrage profit
27 based solely on the privilege of trading on the "stale" NAV.
28

56. Dollar for dollar, the late trader's arbitrage profit comes out of the mutual fund that the late trader buys. In essence, the late trader is being allowed into the fund after it is closed for the day to participate in a profit that would otherwise have gone completely to the fund's buy-and-hold investors. When the late trader redeems his shares and claims his profit, the mutual fund manager has either to sell stock or use cash on hand -- stock and cash that used to belong to the long-term investors--- to give the late trader his gain. This makes late trading basically a zero-sum game. Putting to one side the investment results of the mutual fund for the brief time that the late trader actually holds it, the late trader's gain is the long-term investors' loss. The forward pricing rule was enacted to prevent this kind of abuse. See 17 C.F.R. § 270.22c-1(a).

2. Summary of Canary's Late Trading

57. Canary engaged in late trading on a daily basis from in or about March 2000 until July of 2003. It targeted dozens of mutual funds and extracted tens of millions of dollars from them. During the declining market of 2001 and 2002, it used late trading to, in effect, sell mutual fund shares short. This caused the mutual funds to overpay for their shares as the market went down, serving to magnify long-term investors' losses.

58. Canary obtained some of its late trading "capacity" (the opportunity to engage in late trading) directly from one mutual fund manager, the Bank of America. Bank of America installed special computer equipment in Canary's office that allowed it to buy and sell Bank of America's own mutual funds -- the Nations Funds -- and hundreds of other mutual funds at the 4:00 p.m. price until 6:30 p.m. New York time. In return, Canary agreed to leave millions of dollars in Bank of America bond funds on a long-term basis. These parked funds are known in the trade as "sticky assets."

59. Canary obtained additional late trading capacity from intermediaries, including defendant Security Trust Company ("STC"), an Arizona company providing trust administrative services (including access to mutual funds) to retirement plans. STC gave Canary the ability to trade hundreds of additional mutual funds as late as 9:00 p.m. New York time. So profitable was

1 this opportunity that STC ultimately demanded, and received, a percentage of Canary's
2 winnings.

3 B. Timing

4 60. Mutual funds are meant to be long-term investments. They are designed for buy-
5 and-hold investors, and are therefore the favored homes for Americans' retirement and college
6 savings accounts. Nevertheless, quick-turnaround traders routinely try to trade in and out of
7 certain mutual funds in order to exploit inefficiencies in the way they set their NAVs.

8 61. This strategy works only because some funds use "stale" prices to calculate the
9 value of securities held in the fund's portfolio. These prices are "stale" because they do not
10 necessarily reflect the "fair value" of such securities as of the time the NAV is calculated. A
11 typical example is a U.S. mutual fund that holds Japanese shares. Because of the time zone
12 difference, the Japanese market may close at 2:00 a.m. New York time. If the U.S. mutual fund
13 manager uses the closing prices of the Japanese shares in his or her fund to arrive at an NAV at
14 4:00 p.m. in New York, he or she is relying on market information that is fourteen hours old. If
15 there have been positive market moves during the New York trading day that will cause the
16 Japanese market to rise when it later opens, the stale Japanese prices will not reflect them, and
17 the fund's NAV will be artificially low. Put another way, the NAV does not reflect the true
18 current market value of the stocks the fund holds. On such a day, a trader who buys the Japanese
19 fund at the "stale" price is virtually assured of a profit that can be realized the next day by
20 selling. This and similar strategies are known as "time zone arbitrage." Taking advantage of
21 this kind of short-term arbitrage repeatedly in a single mutual fund is called "timing" the fund.

22 62. A similar type of timing is possible in mutual funds that contain illiquid
23 securities such as high-yield bonds or small capitalization stocks. Here, the fact that some of the
24 fund's securities may not have traded for hours before the New York closing time can render the
25 fund's NAV stale, and thus open it to being timed. This is sometimes known as "liquidity
26 arbitrage."

27 **1. The Effect of Timing on Long Term Shareholders**

28 63. Like late trading, effective timing captures an arbitrage profit. And like

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 18

02 '8 RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4. 8:40AM 02-80-030

late trading, the arbitrage profit from timing comes dollar-for-dollar out of the pockets of the long-term investors: the timer steps in at the last moment and takes part of the buy-and-hold investors' upside when the market goes up, so the next day's NAV is reduced for those who are still in the fund. If the timer sells short on bad days -- as Canary did -- the arbitrage has the effect of making the next day's NAV lower than it would otherwise have been, thus magnifying the losses that investors are experiencing in a declining market.

64. Timing is not entirely risk free, however. For example, the timer has to keep his or her money in the target fund for at least a day, so he or she may enjoy additional gains or incur losses, depending on the market. But such gains and losses are distinct from the timer's arbitrage profit, which is essentially crystallized at the moment of purchase.

65. Besides the wealth transfer of arbitrage (called "dilution"), timers also harm their target funds in a number of other ways. They impose their transaction costs on the long-term investors. Indeed, trades necessitated by timer redemptions can also lead to realization of taxable capital gains at an undesirable time, or may result in managers having to sell stock into a falling market. Accordingly, fund managers often seek to minimize the disruptive impact of timers by keeping cash on hand to pay out the timers' profits without having to sell stock. This "strategy" does not eliminate the transfer of wealth out of the mutual fund caused by timing; it only reduces the administrative cost of those transfers. However, at the same time it can also reduce the overall performance of the fund by requiring the fund manager to keep a certain amount of the funds' assets in cash at all times, thus depriving the investors of the advantages of being fully invested in a rising market. Some fund managers even enter into special investments as an attempt to "hedge" against timing activity (instead of just refusing to allow it), thus deviating altogether from the ostensible investment strategy of their funds, and incurring further transaction costs.

2. Tools to Combat Market Timing

66. Mutual fund managers are aware of the damaging effect that timers have on their funds. And while the effects on individual shareholders may be small once they are spread out over all the investors in a fund, their aggregate impact is not. While it is virtually

1 impossible for fund managers to identify every timing trade, large movements in and out of
2 funds -- like those made by Canary -- are easy for managers to spot. And mutual fund managers
3 have tools to fight back against timers.

4 67. Fund managers typically have the power simply to reject timers' purchases.
5 Many funds have also instituted short-term trading fees ("early redemption fees") that
6 effectively wipe out the arbitrage that timers exploit. Generally, these fees go directly into the
7 affected fund to reimburse it for the costs of short term trading. In addition, fund managers are
8 required to update NAVs at the end of the day in New York when there have been market
9 moves that might render the NAV stale. This is called giving the fund a "fair value." It
10 eliminates the timer's arbitrage. As fiduciaries for their investors, mutual fund managers are
11 obliged to do their best to use these weapons to protect their customers from the dilution that
12 timing causes.

13 3. Incentives for Allowing Market Timing

14 68. Typically a single management company sets up a number of mutual funds to
15 form a family. For example, Banc of America Capital Management, LLC is the manager for the
16 Nations Funds family, including Nations International Equity fund, Nations Small Cap fund and
17 so on. While each mutual fund is in fact its own company, as a practical matter the management
18 company runs it. The portfolio managers who make the investment decisions for the funds and
19 the executives to whom they report are all typically employees of the
20 management company, not the mutual funds themselves. Still, the management company owes
21 fiduciary duties to each fund and each investor.

22 69. The management company makes its profit from fees it charges the funds
23 for financial advice and other services. These fees are typically a percentage of the assets in the
24 fund, so the more assets in the family of funds, the more money the manager makes. The timer
25 understands this perfectly, and frequently offers the manager more assets in exchange for the
26 right to time. Fund managers have succumbed to temptation and allowed investors in the target
27 funds to be hurt in exchange for additional money in their own pockets in the form of higher
28 management fees.

70. Canary found many mutual fund managers willing to take that deal. In the period from 2000 to 2003, Canary entered into agreements with dozens of mutual fund families allowing it to time many different mutual funds. Typically, Canary would agree with the fund manager on target funds to be timed -- often international and equity funds offering time zone or liquidity arbitrage -- and then move the timing money quickly between those funds and a resting place in a money market or similar fund in the same fund family. By keeping the money -- often many million dollars -- in the family, Canary assured the manager that he or she would collect management and other fees on the amount whether it was in the target fund, the resting fund, or moving in between. In addition, sometimes the manager would waive any applicable early redemption fees. By doing so, the manager would directly deprive the fund of money that would have partially reimbursed the fund for the impact of timing.

71. As an additional inducement for allowing the timing, fund managers often received "sticky assets." These were typically long-term investments made not in the mutual fund in which the timing activity was permitted, but in one of the fund manager's financial vehicles (e.g., a bond fund or a hedge fund run by the manager) that assured a steady flow of fees to the manager.

