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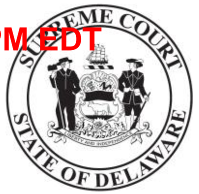

**IN THE SUPREME COURT OF THE STATE OF DELAWARE**

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| HUGH F. CULVERHOUSE, individually and on behalf of all others similarly situated,<br><br>Plaintiff-Appellant,<br><br>v.<br><br>PAULSON & CO. INC. and PAULSON ADVISERS, LLC,<br><br>Defendants-Appellees. | No. 349, 2015<br><br>Certification of Question of Law from the United States Court of Appeals for the Eleventh Circuit<br>C.A. No 14-1426 |

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October 26, 2015

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## INTRODUCTION

Paulson & Co. Inc. and Paulson Advisers, LLC (collectively, "Paulson") would rather that the Eleventh Circuit had certified a different question framed by different facts. Paulson introduces several pages of additional facts that the Eleventh Circuit chose not to include in its Certification Order. Based on those new facts, Paulson argues that it owed no fiduciary or contractual duty to Culverhouse and that Culverhouse contracted away his right to recourse against Paulson. Those arguments are beyond the scope of the certified question and not properly before this Court.

The question that is before the Court is whether Culverhouse stated derivative or direct claims under *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), and *Anglo American Security Fund, L.P. v. S.R. Global International Fund, L.P.*, 829 A.2d 143 (Del. Ch. 2003). In the Certification Order, the Eleventh Circuit focused solely on this issue and framed the certified question against the relevant factual backdrop.

What distinguishes this case from every case cited other than *Anglo American* is that a derivative action here will compensate the wrong parties. A derivative action under the facts in this case will provide new investors in Paulson Advantage Plus and HedgeForum with a windfall, while denying a recovery to

investors like Culverhouse who were actually harmed. That problem is at the core of the certified question.

*Tooley* provides an analytical framework that aligns the party actually harmed with the party who will receive a recovery. That result is achieved under the facts of this case only through a direct action. Accordingly, the Court should answer the certified question in the affirmative.

## ARGUMENT

### 1. Paulson owed Culverhouse a duty, and Paulson's arguments to the contrary are not properly before this Court.

#### A. The certified question asks whether claims are direct or derivative, not whether Paulson had a fiduciary or contractual relationship with Culverhouse.

The Eleventh Circuit's certification order focuses on a single legal issue. It notes that Culverhouse argued that his claims "are direct under *Anglo American*." (Certification Order 5.) The Eleventh Circuit found that "[t]he fund in *Anglo American* is similar to Paulson Advantage Plus and HedgeForum," but that "later developments in Delaware law make [it] hesitant to hold that *Anglo American* controls this appeal." (*Id.* at 6.) "Although the analysis in *Anglo American* appears consistent with the analytical framework set forth in *Tooley*," courts have "questioned whether *Anglo American* remains good law." (*Id.* at 7.) The Eleventh Circuit certified the question to this Court to resolve the issue.

Paulson attempts to redirect the Court to a different legal issue. It argues that "there is no contractual or fiduciary relationship or privity between" an investor in a feeder fund and the general partners of a hedge fund "to provide any basis for a direct suit." (Paulson Br. 17.) According to Paulson, by analyzing the certified question under *Anglo American* and *Tooley*, just as the Eleventh Circuit did in its Certification Order, Culverhouse "blithely skipp[ed] over the distinction between a Feeder Fund investor and an Investment Fund investor." (*Id.* at 16.)

Paulson unsuccessfully made this same argument in its petition for rehearing to the Eleventh Circuit. It claimed that "[t]he primary issue in the underlying action is whether [Culverhouse], as a *Feeder Fund* investor, has standing to bring a direct suit against the fiduciaries of the *Investment Fund* in which the Feeder Fund (not [Culverhouse]) invested." (Pet. Reh'g at 5.) Paulson argued that the certified question failed to "distinguish between investors in the Feeder Fund and investors in the Investment Fund." *Id.* Paulson proposed a new certified question that focused on the distinction between the hedge fund and the feeder fund, and more elaborately explained that Culverhouse invested only in the feeder fund. *Id.* at 7.

The Eleventh Circuit denied the petition for rehearing and declined to rephrase the certified question or amend the Certification Order with additional facts. That decision dispels any notion that the Eleventh Circuit "inadvertently" identified the facts in its Certification Order or sought "an answer that would not assist [it] in deciding the underlying appeal." (Pet. Reh'g 2, 4.) The Eleventh Circuit seeks to know from this Court whether claims are direct or derivative under the facts it identified, not whether Culverhouse and Paulson have a fiduciary relationship under Delaware law.

Paulson argues that it owes no duty to Culverhouse because of the "corporate separateness" of Paulson Advantage Plus and HedgeForum and the "three layers of separation" between Paulson and Culverhouse. (Paulson Br. 17.)

That argument goes to whether Culverhouse pled a valid claim for relief, not whether the claims Culverhouse asserted are derivative or direct. *See Gerber v. Enter. Prods. Holdings, LLC*, 67 A.3d 400, 418 (Del. 2013) (holding that the first element "[u]nder a fiduciary duty or tort analysis" is to show that the defendant owes a duty to the plaintiff), *overruled on other grounds by*, *Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808, 815 n.13 (Del. 2013). Whether Culverhouse stated a claim upon which relief can be granted is not the question before this Court.

This Court recently warned that "the tool of answering certified questions of law should be employed" in a "careful and precise manner." *Espinoza on behalf of JPMorgan Chase & Co. v. Dimon*, 2015 WL 5439176, at *1 (Del. Sept. 15, 2015). The certified question asks whether claims are direct or derivative under the facts set forth in the Certification Order. This Court has jurisdiction to answer that question, not to decide whether Culverhouse adequately pled that Paulson owed him a duty, the breach of which results in a claim. Del. Const. art IV, § 11(8).

**B. Culverhouse adequately alleged that Paulson owed him a duty.**

The question whether Paulson generally owes a duty to feeder fund investors is not before the Court. But in the event the Court considers that issue, Culverhouse has alleged sufficient facts to establish at the pleading stage that Paulson owed Culverhouse a duty, separate from the fiduciary duties Paulson owes to the limited partners in Paulson Advantage Plus.

Culverhouse alleged that he "reposed trust and confidence in [Paulson] to prudently invest [his] assets" and that Paulson was "fully cognizant" that Culverhouse had done so. (Am. Compl. ¶¶ 22, 79, 11th Cir. App. R-20; *see also id.* ¶¶ 23, 58-59, 85.) Such allegations are sufficient to establish that Paulson had a fiduciary relationship with Culverhouse. *See Prestancia Mgmt. Grp. v. Va. Heritage Found., II LLC*, 2005 WL 1364616, at *6 (Del. Ch. May 27, 2005); *Legatski v. Bethany Forest Assoc., Inc. v. Harris*, 2006 WL 1229689, at *6 (Del. Super. Ct. Apr. 28, 2006).

The complaint describes in detail the basis on which Culverhouse reposed trust and confidence in Paulson. The entire feeder fund structure is designed to obtain investment for Paulson Advantage Plus. HedgeForum exists solely to funnel money to Paulson Advantage Plus from a pool of investors who cannot satisfy the minimum investment criteria for investing in the fund. (Am. Compl. ¶¶ 16, 18.) Paulson Advantage Plus reserves $300 million of capacity for HedgeForum investors, and HedgeForum invests "substantially all of its assets" in Paulson Advantage Plus. (*Id.* ¶¶ 16, 21.) Paulson "exercises exclusive responsibility for all investment and trading activities for person investing in Paulson Advantage Plus through HedgeForum." (*Id.* ¶ 22.)

For its part, Paulson deliberately markets Paulson Advantage Plus to and knowingly obtains investment from investors in HedgeForum. Paulson and

Paulson Advantage Plus license the "Paulson" name and related logos to HedgeForum. (*Id.* ¶¶ 19-21.) Paulson provides HedgeForum with marketing materials and offering documents, the accuracy of which are Paulson's responsibility. (*Id.* ¶ 21.) Investors in HedgeForum receive the Paulson Advantage Plus Confidential Private Offering Memorandum. (*Id.* ¶ 22; *Id.* at Ex. C, 11th Cir. App. R-20-4 at p.38.) And Paulson actively refers investors to HedgeForum. (Culverhouse Aff. ¶ 3-5 & Ex. B, 11th Cir. App. R-36-3.)

Fiduciary obligations do not arise only because of formal relationships, such that of a director and stockholder or a limited partner and general partner. A fiduciary relationship may also arise under Delaware law when "one person reposes special trust in and reliance on the judgment of another or where a special duty exists on the part of one person to protect the interests of another." *Prestancia Mgmt. Grp.*, 2005 WL 1364616, at *6; *see also Legatski*, 2006 WL 1229689, at *6. That is precisely what Culverhouse alleged in this case, along with facts to support the allegation. Whether a fiduciary relationship exists under these circumstances is a "pragmatic fact-driven inquiry," not a "formalistic approach" to be decided at the pleading stage. *Mitchell v. Reynolds*, 2009 WL 132881, at *9 (Del. Ch. Jan. 7, 2009).

Paulson's focus on the "corporate separateness" of Paulson Advantage Plus and HedgeForum not only avoids the certified question, it also ignores what

Culverhouse actually pled. Culverhouse has alleged facts to establish that Paulson owed Culverhouse a duty.

### 2. Both *Tooley* and *Anglo American* dictate that the Court answer the certified question in the affirmative.

#### A. Paulson ignores the impact of the fund structure on the standing analysis under *Tooley*.

Paulson argues that Culverhouse's claims are derivative under *Tooley* because he does not allege injury that is independent of any injury to Paulson Advantage Plus and HedgeForum. (Paulson Br. 24.) As Culverhouse explained in his opening brief, that rationale does not apply to the facts here.

The requirement that a plaintiff's injury be independent of injury to a business entity does not fit where that entity "operates more like a bank" than a corporation. *Anglo Am.*, 829 A.2d at 154. Neither Paulson Advantage Plus nor HedgeForum have any "going-concern value" based on "physical assets . . . [or] the speculative value of the entity." *Id.* at 154. Loss at the entity level "is immediately and irrevocably passed through to the partners," and Paulson does not suggest otherwise. *Id.* at 152. With regard to these entities, the derivative analysis should focus on the actual losses at the investor level, not illusory losses at the fund level.

According to Paulson, the fact that losses at the fund level accrue immediately to investors does not change that they are losses to the funds in the

first instance. (Paulson Br. 24.) That argument misses the point. Because of the structure of the funds, the investors suffer the alleged harm and the investors would receive the benefit of any recovery. Any injury at the fund level is "fleeting." *Anglo Am.*, 829 A.2d at 152. That is not true for stockholders in traditional corporations, where losses at the entity level affect the entity's value going forward but may not actually injure stockholders. Paulson ignores that fundamental difference. Its argument makes sense in a traditional corporate context, but not under the facts of this case.

Paulson makes the same mistake by arguing that it is irrelevant that Culverhouse would be denied a recovery in a derivative suit. (Paulson Br. 29-30.) The critical fact is not that Culverhouse will be denied recovery despite having been injured. It is that later investors, who suffered no injury, also will receive a portion of the recovery in a derivative action. A derivative claim in this case both denies recovery to the injured party *and* compensates an uninjured party.

Where a traditional business entity is involved, new investors do not receive a windfall from a derivative action because they succeed to the interests of prior investors in the derivative recovery. Because the result is different for entities like Paulson Advantage Plus and HedgeForum, *Tooley* dictates a different result than what Paulson urges.

Paulson does not even attempt to justify the windfall that new investors in the funds would receive from a derivative action. The purpose of the *Tooley* test is to ensure that parties who suffer harm also receive the recovery. The result Paulson urges would compensate the wrong parties, and Paulson has not shown otherwise.

### B. The reasoning of *Anglo American* is sound and controls the outcome of this appeal.

Paulson attempts to distinguish *Anglo American* on several grounds, none of which is effective. *Anglo American* applies directly to the facts of this case and dictates that the Court answer the certified question in the affirmative.

Paulson first argues that *Anglo American* is inapplicable because it was not a feeder fund case. (Paulson Br. 27.) That is irrelevant. As the Eleventh Circuit found, both Paulson Advantage Plus and HedgeForum have the same structure as the fund in *Anglo American*. (Certification Order 6.) Because the funds immediately allocate losses to individual investor accounts and do not issue transferable shares, "any recovery in this litigation could not 'provide a remedy to wronged former partners nor to their (non-existent) successors in interest.'" (*Id.*, quoting *Anglo Am.*, 829 A.2d at 152.) That Culverhouse invested in a feeder fund instead of the hedge fund does not change the analysis.

Paulson next argues that *Anglo American* is distinguishable because it is not "a case in which all of the investors suffered a proportionately equal diminution in

the value of their partnership interests." (Paulson Br. 27.) This argument mischaracterizes *Anglo American*'s facts.

The plaintiffs in *Anglo American* were each former limited partners of the hedge fund. 829 A.2d at 147-48. They brought suit against the fund's general partner after the general partner withdrew over $22 million from its capital account. That money had accumulated through the partnership's mechanism of compensating the general partner by debiting 15% of net profits from the capital accounts of the limited partners and crediting that amount to the general partner's capital account. *Id.* at 148 & n.4. The general partner's withdrawal allegedly "injure[d] the limited partners . . . in proportion to their *pro rata* interest in the Fund." *Id.* at 151. Although not a feeder fund case, there is no meaningful difference between the proportional loss to the limited partners in *Anglo American* and the harm to investors in Paulson Advantage Plus and HedgeForum in this case.

Even more importantly, it was irrelevant to the reasoning of *Anglo American* that the general partner benefitted from the diminution in the fund's value. In deciding that the plaintiff's claim was direct, *Anglo American* did not rely on or even mention that the alleged loss affected only limited partners. *Id.* at 151-52. Instead, the court relied entirely on the "radical" divergence of the fund's structure "from the traditional corporate model." *Id.* at 152. It is because the same entity structure is also present in this case that *Anglo American* controls.

Finally, Paulson argues that Culverhouse "cannot demonstrate that the structure and operation of [Paulson Advantage Plus and HedgeForum] differ 'so radically' from the corporate model." (Paulson Br. 27.) But *Anglo American* itself demonstrates this point, and the Eleventh Circuit's agreement with that conclusion is the basis for the certification to this Court. Culverhouse has alleged the same material facts about the structure of Paulson Advantage Plus and HedgeForum that the plaintiffs alleged in *Anglo American.* Those allegations are taken as true at this stage. *Anglo American* and a commonsense understanding of the traditional corporate model show the significant differences between Paulson Advantage Plus and HedgeForum and typical business entities.

**C. The decisions on which Paulson relies are all distinguishable.**

In arguing that *Anglo American* is distinguishable and that *Tooley* requires a derivative suit, Paulson chiefly relies on four non-Delaware decisions applying Delaware law. None of those decisions undermines Culverhouse's arguments.[1]

Paulson cites *Saltz v. First Frontier, LP*, 782 F. Supp. 2d 61 (S.D.N.Y. 2010), *Newman v. Family Management Corporation*, 748 F. Supp. 2d 299 (S.D.N.Y. 2010), and *Stephenson v. Citco Group Limited*, 700 F. Supp. 2d 599 (S.D.N.Y. 2010), to argue that a feeder fund investor is limited to a derivative

[1] In addition to the decisions discussed below, Paulson cites *West Palm Beach Police Pension Fund v. Collins Capital Low Volatility Performance Fund II, Ltd.*, 2010 WL 2949856 (S.D. Fla. July 26, 2010). That case applied British Virgin Islands law and did not cite *Anglo American*. *Id.* at 2 n.1

claim because the feeder fund and hedge fund are separate entities. (Paulson Br. 17.) Those cases do not support Paulson's argument. Neither *Saltz* nor *Newman* relied on or discussed the "corporate separateness" of the sub-feeder funds in which the plaintiffs invested and the feeder funds managed by some of the defendants. *See Saltz*, 782 F. Supp. 2d at 78-79; *Newman*, 748 F. Supp. 2d at 314-16. These cases are irrelevant to whether Culverhouse is barred from bringing a direct action because Paulson Advantage Plus and HedgeForum are distinct business entities.

All three cases are also distinguishable on their facts. In *Saltz* and *Newman*, the court assumed that *Anglo American* "remain[s] good law" but did not apply its reasoning because the plaintiffs had failed to allege that the funds in which they invested "differ[ed] so drastically from the corporate model." *Saltz*, 782 F. Supp. 2d at 78 n.15; *Newman*, 748 F. Supp. 2d at 314 n.12. In neither case did the plaintiffs allege that their funds had the same structure as the fund in *Anglo American*. Unlike Culverhouse, the plaintiffs in *Saltz* and *Newman* did not allege that the funds in which they invested immediately allocated losses to their individual capital accounts and did not issue transferrable shares. They pled no facts showing that a derivative recovery would deny compensation to injured parties while giving a windfall to investors who had not been harmed. *See* Am. Compl., *Saltz v. First Frontier, LP*, Case No. 1:10-cv-00964-LBS-AJP (S.D.N.Y.

Apr. 22, 2010) (attached under Tab A); Second Am. Compl., *Newman v. Family Mgmt. Corp.*, Case No. 1:08-cv-11215-LBS-AJP (S.D.N.Y. Dec. 16, 2009) (attached under Tab B).[2] Absent those allegations, *Anglo American* is not controlling.

The plaintiff in *Stephenson* likewise failed to allege the facts alleged in *Anglo American*. *See* Corrected Am. Compl., *Stephenson v. Citco Group Ltd.*, Case No. 1:09-cv-00716-RJH (S.D.N.Y. July 2, 2009) (attached under Tab C). And unlike *Saltz* and *Newman*, the court in *Stephenson* did not consider whether *Anglo American* controlled in light of the structure and operation of the fund.

Paulson also relies on the even more distinguishable case of *BCR Safeguard Holdings, L.L.C. v. Morgan Stanley Real Estate Advisor, Inc.*, 2014 WL 4354457, (E.D. La. Sept. 2, 2014). The court in that case held that the limited liability company at issue was "fundamentally different from the hedge fund at issue in *Anglo American*" because it derived value from its tangible and intangible assets and did not "function[] essentially as a bank." *Id.* at *20. Under those circumstances, the court held that *Anglo American* did not apply. *Id.* All of the factors that the court found were lacking in *BCR Safeguard* are present here.

[2] The Court may take judicial notice of the allegations in these publicly filed complaints. *See* D.R.E. 201; *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006).

Before this case, no decision applying Delaware law has analyzed whether claims are direct or derivative under the facts of *Anglo American.* The cases Paulson cites do not dictate that a claim is derivative under the facts alleged here. Unlike in those cases, the structure of Paulson Advantage Plus and HedgeForum is identical to the hedge fund in *Anglo American.* Under these circumstances, the Court should adopt the reasoning of *Anglo American* and answer the certified question in the affirmative.

**3. This Court lacks jurisdiction to decide whether Culverhouse's claims are barred by contract because the Eleventh Circuit did not certify that question and the district court did not reach the issue.**

Paulson's final argument is that Culverhouse's contractual undertakings bar his claims. Paulson cites a slew of additional contractual provisions and argues that they show that Culverhouse has "no recourse against [Paulson Advantage Plus] or by extension its managers." (Paulson Br. 34; *id.* at 8-11.) In making this argument, Paulson once again strays afield from the certified question.

Paulson criticizes Culverhouse for a "myopic" attention to facts in the record that support his theory of standing. (Paulson Br. 31.) But these are the facts in the certified question. In Paulson's merits brief and again in its petition for rehearing, Paulson presented to the Eleventh Circuit the additional facts and contractual arguments it now raises in this Court. The Eleventh Circuit certified a question that excludes those considerations. Like Culverhouse, the Eleventh Circuit

focused on the fact that the funds "allocate losses to investors' individual capital accounts and do not issue transferable shares and losses are shared by investors in proportion to their investments." (Certified Order 8.)

The Court's jurisdiction extends to the question of law actually certified. Del. Const. art IV, § 11(8). Paulson's contractual arguments go well beyond the certified question and turn to whether Culverhouse can state a claim for breach of fiduciary duty, gross negligence, or unjust enrichment in light of the parties' agreements. As the Eleventh Circuit noted, "[t]he district court did not address whether Culverhouse failed to state a claim." (Certification Order 4.) The district court itself stated that it "need not, and indeed should not, evaluate [Paulson's] Rule 12(b)(6) argument" in light of its holding on standing. (Final Omnibus Order 6, 11th Cir. App. R-56.) This Court lacks jurisdiction to decide an issue that the district court declined to address and the Eleventh Circuit did not certify. *See Espinoza*, 2015 WL 5439176, at *3 (holding that the Court does "not have the leeway to decide the actual case" in a Rule 41 proceeding); *Rales v. Blasband*, 634 A.2d 927, 931 (Del. 1993) ("Because we are addressing a certified question of law, as distinct from a review of a lower court decision, the normal standards of review do not apply.").

Rule 41(c)(iv) provides that "[t]he certification as filed shall constitute the record." Contrary to what Paulson claims, the Certification Order is not

"incomplete" because it fails to set out "all undisputed 'established facts.'" (Paulson Br. 7.) To the extent Paulson quotes Culverhouse's complaint or language in agreements, there is no dispute about the existence of those facts. But the Eleventh Circuit has articulated the certified question by reference to a specific subset of undisputed facts. This Court may not "review the complete record before the district court" in order to formulate an entirely different question of law based on a different set of facts. *Espinoza*, 2015 WL 5439176, at *3.

Paulson's contractual arguments address whether Culverhouse has stated a valid claim for relief, not whether his claims are derivative or direct. Those arguments are beyond the scope of this appeal. And as Culverhouse argued in the Eleventh Circuit, Paulson cannot seek protection from the language of the Subscription Agreement because Paulson was not a party to that agreement. (11th Cir. App. R. 26-1 at 1-2, 12 ¶ V-A.) Whether Paulson was an intended third party beneficiary of the agreement is a question of fact that cannot be addressed at the pleading stage. Likewise, whether Paulson may rely on language in HedgeForum's offering memorandum—to which Paulson is, again, not a party—is a question of fact that the district court did not address and the Eleventh Circuit did not certify to this Court. (Culverhouse 11th Cir. Reply Br. 5-7, 10.)

The question before the Court is whether, under *Tooley* and *Anglo American*, Culverhouse's claims are direct in light of the facts set out in the certified question. The Court should answer that question in the affirmative.

## CONCLUSION

For the foregoing reasons, and those set forth in Culverhouse's opening brief, the Court should answer the question certified by the U.S. Court of Appeals for the Eleventh Circuit in the affirmative.

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October 26, 2015

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# TAB A

**UNITED STATES DISTRICT COURT**
**SOUTHERN DISTRICT OF NEW YORK**

| | |
|---|---|
| **JACK SALTZ as Trustee of SUSAN SALTZ CHARITABLE LEAD ANNUITY TRUST, and SUSAN SALTZ DESCENDANTS TRUST, and SUSAN SALTZ,** | |
| **Plaintiffs,** | **CIVIL ACTION No. 10-cv-00964 (LBS)** |
| ***- versus -*** | |
| **FIRST FRONTIER, L.P., FRONTIER CAPITAL MANAGEMENT, LLC, FRONTIER ADVISORS CORP., MARK OSTROFF, "FNU" OSTROFF, BEACON ASSOCIATES, LLC I, BEACON ASSOCIATES MANAGE-MENT CORP., IVY ASSET MANAGE-MENT CORP., THE BANK OF NEW YORK MELLON CORP., JOEL DANZIGER, ESQ., HARRIS MARKHOFF, ESQ., ANCHIN, BLOCK & ANCHIN, LLP, PARENTEBEARD LLC, and JOHN DOES 1 through 100,** | **Jury Trial Demanded**<br>**Fed. R. Civ. P. 38(a)**<br><br>**<u>Amended Complaint</u>** |
| **Defendants.** | |

Plaintiff JACK SALTZ, as Trustee of SUSAN SALTZ CHARITABLE LEAD ANNUITY TRUST ("SCLAT"), and SUSAN SALTZ DESCENDANTS TRUST ("SDT"), and SUSAN SALTZ (hereinafter referred to as "Plaintiffs"), allege upon the investigation made by and through their counsel, complaints filed by the United States government and the Securities and Exchange Commission (the "SEC"), and reports and interviews published in the financial press, and upon information and belief, as follows:

## I. SUMMARY OF THE ACTION

1. This case arises from a massive, fraudulent scheme perpetrated by Bernard L. Madoff ("Madoff") through his investment firm, Bernard L. Madoff Investment Securities, LLC ("BLMIS"), and others, and which was facilitated by the defendants named herein, who, recklessly or with gross negligence and/or in breach of fiduciary duties owed to Plaintiffs and, caused and permitted the Fund's assets to be invested with Madoff.

2. On December 10th, 2008, Madoff informed his sons that his investment advisory business, BLMIS, was a complete fraud. Madoff stated that he was "finished," that he had "absolutely nothing," and that "it's all just one big lie." He confessed he had been running "basically, a giant Ponzi scheme." Madoff admitted that the business was in-solvent and that it had been so for years. Madoff furthermore stated that he estimated the losses from this fraud to be approximately $50 billion. Published reports now indicate that Madoff's estimate may be conservative and the losses will not be fully known until the full effect of the fraud is understood.[1]

3. On December 11th, 2008, Madoff's fraud was exposed and the SEC charged both Madoff and BLMIS with securities fraud. Criminal charges were also filed against Madoff individually for, among other things, securities, wire, and mail fraud. *United States v. Madoff*, 09-cr-0213 (DC). When he was arrested, Madoff was quoted as saying "there is no innocent explanation" for what had happened and that he "paid investors with money that wasn't there." On March 12th, 2009 Madoff pled Guilty before the Hon.

[1] As just one sign of the immense nature of the Madoff fraud, the district court issued a $171 billion forfeiture order against Madoff on June 29, 2009

Denny Chin, U.S.D.J., S.D.N.Y., and, on June 29th, 2009, was sentenced to one hundred fifty years imprisonment. In short, Madoff and his cohorts, knowing aiders and abettors, and those parties and entities that consciously avoided their fiduciary and legal responsibilities to their clients (such as the named Defendants herein) operated a massive Ponzi scheme the likes of which are unparalleled and will likely never even be approached in terms of number of victims and amounts involved.[2]

4. Madoff would have been unable to perpetrate this massive fraud without the knowing, or grossly negligent conscious avoidance of responsibility and fiduciary and statutory and regulatory assistance, connivance and aiding and abetting by the numerous entities that assisted him. Because the minimum investment amount accepted by Madoff was quite high, feeder funds and aggregators such as the Defendants named herein pooled the investments of numerous individuals, who could only invest smaller amounts, into a collective fund for transmission to Madoff. Numerous funds of funds ("FOF"), feeder funds ("FF"), investment advisors, accountants, attorneys, and affiliates, including the named and un-named defendants, facilitated Madoff's fraud, by investing, and allowing to be invested, billions of dollars of their clients' money with Madoff and his related entities without performing adequate due diligence despite the existence of repeated, numerous and obvious "red flags."[3] These "red flags" included, among others, the abnormally high and stable positive investment results reportedly obtained by Madoff

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[2] As one minor example, on April 1st, 2009 the FBI issued a press release detailing major Ponzi schemes uncovered in the first quarter of the year. The largest ones were a "mere" billion dollars, less than one percent of the size of Madoff's fraud.
See http://www.fbi.gov/pressrel/pressrel09/ponzi040109.htm.

[3] See discussion at ¶¶ 66-70 *infra*

regardless of market conditions; inconsistencies between BLMIS's publicly available financial information concerning its assets and the purported amounts that Madoff managed for clients; and the fact that BLMIS was audited by a small, obscure accounting firm with no experience auditing entities of the apparent size and complexity of BLMIS. Despite having failed to perform the most basic due diligence, these FOFs, FFs, investment advisors, accountants, attorneys, other licensed professionals, and affiliates were paid large management and advisory fees by their clients, often for doing little more than blindly handing over their clients' funds to Madoff or his related entities, without exercising any supervisory, fiduciary or management responsibilities whatsoever.

5. Defendant FIRST FRONTIER, LP, (the "Fund")[4] is a Delaware limited partnership created in December 1998. The General Partner thereof is Defendant FRONTIER CAPITAL MANAGEMENT, LLC. The General Manager of Defendant FIRST FRONTIER, LP is Defendant MARK OSTROFF, and the Manager is Defendant FRONTIER ADVISORS CORP., Defendant MARK OSTROFF, designated as President thereof. The Principal Member and Sole Manager of Defendant FRONTIER CAPITAL MANAGEMENT, LLC is Defendant MARK OSTROFF. Listed as the other Principal Manager is Defendant "FNU" OSTROFF, the spouse of Defendant MARK OSTROFF.

6. Defendants FIRST FRONTIER, *et al.*, utilized the services of several accounting firms, and among these were Defendant ANCHIN, BLOCK & ANCHIN, LLP, who

[4] Hereinafter and throughout this Complaint, Plaintiffs shall use the term "Fund" as a catchall to refer to the actions of FIRST FRONTIER, LP, and all of its related entities and parties as set forth in ¶¶ 19 through 33, and to the actions of BEACON ASSOCIATES, and all of its related entities and parties as set forth in ¶¶ 34 through 39. Actions specific to one or another separate entities shall so enumerate that entity or person.

served as the auditors for Defendant FIRST FRONTIER, LP, and provided, among other things, annual reports and 10-Ks to the First Frontier clients, including the Plaintiffs, and Defendant PARENTEBEARD, LLC, which, as successor in interest to the accounting firm of Lazar Levine & Felix LLP, served as the auditors and preparers of annual financial statements of Defendants FIRST FRONTIER, *et al* and other financial reports for the limited partnership.

7. As a result of Plaintiffs' investment in the Funds her investments have been decimated and she has suffered losses in the millions of dollars, as will be detailed *infra*. These losses are directly and indirectly attributable to the reckless and/or grossly negligent dereliction of their fiduciary duties, and the complete failure of the Fund's auditor, to perform adequate and minimal due diligence despite the existence of myriad red flags indicating that a high concentration of the Fund's assets were ultimately invested in Madoff related investments.

8. Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, and MARK OSTROFF, among others, invested most, if not all of the funds received from Plaintiffs with Defendant BEACON ASSOCIATE MANAGEMENT CORP.

9. Defendant BEACON ASSOCIATE MANAGEMENT CORP. ("Beacon Associates" or the "Managing Member"), which is wholly owned by defendants JOEL DANZIGER, ESQ., HARRIS MARKHOFF, ESQ. and their immediate families, was the "Managing Member" thereof. The Fund's "Investment Consultant" was defendant IVY ASSET MANAGEMENT CORP. ("Ivy Asset Management"), which is a wholly owned

subsidiary of defendant THE BANK OF NEW YORK MELLON CORPORATION. Plaintiffs' investment in Beacon Associates was decimated as a direct result of Beacon Associates and Ivy Asset Management's reckless and/or grossly negligent dereliction of their fiduciary duties, and the complete failure of Friedberg Smith & Co. ("Friedberg Smith"), Beacon Associate's auditor, to perform adequate due diligence, and be aware of the existence of myriad red flags indicating that a high concentration of the Fund's assets were ultimately invested in Madoff related investments.

10. In fact, as a result of the defendants' conduct, Beacon Associates, upon information and belief, has been forced into liquidation, and most of Plaintiffs' investments have been lost.

11. Plaintiffs seek to recover damages caused by defendants' violation of Section 10(b) and 20(a) of the Securities Exchange Act of 1934, as well as for common law fraud, negligent misrepresentation and breach of fiduciary duty under New York law. Plaintiffs also seek to recover derivatively for breach of fiduciary duty, gross negligence and mismanagement, and common law fraud.

## II. JURISDICTION AND VENUE

12. The claims asserted herein arise under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (see *Chiarella v. United States*, 445 U.S. 222, 226 (1980)) and § 78t(a) (see *SEC v. Pimco Fund Management, LLC*, 341 F. Supp.2d 454, 467-68 (S.D.N.Y. 2004)), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder by the Securities and Exchange Commission, 17 C.F.R. § 240.10b 5, as well as under the laws of the State of New York.

13. This Court has jurisdiction in this action pursuant to Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa (*see, e.g., Campito v. McManus*, 470 F. Supp. 986, 995 (N.D.N.Y. 1979)), and the supplemental jurisdiction of this Court. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. § 1331 (federal question jurisdiction, see *Fiero v. Financial Indus. Regulatory Auth.*, 606 F. Supp.2d 500, 508-09 (S.D.N.Y. 2009)) and § 1337(a), Section 22 of the Securities Act of 1933, 15 U.S.C. § 77v(a).

14. Venue is proper in this judicial district pursuant to Section 22(a) of the Securities Act of 1933, 15 U.S.C. §77v; Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa and 28 U.S.C. § 1391(b). Substantial acts in furtherance of the alleged fraud and/or its effects have occurred within this District. Additionally, all named defendants maintain their headquarters or conduct substantial business in this District.

15. In connection with the acts alleged in this Complaint, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the national securities markets.

16. This action is brought within the relevant statute of limitations period; there being no statute of limitations for actions brought under Rule 10b-5 and for securities fraud, the relevant period being that applicable under state law. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n. 29 (1976) ("Since no statute of limitations is provided for civil actions under s 10(b), the law of limitations of the forum State is followed as in other cases of judicially implied remedies."). Under New York State law, whether the action is

brought under New York's Blue Sky Law ("Martin Act") (see N.Y. Gen'l Bus. L. § 352-c, CPLR § 214(2); setting forth a three year statute of limitations period), or under common law fraud (see CPLR § 213(8)), this action is timely, as the Plaintiffs discovered the fraud on or about December 10th, 2008, well within whatever statute of limitations period would be applicable hereto.

## III. PARTIES

17. Plaintiff JACK SALTZ is the Trustee of the named Plaintiffs SUSAN SALTZ CHARITABLE LEAD ANNUITY TRUST, and SUSAN SALTZ DESCENDANTS TRUST. Plaintiff SUSAN SALTZ is the lead and sole beneficiary of the named Plaintiff Trusts. The designated offices for the named Plaintiff Trusts are located at 150 East 52d Street, New York, NY 10022.

18. Plaintiff Trusts invested and lost approximately $4.2 million as a direct and indirect result of the actions of the named Defendants.[5]

19. Defendant FIRST FRONTIER, LP is a Delaware limited partnership created in December 1998. Its stated "objective is to seek optimal risk-adjusted consistent returns

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[5] Indeed, the amount of loss may well be over $5,000,000.00 based upon the refusal of the Beacon Defendants to provide a full accounting to the Plaintiffs, and their failure to distribute the approximately twenty-five percent of the fund that was not invested with BLMIS.