4. Failure to Disclose Timing Arrangements

72. These arrangements were never disclosed to mutual fund investors. On the contrary, many of the relevant mutual fund prospectuses contained materially misleading statements assuring investors that the fund managers discouraged and worked to prevent mutual fund timing. For example, the "Excessive Trading Policy" in the February 25, 2002 prospectus for the Janus Income Funds states:

Frequent trades in your account or accounts controlled by you can disrupt portfolio investment strategies and increase Fund expenses for all Fund shareholders. The Funds are not intended for market timing or excessive trading. To deter these activities, the Funds or their agents may temporarily or permanently suspend or terminate exchange privileges of any investor who makes more than four exchanges out of a Fund in a calendar year and bar future purchases into the Fund by such investor. In addition, the Funds or their agents also may reject any purchase orders (including exchange purchases) by any investor or group of investors indefinitely for any reason, including, in particular, purchase orders that they believe are attributable to market timers or are otherwise excessive or potentially disruptive to the Fund.

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 17

1 Orders placed by investors in violation of the exchange limits or the excessive
2 trading policies or by investors that the Fund believes are market timers may be
revoked or cancelled by a Fund. . .

3 Nevertheless, as described further below, Canary was allowed to time a Janus fund subject to
4 such a prospectus.

5 73. Canary realized tens of millions of dollars in profits as a result of these timing
6 arrangements. In many cases these profits also reflect late trading, as Canary would frequently
7 negotiate a timing agreement with a mutual fund management company, and then proceed to
8 late trade the target funds through Bank of America, STC or another intermediary.

9 V.

10 FACTUAL ALLEGATIONS

11 A. Stern and Canary Capital

12 74. Beginning in or around 2000, defendant Stern became a full-time investor and
13 money manager. He had two main businesses: (1) investing in various hedge funds run by others
14 and (2) the rapid-fire trading of mutual funds. The latter was done through Canary Capital
15 Partners, LLC, a hedge fund devoted to late trading and timing mutual funds. (Canary Capital
16 Partners, Ltd. is a sister hedge fund engaged in mutual fund timing.)

17 75. Canary employed a number of professionals and traders, and used sophisticated
18 computer models and equipment in order to identify and then exploit late trading and timing
19 opportunities. Because so much of its business occurred after the close of U.S. markets, Canary
20 employees regularly worked into the evening.

21 76. Stern is the Managing Member of Canary Investment Management, LLC, which
22 receives a fee for managing Canary assets calculated as 1.5% of assets under management and
23 25% of profits above a certain threshold. As of July 2003, Canary Asset Management had
24 received approximately \$40 million in Canary management and incentive fees. The size of these
25 fees reflects the phenomenal success Canary enjoyed both in terms of its trading results and the
26 amount of capital it was able to gather in the fund.

27 B. Profits and the Growth of Canary

28 77. Stern began timing trading in July of 1998. Initially he used only money he raised

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 18

DEC 4 RECEIVED TIME DEC. 4. 8:28AM

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1 from private sources. In 1998, Stern made a profit of 18%; in 1999, his profit was 110%.

2 78. In September of 2000, Canary began to accept capital from non-family investors.
3 In the year 2000, Canary earned its investors a return of 49.5% (net of fees), while the S&P 500
4 declined by 9% and the NASDAQ declined by 39%. By early 2001, Canary and Canary Capital
5 Partners Ltd. had \$184 million in assets.

6 79. By the end of 2001, the assets of Canary and Canary Capital Partners Ltd. ...
7 had grown to approximately \$400 million. In 2001, Canary earned a return of 28.5% (net of
8 fees), while the S&P 500 and the NASDAQ declined by 13% and 21%, respectively.

9 80. In 2002, the assets of Canary and Canary Capital Partners, Ltd. increased to \$730
10 million. Canary earned 15% (net of fees) in 2002, while the S&P 500 and the NASDAQ
11 declined by 23% and 31%, respectively.

12 81. Canary experienced disappointing returns of 1.5% in the first five months of
13 2003, as U.S. equity markets were rising. As a result, in or about May, 2003, it decided to return
14 all funds contributed by outside investors. In his letter to these investors announcing the
15 decision Stern wrote: "We hope that you considered the ride to be a good one. ..."

16 C. Canary's Trading Strategies

17 82. Stern evolved and improved his trading strategies over time to achieve these
18 above-market results. Prior to 2000, Stern followed a simple timing strategy that consisted
19 largely of buying a small cap technology fund (subject to "liquidity arbitrage") in a certain fund
20 family on days when the market was up, and selling it when the market began to decline. Stern
21 was able to do this over and over again - systematically transferring wealth out of the fund -
22 because of an understanding he had with a senior executive of the fund family, who allowed
23 Stern unlimited timing privileges and received a "sticky asset" private equity fund investment in
24 return.

25 83. Canary's interest in similar negotiated timing capacity deals never flagged, and it
26 continued to devote considerable energy to finding such opportunities in 2000, 2001, 2002 and
27 2003. Indeed, starting in late 2000 Canary engaged a consultant who was devoted exclusively to
28 looking for timing capacity. By July of 2003, Canary had negotiated (sometimes directly, and .

1 sometimes through intermediaries) dining capacity agreements with approximately thirty mutual
2 fund families, many of which involved "sticky assets" of one kind or another.

3 84. In 2000, Canary also began to expand its timing capacity through an approach
4 called "timing under the radar." This refers to placing trades in mutual fund shares in such a way
5 that the timing activity is difficult for the mutual fund family whose funds are targets
6 to detect. Timers pursuing this strategy trade through brokers or other intermediaries (for
7 instance, STC and Bank of America provided this service in addition to late trading) who
8 process large numbers of mutual fund trades every day through omnibus accounts where trades
9 are submitted to mutual fund companies en masse. The timer hopes that his activity will not be
10 noticed among the "noise" of the omnibus account.

11 85. While Canary targeted a number of funds for timing "under the radar," these
12 arrangements were never lasting or dependable. They were subject to being shut down at any
13 time if the mutual fund company noticed the unusual activity. It was much better business for
14 Canary to negotiate for timing capacity directly with the fund managers, even if it had to tie up
15 some of its capital in "sticky assets" to do so.

16 86. In early 2000, Canary began to engage in late trading. Its first opportunity came
17 in the form of an agreement with defendant Kaplan & Co. Securities Inc., a broker dealer
18 located in Boca Raton, Florida, which Canary approached after hearing that it provided late
19 trading. This contract provides that "[f]inal instructions for trades to be executed for Client shall
20 be provided telephonically or by e-mail and shall be received no later than 4:30 p.m. EST at the
21 offices of Kaplan & Co.," and holds out the possibility of Kaplan & Co. executing trades
22 received later than that. In May of 2000, Canary entered into its agreement with STC, and
23 gained the capability of submitting its orders until 8:30 p.m. New York time. Canary continued
24 to expand its channels for late trading in following years, ultimately setting up a number of
25 separate arrangements (including, most notably, Bank of America, which arrangement is
26 described in more detail below) that allowed it to trade after the New York close. As one
27 example, in August of 2002 Canary entered into a contract with the broker-dealer JB Oxford &
28 Company that provided:

Each day that Customer intends to engage in mutual fund transactions, Customer shall send via Excel spreadsheet or other mutually acceptable means to JB Oxford a list of proposed transactions before 4:15 p.m. New York time. . . . Customer intends to confirm and activate such trade communications via telephone by 4:45 p.m., New York time. . . .

JB Oxford received 1% of assets traded as compensation for these services.

87. In 2001, faced with dropping markets, Canary developed a complex strategy that allowed it to in effect sell mutual funds short and profit on declining NAVs. To achieve this, Canary first needed to determine the exact portfolio makeup of a target mutual fund. Mutual fund managers were happy to provide this information to Canary. Canary would then (1) sell these securities short to create a negative mirror image of the fund and (2) buy the fund in an offsetting amount. As a result, Canary would own the shares of the fund, but be overall "market neutral." It would then wait, fully hedged, until there was a market event that would drive down the fund's price and create an opportunity for arbitrage. Canary would sell the shares back to the fund that day at an artificially high price (because the NAV would not yet fully reflect the market movement downward) and then close out the short position with cheaper, market price shares. The cash left over was Canary's profit. To reduce the transaction costs of the strategy, Canary worked with derivatives dealers (including Bank of America) to create "equity baskets" of short positions in fund holdings that mimicked the effect of shorting every stock in the fund, with one customized "basket" per fund. This strategy served Canary well through the market drops in 2001 and 2002.

D. The Bank of America

88. Canary's most extensive late trading and timing relationship was with the Bank of America. Starting in 2001, the Bank of America set Canary up with a state-of-the-art electronic late trading platform, allowing it to trade late in the hundreds of mutual funds that the bank offers to its customers. Bank of America gave Canary permission to time its own mutual fund family, the "Nations Funds," provided Canary with approximately \$300 million of credit to finance this late trading and timing, and sold Canary the derivative short positions it needed to time the funds as the market dropped. None of these facts were disclosed in the Nations Funds

1 prospectuses. In the process, Canary became one of Bank of America's largest customers. The
2 relationship was mutually beneficial: Canary made tens of millions through late trading and
3 timing, while the various parts of the Bank of America that serviced Canary made millions
4 themselves. All of this activity was coordinated through the Bank of America broker who
5 brought Canary in as a client, Theodore C. Sihpol, III.

6 **1. Setting Up the Stern Relationship**

7 89. Defendant Sihpol, who works in the Bank of America Securities' ("BAS") high-
8 net worth group. Sihpol visited Stern at his office in April 2001.