**N.B.**: Both named Trusts have filed Notices of claim with the Securities Investor Protection Corp. in the matter of *SIPC v. Bernard L. Madoff Investment Securities, LLC*, 08-10791, U.S. Bankruptcy Court, S.D.N.Y., seeking compensation under the Securities Investment Protection Act. These claims have been rejected by the Trustee, Irving Picard. Counsel, herein, on behalf of the Trusts, have filed a Notice of Objection to the Trustee's determination on or about December 22, 2009. This Objection has not been ruled upon by the Bankruptcy Court.

that are uncorrelated to the market while taking low risk" [6] It was to accomplish this by selecting an Investment Manager that would invest in a "basket of equity securities".

20. The designated General Partner is Defendant FRONTIER CAPITAL MANAGEMENT, LLC.

21. The General Manager of FIRST FRONTIER, LP is Defendant MARK OSTROFF.

22. The Manager of FIRST FRONTIER, LP is Defendant FRONTIER ADVISORS CORP., a Delaware corporation. Defendant MARK OSTROFF is the President and sole director and shareholder of FRONTIER ADVISORS CORP.

23. The designated address, telephone and facsimile numbers for the Partnership, General Partner [7] and Manager, are: [8]

149 Fifth Avenue
15th Floor
New York, NY 10010
Telephone: 212-674-5500

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[6] Annexed hereto as **Exhibit A** is the Confidential Private Placement Memorandum for FIRST FRONTIER, LP, Subscription Documents to FIRST FRONTIER, LP, and the Limited Partnership Agreement for FIRST FRONTIER, LP.

[7] According to the N.Y.S. Department of State Corporations Division, Defendant FRONTIER CAPITAL MANAGEMENT, LLC, effective June 14, 1999 (prior to the Plaintiffs' investment) changed its operating name to Waterstone Capital, LLC, however, it listed, for purposes of notice, the name and address designated in N. 8 *infra*.

[8] Notwithstanding this information contained in Partnership Memorandum, according to the filing by First Frontier, LP, with the N.Y.S. Department of State Corporations Division, the designated address is as follows:

FIRST FRONTIER, L.P.
ATTN: MARK OSTROFF
375 PARK AVENUE / SUITE 1404
NEW YORK, NEW YORK, 10152

Facsimile: 212-674-5814

24. The designated Investment Manager was Bernard L. Madoff Investment Securities, LLC.

25. The Sole Manager and Principal Member of Defendant FRONTIER CAPITAL MANAGEMENT, LLC is Defendant MARK OSTROFF; and the only other Member of FRONTIER CAPITAL MANAGEMENT, LLC is the spouse of Defendant MARK OSTROFF, "FNU" OSTROFF.

26. Defendant ANCHIN, BLOCK & ANCHIN, LLP served in a designated accounting and auditing capacity, Certified Public Accountants, for Defendant FIRST FRONTIER, LP, and provided annual and other financial reports, including income tax statements, for the limited partnership and its clients, including the Plaintiffs. It is the accountant and advisor for Defendant FIRST FRONTIER, LP. The firm is located at 1375 Broadway, New York, NY 10018, Tel. No. 212-840-3456, and, on its website (www.anchin.com) provides the following as its "Mission Statement",

> Our mission is to be our clients' Expert Partner, accomplishing this through creativity, innovation, insight, integrity and care. We are committed to connecting clients with experts who provide them industry partners who provide them with industry knowledge and innovative insights.

27. Plaintiffs' investment in First Frontier was decimated as a direct result of First Frontier's reckless and/or grossly negligent dereliction of their fiduciary duties, and the complete and utter failure of Defendant ANCHIN, BLOCK & ANCHIN, LLP, First Frontier's auditor, to perform adequate due diligence the existence of myriad red flags

indicating that a high concentration of the Fund's assets were ultimately invested in Madoff related investments.

28. According to the Partnership Agreement and the Offering Memorandum, the required minimum capital contribution was one million dollars. Upon information and belief, immediately prior to the revelation of the fraud perpetrated by Madoff, the total assets in the fund were $13,464,380.72, and the approximate value of the Plaintiff's investments was in excess of $5,200,000.00. Upon information and belief Plaintiffs' investments are worth near zero or zero at this time.

29. Defendant PARENTEBEARD LLC, is an accounting firm, with offices in New York, Pennsylvania, Maryland, New Jersey and Texas. According to its website (www.parentebeard.com), "[i]n 2003, Parente Randolph relocated its headquarters to Philadelphia and completed three mergers in early 2009, including Lazar, Levine & Felix located in New York City, before the landmark combination with Beard Miller Company that created Parent Beard." Emphasis added.

30. Upon information and belief, Defendant PARENTEBEARD LLC maintains offices in the Southern District of New York, located at The Empire State Building, 350 Fifth Avenue, 68th Floor, New York, NY 10118.

31. Upon information and belief, Lazar Levine & Felix LLP was the accounting firm retained by Defendant FIRST FRONTIER, to provide annual Financial Statements and Auditors' Report to clients, among whom were the Plaintiffs herein. Copies of the

Annual Financial Statements for calendar years 2003, 2004, 2005, 2006 and 2007 are annexed hereto as **Exhibit E**.

32. Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, and FRONTIER ADVISORS CORP. all have a responsibility to the Fund's investors to exercise good faith and fair dealing in all dealings affecting the fund.

33. Upon information and belief all (100%) of the invested funds with FIRST FRONTIER LP were given over to and invested with Defendant BEACON ASSOCIATES LLC I for investment purposes, notwithstanding the fact that this was never revealed to investors at the time of any subscription payments made as investments, such as the named Plaintiffs herein.

34. Defendant, BEACON ASSOCIATES LLC I, is a New York limited liability company formed under the laws of the State of New York on April 1, 2004 and managed by Defendant BEACON ASSOCIATES MANAGEMENT CORP. Its principal office is located at 123 Main Street, Suite 900, White Plains, NY 10601. Beginning on or about August 9, 2004, memberships in the Fund were offered via an Offering Memorandum ("Memberships"). The minimum capital contribution entitling an investor to access to the Fund was $500,000, subject to the right of Beacon Associates to modify the requirement. Prior to the revelation of the Madoff fraud, as of October 20,2008, the Net Asset Value of the Fund was approximately $560 million.

35. Defendant BEACON ASSOCIATES MANAGEMENT CORP. is a New York corporation, located at 123 Main Street, Suite 900, White Plains, NY 10601. Beacon Associates is the Managing Member of the Fund. Beacon Associates directs the business operations and affairs of the Fund, and makes allocation and reallocation decisions concerning the Fund's assets. Defendants JOEL DANZIGER and HARRIS MARKHOFF own (beneficially and of record) 100% of the issued and outstanding voting shares of Beacon Associates (constituting 1% of the outstanding stock of Beacon Associates). All of the non-voting common stock of Beacon Associates (consisting 99% of the total outstanding stock of Beacon Associates) is held by the immediate families of defendants DANZIGER and MARKHOFF. Beacon Associates has a responsibility to the Fund's investors to exercise good faith and fair dealing in all dealings affecting the fund.

36. Defendant JOEL DANZIGER, ESQ. ("Danziger") is the President and a Director of Defendant Beacon Associates. Mr. Danziger is a licensed attorney and a partner of the law firm of Danziger & Markhoff, LLP located at 123 Main Street, Suite 900, White Plains, NY 10601, the same address for Defendant BEACON ASSOCIATES MANAGE-MENT CORP. Upon information and belief Mr. Danziger resides in Bedford, NY.

37. Defendant HARRIS MARKHOFF, ESQ. ("Markhoff") is the Vice President, Secretary, Treasurer and Director of Beacon Associates. Mr. Markhoff is a licensed attorney and a partner of the law firm of Danziger & Markhoff LLP, located at 123 Main Street, Suite 900, White Plains, NY 10601, the same address for Defendant BEACON ASSOCIATES MANAGEMENT CORP. Mr. Markhoff resides in Pound Ridge, NY.

38. Defendant IVY ASSET MANAGEMENT CORPORATION ("Ivy Asset Management"), a Delaware corporation located at One Jericho Plaza, Jericho, New York 11753, is a wholly owned subsidiary of Defendant THE BANK OF NEW YORK MELLON CORPORATION. Ivy Asset Management is a registered Investment Advisor under the Investment Advisors Act of 1940 and a commodity trading advisor under the Commodity Exchange Act. Beacon Associates engaged Ivy Asset Management to provide it with advice regarding the selection and allocation of the Fund's assets among various investment managers and investment pools.

39. Defendant THE BANK OF NEW YORK MELLON CORPORATION ("BONY Mellon") is a Delaware corporation headquartered at One Wall Street, New York, NY 10286. According to its Form 10-K for the period ending September 30, 2009, it held Assets Under Management of $966 billion, and Assets Under Custody and Administration of $22.1 trillion. BONY Mellon is the parent company of Defendant Ivy Asset Management.

40. Each of the Defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on Fund investors by their actions.

## III. GENERAL ALLEGATIONS

41. Plaintiff JACK SALTZ, by and on behalf of SUSAN SALTZ CHARITABLE LEAD ANNUITY TRUST, and SUSAN SALTZ DESCENDANTS TRUST, and SUSAN SALTZ do bring this action in the right and for the benefit of the named Trusts and the Trustee Beneficiary to seek redress for the injuries suffered, and to be suffered,

by the Fund as a direct result of the breach of fiduciary duties, abuse of control, gross mismanagement, negligence and fraud alleged herein.

42. Plaintiffs are investors, either directly or indirectly, in the Fund[9] and were investors of the Fund at all times relevant to the named Defendants wrongful course of conduct alleged herein.

43. Plaintiffs have not made any demand[10] upon the Managing Member, Defendant MARK OSTROFF, to bring an action on behalf of the Fund asserting the claims herein to recover damages for the injuries suffered by Fund, since such demand would have been a futile, wasteful and useless act, especially in light of the fact that said Defendant was himself grossly negligent in the operation and conduct of managing the Fund, and breached his fiduciary duty to the Fund and its investors.

44. Demand is excused because the unlawful acts and practices alleged herein cannot be defended by the Managing Member, and are not subject to the protection of any independent business judgment since it would undoubtedly be to the benefit of the Fund to recover the damages caused by all of the Defendants' individual and collective wrongdoing and to assert these derivative claims.

45. Demand is excused because the wrongs alleged herein constitute violations of the fiduciary duties owed by the Managing Member to the Members and the Fund. The Managing Member is subject to liability for breaching its fiduciary duties to the Fund by,

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[9] See N. 4 *supra*.

[10] See First Frontier, LP Subscription Agreement at Art. III, § 3.02; Art. XIV, § 14.01, **Exhibit A**, annexed hereto.

*inter alia,* causing the Fund's assets to be invested with Madoff or Madoff-related entities without any oversight or supervision, causing or permitting the reckless investing practices alleged herein, failing to adequately monitor the investment vehicles in which it placed the Fund's assets, failing to monitor those entities to which it entrusted the moneys of the Fund Members, failing to adequately supervise and improperly relying upon the ineffective and grossly negligent performance of the Funds accountants, and failing to detect, prevent, or halt the misstatements and omissions of material fact alleged herein.

46. The dramatic breakdowns and gaps in the Managing Member's internal controls were so widespread and systemic that the Managing Member faces substantial exposure to liability under the *Caremark* or similar doctrine for total abrogation of its duty of oversight.[11] The Managing Member either knew, or should reasonably have known that the Fund's assets, which had been entrusted to his care, were invested in a fund of funds and or feeder fund that were actually part of a massive Ponzi scheme, or otherwise generated purported, results that would have been impossible to achieve under Madoff's investment strategy, and took no steps in a good faith effort to prevent or remedy that situation, proximately causing millions of dollars of losses to the Plaintiffs herein.

47. In addition, thereto, demand of the Managing Member is also excused because the Managing Member has ratified the egregious actions outlined herein, and the Managing

[11] "[O]nly a sustained or systematic failure of the board to exercise oversight — such as an utter failure to attempt to assure a reasonable information and reporting system exists — will establish the lack of good faith that is a necessary condition to liability." *In re Caremark Int'l Derivative Litigation*, 698 A.2d 967, 971 (Dela. Chancery Ct. 1996). See also *In re IAC/InterActiveCorp Securities Litigation*, 478 F. Supp.2d 574, 605 (S.D.N.Y. 2007)

Member cannot be expected to prosecute claims against itself and persons or entities with whom it has extensive inter-related business, professional and personal entanglements,[12] if Plaintiffs demanded that it do so. The Managing Member, because of these relationships, has developed debilitating conflicts of interest that prevent it from taking the necessary and proper action on behalf of the Fund and its investors.

48. Demand is also excused because the Managing Member participated in, approved, or permitted the wrongs alleged herein, concealed or disguised those wrongs, or recklessly or negligently disregarded them, and therefore is not a disinterested party and lacks sufficient independence to exercise business judgment as alleged herein.

49. Given the size, scope, and blatancy of the wrongdoing and the misrepresentations alleged herein and above, the Managing Member either knew of the financial risks to the Fund's assets and the investors therein or he recklessly, negligently, and with misfeasance turned a blind eye to them. Such conduct is not protected by the business judgment rule and exposes the Managing Member to direct liability in this action.

50. The Fund has been directly and substantially injured by reason of the Managing Member's intentional breach and/or reckless disregard of its fiduciary duties to the Fund. Plaintiffs, as Members and Investors of the Fund, seek damages and other relief for the Fund, in an amount to be proven at trial; however, minimally in excess of four million dollars.

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[12] As was mentioned *supra* (see ¶ 5), the other Principal Manager of Defendant First Frontier, LP, was Defendant Ostroff's spouse.

51. Defendant OSTROFF and his related entities, FIRST FRONTIER, LP, FRONTIER ADVISORS CORP., and FRONTIER CAPITAL MANAGEMENT, LLC, among others known and unknown, violated their individual and collective duties to the Fund and its Investors to behave and conduct themselves in good faith, and to exercise their judgment with due diligence and in recognition of their fiduciary responsibilities, when they failed to conduct any due diligence regarding the use of Bernard L. Madoff Investment Securities, LLC, as the fund's Investment Advisor.

**IV. SUBSTANTIVE ALLEGATIONS**

52. During the period relevant hereto, Defendant FIRST FORNTIER, LP, offered investment opportunities to qualified investors.

53. The "Confidential Private Placement Memorandum" was dated January 18, 1999, and was offered by Defendant FIRST FRONTIER, LP, a Delaware Limited Partnership, formed in December 1998.

54. As stated in the "Summary of the Offering",[13] the objective was to achieve a "risk-adjusted consistent return, uncorrelated to the market while taking low risk."[14] This

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[13] A full copy of the Private Placement Memorandum, Partnership Agreement, and Subscription Agreement, with Participation Forms, is annexed hereto as **Exhibit A**.

[14] It is the position of the Plaintiffs, herein, that the limited cautionary language in the Private Placement Memorandum regarding risk is insufficient to accord the Defendants the benefit of the "bespeaks caution doctrine." See generally *P. Stolz Family Partnership, L.P. v. Daum*, 355 F.3d 92, 96-97 (2d Cir. 2004); *In re Britannia Bulk Holdings Securities Litigation*, 2009 WL 3353045 at *8 (S.D.N.Y. 2009) (Cote, USDJ); *Zirkin v. Quanta Capital Holdings Ltd.*, 2009 WL 185940 (S.D.N.Y. 2009) (Patterson, USDJ) ("bespeaks caution doctrine" applicable "due to the *significant cautionary language repeatedly made* in the offering documents." *Id.* at *13. Emphasis added.) And, any such affirmative defense cannot be successfully raised. *See, e.g., Treeline Investment Partners LP v. Koren*, 2007 WL 1933860 at *6-*7 (S.D.N.Y. 2007) (Cote, USDJ).

was to be achieved by investing with the designated Investment Manager, who would purchase a "basket of equity securities." While the Summary qualified its statement by noting that "no assurance can be given that the objective will be achieved", nevertheless, investors "will be able to obtain the benefit of having their investment managed by the Investment Manager to an extent they may not otherwise be able to obtain." See Summary of the Offering at p. A. See also Investment Strategies at p. 3.[15]

55. The Memorandum set forth the "General Partner" as being Defendant FRONTIER CAPITAL MANAGEMENT, LLC", with Defendant MARK OSTROFF, as the "sole manager and principal member of the General Partner." See Summary of the Offering at p. A.

56. The Partnership's Manager was designated as Defendant FRONTIER ADVISORS CORP. See Summary of the Offering at p. A.

57. The Investment Manager was designated as Bernard L. Madoff Investment Securities, and its role was described as such:

> Bernard L. Madoff Investment Securities, which commenced business in 1960. The Investment Manager is a registered broker/dealer under the Securities Exchange Act of 1934, as amended (the "1934 Act"). The General Partner has delegated to the Investment Manager sole and complete authority to mange the assets of the Partnership.

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[15] Although, among the Risk Factors in the Memorandum it was stated that the Investment Manager (*i.e.*, BLMIS) was independent of the Partnership and the General Partner, investments were to be made "pursuant to an agreement between the Partnership and the Investment Manager which provides, among other things, guidelines by which the Investment Manager will trade for the Partnership." And, furthermore, BLMIS was to be "bound by a written agreement to follow specified trading strategies, . . ." See Risk Factors at p. 6, ¶ 5. Nevertheless, this did not relieve the named Defendants from their fundamental fiduciary and common law and statutory duties. Indeed, there is no evidence that the Defendants ever even set forth "guidelines" for BLMIS.

See Summary of the Offering at p. A.

58. A minimum investment of one million dollars ($1,000,000.00) was required to participate as a Limited Partner. See Summary of the Offering at p. B; Financial Summary of the Offering at p. 9.