9 90. During that meeting, Stern outlined Canary's approach to timing mutual funds
10 and results it had achieved doing so, but did not mention late trading. He asked if Canary would
11 be allowed to time the Nations Funds family, and proposed that the Bank of America could both
12 lend Canary the money to do so and provide clearing services for the timing trades. Sihpol
13 agreed to check with the Bank of America and get back to Canary. He returned to the office and
14 set about obtaining approval for Canary's proposal from his superiors.

15 91. After making some inquiries within the Bank of America and speaking with
16 Stern on the telephone, Sihpol asked Stern to come to the bank's New York headquarters and
17 explain his proposal in person to a larger group that included representatives from the BAS
18 clearing business. At this meeting, which took place in late April, 2001, Stern and two of
19 Canary's traders explained their strategy to the Bank of America group again, discussed their
20 credit needs, and presented a list of the Nations Funds they would most like to time.

21 92. When the conversation turned to clearing, the representatives of the BAS
22 clearing business offered to set up Canary with direct access to the bank's clearing function
23 through their electronic ADP system. Using technology that was proprietary to BAS, Canary
24 would be able to enter its trades directly into Canary's computers in New Jersey after the market
25 closed until 6:30 p.m. New York time, without having to speak to a Bank of America
26 representative. The representatives of the bank's clearing business mentioned this late trading
27 capability as an additional selling point for ADP.

28 93. The meeting was a success. The parties agreed to go forward, subject to final

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 22

RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4. 8:39AM 002-ED-030

1 approval of the list of Nations Funds to be timed, Sihpol prepared a memorandum summarizing
2 the Canary/Stern relationship and their efforts thus far to implement Canary's mutual fund
3 trading strategy. This memo, dated April 16, 2001, was sent to Charles D. Bryceland, his
4 superior in the high-net worth brokerage business at BAS, and to a BAS compliance officer.
5 Among other things, the memo notes that:

6 • Canary uses a proprietary strategy involving market timing through daily
7 mutual fund trading;

8 • (a) the "immediate objective" was to implement Canary's "proprietary market-
9 timing trading strategy, through the use of [BAS'] mutual fund clearing
10 operations," (b) initially it was contemplated that Bank of America would permit
11 Canary to time \$20 million to \$30 million in Nations Funds, and (c) Canary
12 would make a "sticky" asset investment of the same amount of money in Nations
13 bond funds;

14 • (a) initially Canary would execute its mutual fund timing trades by calling the
15 trades into Sihpol, (b) later, however, Canary would be provided a direct link to
16 BAS' proprietary mutual fund clearing system, and (c) the BAS clearing
17 department had approved installation of the "direct link;" and

18 • other potential business Bank of America could pursue with Canary and the
19 Stern family included a potential \$100 to \$200 million line of credit to facilitate
20 Canary's trade operations and a \$25 million to \$30 million opportunity for the
21 BAS' derivatives desk to assist Canary in shorting the stocks owned by the
22 mutual funds Canary was timing.

23 Sihpol acknowledged that Canary's requests were "a bit unorthodox," but stated that Canary
24 "made it clear they are not only willing to play by the guidelines we agree on, but also pay
25 [Bank of America] for the value we can add."

26 94. Bryceland, Sihpol's branch manager, favored the market timing relationship with
27 Canary and would later commend the diligence of Sihpol and his team to some of the most
28 senior Bank of America executives. The BAS compliance representative initially questioned the
29 propriety of giving a client "direct access" to BAS' mutual fund clearing capabilities.
30 Apparently the compliance officer's concerns were satisfied when Sihpol informed him that
31 other Bank of America employees "felt the business was worthwhile and an appropriate use of
32 [Bank of America's] resources."

33 95. On May 1, 2001, Canary sent Sihpol a letter confirming the Nations Funds he
34 hoped to time and providing the dollar amounts of timing for each fund. Initially, Canary

1 intended to time four funds - Nations Convertible, Nations International Equity, Nations
2 Emerging Markets and Nations Small Cap - in an aggregate amount of \$16.8 million. The short
3 term trading was to average one "round turn" per week (i.e., one purchase and one sale of the
4 mutual fund shares each week). After selling a fund, the proceeds of the sale were to be
5 deposited into a Nations money market fund or short-term bond fund until such time that Canary
6 decided to "redeploy" it for the next timing trade in the "approved" Nations funds.

7 96. The letter further confirmed the understanding reached with respect to manual,
8 electronic and late trading, and BAS' intention to provide financing for it. Canary wrote:

9 We plan on transacting our trades manually at first (via Fax), at a time of day that
10 is a little bit earlier than [the BAS clearing representative] specified in our first
11 meeting. As soon as we can work out our lending arrangement with the bank and
12 begin transacting electronically via ADP, we will draw down leverage against the
13 capital we have deployed in the Nations funds, effectively increasing our trading
14 capital with your firm to \$32 million. If all goes well, this capital should grow
15 larger as we get a sense of what trades can and cannot be done via the Banc of
16 America Securities Platform. We really would like to get going with ADP and
17 begin trading electronically as soon as possible.

18 Canary also confirmed one of Bank of America's rewards for allowing such timing activity -
19 "sticky assets." The letter notes:

20 It is also our intention to commit "permanent" capital to Nations
21 funds in an amount equal to the dollars that [a special purpose mutual fund
22 timing vehicle affiliated with Canary] trades. For the time being, we have chosen
23 to invest in Nations Short to Intermediate Government and Nations Short Term
24 Income Fund...

25 97. Though Sihpol had obtained the go-ahead from clearing operations, his branch
26 manager and the compliance department, he still needed the consent of Banc of America Capital
27 Management, LLC ("BACAP"), the investment manager of the Nations Funds. Sihpol had kept
28 Robert H. Gordon, then the co-President of BACAP, abreast of the negotiations with Stern from
the beginning, and had obtained from him the list of Nations Funds from which Canary had
made its selection of target funds. On May 3, 2001, Sihpol sent Gordon an e-mail, apparently
attaching a copy of Canary's May 1, 2001 letter, in which he advised Gordon of the names of
the trading vehicles Canary would be using for its timing trades and that a Canary affiliate
would be "making the dollar for dollar investment in the two short-term government funds."

98. Sihpol also sought to enlist Gordon's assistance with Canary's proposed

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 24

08 1
RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4. 8:39AM

1 derivatives transactions involving the securities held in certain of the Nations mutual funds. In
2 the same e-mail, Sihpol wrote:

3 Additionally, if you could...let us know what the most efficient, proper way of
4 getting the portfolio's positions and weightings to Cockatoo that would put us on
5 track for a conversation with our derivatives desk.

6 Thanks again for all your help....

7 Ted

8 That same day, Gordon forwarded Sihpol's e-mail and its attachment to various senior managers
9 within BACAP as well as certain individual portfolio managers. Gordon wrote:

10 I've spoken to a number of you about this day trading exception. The account is
11 the Stern Family, a significant and growing GCIB/Bank relationship. Also, nice
12 incentive of matching funds in the Short-Term Gov't Fund....
13 thanks, and let me know if there are any issues.

14 Apparently, no one raised any issues. Indeed, after being notified in a subsequent e-mail from
15 Sihpol that the \$20 million in "sticky" assets promised by Canary had arrived, Gordon
16 forwarded the e-mail to various BACAP personnel confirming that Canary was "an approved
17 timer."

18 99. In addition, Gordon's e-mail granting a special market timing dispensation to
19 Canary was forwarded to the BACAP "timing police" responsible for protecting the Nations
20 Funds from market timers.

21 2. Late Trading at the Bank of America

22 100. At first, Canary conducted its late trading with the Bank of America "manually."
23 Prior to 4:00 p.m. New York time, Canary sent Sihpol or a member of his team a series of
24 "proposed" mutual fund trades by e-mail or fax. Upon receipt, Sihpol or a member of his team
25 filled out an order ticket, time stamped it, and set it to one side until that evening. Sometime
26 after 4 p.m. New York time, Canary telephoned Sihpol or a member of his team to either
27 confirm or cancel the "proposed" order. If confirmed, the order (with its pre-close time stamp)
28 was sent by fax to Bank of America's mutual funds clearing department for processing, and
destroyed that day's NAV. If the order was cancelled, Sihpol or a member of his team would
destroy the ticket.

1 101. This procedure violated not only the SEC's "forward pricing rule" and the bank's
2 compliance manual, but was contrary to the Nations Funds prospectus. For example, the Nations
3 Funds Primary A Shares prospectus dated August 1, 2001 states that orders received
4 before the end of a business day (usually 4:00 p.m. Eastern time, unless the
5 NYSE closes early) will receive that day's net asset value per share. Orders
6 received after the end of a business day will receive the next business day's net
asset value per share.

7 102. The manual trading system was cumbersome, and Canary soon began using
8 ADP, the "direct link." After Bank of America technicians installed it in Canary's offices in
9 June of 2001, the link became the preferred route for Canary's late trading (although the manual
10 procedure was still followed occasionally for certain orders and when Canary experienced
11 technical problems). The link enabled Canary to trade late not just in the Nations Funds where it
12 had negotiated capacity, but in the many other mutual fund families with which the bank had
13 clearing agreements. When there was a significant market event after 4:00 p.m. EST but before
14 the ADP trading window closed at 6:30 p.m., the NAVs of many of these funds would be stale
15 and potentially ripe for arbitrage trading by Canary.

16 103. Sihpol and his team collected a so called "wrap fee" of one percent of the Canary
17 assets in Nations Funds and one half of one percent of the assets in other funds traded through
18 the platform. Throughout 2001, 2002 and up until July 2003, Canary placed late orders for
19 hundreds of mutual fund trades through ADP. Each evening, summaries of Canary's late trades
20 were faxed to Sihpol's team, which used them to reconcile trading reports and then discarded
21 them.

22 3. Financing Canary's Late Trading and Timing

23 104. Sihpol went to the Bank of America's private banking area to obtain additional
24 financing for Canary's trading strategies. The executives who approved this financing knew that
25 the money would be used to time the bank's own funds. Bank of America initially agreed to a
26 \$75 million line of credit, and later increased it to \$100 and then \$200 million. The collateral for
27 these loans was Canary's mutual fund positions, so the bank's credit area tracked Canary's
28 trading closely to make sure the bank was fully secured. Canary paid the bank a generous

1 interest rate of LIBOR plus 1.25% for this loan.

2 4. Derivatives

3 103. Sihpol also sought and obtained approval for the BAS equity derivatives area to
4 engage in the complex "equity basket" transactions that enabled Canary to sell mutual funds
5 short and profit from falling markets. Sihpol facilitated establishing these "synthetic" short
6 positions by obtaining from Gordon's group the precise makeup of the Nations Funds that
7 Canary was interested in shorting. This information was then transferred to the bank's
8 derivatives desk, which would then sell the stocks that the Nations Funds managers were buying
9 in order to create a hedge. Sihpol helped Canary update these positions on a regular basis so that
10 the positions tracked the changing portfolios of the Nations Funds. Canary paid the bank
11 derivatives group commissions for the stock sales plus a generous financing spread.

12 5. The Canary Relationship Expands

13 106. Canary's timing activity in Nations Funds proceeded during 2001. In early 2002,
14 however, Gordon raised an issue with Sihpol about an agreement the two had reached in
15 December, 2001 to provide Canary with more timing capacity. This agreement was reflected in
16 an e-mail sent to Bryceland, Sihpol's branch manager, in which Sihpol wrote:

17 Canary is currently OK to trade 1% (or approx. \$5MM) of the Nation's
18 International fund. When Rob [Gordon] and I spoke in December we agreed an
19 increase to 2% would be acceptable provided it was accompanied by an amount of
"sticky" assets to be determined later.

20 When the time had come for Gordon to make good on this agreement, Sihpol sent an e-mail
21 dated January 2, 2002:

22 Rob-

23 Happy New Year. We wanted to let you know Canary's line of credit with the
24 bank has been increased to \$100MM (from \$75) and they are anticipating pulling
25 it to work with us over the next couple of weeks. Do you have any feel on when
26 we could expand their space in [the International Fund] as we discussed last
month? This is a top priority for them and have [sic] offered "sticky" assets
in return for additional trading space.

27 Thanks again for the help.

28 Ted

107. Gordon disagreed. The agreement, according to Gordon, was only that he would

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 37

88 RECEIVED TIME DEC. 4 8:28AM

PRINT TIME DEC. 4 8:39AM 002-EO-030

1 consider approving an increase in Canary's timing capacity which was, in any event, contingent
2 upon the fund sub-advisor's consent to the timing activity. Gordon then enlisted the assistance
3 of a senior executive at Bank of America's private bank, with whom he had already discussed
4 the issue. In an e-mail forwarding Sihpol's January 2nd e-mail, Gordon wrote:

5 ... you and I talked briefly about this on the bus in Phoenix — is
6 this something that you want me to continue to make exceptions
7 for (we don't as a general rule except market timers)? The
8 corresponding balances they give us in the funds are nice but I
9 wouldn't do it for that.

10 Rob

11 108. This message was forwarded to another Bank of America executive with the note
12 that the Canary relationship "is controversial within bacap" and requesting that she speak with
13 Gordon and advise on a game plan. According to an e-mail from Bryceland, Sihpol's supervisor,
14 the private bank's concern "was making sure we do additional business if we are giving them
15 100mm of our balance sheet?" Bryceland then scheduled a lunch meeting for the following day
16 to discuss the Canary relationship and related issues with Gordon.

17 109. The next day, January 4, 2002, Sihpol sent an e-mail, at Bryceland's request,
18 quantifying the past and future Canary relationship. In relevant part, Sihpol wrote:

19 The commission generated as of 12/31/01 has totaled over \$655,000 (not
20 including any revenue generated from the LIBOR + 125 [basis points] \$100MM
21 line of credit from the bank - of which \$70 MM is currently drawn). This means
22 the revenues for AMG would total over \$2,250,000 on an annualized basis. This
23 number assumes zero growth over the next year and does not include the one time
24 fees (initial mutual funds charges, loan closings, etc.) the account experienced this
25 year. We are meeting with Eddie Stern on Monday to discuss dramatically
26 expanding their derivative business and the addition of new capital to their trading
27 accounts.

28 Bryceland then forwarded Sihpol's "quantification" of the Canary relationship to still further
29 senior members in the Bank of America hierarchy. Recipients included Richard DeMartini, the
30 head of all of Bank of America's asset management businesses. Included with Sihpol's e-mail
31 was Bryceland's praise for the individuals involved:

32 Accolades go to:

- 33 * Rob Gordon & BACAP for giving access to BACAP funds for market timing
34 activities (initial business we booked and not normally accepted by BACAP)
35 * [Private Bank executives] - Line of credit for 75 mm, now 100mm to provide
36 leverage for derivative and market timing transactions in an expedited and

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 28

RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4. 11 8:39AM 002-ED-030

extremely professional way

* Ted Sihpol ... - for...appropriately drawing on the firms [sic] resources to establish [the Canary relationship].

It is always nice to enter a new year with a success like this. Thanks to all team members who have contributed to this profitable relationship and for thinking across divisional lines to make money for the firm.

110. After these e-mail briefings of the upper ranks of Bank of America management,

Sihpol met with Canary as he indicated he would in the "quantification" e-mail. Apparently the

controversy within BACAP continued, however, as Gordon had not yet approved Canary's

request for additional timing capacity. Sihpol e-mailed the results of his Canary meeting to

Gordon as follows:

1. They are adding an additional \$50MM to their trading accounts to be run at 50 [basis points]. This is part of \$90MM worth of negotiated space they have been promised by another firm and wish to trade the space here. This will be followed by the additional 40MM as they use the \$100MM line of credit.

2. They agreed to try and increase their communication with us/the funds when increasing or decreasing the size of their trade in our (Nations) funds.

3. They would like to see a term sheet on the principal protected note managed by Marsico as soon as one becomes available - and understand the value of participating in proprietary offerings.

4. They [sic] fund would like to increase their business w/ [the derivatives area] - esp. the ability to trade the same contracts more frequently (weekly). The

execution of our (derivatives) desk is the best they have on the street.

5. Lastly, they would like to ask if we could grant them space (1-2%) in 3 additional Nations Funds. ...

While I know we continue to ask for space, the client continues to bring us new, outside, assets and continues to pay us generously on in-house, outside and derivative accounts. Thanks again for the help and anything you could do would be great...

Gordon forwarded Sihpol's status e-mail to DeMarini with the following message:

Rich — Once we've gotten the Marsico Principal Protected Fund off the ground, we intend to ask Mr. Stern for a commitment of \$20 million in return for the market timing commitments.

Rob

BACAP, however, was unable to launch the Marsico Principal Protected Fund into which the

sticky money was to be deposited. Gordon nonetheless approved additional timing capacity.

and Canary continued timing various Nations Funds throughout 2002 and into 2003.

6. Disclosures in the Nations Funds Prospectuses

111. At no time did the Nations Funds disclose to shareholders (1) the agreements

1 with Canary, (2) Canary's extensive market timing activities pursuant to these agreements, (3)
2 the "sticky asset" deals, (4) the fact that Canary had access to a BAS trading platform that
3 enabled Canary to trade late, or (5) the other financial services the Bank of America had
4 provided Canary (and the revenues the Bank of America derived therefrom) in connection with
5 Canary receiving timing capacity in the Nations Funds.

6 -- 112. -- The 2001 Nations Funds prospectus contains no meaningful disclosures relating
7 to market timing. In 2002, however, when Canary's timing activity was in full swing, Nations
8 Funds added language to the prospectus disclosing the harmful effect of market timing and
9 reassuring shareholders that Nations Funds would protect them. For example, the August 1,
10 2002 Nations Funds prospectus for Primary A shares discloses the following:

11 The interests of a Fund's long-term shareholders and its ability to manage
12 investments may be adversely affected when its shares are repeatedly bought and
13 sold in response to short-term market fluctuations — also known as "market
14 timing." The exchange privilege is not intended as a vehicle for market timing.
15 Excessive exchange activity may interfere with portfolio management and
16 have an adverse effect on all shareholders. When BA Advisors believes frequent
17 trading would have a disruptive effect on a Fund's ability to manage its
18 investments, a Fund may reject purchase orders and exchanges into a Fund by any
19 person, group or account that is believed to be a market timer.