59. The Manager (*i.e.*, Defendant FRONTIER ADVISORS CORP.) was entitled to a "Management Fee" calculated at one-eighth of one percent (0.125%) "of each Limited Partner's capital account balance at the beginning of each calendar quarter." See Summary of the Offering at p. B; Financial Summary of the Offering at p. 10.

60. The Memorandum provided that every Limited Partner was to received audited results each year, and a quarterly statement of that Limited Partner's account, with a letter from the General Partner "discussing the results of the Partnership for the quarter just ended", along with that Limited Partner's K-1 for income tax purposes. See Summary of the Offering at p. D.

61. The Memorandum was clear and unequivocal that "[s]ubstantially all of the Partnership's assets will be invested with the Investment Manager [*i.e.*, Bernard L. Madoff Investment Securities, LLC]." See Introduction at p. 1.

62. As with any planned investment, the designated Investment Strategy is the key issue for any investor. It should lay out the fundamentals of risk versus reward, how investments will be maintained, issues of timing, planned returns, expected growth, the riskiness of certain types of investments (ranging from investments in U.S. Treasury securities to complex financial derivatives), and the anticipated results of these

aforementioned investments. See generally *Shepard v TCW/DW Term Trust 2000*, 938 F. Supp. 171, 175 (S.D.N.Y. 1996)

63. These planned investments were to be left, by the General Partner, to the sole and exclusive discretion of the Investment Manager, *i.e.*, BLMIS. The stated plan was to make a series of investments, and to hedge any losses by a clear strategy; a strategy that minimized risk by spreading the investments over a "basket, which typically consists of 30-35 positions". Although certain risks were set forth, these were reduced due to the Investment Manager's (*i.e.*, BLMIS) use of a so-called "collar", which was described as follows: "The collar consists of options on the Index and serves as a hedge against the Partnership's long portfolio." Finally, any additional funds will be invested in short-term "A" rated liquid assets, such as money market funds, or U.S. Treasury obligations.

64. More completely, as set forth in the Memorandum,

> A. Basket of Long S&P 100 (OEX) Index Securities Hedged by Options on the Index. This investment strategy involves the purchase of a basket of common stocks included in the Index and the simultaneous sale of an Index call option and purchase of an Index put option. In each case, the expiration date of the call option and the put option are identical. All such transactions are undertaken on a hedged basis such that the basket of common stocks purchased correlates significantly with the Index.
>
> *This strategy of selling a call against a long position increases income while allowing appreciation to the strike price of the short call. Additional income is earned through the collection of dividends from the equity investments. Finally, the purchase of the put provides downside protection for the underlying securities and is substantially funded by the call premium.*
>
> Index options are commonly utilized in this trading methodology. This strategy involves buying a group of equities which in the aggregate highly correlates to the Index. Out-of-the-money Index call options are sold, and out-of-the-money Index put options are purchased, against the long basket of securities. The basket, which typically consists of 30-35 positions, is designed to closely track the performance of the Index

> without having to purchase all one hundred (100) securities that comprise the Index.
>
> Among the risks involved in the strategy are tracking, market and timing risks. The strategy to be employed by the Investment Manager involves the establishment of a "collar". The collar consists of options on the Index and serves as a hedge against the Partnership's long portfolio. It is possible that the Partnership's portfolio of securities may not perfectly track the performance of the Index. When the price of the Index is within the collar (the difference between the strike prices of the long put and the short call), the Partnership's portfolio is at the risk of the market, which risk is limited to the size of the collar. The size of the collar is typically around 5% to 10% of the value of the Index. A third risk is timing risk. The Partnership's assets will not always be invested so the risk exists that the timing of entry and exit into and out of the market may not be optimal.
>
> B. Other. The General Partner may invest Partnership funds that are not currently allocated to the Investment Manager in short-term U.S. Government securities, money market accounts and/or other short-term interest bearing instruments located at major financial institutions in the United States. Any income earned from such investments will be reinvested by the Partnership in accordance with the Partnership's investment strategies.

See Investment Strategies at p. 2. Emphasis added.

65. The Memorandum, which was the key selling tool for the Defendants, relied upon representations of the safety, security, and long-standing position of BLMIS as a safe, reliable Investment Manager. In describing BLMIS, the Memorandum used the following language,

> Bernard L. Madoff Investment Securities is registered as a broker/dealer under the 1934 Act. The General Partner has selected the Investment Manager to trade, invest and deal in securities and financial instruments for the Partnership. The Investment Manager is a market maker for dealers, banks and institutions. The Investment Manager has locations in New York and London, and makes markets in both listed and unlisted securities. The Investment Manager currently is a market maker for approximately 650 securities. The Investment Manager also trades in convertible bonds, convertible preferred stocks, warrants and listed equity and index options. The Investment Manager began operations in 1960 and has approximately 210 employees.

See Management at p. 4.

See also Conflicts of Interests at p. 13.

66. Whether, and to what extent the Defendants verified any of the above information, or did the due diligence required by any fiduciary, can only be speculated based upon the succeeding events. Indeed, as far back as 1992 the SEC had investigated the Avellino & Bienes Ponzi Scheme, and Madoff's connection thereto. Although there were "red flags" raised at this time, and this was a matter of public record, the Defendants had no qualms regarding the use of BLMIS for ALL of the investors' funds. Additional red flags and investigations by the SEC, all a matter of public record (including investigations in 2001, 2004, 2005, 2006) failed to either prevent the Defendants from using BLMIS, or terminating the relationship. See generally INVESTIGATION AND FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME (Office of Investigations, SEC Aug. 31, 2009) (SEC Report No. OIG-509).

67. Indeed, as the SEC noted,

> Numerous private entities conducted basic due diligence of Madoff's operations and, without regulatory authority to compel information, came to the conclusion that an investment with Madoff was simply too risky. These decisions were made based upon the same "red flags" in Madoff's operations that the SEC considered in its examinations and investigations, but ultimately dismissed.

See SEC Report No. OIG-509 at p. 424.[16]

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[16] The Conclusion in the SEC Report continued as follows,

> An explanation of why these private entities were able to understand and appreciate the suspicious aspects of Madoff's strategies and operations may be related to the differing approaches utilized by these private sector individuals conducting the analysis as compared to SEC examinations. The private entities generally described an "iterative" approach to due diligence, focusing on basic items, such as independence and transparency, while many faulted the SEC examinations for being too "checklist oriented." Through this "iterative" approach, the private entities were able to better understand the matters they were analyzing, such as the improbability of Madoff achieving his returns using his split-strike conversion strategy and the fact that Madoff could not be trading options in such high volumes without affecting the market or having counterparties that

68. As reported in the financial press, Robert Rosenkranz of Acorn Partners steered his clients away from Madoff finding that his consistent returns, in the face of fluctuating markets was impossible to explain. "Our due diligence, which got into both account statements of his customers, and the audited statements of Madoff Securities, which he filed with the S.E.C., made it seem highly likely that the account statements themselves were just pieces of paper that were generated in connection with some sort of fraudulent activity," Mr. Rosenkranz said. Simon Fludgate, head of operational due diligence for Aksia, another advisory firm that told clients not to invest with Mr. Madoff, said the secrecy of his strategy also raised red flags. And Mr. Madoff's stock holdings, which he disclosed each quarter with the Securities and Exchange Commission, appeared to be too small to support the size of the fund he claimed. Mr. Madoff's promoters sometimes tried to explain the discrepancy by explaining that he sold all his shares at the end of each quarter and put his holdings in cash. "There were no smoking guns, but too many things that didn't add up," Mr. Fludgate said.

(See http://investorshub.advfn.com/boards/read_msg.aspx?message_id=34166288)

69. Similarly, as *The New York Times* reported on December 17, 2008, routine due diligence on Madoff conducted by Societe Generale revealed serious irregularities:

> What [Societe Generale] found that March was hardly routine: Mr. Madoff's numbers simply did not add up. Societe Generale immediately put Bernard L. Madoff Investment Securities on its internal blacklist, forbidding its investment bank from doing business with him, and also strongly discouraged wealthy clients at its private bank from his investments.

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could be located. In addition, *private entities who conducted due diligence appreciated the "red flags" that the SEC personnel dismissed because they had a greater experience and knowledge base in the industry than many SEC examiners have.*
Emphasis added.

> The red flags at Mr. Madoff's firm were so obvious, said one banker with direct knowledge of the case, that Societe Generale "didn't hesitate. It was very strange."

Schwartz, N., "European Banks Tally Losses Linked to Fraud," *The New York Times*, December 17, 2008.

70. Furthermore, *Business Week* wrote about the Rye Select Board Market Prime Fund, which had invested all of its assets with BLMIS. *Business Week* reported that "managers of the Fort Worth pension fund, who first invested with Rye five years ago, started to rethink their investment in early 2008 after hiring Albourne Partners, a London due diligence firm, to assess their hedge fund portfolio. The Rye Fund raised red flags almost immediately. Albourne's managing director, Simon Ruddick, says the firm, which had long-standing concerns about Madoff's trading strategy and, consistent returns, had urged clients for nearly a decade to avoid affiliated funds such as Rye. In July, the pension's board voted unanimously to dump its Rye stake."

71. The Limited Partnership Agreement, in the Management section (Article III) set forth the manner in which the Partnership would be managed, and how investments would be made. More specifically, it was stated that "[i]t is the present intention of the General Partner to allocate the capital of the Partnership to one (1) independent investment manager (the 'Investment Manager') which is *currently engaged in split conversion hedged option (option basket) investment strategies*." Limited Partnership Agreement at § 3.01, 2. This stratagem of BLMIS had come under intense scrutiny in the past and, yet, the Defendants, nevertheless, saw no reason, whatsoever, to question its validity. In 2000, Neil Chelo, a colleague of Harry Markolpolos, the now-acknowledged whistle-blower on Madoff, who was then with Rampart Investment Management

Company, described the Madoff investment strategy — which the Defendants here were relying upon — as follows,

> Chelo believed that Madoff's claimed returns were impossible to achieve using Madoff's claimed split-strike conversion strategy, stating:
>
> > I just don't know how you can produce these types of returns given the strategy that was outlined in the marketing material. It was just, in my mind, impossible . . . Mainly the consistency because you'd have to have basically like perfect market timing every month or every year, depending on how he structures his split strike conversions. It's like impossible. No one has that ability to forecast market direction for such a long period and so consistently. . . .
>
> And if you did have that ability, you would do another strategy besides split strike conversion. You would do like a leveraged future strategy. You'd make way more money, and it just didn't make sense. It just didn't make sense, period.

SEC Report No. OIG-509 at p. 68.

72. The Plaintiff Trusts, herein, made its first investment with Frontier (*i.e.*, BLMIS) in or about July 2005. Successive investments were made in 2006, 2007 and 2008. Well before these investments were made serious questions had been raised regarding Madoff For example, A May 2001 article entitled "Madoff Tops Charts; Skeptics Ask How" in *MAR/Hedge,* a semi-monthly newsletter reporting on the hedge fund industry, reported that Madoff had reported positive returns for the last 11-plus years for Fairfield Sentry and other feeder funds, but that current and former traders, other money managers, consultants, quantitative analysts and fund-of-funds executives, many of whom were familiar with the so-called split-strike conversion strategy used by Madoff, questioned the consistency of the returns. These professionals noted that others using the strategy had nowhere near the same degree of success, and that Gateway, a publicly traded mutual fund, which also used the strategy purported employed by Madoff, had experienced far greater volatility and lower returns than Madoff. See SEC Report No. OIG-509 at pp. 74-75.

73. Unfortunately, none of the named Defendants, in the case at bar, came to the same conclusions regarding BLMIS, and this abject failure to be warned away by these "red flags" has resulted in the Plaintiffs losses herein.

74. Although the General Partner, in the Risk Factors section of the Memorandum attempted to limit its responsibility (see Risk Factors at pp. 6-8), at the same time the Partnership Agreement vested "exclusive authority to control the management of the day to day business operations and all other aspects of the Partnership" with Defendant FRONTIER CAPITAL MANGEMENT. See Summary of Certain Provisions of the Partnership Agreement at p. 18.

75. Significantly, while the Memorandum, Subscription Forms and Agreement, and the Limited Partnership Agreement all contained detailed listings and descriptions of the various parties involved (Frontier Capital Management, LLC, Mark Ostroff and his spouse, Frontier Advisors Corp., and Bernard L. Madoff Investment Securities, LLC) there was no mention of the fact that all of the funds invested with Frontier, *et al.*, were, in fact, invested with Defendants BEACON ASSOCIATE MANAGEMENT CORP., and BEACON ASSOCIATES LLC I. And, that through the aforementioned entities, investment decisions and strategies were made, and implemented, by Defendants IVY ASSET MANAGEMENT CORP. and THE BANK OF NEW YORK MELLON CORPORATION. See Summary of the Offering at p. A; Management at pp. 4-5.

76. The failure to make any reference to the non-Frontier parties was false and misleading and was a material omission of a significant factor that any and of which all investors were entitled to be apprised.

77. While Defendants BEACON ASSOCIATE MANAGEMENT CORP., and BEACON ASSOCIATES LLC I had no direct privity with the Plaintiffs, nevertheless, they owed a fiduciary duty to the investors in Defendants Frontier. And, the same holds true for the Defendants IVY ASSET MANAGEMENT CORP. and THE BANK OF NEW YORK MELLON CORPORATION. These parties had entrusted to them the assets of Frontier, and were well aware (or certainly should have been) they owed fiduciary duties of good faith, fair dealing, and due care.

78. They knew, or, in the exercise of due care in discharging their fiduciary duties, were reckless in not knowing that Madoff was engaged in a massive Ponzi scheme, or, at a minimum, were reporting results that could neither be verified nor explained. None-theless, they knowingly and willfully invested Frontier's assets in BLMIS or other Madoff-managed investment vehicles. They had a fiduciary obligation to protect the assets of the Fund, which they utterly failed to fulfill.

79. Despite Defendants Frontiers, *et al.*, egregious conduct in failing to properly conduct due diligence and failing to ensure that the investors' assets were invested in accord with the Offering Memorandum instead of in a Ponzi scheme orchestrated by Madoff, Frontier, Beacon Associates, and Ivy Asset Management, and their related and affiliated entities, named and un-named herein, nevertheless, Frontier was collecting a Managing Member fee from the value of each Member's Capital Account at an annual rate of one-eighth of one percent (.0125%).

80. While the Plaintiffs, and other investors with Frontier, *et al.*, did receive their K-1 Statements, annually for income tax purposes, and did receive annual and quarterly

financial statements, nevertheless, Defendant ANCHIN, BLOCK & ANCHIN, LLP, among the Fund's auditors and retrained accountant advisors, failed to perform its work in a manner consistent with, and according to the standards of the accounting and auditing profession as required by Generally Accepted Auditing Standards ("GAAS").

81. Defendant ANCHIN, BLOCK & ANCHIN, LLP either knew of or recklessly disregarded: (a) the concentration of the Fund's investments in a single third party investment manager (BLMIS); (b) the materially heightened risk to the Fund's assets from such reliance on Madoff, particularly given the lack of transparency of Madoff's operations; (c) the abnormally high and stable positive investment results reportedly obtained by Madoff; and (d) the inconsistency between BLMIS's publicly available financial information concerning its assets and the purported amounts that Madoff managed for clients such as the Fund.

82. As Defendant ANCHIN, BLOCK & ANCHIN, LLP failed to perform as discussed above, and signally either failed to be aware of the numerous "red flags" of the Madoff operations, or recklessly disregarded those flags in the pursuit of fees and clients, its behavior was grossly negligent, and a clear and unmistakable violation of numerous Rules and Sections of the GAAS. For example,

A. Defendant ANCHIN, BLOCK & ANCHIN, LLP failed to "exercise due professional care in the performance of the audit and the preparation of the report" (SAS 1, AU § 230).[17]

[17] Significantly, Section 230.05 states the following: "An auditor should possess 'the degree of skill commonly possessed' by other auditors and should exercise it with 'reasonable care and diligence' (that is, with due professional care)." As was noted *supra*, many fund managers refused to invest with BLMIS finding numerous "red flags"; those parties, while not Defendants

B. Defendant ANCHIN, BLOCK & ANCHIN, LLP clearly failed to adequately plan the audit by "developing an overall audit strategy for the expected conduct, organization, and staffing of the audit." (SAS 108, AU § 311). This standard requires the dedication and utilization of adequate and competent resources commensurate with the size and complexity of the audit. § 311.02.

C. Defendant ANCHIN, BLOCK & ANCHIN, LLP clearly and unmistakably failed in its "responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." (SAS 99, AU § 316.01). Defendant ANCHIN was still issuing its audits and failing to apprise its clients, as late as September 2008, barely three months before the Madoff fraud was exposed, and even after the SEC Report had detailed numerous instances of serious questionable activity and performance for BLMIS.

D. Defendant ANCHIN, BLOCK & ANCHIN, LLP failed to accumulate the required evidence from BLMIS to substantiate the performance of the Funds. (SAS 106, AU § 326.01). This GAAS Standard mandates that "all the information used by the auditor in arriving at the conclusions on which the audit opinion is based and includes the information contained in the accounting records underlying the financial statements and other information." *Id.* at § 326.02. It further defines "accounting records" as "the records of initial entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal

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PARENTEBEARD, LLC and/or ANCHIN BLOCK, unfortunately for the Plaintiffs herein, possessing the degree of skill referenced in this section

entries, and other adjustments to the financial statements that are not reflected in formal journal entries; and records such as worksheets and spreadsheets supporting cost allocations, computations, reconciliations, and disclosures." *Id.* at § 326.03. Without question had Defendant ANCHIN observed this most basic of GAAS requirements the Plaintiffs would not have suffered their losses.

83. Similarly, while the Plaintiffs, and other investors with Frontier, *et al.*, did receive annual and quarterly audited financial statements, nevertheless, Defendant PARENTEBEARD, LLC, as successor in interest to accountants Lazar Levine & Felix, LLP, among the Fund's auditors and retained accountant advisors, failed to perform its work in a manner consistent with, and according to the standards of the accounting and auditing profession as required by Generally Accepted Auditing Standards ("GAAS").

84. Defendant PARENTEBEARD, LLC either knew of or recklessly disregarded: (a) the concentration of the Fund's investments in a single third party investment manager (BLMIS); (b) the materially heightened risk to the Fund's assets from such reliance on Madoff, particularly given the lack of transparency of Madoff's operations; (c) the abnormally high and stable positive investment results reportedly obtained by Madoff; and (d) the inconsistency between BLMIS's publicly available financial information concerning its assets and the purported amounts that Madoff managed for clients such as the Fund.

85. As Defendant PARENTEBEARD, LLC failed to perform as discussed above, and signally either failed to be aware of the numerous "red flags" of the Madoff operations, or

recklessly disregarded those flags in the pursuit of fees and clients, its behavior was grossly negligent, and a clear and unmistakable violation of numerous Rules and Sections of the GAAS. For example,

A. Defendant PARENTEBEARD, LLC failed to "exercise due professional care in the performance of the audit and the preparation of the report" (SAS 1, AU § 230).[18]

B. Defendant PARENTEBEARD, LLC clearly failed to adequately plan the audit by "developing an overall audit strategy for the expected conduct, organization, and staffing of the audit." (SAS 108, AU § 311). This standard requires the dedication and utilization of adequate and competent resources commensurate with the size and complexity of the audit. § 311.02.

C. Defendant PARENTEBEARD, LLC clearly and unmistakably failed in its "responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." (SAS 99, AU § 316.01). Defendant ANCHIN was still issuing its audits and failing to apprise its clients, as late as September 2008, barely three months before the Madoff fraud was exposed, and even after the SEC Report had detailed numerous instances of serious questionable activity and performance for BLMIS.

[18] Significantly, Section 230.05 states the following: "An auditor should possess 'the degree of skill commonly possessed' by other auditors and should exercise it with 'reasonable care and diligence' (that is, with due professional care)." As was noted *supra*, many fund managers refused to invest with BLMIS finding numerous "red flags"; those parties, while not Defendant PARENTEBEARD, LLC, unfortunately for the Plaintiffs herein, possessing the degree of skill referenced in this section.

D. Defendant PARENTEBEARD, LLC failed to accumulate the required evidence from BLMIS to substantiate the performance of the Funds. (SAS 106, AU § 326.01). This GAAS Standard mandates that "all the information used by the auditor in arriving at the conclusions on which the audit opinion is based and includes the information contained in the accounting records underlying the financial statements and other information." *Id.* at § 326.02. It further defines "accounting records" as "the records of initial entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries, and other adjustments to the financial statements that are not reflected in formal journal entries; and records such as worksheets and spreadsheets supporting cost allocations, computations, reconciliations, and disclosures." *Id.* at § 326.03. Without question had Defendant ANCHIN observed this most basic of GAAS requirements the Plaintiffs would not have suffered their losses.

86. On or about December 18, 2008, investors in the Frontier Funds received a letter from Defendant BEACON ASSOCIATE MANAGEMENT CORP. informing the affected parties of the Madoff fraud and the intention to "liquidate the fund". See **Exhibit B**.

87. On October 31, 2008 Defendant ANCHIN, BLOCK & ANCHIN, LLP provided a statement of account for the Plaintiff SUSAN SALTZ CHARITABLE LEAD ANNUITY TRUST in which it reported a Capital Account in the amount of $2,235,670.00. Following the disclosure of the Madoff fraud, on December 31, 2008, Defendant ANCHIN,

BLOCK & ANCHIN, LLP provided a statement of account for the Plaintiff SUSAN SALTZ CHARITABLE LEAD ANNUITY TRUST in which it reported a Capital Account in the amount of $558,597.00, with a Loss of $1,641,403.00. See **Exhibit C**.

88. On October 31, 2008 Defendant ANCHIN, BLOCK & ANCHIN, LLP provided a statement of account for the Plaintiff SUSAN SALTZ DESCENDANT'S TRUST in which it reported a Capital Account in the amount of $3,573,366.00. Following the disclosure of the Madoff fraud, on December 31, 2008, Defendant ANCHIN, BLOCK & ANCHIN, LLP provided a statement of account for the Plaintiff SUSAN SALTZ DESCENDANT'S TRUST in which it reported a Capital Account in the amount of $894,100, with a Loss of $2,576,388.00. See **Exhibit D**.

89. At end of calendar year 2003, Defendant PARENTEBEARD, LLC provided an audited financial statement in which it reported total assets in the FIRST FRONTIER account, of $15,027,432. Notwithstanding the near total investment with BLMIS, these accounts were designated as "Investment at fair value". See **Exhibit E**. According to the accompanying Notes to said Financial Statement, the valuation of assets was based upon a reliance of information provided by Defendant BEACON ASSOCIATES, LLC. See Note 4 to 2003 Financial Statement.

90. Similar results were reported for calendar years 2004 ($10,774,775), 2005 ($15,360,746), 2006 ($12,595,939), and 2007 ($17,218,006). All of said reported results were reported as "Investment at Fair Value". And, relied upon the information provided by Defendant BEACON ASSOCIATES, LLC. See **Exhibit E**.

91. On or about June 10th, 2009 Defendant OSTROFF, emailed the Plaintiff informing him that, of the moneys through BEACON ANDOVER, approximately 75% was actually invested with Madoff, "and the remaining funds were invested in several other funds, . . ." This communication made clear that a distribution of the moneys not invested with Madoff, and hence not lost, would be distributed to the investors.

92. On August 14th, 2009 Defendant OSTROFF emailed the Plaintiffs that "[t]hey [*i.e.*, BEACON] are working closely with their attorneys *vis-à-vis* the distributions and accounting."

93. On August 27th, 2009 Defendant OSTROFF emailed the Plaintiffs that

> The papers have been filed with the Court on an expedited basis and he [i.e., Defendant DANZIGER] thinks they should have a ruling over the next 60-75 days, at which point, the 25-26% will be distributed immediately (less the 9% holdback for admin, legal and acct'g) per Joel Danziger of Beacon. That's his best guess and opinion.

94. On September 2nd, 2009 Defendant OSTROFF emailed the Plaintiffs again re-iterating that a distribution of assets should be expected

> in the next 60-75 days. If Joel [Danziger] is correct in his estimation, he believes that the funds should be ready for distribution in early to mid November.

95. Plaintiffs have received no further communications from Defendant OSTROFF, and have, needless to say, received not one dime of the funds still held by the Beacon Defendants.

96. The reported combined losses for the Plaintiff Trusts came to $4,217,791.00. The undistributed assets that Beacon supposedly still held onto totaled approximately another million dollars.

## IV. COUNT ONE

### VIOLATION OF SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934 (15 U.S.C. § 78j(b)), AND RULE 10b-5 OF THE SECURITIES AND EXCHANGE COMMISSION (17 C.F.R. § 240.10b-5)

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**(Against Defendants First Frontier, LP; Frontier Capital Management, LLC; Mark Ostroff; "FNU" Ostroff; Frontier Advisors Corp.; Beacon Associates LLC I; Beacon Associates Management Corp.; Joel Danziger; Harris Markhoff; The Bank of New York Mellon Corp.; and Ivy Asset Management Corp.)**

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97. Plaintiff repeats and re-iterates ¶¶ 1 through 96 inclusive as if set forth herein.

98. This Count is asserted against all Defendants and is based upon Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)),[19] and Rule 10b-5 of the Securities and Exchange Commission (17 C.F.R. § 240.10b-5) promulgated thereunder.

99. During the period relevant herein, Defendants directly engaged in a common plan, scheme, and unlawful course of conduct, pursuant to which they knowingly or recklessly

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[19] 15 U.S.C. § 78j(b) provides as follows,

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> **(b)** To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors

engaged in acts, practices, and courses of business which operated as a fraud and deceit upon the Plaintiffs, and made various deceptive and untrue statements of material fact and omitted to state material facts in order to make the statements made, in light of the circumstances under which they were made, not misleading to Plaintiffs. The purpose and effect of the scheme, plan, and unlawful course of conduct was, among other things, to induce the Plaintiffs to purchase Memberships in the Fund.

100. As a result of the Defendants' conduct, the Fund has been forced into liquidation, and Plaintiffs' investment has been decimated.

101. During the period relevant hereto, the Defendants, pursuant to said scheme, plan, and unlawful course of conduct, knowingly and recklessly issued, caused to be issued, participated in the issuance of, the preparation and issuance of deceptive and materially false and misleading statements to the Plaintiffs as particularized above.

102. In ignorance of the false and misleading nature of the statements described above and the deceptive and manipulative devices and contrivances employed by said Defendants, Plaintiffs relied, to their detriment, on such misleading statements and omissions in purchasing Memberships in the Fund, re-investing in the Fund, and maintaining their accounts with the Fund. Plaintiffs have suffered substantial damages as a result of the wrongs alleged herein in an amount to be proven at trial.

103. By reason of the foregoing, Defendants directly violated Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder (17 C.F.R. § 240.10(b)-5) in that they:

(a) employed devices, schemes, and artifices to defraud;

(b) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and/or

(c) engaged in acts, practices, and a course or courses of business which operated as a fraud and deceit upon Plaintiffs in connection with the acquisitions of Memberships in the Fund.

## V. COUNT TWO

**VIOLATION OF SECTION 20(a) OF THE SECURITIES EXCHANGE ACT OF 1934 (15 U.S.C. § 78t-1(a))**

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**(Against Defendants First Frontier, LP; Frontier Capital Management, LLC; Mark Ostroff; "FNU" Ostroff; Frontier Advisors Corp.; Beacon Associates LLC I; Beacon Associates Management Corp.; Joel Danziger; Harris Markhoff; The Bank of New York Mellon Corp.; and Ivy Asset Management Corp.; John Does 1 - 100)**

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104. Plaintiff repeats and re-iterates ¶¶ 1 through 103 inclusive as if set forth herein.

105. This Count is asserted against all Defendants and is based upon Section 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. § 78t-1(a)).[20]

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[20] 15 U.S.C. § 78t-1(a) provides as follows,

(a) Private rights of action based on contemporaneous trading
Any person who violates any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information shall be liable in an action in any court of competent jurisdiction to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased (where such violation is based on a sale of securities) or sold (where such violation is based on a purchase of securities) securities of the same class.

106. Defendants MARK OSTROFF and "FNU" OSTROFF acted as the controlling parties of the Frontier Defendants; and Defendants JOEL DANZIGER and HARRIS MARKHOFF acted as controlling persons of the Beacon Defendants within the meaning of Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t-1(b) as alleged herein. By virtue of their high level positions, participation in and/or awareness of the Fund's operations, and/or intimate knowledge of the Fund's products, sales, accounting, plans and implementation thereof, they had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Fund, including the content and dissemination of the various statements that Plaintiffs contend are false and misleading. They also had the ability to prevent the issuance of the statements or cause the statements to be corrected. None of these Defendants acted as they should have and is required by Section 20(a) of the Exchange Act.

107. Defendants MARK OSTROFF and "FNU" OSTROFF acted as the controlling parties of the Frontier Defendants; and Defendants JOEL DANZIGER and HARRIS MARKHOFF acted as controlling persons of the Beacon Defendants within the meaning of Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t-1(b) as alleged herein had direct and supervisory involvement in the day-to-day operations and management of the Fund and, therefore, are presumed to have, or should have, had the power to control or influence the particular statements giving rise to the securities violations as alleged herein, and exercised the same.

108. Similarly, Defendants JOHN DOES 1-100 were in positions of ownership and/or control over the Fund, including the members of the Managing Member's Advisory

Board. By virtue of their high level positions, participation in and/or awareness of the Fund's investments, they had the power to influence and control, and did influence and control, directly or indirectly, the decision-making of the Fund, including the content and dissemination of some of the statements that Plaintiffs contend are false and misleading, including, without limitation, the described investment strategies of the Fund.

109 Finally, Defendant THE BANK OF NEW YORK MELLON CORP., as the parent company of Defendant IVY ASSET MANAGEMENT CORP., had the power to influence and control and did influence and control the decision making of Ivy Asset Management, including its recommendations regarding the Fund's Managers and the allocation of the Fund's assets.

110. By virtue of their positions as controlling persons, the above-referenced entities, parties and persons, both individually and collectively, are liable pursuant to the Plaintiffs pursuant to Section 20(a) of the 1934 Exchange Act. As a direct and proximate result of their knowing wrongful conduct, Plaintiffs suffered damages in connection with their acquisitions of Memberships in the Fund, and continued participation therein.

## VI. COUNT THREE

**COMMON LAW FRAUD**

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**(Against Defendants First Frontier, LP, Frontier Capital Management, LLC, Mark Ostroff, "FNU" Ostroff, Frontier Advisors Corp., ParenteBeard LLC, and Anchin Block & Anchin)**

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111. Plaintiff repeats and re-iterates ¶¶ 1 through 110 inclusive as if set forth herein.

112. This Count is asserted against Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, FRONTIER ADVISORS CORP., PARENTEBEARD LLC, and ANCHIN, BLOCK & ANCHIN, LLP, and is based upon the tort of common law fraud.

113. The elements of common law fraud, under New York law, include representation of a material fact, falsity, scienter, deception and injury. See *Channel Master Corp. v. Aluminum Limited Sales, Inc.*, 4 N.Y.2d 403, 407, 176 N.Y.S.2d 259 (1958). See also *Schreiber v. Tire Centers, LLC*, 2005 WL 2293584 at *2 (W.D.N.Y. 2005) (Siragusa, USDJ).

114. Plaintiffs, in reasonable and justifiable reliance upon the statements and representations made by the Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, and FRONTIER ADVISORS CORP., as previously set forth herein, purchased Memberships in the Fund. Plaintiffs would not have purchased their Member-ships in the Fund and re-invested their moneys except for their reliance upon the representations made by the aforementioned Defendants in the Offering Memorandum, and would not have purchased them had they been aware of the material omissions and concealment by the Defendants named herein, and the fact that the named Defendants had entrusted the Plaintiffs' moneys to Madoff-related entities, and the extraordinary risks inherent therein.

115. Furthermore, Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, and FRONTIER ADVISORS CORP. failed to reveal a material fact, that being the use of Beacon and its

various entities, and through them, Ivy Asset Management and The Bank of New York Mellon Corp. to funnel moneys to BLMIS. This failure to disclose a material fact damaged the Plaintiffs by generating additional fees and expenses, creating another layer to protect the Defendants named in this Count, and constituted

116. At the time the statements and representations were made by the Frontier Defendants in the Offering Memorandum, the Frontier Defendants knew or should have known them to be false and intended to deceive Plaintiffs by making such statements and representations.

117. Similarly, as the Fund's auditor and accounting professionals, Defendants ANCHIN, BLOCK & ANCHIN, LLP, and PARENTEBEARD, LLC, knew or should have known that the majority of the Fund's assets were not invested as set forth in the Offering Memorandum, but invested through Beacon, *et al.*, and in BLMIS, and other Madoff-related vehicles. ANCHIN, BLOCK & ANCHIN, LLP, and PARENTEBEARD, LLC, nevertheless failed to disclose this material information to the Fund's Members.

118. ANCHIN, BLOCK & ANCHIN, LLP, and PARENTEBEARD, LLC, falsely certified the Fund's financial statements and reports.

119. At the time of the false statements, misrepresentations and omissions set forth above, each of the First Frontier Defendants and Defendants ANCHIN BLOCK & ANCHIN, and PARENTEBEARD, LLC, intended that Plaintiffs would act on the basis of the misrepresentations and omissions contained in the Offering Memorandum in determining whether to initially purchase, make subsequent investments in, and/or retain

Memberships in the Fund. Plaintiffs reasonably relied thereon to their detriment in making such decisions.

120. Had Plaintiffs known of the material facts that the First Frontier Defendants and Defendants ANCHIN BLOCK & ANCHIN, and PARENTEBEARD, LLC, mis-represented, and the falsity of their statements and representations, Plaintiffs would not have purchased and/or retained their Memberships in the Fund.

121. Plaintiffs, as a result of their purchase of Memberships in the Fund and by reasons of the First Frontier Defendants and Defendants ANCHIN BLOCK & ANCHIN, and PARENTEBEARD, LLC's wrongful misrepresentations, have sustained damages, suffered material and emotional distress and have lost a substantial part of their respective investments in an amount yet to be fully determined, and to be proven at trial.

122. This failure on the Frontier Defendants' part was intended to deceive, manipulate, or defraud, the Plaintiffs, or, minimally constituted reckless conduct.

123. By reason of the foregoing, the First Frontier Defendants, Defendants ANCHIN BLOCK & ANCHIN, and PARENTEBEARD, LLC, are jointly and severally liable to Plaintiffs.

124. The First Frontier Defendants, and Defendants ANCHIN BLOCK & ANCHIN, and PARENTEBEARD, LLC, fraudulent acts were willful and wanton and Plaintiffs are entitled to punitive damages.

## VIII. COUNT FOUR

### FRAUDULENT CONCEALMENT

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**(Against Defendants First Frontier, LP, Frontier Capital Management, LLC, Mark Ostroff, "FNU" Ostroff, Frontier Advisors Corp., ParenteBeard, LLC, and Anchin Block & Anchin)**

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125. Plaintiff repeats and re-iterates ¶¶ 1 through 124 inclusive as if set forth herein.