16 113. As one of Bank of America's "timing police" stated in an internal email
17 discussing another timers' approach to Nations Funds in search of timing capacity:

18 Our stated policy for the Funds, and our representation to the Board, is that we do
19 not allow market timing activity.

20 A copy of this email was sent to Gordon on March 18, 2003. Five days later, Gordon approved
21 further Canary timing in two additional Nations funds.

22 7. The End of the Canary Relationship

23 114. Ultimately, even BACAP's own employees questioned whether Canary's timing
24 trading was detrimental to long-term shareholders. In a May 12, 2003 e-mail, a BACAP
25 employee complained vociferously to the "timing police" about the damage a timer —
26 apparently Canary — was doing to one of the Nations Funds:

27 the PB has a client who trades \$9 million in and out of the midcap index fund all
28 the time. It wasn't so bad when he held his positions for a while, but now he's
trading extremely short swings, sometimes with holding periods of only a day.
The impact of this has been lessened since we have been getting notification in

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 30

88 d RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4. 8:38AM 02-80-030

1 time to hedge at the close, but there is still a cost that's being borne by other fund
2 shareholders. We would be happy to set up a futures trading account for this guy
and handle his futures trades for him, but a mutual fund is not the right vehicle
for this kind of trading.

3 Notwithstanding these concerns, Canary continued to time the Nations Funds until early July,
4 2003, when Canary received a subpoena from the New York Attorney General's Office. At that
5 point, Canary's timing of Nations Funds ceased. On July 3, 2003, a member of the BACAP
6 "timing police" force sent the following e-mail to his colleague:

7 This [attachment] is the [Canary] account in Small Company that came in on June
8 11 through Bear Stearns that Ted Sihpol indicated would be "sticky" money. They
9 placed a full liquidation yesterday.

10 The BACAP "timing police" noticed right away that Canary's "sticky assets" had left the bank.

11 E. Security Trust Company

12 115. Defendant Security Trust Company provides corporate trust services to
13 retirement plans, third-party administrators and various institutional clients. It became Canary's
14 partner in a wide-ranging late trading and timing venture.

15 116. STC provides an electronic trading platform to the administrators of retirement
16 plans and other clients that allows them to trade in mutual funds. This platform gives access to
17 hundreds of mutual funds and processes thousands of mutual fund trades each day. Many of
18 these are submitted by individual participants in retirement plans -- essentially, when an
19 individual shifts retirement money among the mutual funds available in his or her retirement
20 plan, that plan in turn executes the resulting trades through STC. After aggregating the orders it
21 receives during the course of the trading day, STC submits them in the evening to the National
22 Securities Clearing Corporation for processing. STC charges retirement plans a fee of
23 approximately ten basis points (one-tenth of one percent) of custodied assets for such trades.

24 117. Canary's relationship with STC began in May of 2000, when Canary met
25 with STC to see if it could use the STC electronic platform for its late trading and timing
26 business. This platform provided Canary with one-stop shopping: (1) It could trade until 9:00
27 p.m. New York time and (2) STC offered an unusually broad range of mutual funds for "under
28 the radar" timing. STC agreed to give Canary access to the STC trading platform at its standard

1 rate of ten basis points.

2 118. Canary and STC memorialized their understanding in part in a written protocol
3 entitled "Best Practices." Among other things, this provided that:

4 • Canary would vary the sizes of trades through STC to make them more difficult
5 for fund companies to detect;

6 • "Upon receipt of concerned feedback from a fund complex (a "Fund") with
7 respect to trade activity that cannot be alleviated by either conversations between
8 the Fund and [STC] or a change in trading activity, [STC] shall request
9 to [Canary] that the Fund no longer be used in the Account";

10 • "[STC] should arrange to Commingle 'sticky' or static assets into the multiple
11 Omnibus Accounts in order to increase stability in the Fund and decrease
12 perceived activity"; and

13 • STC would not provide "the same or similar services" to other mutual fund
14 investors with the exception of another hedge fund named Samaritan and another
15 Stern vehicle named the Da Vinci fund.

16 At or about the time the "Best Practices" document was prepared, STC demanded a new
17 arrangement with Canary that reflected its status as Canary's partner. Canary would now pay
18 STC "market value fees" of one percent on custodied assets (ten times what legitimate
19 customers paid) and "profit sharing fees" of four percent of Canary's gains. In October of 2000,
20 STC also asked for and received a belated written assurance that the trades Canary sent to STC
21 as late as 9:00 p.m. were in fact "received" by Canary before 4:00 p.m. New York time.

22 119. STC thereafter assisted Canary in locating new timing capacity. With regard to
23 "under the radar" trading, STC helped Canary camouflage its trades by revealing to Canary the
24 mutual fund positions and trades of the retirement plans that were STC's legitimate customers.
25 This allowed Canary to piggyback onto the retirement funds' trade flows in such a way that the
26 targeted mutual fund families would not notice Canary's timing. While potentially damaging to
27 STC's pension fund clients (because now their own mutual fund investments were targets for
28 Canary's timing), this was a significant help for Canary. STC also introduced Canary to the
29 mutual fund managers at the bank where STC does its commercial banking business, Bank
30 One.

31 E. Bank One

32 120. Bank One Corporation owns Bank One Investment Advisors ("BOIA"), the

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 32

1 management company for the "One Group" mutual funds. STC introduced Stern to the
2 President of BOIA, Mark Beeson, in the spring of 2002. Stern explained Canary's strategy, and
3 eventually Canary and Beeson agreed to the following: (1) Canary would create a "special
4 purpose vehicle" (i.e., create a Canary affiliate) to conduct timing trading and fund it with \$15
5 million; (2) Bank One would lend the special purpose vehicle \$15 million at a high interest rate
6 in order to finance the timing; (3) Canary would be given timing capacity in the One Group
7 funds; and (4) Canary would consider making a "sticky asset" investment in a Bank One hedge
8 fund. Beeson confirmed the deal in an e-mail to Stern dated March 21, 2002:

9 Our managers are willing to work with you on the equity funds. They would like
10 to start with 1/4% of the fund's net assets as the maximum position and then
11 evaluate moving to 1% later. . . . We will be ready to start trading once the other
12 banking arrangements are complete. Also, the head of our hedge group will be in
New York on April 2. Is it possible to meet with you or your hedge fund manager
to discuss this opportunity more?

13 Stern responded on March 26:

14 Here is the list of mutual funds we would like to trade, along with some other
15 relevant information about the trading we want to do. . . . How does the
following week look for your hedge fund guy?

16 121. Thereafter, Bank One permitted Canary to time the One Group funds it had
17 chosen: the two international funds, the Small Cap Growth Fund, and two mid cap funds. Since
18 these trades were executed through STC, Canary was also able to engage in late trading. The
19 prospectus for the One Group funds reassured investors that Bank One protected them from
20 timers like Canary. For instance, it states:

21 The exchange privilege [i.e., selling shares] is not intended as a way for you to speculate
22 on short term movements in the market. Therefore:

23 • To prevent disruptions in the management of the Funds,
24 One Group limits excessive exchange activity. Exchange
activity is excessive if it exceeds two substantive
exchange redemptions within 30 days of each other.

25 • Excessive exchange activity will result in revocation of
26 your exchange privilege.

27 Canary engaged in "excessive exchange activity" under this definition, but was not shut down.

28 122. One Group had also established special penalties for timers of their international
funds. These are also described in the prospectus:

1 If you sell your shares of the International Equity Index Fund or the Diversified
2 International Fund within 90 days of purchase, you will pay a redemption fee of
3 2.00% on the value of the shares sold. . . . The redemption fees are paid to the
4 Funds and are designed to offset the brokerage commissions, capital gains impact,
5 and other costs associated with fluctuations in Fund assets levels caused by short-
6 term shareholder trading.

7 The redemption fees were waived for Canary.

8 123. In early 2003, Beeson asked Canary to stop timing the international funds, as he
9 was uncomfortable continuing to waive the redemption fees required by the prospectus. He also
10 relayed that the One Group fund managers were complaining to him about the effects of
11 Canary's timing activity, and asked if Canary could reduce the frequency of its trading. In
12 return, he offered Canary four new funds to time.

13 124. Bank One subsequently offered to double its loan to the Canary special purpose
14 vehicle, and asked for the "sticky asset" hedge fund investment that had been discussed in
15 2002. Canary was only willing to do so if Bank One would finance the investment. When Bank
16 One was unable to do so, the relationship with Canary soured. Canary stopped its timing
17 activity at Bank One in April of 2003.

18 G. Janus

19 125. Janus Capital Corporation ("Janus") is the investment advisor for the Janus
20 family of funds. In or about April, 2002, Janus granted permission for Canary to time the Janus
21 Mercury fund. In exchange, Canary deposited "sticky" money into a Janus money market fund.
22 Canary timed the Janus Mercury fund during 2002 and 2003. Canary also received capacity to
23 time the Janus High Yield fund. Janus subsequently granted Canary capacity to time its High
24 Yield fund as well.

25 I. Canary's Additional Timing Capacity at Janus

26 126. In early 2003, Canary sought timing capacity in Janus' offshore funds. Through
27 an intermediary, it contacted Janus and offered "sticky" assets in exchange for this additional
28 timing capacity. In response, a concerned Janus employee sent e-mails to Richard Garland, the
CEO of Janus International, expressing alarm over the volume of market timing activity in
Janus funds:

1 I'm getting more concerned w/ all of these market timers and how they are
2 affecting our PM's [i.e., Portfolio Managers] trading activity. [Portfolio
3 Managers] have voiced their sensitivity on a number of occasions re: this type of
4 activity in JWF. I spoke to [a Janus employee] and confirmed that this is a big
5 problem domestically and I want to avoid this at all cost before it gets too
6 problematic offshore. Now that we have our exchange limitation in our
7 prospectus, I would feel more comfortable not accepting this type of business
8 because its too difficult to monitor/enforce & it is very disruptive to the PM's &
9 operation of the funds. Obviously, your call from the sales side.

10 127. The employee also recommended to Garland that Janus refuse the additional
11 business from Canary due to the issues created for portfolio managers: "For now, I don't think
12 we should take on additional business of this nature... We need to keep our funds clean &
13 minimize [sic] issues for PM's/fund performance. Do you agree?" Garland did not agree. He
14 replied:

15 I have no interest in building a business around market timers, but at the same
16 time I do not want to turn away \$10-\$20m! How big is the [Canary] deal ...?

17 After learning that Canary's timing could amount to between \$10 and \$50 million dollars,
18 Garland gave the "[g]o ahead" for Canary's additional timing capacity on April 3, 2003. The
19 new agreement with Canary was never finalized, however.

20 2. Janus Attempts To Establish A Timing Policy

21 128. Managing the extensive timing activity in its funds became difficult for
22 Janus. In early June, 2003, it began to consider adopting a consistent policy on market timing.
23 Discussion concerning development of such a policy was opened up to certain Janus employees.
24 Comments included:

25 • "Our stated policy is that we do not tolerate timers. As such, we won't actively
26 seek timers, but when pressed and when we believe allowing a limited/controlled
27 amount of timing activity will be in JCG's best interests (increased profitability to
28 the firm) we will make exceptions under these parameters."

29 • "My own personal recommendation is not to allow timing, period, and follow
30 the prospectus....[T]imers often hide multiple accounts and move on the same day
31 which could hurt other investors and enrage the Pms....I don't think the static
32 assets that we might be able to hold onto are worth the potential headaches, nor
33 does this fall into our 'narrow and deep' focus. I suggest we maintain the timing
34 agreements we have, but allow no more."

35 • "[I]f we are going to allow timing, we want to be sure that there are enough
36 static assets [i.e., "sticky" assets] so that we are making a decent profit for all the
37 trouble we are put through."

3. The Janus Prospectuses

129. The Janus prospectus did not disclose the approved market timing activity in Janus funds. On the contrary, the disclosures in the prospectus gave the appearance that market timers were being policed and shut down. For example, the February 25, 2002 prospectus for the Janus Income Funds (including the HighYield Fund that Canary was timing) states under the heading "Excessive Trading Policy":

Frequent trades in your account or accounts controlled by you can disrupt portfolio investment strategies and increase Fund expenses for all Fund shareholders. The Funds are not intended for market timing or excessive trading. To deter these activities, the Funds or their agents may temporarily or permanently suspend or terminate exchange privileges of any investor who makes more than four exchanges out of a Fund in a calendar year and bar future purchases into the Fund by such investor. In addition, the Funds or their agents also may reject any purchase orders (including exchange purchases) by any investor or group of investors indefinitely for any reason, including, in particular, purchase orders that they believe are attributable to market timers or are otherwise excessive or potentially disruptive to the Fund.

Orders placed by investors in violation of the exchange limits or the excessive trading policies or by investors that the Fund believes are market timers may be revoked or cancelled by a Fund...

G. Strong Capital Management

130. Strong Capital Management, Inc. ("Strong") is the advisor for the Strong family of mutual funds. Canary met with Strong representatives on October 16, 2002, asked for permission to time their mutual funds, and at the same time offered to invest in a proprietary Strong hedge fund. After agreeing which funds Canary would be allowed to time, Strong provided Canary with the September month-end portfolio holdings of the target funds on November 13. On November 26, an internal Strong email documented the understanding with Canary:

"[Canary] will be opening a brokerage account... valued somewhere around \$18 million dollars. The purpose of the brokerage account will be to trade mutual funds and trade on margin. [It] will be actively trading the mutual funds that [a Portfolio Manager] manages, but will not trade more than 1% of the total assets of the fund on any one day, ... The client will also have substantial additional assets in other areas of Strong for Cash Management and Hedge Fund purposes.

The trading arrangement was documented in more detail in a letter to Canary that day:

- The following funds are available for your strategy;
- Strong Growth 20 Fund

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 36

RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4. 8:38AM 002-80-030

1 • Strong Growth Fund

2 • Advisor Mid Cap Growth Fund

3 • Strong Large Cap Growth Fund

4 • Strong Dividend Income Fund

5 • If your assets are not invested in one of the above funds then these assets will
6 reside in one of the Strong Money Markets.

7 • You will need to be invested in any fund on the last day of the month if you are
8 invested in that same fund on the first day of that same month.

9 • All funds will be available for margin according to Reg T.

10 • We will need trading instructions from you by 2:45 PM CST/3:45 PM EST on
11 any day you wish to trade.

12 • All positions are limited to 1% of the assets within the fund...

13 An e-mail the following day shows Strong alerting its transfer agent and clearing broker to the
14 arrangement with Canary so that the trades would not be rejected for "slipping."

15 131. Strong's prospectus gave investors no warning that their funds would be used for
16 timing, but rather created the misleading impression that Strong identified and barred timers
17 from its funds. A Strong prospectus for one of the funds Canary timed reads:

18 **Market Timers**

19 The Fund will consider the following factors to identify market timers:
20 shareholders who (1) have requested an exchange out of the fund within 30 days
21 of an earlier exchange request; (2) have exchanged shares out of the Fund more
22 than twice in a calendar quarter; (3) have exchanged shares equal to at least \$5
23 million or more than 1% of the Fund's net assets; or (4) otherwise seem to follow
24 a timing pattern....

25 It then goes on to reserve the right to shut market timers down:

26 We reserve the right to:

27 • Refuse, change, discontinue, or temporarily suspend account services, including
28 purchase, exchange, or telephone, facsimile and online account redemption
29 privileges, for any reason.

30 • Reject any purchase request for any reason, including exchanges from other
31 Strong Advisor Funds or Strong Funds. Generally, we do this if the purchase or
32 exchange is disruptive to the efficient management of a fund (due to the timing of
33 the investment or an investor's history of excessive trading).

34 After several months of trading, Canary wrote Strong on February 21, 2003:

35 We are prepared to make an investment in your hedge fund. We will also step up
36 our allocation to your mutual funds to our full \$18 MM if that is still ok.

37 At about this time, Canary asked if it could clear its Strong trades through the Bank of America
38 (which Canary knew would allow it to engage in late trading). On February 25, Strong replied to
39 Canary: "As for the clearing through B of A, it is not going to work out."

40 132. Strong regularly provided Canary with detailed breakdowns of the portfolios of

1 one target funds. These allowed Canary to sell short the stocks that the portfolios contained.

2 Canary was satisfied with the relationship. In May, Canary wrote Strong:

3 Hey, we are going to be doubling up our mutual fund positions in a week or two.
4 Some time shortly thereafter, we will double up on our hedge fund position.

5 H. Alliance

6 133. The AllianceBernstein Funds' website states: *"A little planning goes a long way.
7 Whatever your long-term goal, we can help you begin to plan a savings strategy. If your goal
8 is listed below, let us show you how. I want to invest for a comfortable retirement - I'm saving
9 for a college education. I'm saving toward a dream purchase."* [Emphasis added.] However,
10 unbeknownst to investors, from at least as early as October 2, 1998 and until September 29,
11 2003, inclusive, defendants engaged in fraudulent and wrongful schemes that enabled certain
12 favored investors to reap many millions of dollars in profit, at the expense of the
13 AllianceBernstein Funds' investors, through secret and illegal after-hours trading and timed
14 trading. In exchange for allowing and facilitating this improper conduct, Alliance Holding,
15 Alliance Corporation, Alliance Capital Management, AXA and AllianceBernstein Registrants
16 (collectively, the "Alliance Defendants") received substantial fees and other remuneration for
17 themselves and their affiliates to the detriment of other mutual fund investors who knew nothing
18 of these illicit arrangements.

19 134. Specifically, Alliance Capital Management, as manager of the AllianceBernstein
20 Funds, and each of the relevant fund managers, profited from fees Alliance Capital Management
21 charged to the AllianceBernstein Funds that were measured as a percentage of the fees under
22 management. In exchange for the right to engage in illegal late trading and timing, which hurt
23 unknowing AllianceBernstein Funds investors by artificially and materially affecting the value
24 of the AllianceBernstein Funds, the Canary Defendants, and the John Doe Defendants, agreed to
25 park substantial assets in the Alliance Funds, thereby increasing the assets under
26 AllianceBernstein Funds' management and the fees paid to AllianceBernstein Funds' managers.
27 Furthermore, the Canary Defendants secretly disguised additional, improper compensation to
28 the Alliance Defendants as interest payments on monies loaned by the Alliance Defendants to

1 the Canary Defendants for the purpose of financing the illegal scheme. The synergy between the
2 Alliance Defendants and the Canary Defendants hinged on ordinary investors' misplaced trust in
3 the integrity of mutual fund companies and allowed defendants to profit handsomely at the
4 expense of plaintiff and others.