126. The elements of fraudulent concealment, under New York law, are the following:

(1) relationship between the parties that creates a duty to disclose;
(2) knowledge of the material facts by the party bound to make such disclosures;
(3) nondisclosure;
(4) scienter;
(5) reliance; and
(6) damage.

See *Zackiva Communications Corp. v. Horowitz*, 826 F. Supp. 86, 89 (S.D.N.Y. 1993).

127. Plaintiffs, in reasonable and justifiable reliance upon the statements and representations made by the Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, and FRONTIER ADVISORS CORP., as previously set forth herein, purchased Memberships in the Fund. Plaintiffs would not have purchased their Member-ships in the Fund and re-invested their moneys except for their reliance upon the representations made by the aforementioned Defendants in the Offering Memorandum, and would not have purchased them had they

been aware of the material omissions and concealment by the Defendants named herein, and the fact that the named Defendants had entrusted the Plaintiffs' moneys to Madoff-related entities, and the extraordinary risks inherent therein.

128. Furthermore, Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, and FRONTIER ADVISORS CORP. failed to reveal a material fact, that being the use of Beacon and its various entities, and through them, Ivy Asset Management and The Bank of New York Mellon Corp. to funnel moneys to BLMIS. This failure to disclose a material fact damaged the Plaintiffs by generating additional fees and expenses, creating another layer to protect the Defendants named in this Count, and constituted.

129. At the time the statements and representations were made by the Frontier Defendants in the Offering Memorandum, the Frontier Defendants knew, or should have known, them to be false and intended to deceive Plaintiffs by making such statements and representations.

130. Furthermore, the Frontier Defendants knew, or should have known, that the use of a secondary Fund (*i.e.*, the Beacon Defendants and related entities) was of a material nature, and that such fact should have been revealed to the Plaintiffs, and would have materially affected the Plaintiffs decision regarding investment with Frontier, *et al.*

131. The detailed nature of the Offering Memorandum and the Limited Partnership Agreement served to put the Plaintiffs on notice that these constituted the entire terms of the subject investment, and that all decisions regarding investments would be made by

the parties named in the aforementioned documents. Nowhere in these documents were Defendants BEACON ASSOCIATES LLC I, BEACON ASSOCIATES MANAGEMENT CORP., JOEL DANZIGER, HARRIS MARKHOFF, IVY ASSET MANAGEMENT CORP., and/or THE BANK OF NEW YORK MELLON CORP. ever made reference to, or their existence even hinted at.[21]

132. The Plaintiffs relied upon the representations of the Frontier Defendants that the sole parties involved were as set forth in the Offering Memorandum and Limited Partnership Agreement.

133. This failure on the Frontier Defendants' part was intended to deceive, manipulate, or defraud, the Plaintiffs, or, minimally constituted reckless conduct.

134. Plaintiffs, furthermore, relied upon the knowingly false statements of the Defendant OSTROFF that they would receive at least a partial distribution of between 24% and 26% of the investment after the Madoff scheme was revealed, based upon the Beacon investments on non-Madoff securities. See ¶¶ 86-90 *supra*.

135. On this basis the Plaintiffs withheld any action relying upon the aforesaid statements of OSTROFF.

136. This failure, too, on the Frontier Defendants' part was intended to deceive, manipulate, or defraud, the Plaintiffs, or, minimally constituted reckless conduct.

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[21] See **Exhibit A** annexed hereto

137. Furthermore, the Plaintiffs relied upon the professionalism and representations of the Defendants ANCHIN BLOCK & ANCHIN, and PARENTEBEARD, LLC, to make all disclosures in their statements of account, not merely to reference, in a footnote, to the presence of Defendant BEACON ASSOCIATES LLC I.

138. By reason of the foregoing, the First Frontier Defendants, and Defendants ANCHIN BLOCK & ANCHIN, and PARENTEBEARD, LLC are jointly and severally liable to Plaintiffs.

139. The First Frontier Defendants, and Defendants ANCHIN BLOCK & ANCHIN, and PARENTEBEARD, LLC fraudulent acts were willful and wanton and Plaintiffs are entitled to punitive damages.

## VIII. COUNT FIVE

### CONSTRUCTIVE FRAUD

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**(Against Defendants First Frontier, LP, Frontier Capital Management, LLC, Mark Ostroff, "FNU" Ostroff, Frontier Advisors Corp., ParenteBeard, LLC, and Anchin Block & Anchin)**

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140. Plaintiff repeats and re-iterates ¶¶ 1 through 139 inclusive as if set forth herein.

141. The elements of constructive fraud, under New York law, are the following:

(1) a representation is made;

(2) the representation deals with a material fact;

(3) the representation is false;

(4) the representation is made with the intent to make the other party rely upon it;

(5) reliance by the other party;

(6) damage; and

(7) the parties are in a fiduciary or confidential relationship.

See *Del Vecchio By Del Vecchio v. Nassau County*, 118 A.D.2d 615, 617-18, 499 N.Y.S 2d 765 (2d Dep't 1986).

See also *Harris v. Key Bank Nat'l Ass'n*, 89 F. Supp 2d 408, 416-17 (W.D.N.Y. 2000).

142. This Count is asserted against Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, FRONTIER ADVISORS CORP., PARENTEBEARD, LLC, and ANCHIN, BLOCK & ANCHIN, LLP, and is based upon the tort of constructive fraud.

143. Plaintiffs, in reasonable and justifiable reliance upon the statements and representations made by the Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, and FRONTIER ADVISORS CORP., as previously set forth herein, purchased Memberships in the Fund. Plaintiffs would not have purchased their Memberships in the Fund and re-invested their moneys except for their reliance upon the representations made by the aforementioned Defendants in the Offering Memorandum, and would not have purchased them had they been aware of the material omissions and concealment by the Defendants named herein, and the fact that the named Defendants had entrusted the Plaintiffs' moneys to Madoff-related entities, and the extraordinary risks inherent therein.

144. Furthermore, Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, and FRONTIER ADVISORS CORP. failed to reveal a material fact, that being the use of Beacon and its various entities, and through them, Ivy Asset Management and The Bank of New York Mellon Corp. to funnel moneys to BLMIS. This failure to disclose a material fact damaged the Plaintiffs by generating additional fees and expenses, creating another layer to protect the Defendants named in this Count, and constituted.

145. At the time the statements and representations were made by the Frontier Defendants in the Offering Memorandum, the Frontier Defendants knew, or should have known, them to be false and intended to deceive Plaintiffs by making such statements and representations

146. Furthermore, the Frontier Defendants knew, or should have known, that the use of a secondary Fund (*i.e.*, the Beacon Defendants and related entities) was of a material nature, and that such fact should have been revealed to the Plaintiffs, and would have materially affected the Plaintiffs decision regarding investment with Frontier, *et al*

147. The detailed nature of the Offering Memorandum and the Limited Partnership Agreement served to put the Plaintiffs on notice that these constituted the entire terms of the subject investment, and that all decisions regarding investments would be made by the parties named in the aforementioned documents. Nowhere in these documents were Defendants BEACON ASSOCIATES LLC I, BEACON ASSOCIATES MANAGEMENT CORP., JOEL DANZIGER, HARRIS MARKHOFF, IVY ASSET MANAGE-

MENT CORP., and/or THE BANK OF NEW YORK MELLON CORP. ever made reference to, or even hinted at.

148. Furthermore, the Plaintiffs relied upon the professionalism and representations of the Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN, to make all disclosures in its statements of account, not merely to reference, in a footnote, to the presence of Defendant BEACON ASSOCIATES LLC I.

149. By reason of the foregoing, the First Frontier Defendants, and Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN are jointly and severally liable to Plaintiffs.

150. The First Frontier Defendants, and Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN's fraudulent acts were willful and wanton and Plaintiffs are entitled to punitive damages.

## VIII. COUNT SIX

### NEGLIGENT MISREPRESENTATION

**(Against Defendants First Frontier, LP, Frontier Capital Management, LLC, Mark Ostroff, "FNU" Ostroff, Frontier Advisors Corp., ParenteBeard, LLC and Anchin Block & Anchin)**

151. Plaintiff repeats and re-iterates ¶¶ 1 through 150 inclusive as if set forth herein.

152. Under New York law, the elements of negligent misrepresentation are:

(1) carelessness in imparting words,

(2) upon which others were expected to rely,

(3) upon which they did act or failed to act,

(4) to their damage, and

(5) the author must express the words directly, with knowledge they will be acted upon, to one whom the author is bound by some relation or duty of care.

See *In re Drexel Burnham Lambert Group, Inc.*, 151 B.R. 49, 60 (S.D.N.Y. 1990), citing to *White v. Guarente*, 43 N.Y.2d 356, 362, 401 N.Y.S.2d 474 (1977).

153. The First Frontier Defendants, and Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN owed to Plaintiffs a duty: (a) to act with reasonable care in preparing and disseminating the Offering Memorandum, and (b) the statements of account and other financial reports that the aforementioned Defendants knew, or should reasonable have known, would be provided to the named Plaintiffs and relied upon them in deciding to both purchase their Membership interests in the Fund, and to maintain their accounts with the Fund, and (c) to use reasonable diligence in determining the accuracy of and preparing the information contained in the Offering Memorandum.

154. In addition, Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN knew that their respective audited and other financial reports would be provided to the Fund's Members and potential investors in the Fund and would be relied on by them in making investment decisions concerning the Funds.

155. The First Frontier Defendants, and Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN failed to investigate, confirm, prepare and review, with reasonable care and diligence, the information contained in the Offering Memorandum and other representations, including the audited annual financial statements.

156. Neither the Offering Memorandum nor any other offering material used in soliciting investment in the Fund ever disclosed that a majority of the Fund's assets were ultimately invested with the Beacon Defendants, and the related entities (*i.e.*, Ivy Asset Management and The Bank of New York Mellon Corp.)

157. Nor did the Offering Memorandum nor any other offering material used in soliciting investment in the Fund ever disclose the risks involved in the Madoff investment strategy, notwithstanding its suspect nature, both financially and mathematically.[22]

158. As a direct, foreseeable and proximate result of this negligence, Plaintiffs have sustained damages, suffered mental and emotional distress and have lost a substantial part of their respective investments in an amount yet to be determined and to be proven at trial, but minimally in excess of four million dollars.

159. By reason of the foregoing, Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, FRONTIER ADVISORS CORP., PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN are jointly and severally liable to Plaintiffs.

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[22] It should be noted that the Offering Memorandum did, in the "Investment Strategies" section, state that

> In the event that the General Partner determines to allocate some or all of the Partnership's assets to one or more investment managers other than Bernard L. Madoff Investment Securities, the General Partners shall provide not less than ninety (90) days prior written notice to the Limited Partners of its intention to do so and each Limited Partner shall have the right to withdraw all or any amount of value from their respective Capital Account as of the last day of the month immediately preceding the month in which the General Partner intends to invest the Partnership's assets with such other investment manager(s).

See Offering Memorandum, Investment Strategies at p. 2, ¶ C

Nevertheless, the General Partner never made such a determination, even in the face of numerous and significant "red flags".

160. The First Frontier Defendants, and Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN fraudulent acts, were of such a reckless and negligent manner such that Plaintiffs are entitled to punitive damages.

## IX. COUNT SEVEN

### BREACH OF FIDUCIARY DUTY

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**(Against Defendants First Frontier, LP, Frontier Capital Management, LLC, Mark Ostroff, "FNU" Ostroff, Frontier Advisors Corp., ParenteBeard, LLC and Anchin Block & Anchin)**

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161. Plaintiff repeats and re-iterates ¶¶ 1 through 160 inclusive as if set forth herein.

162. The Frontier Defendants owed and continue to owe Plaintiffs fiduciary obligations. By reason of their fiduciary relationships, the Frontier Defendants owed and continue to owe Plaintiffs the highest obligation of good faith, fair dealing, loyalty and due care.

163. Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN, the Fund's auditors and accounting professionals, owed and continue to owe Plaintiffs fiduciary duties.

164. As a result of the Defendant FIRST FRONTIER, LP, Defendant FRONTIER CAPITAL MANAGEMENT, LLC., Defendant MARK OSTROFF, Defendant "FNU" OSTROFF, Defendant PARENTEBEARD, LLC, and Defendant ANCHIN, BLOCK & ANCHIN, LLP abrogation of their duties to use due care in the management of the investors' funds, including those of the Plaintiffs, these Defendants have violated and

breached their fiduciary duties of care, loyalty, reasonable inquiry, oversight, good faith, and supervision owed to Plaintiffs. They acted in bad faith, with gross negligence and with reckless disregard of their obligation to use due care, and employ reasonable and prudent investment standards.

165. As a result of Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN failure to adequately investigate the Fund's investments and failure to discover that its assets were invested in a Ponzi-type scheme, with innumerable red flags attached to it, said Defendants have failed to fulfill their fiduciary duty owed to Plaintiffs.

166. Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN acted in bad faith, with gross negligence and with complete, utter and total disregard of their obligation to use due and prudent care, including, without limitation, ensuring that the Frontier Defendants were investing the Fund's assets in accordance with the Offering Memorandum's "objective of seeking optimal risk-adjusted consistent returns that are uncorrelated to the market while taking low risk," and were using reasonable and prudent investment standards.

167. In addition, Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN breached their respective fiduciary duties by falsely certifying the Fund's financial statements.

168. As a proximate and direct result of the aforementioned Defendants' malfeasance, non-feasance and knowing bad faith breaches of their fiduciary duties, Plaintiffs have sustained damages, suffered mental and emotional distress and have lost most, if not all,

of their respective investments in an amount yet to be determined, and to be proven at trial, however, minimally of at least four million dollars.

169. By reason of the foregoing, Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, FRONTIER ADVISORS CORP., PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN are jointly and severally liable to Plaintiffs

170. The First Frontier Defendants, and Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN fraudulent acts, were of such a reckless and negligent manner such that Plaintiffs are entitled to punitive damages

## X. COUNT EIGHT

### GROSS NEGLIGENCE AND MISMANAGEMENT

**(Against Defendants First Frontier, LP, Frontier Capital Management, LLC, Mark Ostroff, "FNU" Ostroff, Frontier Advisors Corp., ParenteBeard, LLC, Anchin Block & Anchin, Beacon Associates LLC I, Ivy Asset Management Corp., Bank of New York Mellon Corp., Beacon Associates Management Corp., Joel Danziger, and Harris Markhoff)**

171. Plaintiff repeats and re-iterates ¶¶ 1 through 170 inclusive as if set forth herein.

172. The Frontier Defendants, and Defendants PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, the BEACON DEFENDANTS, IVY ASSET MANAGEMENT, BONY MELLON and JOHN DOES 1-100 were retained by the Fund to invest Plaintiffs' money in a manner consistent with, the Fund's investment objectives as set forth in the Offering Memorandum.

173. The Frontier Defendants, and Defendants PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, the BEACON DEFENDANTS, IVY ASSET MANAGEMENT, BONY MELLON and JOHN DOES 1-100 owed fiduciary duties to the Plaintiffs to conduct, manage and supervise their investments in good faith and with due care.

174 As set forth above the Frontier Defendants, and Defendants PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, the BEACON DEFENDANTS, IVY ASSET MANAGEMENT, BONY MELLON and JOHN DOES 1-100 breached their fiduciary duties to Plaintiffs by acting in bad faith and failing to exercise due care in the performance of their duties as fiduciaries.

175. The Frontier Defendants, and Defendants PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, the BEACON DEFENDANTS, IVY ASSET MANAGEMENT, BONY MELLON and JOHN DOES 1-100 should have prevented, through the exercise of reasonable and due diligence, the improper investing of the Fund's assets into Madoff-related vehicles.

176. The Frontier Defendants, and Defendants PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, the BEACON DEFENDANTS, IVY ASSET MANAGEMENT, BONY MELLON and JOHN DOES 1-100 authorized, approved, participated in, failed to disclose, and improperly concealed the improper conduct described herein.

177. Plaintiffs relied, to their financial detriment, on the Frontier Defendants, and Defendants PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, the BEACON

DEFENDANTS, IVY ASSET MANAGEMENT, BONY MELLON and JOHN DOES 1-100 to discharge their duties as fiduciaries in a reasonable, careful and prudent manner.

178. As a direct and proximate result of result of the gross negligence and misconduct of the Frontier Defendants, and Defendants PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, the BEACON DEFENDANTS, IVY ASSET MANAGEMENT, BONY MELLON and JOHN DOES 1-100, Plaintiffs have been irreparably and punitively harmed. These Defendants are liable to Plaintiffs in an amount yet to be determined and to be proven at trial, however, minimally in an amount of at least four million dollars.

179 By reason of the foregoing, Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, FRONTIER ADVISORS CORP., PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, LLP, BEACON ASSOCIATES LLC I, IVY ASSET MANAGEMENT CORP., BANK OF NEW YORK MELLON CORP., BEACON ASSOCIATES MANAGEMENT CORP., JOEL DANZIGER, and HARRIS MARKHOFF are jointly and severally liable to Plaintiffs.

180. The Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, FRONTIER ADVISORS CORP., PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, LLP, BEACON ASSOCIATES LLC I, IVY ASSET MANAGEMENT CORP., BANK OF NEW YORK MELLON CORP., BEACON ASSOCIATES MANAGEMENT CORP., JOEL DANZIGER, and HARRIS MARKHOFF acts were of such a reckless and negligent manner such that Plaintiffs are entitled to punitive damages.

## XI. COUNT NINE

### UNJUST ENRICHMENT

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**(Against all Defendants)**

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181. Plaintiff repeats and re-iterates ¶¶ 1 through 180 inclusive as if set forth herein.