5 135. On September 30, 2003, Alliance Capital Management announced in a press
6 release published over PR Newswire that the New York Attorney General and the SEC had
7 contacted Alliance Capital Management in connection with the regulators' investigation of
8 market timing and late trading practices in the mutual fund industry. Additionally, Alliance
9 Capital Management revealed the following:

10 based on the preliminary results of its own ongoing internal investigation
11 concerning mutual fund transactions, it has identified conflicts of interest in
12 connection with certain market timing transactions. In this regard, Alliance
13 Capital has suspended two of its employees, one of whom is a portfolio manager
14 of the Alliance Bernstein Technology Fund, and the other of whom is an
15 executive involved with selling Alliance Capital hedge fund products. [Emphasis
16 added.]

17 136. On October 1, 2003, an article appearing in *The Wall Street Journal* identified
18 the two Alliance Capital Management employees who were suspended as a result of their
19 involvement in conflicts of interests as defendants Gerald Malone and Charles Schaffran. The
20 article revealed that Alliance Capital Management had been subpoenaed by the New York
21 Attorney General's Office early in its inquiry into the mutual fund industry, and further,
22 elaborated on defendants Malone and Schaffran's wrongful and illegal misconduct:

23 certain investors were allowed to make rapid trades in a mutual
24 fund managed by Mr. Malone in exchange for making large
25 investments in Alliance hedge funds also run by Mr. Malone[.]

26 ***

27 Mr. Schaffran is alleged to have helped a broker at a Las Vegas
28 firm called Security Brokerage Inc. gain the ability to make short-
term trades in shares of Mr. Malone's mutual fund in exchange for
investments into Mr. Malone's hedge funds[.]

As previously reported, [defendant Edward] Stern's firm, Canary, appears to
had arrangements allowing short-term trading with Alliance funds...
Meanwhile, according to a copy of trade orders obtained by [Attorney General
Elliot] Spitzer's office, on the evening of Jan. 13 this year, Mr. Stern placed late

trades through Bank of America's trading system to sell 4,178,074 shares of Alliance Growth and Income Fund, which at the time would have amounted to an approximately [sic] \$11 million transaction. [Emphasis added.]

137. In addition to the AllianceBernstein Technology Fund, the article stated that defendant Malone also managed two technology hedge funds, the ACM Technology Hedge Fund and the ACM Technology Partners LLP.

138. The AllianceBernstein Prospectuses Were Materially False and Misleading

Each AllianceBernstein Funds investor was entitled to, and did receive, one of the Prospectuses, each of which contained substantially the same materially false and misleading statements regarding the AllianceBernstein Funds' policies on late trading and timed trading, and acquired shares pursuant to one or more of the Prospectuses.

139. The Prospectuses contained materially false and misleading statements with respect to how shares are priced, typically representing as follows:

How the Funds Value Their Shares

The Funds' net asset value or NAV is calculated at 4 p.m., Eastern time, each day the Exchange is open for business. To calculate NAV, a Fund's assets are valued and totaled, liabilities are subtracted, and the balance, called net assets, is divided by the number of shares outstanding. The Funds value their securities at their current market value determined on the basis of market quotations, or, if such quotations are not readily available, such other methods as the Funds' directors believe accurately reflect fair market value.

140. The Prospectuses, in explaining how orders are processed, typically represented that orders received before the end of a business day will receive that day's net asset value per share, while orders received after close will receive the next business day's price, as follows:

Your order for purchase, sale, or exchange of shares is priced at the next NAV calculated after your order is received in proper form by the Fund. Your purchase of Fund shares may be subject to an initial sales charge. Sales of Fund shares may be subject to a contingent deferred sales charge or CDSC.

HOW TO EXCHANGE SHARES

You may exchange your Fund shares for shares of the same class of other Alliance Mutual Funds (including AFD Exchange Reserves, a money market fund managed by Alliance). Exchanges of shares are made at the next determined NAV, without sales or service charges. You may request an exchange by mail or telephone. You must call by 4:00 p.m., Eastern time, to receive that day's NAV. The Funds may modify, restrict, or terminate the exchange service on 60 days'

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 40

1 wjjen notice

2 HOW TO SELL SHARES

3 You may "redeem" your shares (i.e., sell your shares to a Fund) on any day the
4 Exchange is open, either directly or through your financial intermediary. *Your*
5 *sales price will be the next determined NAV, less any applicable CDSC, after the*
6 *Fund receives your sales request in proper form. Normally, proceeds will be sent*
7 *to you within 7 days. If you recently purchased your shares by check or electronic*
8 *funds transfer, your redemption payment may be delayed until the Fund is*
9 *reasonably satisfied that the check or electronic funds transfer has been collected.*
10 *(which may take up to 15 days). [Emphasis added.]*

11 141. The Prospectuses falsely stated that Alliance Capital Management actively
12 safeguards shareholders from the harmful effects of timing. For example, in language that
13 typically appeared in the Prospectuses, the March 31, 2003 AllianceBernstein Technology Fund
14 Prospectus and the AllianceBernstein All-Asia Investment Fund Prospectus stated as follows:

15 A Fund may refuse any order to purchase shares. In particular, the Funds reserve
16 the right to restrict purchases of shares (including through exchanges) when they
17 appear to evidence a pattern of frequent purchases and sales made in response to
18 short-term considerations.

19 In an effort to discourage frequent trading, mutual funds may impose a
20 redemption fee if shares are sold or exchanged within a prescribed time.

21 142. The Prospectuses failed to disclose and misrepresented the following material
22 and adverse facts:

23 (a) that defendants had entered into an agreement allowing the Canary
24 Defendants and the John Doe Defendants to time their trading of the AllianceBernstein Funds
25 shares and to "late trade";

26 (b) that, pursuant to that agreement, Canary and other favored investors
27 regularly timed and late-traded the AllianceBernstein Funds shares;

28 (c) that, contrary to the express representations in the Prospectuses, the
AllianceBernstein Funds enforced their policy against frequent traders selectively, i.e., they did
not enforce it against the Canary Defendants and the John Doe Defendants and they waived the
redemption fees that these defendants should have been required to pay pursuant to stated
AllianceBernstein Funds policies;

(d) that the Fund Defendants regularly allowed Canary and other favored

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 41

27 RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4. 8:37AM 002-30-230

1 Investors to engage in trades that were disruptive to the efficient management of the
2 AllianceBernstein Funds and/or increased the AllianceBernstein Funds' costs and thereby
3 reduced the AllianceBernstein Funds' actual performance; and

4 (e) that the amount of compensation paid by the AllianceBernstein Funds to
5 Alliance Capital Management, because of the AllianceBernstein Funds' secret agreement with
6 Canary and others, provided substantial additional undisclosed compensation to Alliance
7 Capital Management by the AllianceBernstein Funds and their respective shareholders.

8 **L. Putnam**

9 143. On September 5, 2003, *The Wall Street Journal* reported that the New York
10 Attorney General's Office had subpoenaed "a large number of hedge funds" and mutual funds as
11 part of its investigation, "underscoring concern among investors that the improper trading of
12 mutual fund shares could be widespread" and that the SEC, joining the investigation, plans to
13 send letters to mutual funds holding about 75% of assets under management in the U.S. to
14 inquire about their practices with respect to market timing and fund-trading practices. Putnam
15 Investments was one of the mutual fund entities subpoenaed by the New York Attorney General.

16 144. On September 16, 2003, Massachusetts Secretary of the Commonwealth William
17 Galvin announced the launching of a probe into improper fund trading at Putnam Investments in
18 Boston. The *Boston Herald* reported on September 16, 2003 that "Galvin said his staff sent
19 several subpoenas to Putnam last Thursday to learn about possible improper market timing--
20 that is, making short-term trades of fund shares, often at the expense of long-term shareholders."
21 The article highlighted that Secretary of State Galvin noted that his office had good reasons to
22 believe that Putnam Investments was involved in the conduct alleged herein, stating that, "This
23 is not a fishing expedition ... We obviously have probably cause of some kind to make these
24 inquiries," (Emphasis added). The probe was focused on "trades in one of Putnam's
25 international funds," according to the article.

26 145. On October 21, 2003, the *Boston Globe* reported that Massachusetts Secretary of
27 State William F. Galvin plans to charge Putnam Investments with civil securities fraud for
28 engaging in market timing. In relevant part, the *Globe* reported as follows:

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 42

9b RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4. 8:37AM

Massachusetts Secretary of State William F. Galvin plans to charge Putnam Investments with civil securities fraud within the next few days, say two people involved in the investigation. The charges would ensnare one of Boston's largest mutual fund firms in a burgeoning probe into abusive practices in the fund industry. [Emphasis in original].