182. As a result of the misconduct detailed herein, the Defendants FIRST FRONTIER, LP, FRONTIER CAPITAL MANAGEMENT, LLC, MARK OSTROFF, "FNU" OSTROFF, FRONTIER ADVISORS CORP., PARENTEBEARD, LLC, ANCHIN BLOCK & ANCHIN, LLP, BEACON ASSOCIATES LLC I, IVY ASSET MANAGEMENT CORP., BANK OF NEW YORK MELLON CORP., BEACON ASSOCIATES MANAGEMENT CORP., JOEL DANZIGER, and HARRIS MARKHOFF have reaped substantial fees, dividends and other pecuniary benefits at the expense of the Plaintiffs.

183. Said Defendants have therefore been unjustly enriched and in equity and good conscience require that these Defendants disgorge to the Plaintiffs, all such unjust enrichment in an amount to be determined at trial.

## XII. COUNT TEN

### AIDING AND ABETTING BREACHES OF FIDUCIARY DUTY

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**(Against Defendants Beacon Associates LLC I, Ivy Asset Management Corp., Bank of New York Mellon Corp., Beacon Associates Management Corp., Joel Danziger, and Harris Markhoff)**

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184. Plaintiff repeats and re-iterates ¶¶ 1 through 183 inclusive as if set forth herein.

185. The First Frontier Defendant entrusted the Fund's assets, and the Plaintiff's moneys to the custody and care of Defendants BEACON ASSOCIATES LLC I, BEACON ASSOCIATES MANAGEMENT CORP., JOEL DANZIGER, and HARRIS MARKHOFF.

186. Defendants BEACON ASSOCIATES LLC I, BEACON ASSOCIATES MANAGEMENT CORP., JOEL DANZIGER, and HARRIS MARKHOFF relied upon the Investment Consultant, Defendant IVY ASSET MANAGEMENT which had actual knowledge of the investments Beacon Associates was making on behalf of the Fund. With that knowledge, Ivy Asset Management knew of the fiduciary duty breaches by the Beacon and Frontier defendants, or willfully and knowingly turned a blind eye to substantial evidence of such breaches.

187. Defendant IVY ASSET MANAGEMENT CORP. substantially assisted the fiduciary duty breaches of the Beacon Defendants.

188. Similarly, as Ivy Asset Management's parent company, Defendant THE BANK OF NEW YORK MELLON CORP. had knowledge of Ivy Asset Management's investment consulting business, including its consulting the Fund regarding its investment strategy. With that knowledge, BONY Mellon knew of the fiduciary duty breaches of Ivy Asset Management.

189. Plaintiffs have suffered damages proximately caused by Ivy Asset Management's aiding and abetting of the breach of fiduciary duties by the Beacon Defendants, as well as BONY Mellon's aiding and abetting of the breach of fiduciary duties by Ivy

Asset Management, in an amount to be proven at trial, however, minimally, at least four million dollars, and likely well over five million dollars, exclusive of interest.

190. Defendants BEACON ASSOCIATES LLC I, BEACON ASSOCIATES MANAGEMENT CORP., JOEL DANZIGER, and HARRIS MARKHOFF, and Defendants IVY ASSET MANAGEMENT CORP. and THE BANK OF NEW YORK MELLON CORP. acted, individually and jointly, in such a wanton and careless manner such that Plaintiffs are entitled to punitive damages.

## XII. COUNT ELEVEN

**BREACH OF ACCOUNTANT'S DUTY; ACCOUNTANT'S MALPRACTICE**

**(Against Defendants ParenteBeard, LLC, and Anchin Block & Anchin)**

191. Plaintiff repeats and re-iterates ¶¶ 1 through 190 inclusive as if set forth herein.

192. The Generally Accepted Auditing Standards ("GAAS") set forth the standards of practice for all auditors. *United States v. Arthur Young & Co.*, 465 U.S. 805, 811 (1984). As long as the accountant engages in good faith compliance with the GAAS and with Generally Accepted Accounting Principles ("GAAP") it will have discharged its accountant's professional obligation to act with reasonable care. *Mishkin v. Peat, Marwick, Mitchell & Co.*, 744 F. Supp. 531, 538 (S.D.N.Y. 1990). Any deviations from established practice must be evaluated on what the auditor knew at the time, or should have reasonably known, based upon its expertise and representations, under the circumstances. *In re CBI Holding Co., Inc.*, 2009 WL 4642005 at *6 (S.D.N.Y. 2009) (Wood, USDJ).

193. The Defendants named herein, PARENTEBEARD, LLC, and ANCHIN, BLOCK & ANCHIN, have failed to abide by established duties under the GAAS, and has committed such malpractice, as set forth below,[23] resulting in harm to the Plaintiffs.

194. For example, GAAS AU § 317 requires that the auditor, based upon its experience and expertise, advise its client[s] of the possibility that illegal and unlawful acts may have been committed by the parties whom it has audited. See SAS 54, AU §§ 317.02, 317.03.

195. For example, GAAS AU § 333 requires that the auditor, while it may rely upon representations of management, must conduct further investigation "[i]f a representation made by management is contradicted by other audit evidence . . ." SAS 54, AU § 333.04

196. For example, GAAS AU § 316 requires that the auditor, while not trained as an expert in the authentication of documents and documentary evidence, "however, if the auditor believes that documents may not be authentic, he or she should investigate further and consider using the work of a specialist to determine the authenticity." SAS 82, AU § 316.67 n. 29. See also § 316.77.c. Indeed, GAAS AU § 316 contains a detailed "Exhibit", subtitled, "Guidance to Help Prevent, Deter and Detect Fraud". See GAAS AU § 316.86.

[23] The listed violations of the GAAS in the foregoing paragraphs are for illustration purposes only, and are not meant to be exclusive of any other violations of the GAAS by the Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN.

197. For example, GAAS AU § 311 requires that the auditor have the requisite expertise and experience to conduct the audit for which it has been engaged. See SAS 22 § 311.15. As such, it should select a team that satisfies the following mandate,

> The selection of the audit team (including, where necessary, the engagement quality control reviewer) and the assignment of audit work to the team members, including *the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement.*

GAAS § 311.34. Emphasis added.

198. For example, GAAS AU § 314 requires that the auditor fully understand the entity which it is conducting an audit upon, and its internal controls, so as to "to assess the risk of material misstatement of the financial statements whether due to error or fraud, . . ." SAS 109 § 314.01. This standard continues (for more than forty pages), in significant detail, to set forth the duties of the auditor to utilize the appropriate analytical procedures, experienced audit team, regulatory environment, related business risks, among other factors, so as to be able to detect fraud in its infancy.

199. For example, GAAS AU § 318 (SAS 55) requires that the auditor conduct further inquiry and investigation in the event of material misstatements at the financial statement level. For example, this standard, with regard to subsequent audits, provides as follows,

> When performing substantive procedures at an interim date, the auditor may compare and may reconcile information concerning the balance at the period end with the comparable information at the interim date to identify amounts that appear unusual, investigates any such amounts, and may perform substantive analytical procedures or tests of details to test the intervening period.

GAAS 318.62.

200 As set forth *supra* (see generally ¶¶ 66-70), many investors found that the Madoff investment returns were inconsistent with both market performance in general and with all other similarly situated funds. Nevertheless, Defendants PARENTEBEARD, LLC, and ANCHIN BLOCK & ANCHIN failed to conduct any additional inquiry that would have protected the investors.

201. These abject failures, among many others, on the part of Defendants PARENTEBEARD, LLC and ANCHIN, BLOCK & ANCHIN created a direct causal link between the alleged misconduct and the economic harm ultimately suffered by the Plaintiffs (see *In re Vivendi Univeral S.A. Securities Litigation*, 605 F. Supp.2d 586, 595 (S.D.N.Y. 2009)) resulting in the Plaintiffs suffering losses in the millions of dollars. See also *VTech Holdings, Ltd. v. Price Waterhouse Coopers, LLP*, 348 F. Supp. 255, 262 & n. 49 (S.D.N.Y. 2004).

202. Defendants PARENTEBEARD, LLC and ANCHIN, BLOCK & ANCHIN negligent acts constituting malpractice, as set forth under applicable New York law (CPLR § 214(6)) thus, so harmed the Plaintiffs such that they are entitled to punitive damages.

## XIII. RESERVATION OF RIGHTS

**(Against All Defendants, Named and Otherwise)**

203. Plaintiff repeats and re-iterates ¶¶ 1 through 202 inclusive as if set forth herein.

204 Plaintiffs reserve all rights afforded them under Rule 15, Federal Rules of Civil Procedure, to so amend the Complaint, should such circumstances arise.

**DEMAND FOR RELIEF**

WHEREFORE, Plaintiffs do demand and pray for relief as set forth below:

A. Awarding compensatory damages in favor of the Plaintiffs, and against the named Defendants, both jointly and severally, for all damages sustained as a result of the Defendants' wrongdoing (including, but not limited to, the return of all administrative and management fees paid by the limited partners, with interest thereon), in an amount to be proven at trial, including both pre-judgment and post-judgment interest, to the extent and at the rate set forth by law;

B. Awarding punitive damages in favor of the Plaintiffs, and against the named Defendants herein, due to the willful and wanton acts of malfeasance, mis-feasance, and nonfeasance, including the award of both pre-judgment and post-judgment interest, to the extent and at the rate set forth by law;

C. Awarding to the named Plaintiffs all costs and disbursements of this action, including the awarding of reasonable attorney fees, expert fees, and court costs;

D. Finding in favor of the Plaintiffs on Counts One through Eleven inclusive; and

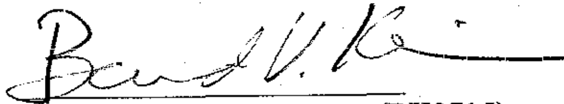
E. Such further relief as this Court shall deem appropriate.

## XIV. JURY TRIAL DEMAND

Pursuant to Rule 38(a), Fed. R. Civ. P., Plaintiffs demand a jury trial on all issues so triable.

Dated: April 21, 2010
White Plains, NY

AITKEN BERLIN LLP



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*Attorneys for Plaintiffs JACK SALTZ, as Trustee of SUSAN SALTZ CHARITABLE LEAD ANNUITY TRUST, and SUSAN SALTZ DESCENDANTS TRUST, and SUSAN SALTZ*

## PLAINTIFFS' CERTIFICATION

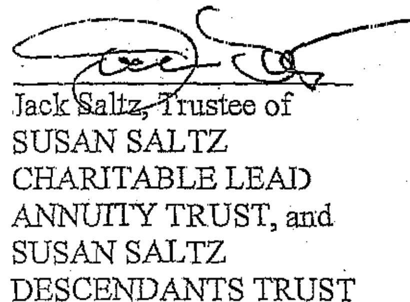
Jack Saltz ("Saltz") as Trustee of the Trust of SUSAN SALTZ CHARITABLE LEAD ANNUITY TRUST, and SUSAN SALTZ DESCENDANTS TRUST, together with Susan Saltz, as beneficiary of the aforementioned Trusts, does declare under penalty of perjury of the laws of the United States of America, as to the claims asserted under the federal securities laws, under the claims asserted under the laws of the State of New York, and under the claims asserted under the common law, that:

1. I have reviewed the annexed Amended Complaint and have authorized the commencement of an action on the Plaintiffs' part.

2. Plaintiffs did not participate in the purchase of any securities that are the subject of this action at the behest or suggestion of Plaintiff's counsel herein.

3. I declare under penalty of perjury that the foregoing is true and accurate and correct.

Executed this 21st day of April 2010

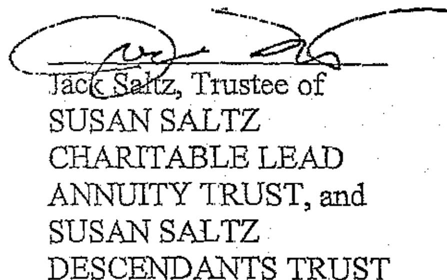


Jack Saltz, Trustee of
SUSAN SALTZ
CHARITABLE LEAD
ANNUITY TRUST, and
SUSAN SALTZ
DESCENDANTS TRUST

**VERIFICATION**

I, Jack Saltz, as Trustee of the Trust of SUSAN SALTZ CHARITABLE LEAD ANNUITY TRUST, and SUSAN SALTZ DESCENDANTS TRUST, do hereby verify that I am familiar with the allegations in the annexed Amended Complaint, and that I have authorized the filing of this Amended Complaint. Based upon the investigation of my Counsel, the allegations in the annexed Amended Complaint are true to my knowledge, information and belief. I declare, under penalty of perjury of the laws of the United States of America, that the foregoing is true and correct.

Dated: April 2/15, 2010

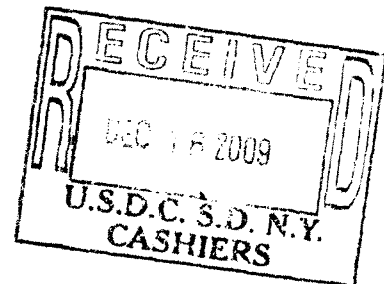


Jack Saltz, Trustee of
SUSAN SALTZ
CHARITABLE LEAD
ANNUITY TRUST, and
SUSAN SALTZ
DESCENDANTS TRUST

# TAB B

**UNITED STATES DISTRICT COURT**
**SOUTHERN DISTRICT OF NEW YORK**

| | |
|---|---|
| DAVID B. NEWMAN and IRA F/B/O DAVID NEWMAN- PERSHING LLC as Custodian, on behalf of themselves and all Others Similarly Situated, and Derivatively on behalf of FM LOW VOLATILITY FUND, L.P., Plaintiffs,<br><br>v.<br><br>FAMILY MANAGEMENT CORPORATION; SEYMOUR W. ZISES; ANDREA L. TESSLER; ANDOVER ASSOCIATES LLC I; ANDOVER ASSOCIATES MANAGEMENT CORP.; BEACON ASSOCIATES LLC I; BEACON ASSOCIATES MANAGEMENT CORP.; JOEL DANZIGER, HARRIS MARKHOFF; IVY ASSET MANAGEMENT CORP.; THE BANK OF NEW YORK MELLON CORPORATION; MAXAM ABSOLUTE RETURN FUND, LP; MAXAM CAPITAL MANAGEMENT LLC; MAXAM CAPITAL GP, LLC; MAXAM CAPITAL MANAGEMENT LIMITED; SANDRA MANZKE; and JOHN DOES 1-100,<br><br>Defendants,<br><br>and FM LOW VOLATILITY FUND, L.P.,<br><br>Nominal Defendant. | 1:08-cv-11215-LBS<br><br>JURY TRIAL DEMANDED |




**SECOND AMENDED CLASS ACTION**
**AND DERIVATIVE COMPLAINT**

Plaintiffs David B. Newman and IRA F/B/O David Newman, Pershing LLC as Custodian, of which David B. Newman is the owner ("Newman IRA") (together, "Plaintiffs"), on behalf of themselves and the Class (defined below), and on behalf of the Nominal Defendant (defined below), allege upon the investigation made by and through their counsel, complaints

filed by the United States Government, the U.S. Securities and Exchange Commission (the "SEC") and other entities, reports filed by the SEC, and other reports and interviews published in the financial press, as follows:

## I. SUMMARY OF ACTION

1. This is both a derivative action brought by Plaintiffs, who are limited partners of FM Low Volatility Fund LP (the "Fund" or the "Low Volatility Fund"), on behalf of the Fund, and a class action on behalf of all persons, other than Defendants (defined below), who invested in the Fund between April 8, 2008 through and including December 11, 2008 (the "Class Period"), to recover damages caused by Defendants' violations of the federal securities laws and common law (the "Class").

2. This case arises from the egregious conduct of Defendants, who knowingly or recklessly allowed Class members' investments in the Fund to be used as part of a massive, fraudulent Ponzi scheme perpetrated by Bernard L. Madoff and through Madoff's investment firm, Bernard L. Madoff Investment Securities, LLC ("BMIS").

3. On December 10, 2008, the Ponzi scheme began to unravel after Madoff informed his sons that BMIS's investment advisory business was a complete fraud. Madoff stated that he was "finished," that he had "absolutely nothing," that "it's all just one big lie." He confessed he had been running "basically, a giant Ponzi scheme," in which he used the principal investments of new clients to pay phantom returns to other clients. Madoff stated that the business was insolvent and that it had been for years. Irving Picard, the Court-appointed trustee overseeing the liquidation of BMIS (the "Madoff Trustee") estimates that the losses from Madoff's fraud exceed $20 billion.

4. On December 11, 2008, Madoff was arrested by federal authorities and both he and BMIS were charged with securities fraud and other federal offenses by the SEC. In addition,

the United States Attorney's Office for the Southern District of New York charged Madoff with securities fraud and other felony counts. On March 12, 2009, Madoff pleaded guilty to all of the eleven charges leveled against him and admitted that he had not made trades for his clients since at least the early 1990s, despite telling investors that he was investing their funds using a "split-strike conversion strategy."

5. In basic terms, the strategy involved: (i) the purchase of equity shares in select companies that were included in the blue-chip Standard & Poor's 100 Index ("S&P Index"); (ii) the simultaneous sale of "call" options, which give the investor the right to buy a stock at fixed prices; and (iii) the purchase of "put" options, which allows the investor to sell a stock at fixed prices. The call options would, to some degree, limit any gains that would be earned on the underlying equity shares. Madoff claimed that, under the right market conditions, he could achieve steady returns regardless of whether the market as a whole had advanced or declined. Over time, Madoff claimed that he was using a larger "basket" of equity shares selected from the S&P Index, combined with put and call options on the S&P Index itself, rather than options on individual equity shares. These positions were held for a short period of time lasting from a week to two months, and then liquidated. Madoff claimed to execute this "split strike conversion" strategy six to eight times per year. At some point, he purportedly began to exit the market at the end of every quarter and to put the funds in Treasury Bills, and, accordingly, the quarterly and annual statements to Madoff's clients showed only investments in Treasury Bills. Madoff's consistent double-digit returns and his investment strategy were unable to be replicated by rival fund managers, despite numerous attempts.