Galvin and New York Attorney General Eliot Spitzer have moved aggressively in the last two months against the mutual fund industry, which had largely avoided the lawsuits and scandals that have plagued corporate America and the securities industry since the Internet bubble burst in early 2000. Spitzer, in particular, has shown that certain big investors received preferential treatment at some fund houses, undermining investors' faith that the rules apply equally to all shareholders. Formal complaints against Putnam, the nation's fifth-largest fund family, would suggest that the scope of the inquiries is widening.

Investigators are probing whether the trading practice known as market timing — trading quickly into and out of funds, to take advantage of short-term price fluctuations — was being employed by small-time individual investors as well as by sophisticated brokerage houses. The two people involved in the investigation said the state Securities Division, which Galvin oversees, intends to charge Putnam with at least two counts of securities fraud. One count would allege the company let individuals trade rapidly in and out of their mutual fund accounts — despite company policies that prohibit excessive trading. A second would allege that Putnam failed to treat shareholders equally, by allowing some to market-time their accounts, and not others.

The state is expected to allege that by not upholding its policies, Putnam in effect said one thing and did another as well as treated its customers unequally. The state is expected to argue that both would constitute civil fraud in Massachusetts. [emphasis added].

1. The Putnam Prospectuses Were Materially False and Misleading

140. Prior to investing in any of the Putnam Funds, plaintiffs and each member of the class were entitled to and did receive one of the Prospectuses, each of which contained substantially the same materially false and misleading statements regarding the Putnam Funds' policies on timed trading.

141. The Prospectuses falsely stated that the Putnam Funds actively safeguard shareholders from the recognized harmful effects of timing. For example, in language that typically appeared in the Prospectuses, the January 30, 2003 Putnam International New Opportunities Fund prospectus acknowledged that "short-term trading" is harmful to shareholders and represented that the Putnam Funds detest the practice, stating as follows:

The exchange privilege is not intended as a vehicle for short-term trading. Excessive exchange activity may interfere with portfolio management and have an adverse effect on all shareholders. In order to limit excessive exchange activity and otherwise to promote the best interests of the fund, the fund imposes a

1 redemption fee of 1.00% of the total exchange amount (calculated at market
2 value) on exchanges of shares held less than 90 days. The fund also reserves the
3 right to revise or terminate the exchange privilege, limit the amount or number of
4 exchanges or reject any exchange. The fund into which you would like to
5 exchange may also reject your exchange. These actions may apply to all
6 shareholders or only to those shareholders whose exchanges Putnam Management
7 determines are likely to have a negative effect on the fund or other Putnam funds.

8 ***

9 The fund imposes a redemption fee of 1.00% of the total redemption amount
10 (calculated at market value) if you sell or exchange your shares after holding them
11 for less than 90 days. The redemption fee is paid directly to the fund, and is
12 designed to offset brokerage commissions, market impact, and other costs
13 associated with short-term trading. For purposes of determining whether the
14 redemption fee applies, the shares that were held the longest will be redeemed
15 first.

16 142. The Prospectuses failed to disclose and misrepresented the following material
17 and adverse facts:

18 (a) that defendants had entered into an agreement allowing the John Doe
19 Defendants to time their trading of the Putnam Funds shares;

20 (b) that, pursuant to that agreement, the John Doe Defendants regularly timed
21 their trading in the Putnam Funds shares;

22 (c) that, contrary to the express representations in the Prospectuses, the
23 Putnam Funds enforced their policy against frequent traders selectively, i.e., they did not enforce
24 it against the John Doe Defendants;

25 (d) that the Fund Defendants regularly allowed the John Doe Defendants to
26 engage in trades that were disruptive to the efficient management of the Putnam Funds and/or
27 increased the Putnam Funds' costs and thereby reduced the Putnam Funds' actual performance;
28 and

29 (e) the Prospectuses failed to disclose that, pursuant to the unlawful
30 agreements, the Fund Defendants benefited financially at the expense of the Putnam Funds
31 investors.

32 VI.

33 PLAINTIFF'S SPECIFIC FACTS

34 143. Plaintiff, at all times relevant hereto, owned or acquired the mutual funds of

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 44

1 Defendant Janus.

2 144. At all times relevant hereto, Plaintiff owned or acquired Janus mutual funds in
3 and around the Los Angeles County area.

4 145. At all times relevant hereto, Plaintiff was and is being subjected to the illegal
5 practices of Defendants, as aforesaid, and has been damaged thereby.

6 ~~SECTION VII~~

7 **FIRST CAUSE OF ACTION**

8 **Unfair Business Practices - Violation of**
9 **Cal. Bus. & Prof. Code §§17200 and 17203 Against All Defendants**

10 146. Plaintiff herein recites and incorporates each and every one of the allegations
11 contained in Paragraphs 1 through 145, inclusive of this Complaint, as if fully set forth herein.

12 147. Business and Professions Code (B&PC) Section 17200, Section 17203, et. seq.,
13 often referred to as the "Unfair Competition Law" (B&PC §17200), prohibits unfair
14 competition, which is defined to include any unlawful, unfair or fraudulent business action or
15 practice. Defendants systematically engaged in illegal and improper mutual fund trading
16 practices.

17 148. Defendants, and each of them, have engaged in unfair business practices in
18 California by utilizing the practices outlined above. The aforesaid conduct is also unlawful and
19 subjects Defendants to sanctions and fines and is actionable under B&PC §§17200 and 17203.
20 Defendants' use of such practices constitutes an unfair business practice, unfair competition and
21 provides an unfair advantage over Defendants' competitors. Plaintiff on behalf of the general
22 public seeks full restitution and disgorgement of said monies by Defendants, as necessary and
23 according to proof, to restore any and all monies acquired and/or converted by the Defendants
24 by means of the unfair practice complained of herein. Plaintiff further seeks on behalf of the
25 general public, the appointment of a receiver, as necessary, to establish the total monetary relief
26 sought from Defendants. The restitution includes all profit realized as a result of the unfair
27 business practice, including interest thereon.

28 149. Plaintiff is informed and believes and on that basis alleges that at all times herein

1 mentioned Defendants have engaged in unlawful, deceptive and unfair business practices
2 prohibited by California B&PC §17200, including those set forth above, inclusive, thereby
3 depriving Plaintiff and the other members of the general public of fair and honest business
4 practices. The conduct of Defendants is inimical to the public welfare since it transgresses civil
5 statutes of this state.

6 150. By and through their unfair, unlawful and/or improper business practices-
7 described herein, Defendants have exploited Plaintiff and others.

8 151. Plaintiff and others are entitled to and do seek relief as may be necessary to
9 restore to them the money of which Plaintiff and others have been deprived by means of the
10 herein described unfair, unlawful and/or fraudulent business practices.

11 152. Plaintiff seeks an injunction preventing Defendants from continuing the unfair
12 business practices set forth above. Plaintiff further seeks an order requiring Defendants to
13 timely pay restitution to all current and former customers, including penalties, interest and
14 attorneys' fees and costs, pursuant to Code of Civil Procedure §1021.5.

15 153. Plaintiff and others are further entitled to and do seek a declaration that the
16 above-described business practices are unfair, unlawful and/or fraudulent and seek injunctive
17 relief restraining Defendants from engaging in any of the herein described unfair, unlawful
18 and/or fraudulent business practices at all times in the future.

19 **PRAYER FOR RELIEF**

20 WHEREFORE, for all of the above and foregoing reasons, Plaintiff prays for judgment
21 against all Defendants, and each of them, as follows:

22 1. For an Order permanently enjoining Defendants from engaging in the practices
23 challenged herein;

24 2. For an Order for full restitution of all monies, as necessary and according to
25 proof, to restore any and all monies acquired and/or converted by Defendants by means of the
26 also seeks pre-judgment interest and attorneys' fees as a result of the unfair business practices;

27 3. For an Order finding and declaring that Defendants' acts and practices as
28 challenged herein are unlawful, unfair and/or fraudulent;

PRIVATE ATTORNEY GENERAL COMPLAINT

Page 45

29 RECEIVED TIME DEC. 4. 8:28AM

PRINT TIME DEC. 4. 8:37AM

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1 4. For an accounting, under administration of Plaintiff and subject to court review,
2 to determine the amount to be returned by Defendants and the amounts to be refunded to
3 members of the public who are or were affected by Defendants' illegal acts;

4 5. For the creation of an administrative process wherein each current and former
5 injured customer of Defendants' receives his or her losses.

6 **DEMAND FOR JURY TRIAL**

7 Plaintiff hereby demands a trial by jury.

8 DATED: October 22, 2003

GLANCY & BINKOW LLP

9
10 By: 

Lionel Glancy #134180

11
12 Michael Goldberg #188669
13 Peter A. Binkow #173648
14 1801 Avenue of the Stars, Suite 311
15 Los Angeles, CA 90067
16 Telephone: (310) 201-9150
17 Facsimile: (310) 201-9160

18 Law Offices of Brian Barry
19 Brian Barry #135631
20 1801 Avenue of the Stars Suite 307
21 Los Angeles, CA 90067
22 Telephone: (310) 788-0831
23 Facsimile: (310) 788-0841

24 Attorneys for Plaintiff Mike Soyegh
25
26
27
28