6. In reality, however, this strategy was never implemented and Madoff merely paid certain senior investors with the investments received from other junior investors. Irving Picard,

the Madoff Trustee, has stated that he found no evidence that Madoff actually traded ***any*** stocks or options from 1996 to the present. In other words, Madoff did not make any trades for ***at least the past twelve years.*** On March 12, 2009, Madoff pleaded guilty to charges of securities fraud and admitted that he had not made trades for his investment management clients since at least the early 1990s. Instead, the investors' funds were placed in a Chase Manhattan Bank account, which Madoff used to cover the redemption transfers to other investors. The trade confirmations and account statements that investors received reflected fictitious gains to give the appearance that Madoff was executing the split strike conversion strategy, when, in fact, he was not. On June 29, 2009, Madoff was sentenced to 150 years in prison for his fraudulent scheme.

7. Defendants ignored numerous "red flags" of Madoff's fraud including the following:

(a) the fact that Madoff offered consistent investment returns, beyond reasonable investment benchmarks, in both up and down markets;

(b) the fact that there was a discrepancy between the trading activity in which Madoff claimed to be buying and selling puts and calls and the open interest of index option contracts;

(c) the fact that BMIS was audited by a small accounting firm, Friehling & Horowitz ("F&H"), a storefront accounting firm in New City, New York since 1991, as opposed to the 90% of single strategy hedge funds that are audited by one of the top 10 audit firms;

(d) the fact that Madoff did not employ any third party administrators and custodians; Madoff ran his own back office operations – *i.e.*, the calculation of net asset values, the preparation of account statements, etc.;

(e) the fact that Madoff lacked transparency and limited access to his books

and records, thereby maintaining a false appearance of exclusivity; and

(f) the fact that Madoff admitted to illegally manipulating his accounting records by personally subsidizing returns in slow quarters in order to minimize risk and to maximize reported performance.

8. Importantly, these and other "red flags" were detected by many investment professionals in the industry. Indeed, many managers of hedge funds of funds ("FOFs"), investment advisors, investment banks, and pension funds, who, unlike Defendants here, took the time and effort to conduct proper due diligence reviews, and, chose ***not*** to invest with Madoff or any of his affiliated funds as a result of these warning signs. On August 31, 2009, the SEC Office of the Inspector General issued a 457-page report entitled "Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme" (the "SEC OIG Report"), which detailed these investment professionals' due diligence – some of whom, unlike Defendants here, had access only to publicly available information – and their explanation of why they would not entrust their clients' money to Madoff. The SEC OIG Report concluded that the SEC employees, had they properly examined the red flags and took basic steps to determine if Madoff was operating a Ponzi scheme, would have recognized the significance of the red flags that the investment professionals heeded, and would have discovered the fraud "well before Madoff confessed." Defendants here failed to conduct even a rudimentary due diligence review, which, if conducted, would have alerted them to Madoff's fraudulent scheme, or at least that he could not possibly achieve the returns he claimed.

9. Madoff could not and did not perpetrate this massive fraud on his own. The Madoff fraud was perpetrated by a network of "feeder funds" that enabled Madoff to evolve from an asset manager for select individual clients to a manager of billions of dollars for

thousands of fund investors. Numerous FOFs, which invest fund assets in other investment funds instead of investing directly in stocks, bonds or other securities, were feeder funds to Madoff, and FOFs that invested with Madoff through other FOFs were "sub-feeder funds."

10. The Low Volatility Fund was one such sub-feeder fund that invested in Madoff through feeder funds. The FMC Defendants (defined below) knowingly, recklessly and in breach of their fiduciary duties to the Class and the Fund, permitted the Fund's assets to be invested in three feeder funds, Andover Associates LLC I, Beacon Associates LLC I, and MAXAM Absolute Return Fund, LP (together, the "Feeder Funds"), which were conduits to Madoff. Madoff's role as a manager of the Low Volatility Fund and the Feeder Funds is concealed in the offering materials for all of the funds. Plaintiffs and the Class were unaware that their investments in the Fund were ultimately being invested with Madoff, BMIS and other Madoff-controlled entities (sometimes collectively referred to as "Madoff"). Throughout the Class Period, the Low Volatility Fund's and Feeder Funds' statements in their funds' offering documents and other documents were false and misleading, and the lack of diversification of the Low Volatility Fund's and some of the Feeder Fund's investment portfolios decimated the investments of the Plaintiffs and the Class.

11. The offering memoranda for the Fund and the Feeder Funds included lists of rote "Risk Factors" common to nearly all hedge funds. There was no warning, however, about the largest risk that the Defendants took in the management of their funds, and the one that ultimately caused the funds to lose all or part of their value: namely, entrusting Madoff, a single sub-manager with sole discretion over the custody and trading of the bulk of the funds' assets, without having conducted even the most basic due diligence. None of the written materials

distributed by the Defendants to investors properly disclosed the Madoff relationship and/or the fact that all of the funds, in whole or in part, were pipelines to Madoff.

12. The FMC Defendants, together with the Feeder Fund Defendants (defined below), violated the law by, among other things, making false and misleading statements regarding the investment strategies and objectives of their funds, their purported due diligence and monitoring of the performance of their funds, and their purported due diligence and oversight of the outside managers of their funds. Further, the FMC Defendants, the Feeder Fund Defendants, and Defendant Ivy Asset Management (the investment consultant for two of the Feeder Funds), knowingly, recklessly and in a grossly negligent dereliction of their fiduciary duties, failed to perform adequate due diligence despite the existence of a myriad of red flags of Madoff's fraud, or, at a minimum, the impossibility of Madoff's reported returns, which other investment professionals, who did conduct proper due diligence, detected.

13. Despite having failed to perform the requisite due diligence, which did or would have alerted them to these obvious warning signs, the FMC Defendants, the Feeder Fund Defendants, and Defendant Ivy Asset Management collected large management, advisory, and performance fees from Plaintiffs and the Class, which were wholly unearned and should be disgorged.

14. As a result of Defendants' undisclosed and wrongful conduct, including making false and misleading statements and failing to conduct adequate due diligence, the percentage of the Fund's assets that were invested with Madoff, reportedly at least 60%, have been wiped out, and the Fund and the Feeder Funds have been placed into liquidation, causing the Class members' investments in the Fund, and the Fund's investment in the Feeder Funds, to be decimated.

15. Plaintiffs now seek to recover damages caused to the Class by Defendants' violation of Section 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), as well as for common law fraud, negligent misrepresentation, breach of fiduciary duty, gross negligence and mismanagement, unjust enrichment, aiding and abetting, and malpractice and professional negligence under New York law. Plaintiffs also seek to recover derivatively, on behalf of the Fund, for common law fraud, negligent misrepresentation, breaches of fiduciary duty, gross negligence and mismanagement, and malpractice and professional negligence caused by the Feeder Fund Defendants' violations of the Exchange Act.

## II. JURISDICTION AND VENUE

16. The claims asserted herein arise under Sections l0(b) and 20(a) of the Securities Exchange Act, 15 U.S.C. §§78j and 78t(a), and Rule 10b-5, 17 C.P.R. §240.10b-5, promulgated thereunder by the SEC, 17 C.P.R. § 240.10b.5., as well as under the laws of the State of New York. This Court has jurisdiction in this action pursuant to Section 27 of the Exchange Act, 15 U.S.C. 78aa and pursuant to the supplemental jurisdiction of this Court. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §§ 1331 and 1337, Section 22 of the Securities Act, 15 U.S.C. § 77u, and Section 27 of the Exchange Act, 15 U.S.C. § 78aa.

17. Venue is proper in this judicial district pursuant to Section 22(a) of the Securities Act, 15 U.S.C. §77v, Section 27 of the Exchange Act, 15 U.S.C. § 78aa and 28 U.S.C. §1391(b). Substantial acts in furtherance of the alleged fraud and/or its effects have occurred within this District. Additionally, Defendants (defined below) maintain their headquarters or conduct substantial business in this District.

18. In connection with the acts alleged in this Complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not

limited to, the mails, interstate telephone communications and the facilities of the national securities markets.

## III. PARTIES

19. Plaintiff David B. Newman, a resident of Virginia, is a limited partner in the Fund. Plaintiff Newman IRA, which is owned by David B. Newman, also invested in the Fund. Plaintiffs invested approximately $610,000 in the Fund, the majority of which has been lost to Madoff's Ponzi scheme as a result of Defendants' violations of the law.

20. Nominal Defendant FM Low Volatility Fund, LP, is a Delaware limited investment partnership formed under the laws of the State of Delaware on April 8, 2008, whose general partner was defendant Family Management Corporation. Its principal office is located at 485 Madison Avenue, New York, NY 10022. In or about April 2008, limited partnership interests in the Fund were offered via an offering memorandum. The minimum capital contribution for an investor to have access to the Fund was $250,000, unless the general partner determined that a lower amount was acceptable. Prior to the public exposure of Madoff's fraud on December 11, 2008, the net asset value of the Fund was approximately $25 million.

21. Defendant Family Management Corporation ("FMC" or the "General Partner") is a New York corporation, located at 485 Madison Avenue, 19th Floor, New York, NY 10022. FMC is a registered investment advisor. As of May 31, 2008, FMC had approximately $1.3 billion in assets under management. FMC is the General Partner of the Fund. FMC has a responsibility to the Fund's investors to exercise good faith and fair dealing in all dealings affecting the Fund.

22. Defendant Seymour W. Zises ("Zises") is the President and Chief Executive Officer ("CEO") of FMC, as well as the co-head of the Fund's Investment Committee with Defendant Tessler (identified below). Mr. Zises is also President and CEO of Family

Management Securities, LLC ("FMS"), a registered broker dealer affiliate of FMC, and Forest Hill Capital Corporation, an insurance brokerage firm. Prior to founding FMC in 1989, Zises was an independent financial service representative licensed with Integrated Resources Equity Corporation, a broker-dealer, and a registered representative of another broker-dealer, Nathan & Lewis Securities, Inc.

23. Defendant Andrea L. Tessler ("Tessler") is the Managing Director and Chief Operating Officer of FMC. She is also co-head of the Fund's Investment Committee with Defendant Zises. Defendant Tessler is also the Managing Director and Chief Operating Officer of FMS and Forest Hill Capital Corporation. Prior to founding FMC with Defendant Zises in 1989, defendant Tessler was a registered representative of Integrated Resources Equity Corporation and Nathan & Lewis Securities, Inc.

24. FMC, Zises and Tessler are sometimes referenced collectively as the "FMC Defendants."

25. Defendant Andover Associates LLC I ("Andover" or the "Andover Fund") is a New York limited liability Company formed on June 1, 2008 and managed by defendant Andover Associates Management Corp. Andover is a hedge fund of funds that was a feeder fund to Madoff, with approximately 23% of its assets invested with Madoff. Its principal office is located at 123 Main Street, Suite 900, White Plains, NY 10601. Prior to its conversion to a limited liability company in June 2008, Andover operated as a New York limited partnership that was formed on November 9, 1992 and commenced operations on January 1, 1993. In or about June 2008, limited partnership interests in the Fund were offered via an offering memorandum. The minimum capital contribution to invest in the Andover Fund was $250,000, subject to the right of Andover Associates to modify the requirement. Upon information and belief, prior to

June 2008, interests in the Andover Fund were offered via an offering memorandum that was substantially similar to the June 2008 offering memorandum.

26. Defendant Andover Associates Management Corp. ("Andover Associates") is a Delaware corporation, located at 123 Main Street, Suite 900, White Plains, NY 10601. Andover Associates is the managing member of the Andover Fund. Andover Associates directs the business operations and affairs of the Andover Fund, and makes all allocation and reallocation decisions concerning Andover's assets. Defendants Joel Danziger and Harris Markhoff own (beneficially and of record) 100% of the issued and outstanding voting shares of Andover Associates (constituting 1% of the outstanding stock of Andover Associates). All of the non-voting common stock of Andover Associates (consisting 99% of the total outstanding stock of Andover Associates) is held by the immediate families of defendants Danziger and Markhoff. Andover Associates has a responsibility to Andover's investors to exercise good faith and fair dealing in all dealings affecting the Andover Fund.

27. Defendant Beacon Associates LLC I ("Beacon" or the "Beacon Fund") is a hedge fund of funds that was a feeder fund to Madoff, with approximately 74% of its assets invested with Madoff. Beacon is a New York limited liability company formed under the laws of the State of New York on April 1, 2004 and managed by Beacon Associates Management Corp. Its principal office is located at 123 Main Street, Suite 900, White Plains, NY 10601. Beginning on or about August 9, 2004, memberships in the Beacon Fund were offered via an offering memorandum. The minimum capital contribution to invest in the Beacon Fund was $500,000, subject to the right of Beacon Associates to modify the requirement. Prior to the public exposure of Madoff's fraud, as of October 20, 2008, the net asset value of the Fund was approximately $560 million.

28. Defendant Beacon Associates Management Corp. ("Beacon Associates") is a New York corporation, located at 123 Main Street, Suite 900, White Plains, NY 10601. Beacon Associates is the Managing Member of the Beacon Fund. Beacon Associates directs the business operations and affairs of the Beacon Fund, and makes all allocation and reallocation decisions concerning Beacon's assets. Defendants Joel Danziger and Harris Markhoff own (beneficially and of record) 100% of the issued and outstanding voting shares of Beacon Associates (constituting 1% of the outstanding stock of Beacon Associates). All of the non-voting common stock of Beacon Associates (consisting 99% of the total outstanding stock of Beacon Associates) is held by the immediate families of defendants Danziger and Markhoff. Beacon Associates has a responsibility to Beacon's investors to exercise good faith and fair dealing in all dealings affecting the Beacon Fund.

29. Defendant Joel Danziger, Esq. ("Danziger") is the President and a Director of Andover Associates, as well as the President and a Director of Beacon Associates. Mr. Danziger is a licensed attorney and a partner of the law firm of Danziger & Markhoff LLP located at 123 Main Street, Suite 900, White Plains, NY 10601. Mr. Danziger resides in Bedford, NY.

30. Defendant Harris Markhoff, Esq. ("Markhoff") is the Vice President, Secretary, Treasurer and Director of Andover Associates, as well as the Vice President, Secretary, Treasurer and Director of Beacon Associates. Mr. Markhoff is a licensed attorney and a partner of the law firm of Danziger & Markhoff LLP located at 123 Main Street, Suite 900, White Plains, NY 10601. Mr. Markhoff resides in Pound Ridge, NY.

31. Defendants Andover, Andover Associates, Danziger, and Markhoff are sometimes collectively referred to as the "Andover Defendants."

32. Defendants Beacon, Beacon Associates, Danziger, and Markhoff are sometimes collectively referred to as the "Beacon Defendants."

33. The Andover Defendants and Beacon Defendants are sometimes collectively referred to as the "Andover Beacon Defendants."

34. Defendant Ivy Asset Management Corporation ("Ivy Asset Management"), a Delaware corporation located at One Jericho Plaza, Jericho, New York 11753, is a wholly owned subsidiary of The Bank of New York Mellon Corporation. Ivy Asset Management is a registered Investment Advisor under the Investment Advisors Act of 1940 and a commodity trading advisor under the Commodity Exchange Act. Both Beacon Associates and Andover Associates engaged Ivy Asset Management to provide them with advice regarding the selection and allocation of their funds assets among various investment managers and investment pools. Ivy Asset Management also provided administrative services for Andover and Beacon.

35. Defendant The Bank of New York Mellon Corporation ("BONY") is a Delaware corporation headquartered at One Wall Street, New York, NY 10286. According to its Form 10-K for the year ending December 31, 2007, BONY "is a global financial services company headquartered in New York, New York, with approximately $1.121 trillion in assets under management and $23.1 trillion in assets under custody and administration." BONY is the parent company of Ivy Asset Management.

36. Defendant MAXAM Absolute Return Fund, L.P. ("Maxam" or the "Maxam Fund") is a hedge fund that was a feeder fund to Madoff, with 100% of its assets invested with Madoff. Its principal office is located at 16 Thorndal Circle, Darien CT. Maxam is a limited partnership organized under the laws of Delaware. Limited partnership interests in the Maxam Fund were offered via a private placement memorandum dated March 5, 2008. The minimum

capital contribution for an investor to have access to the Maxam Fund was $1,000,000, unless the general partner determined a lower amount was acceptable. Prior to the public exposure of Madoff's fraud, the net asset value of the Maxam Fund was approximately $280 million.

37. Defendant MAXAM Capital Management LLC ("Maxam Capital") is a Delaware limited liability company located at 16 Thorndal Circle, Darien, CT 06820. Maxam Capital is the investment manager of the Maxam Fund.

38. Defendant Maxam Capital GP, LLC ("Maxam Capital GP") is the general partner of the Maxam Fund. Upon information and belief, Maxam Capital GP is located at 16 Thorndal Circle, Darien, CT 06820. Maxam Capital GP engaged Maxam Capital as investment manager of the Maxam Fund.

39. Defendant Maxam Capital Management Limited ("MCML") is the administrator of the Fund. MCML is located at 11 Winton Hill Lane, Upper Apartment 11, Hamilton Parish, Bermuda CR03.

40. Defendant Sandra Manzke ("Manzke") is the founder, principal and CEO of Maxam Capital. Prior to establishing Maxam in 2005, she was the founder and Co-CEO of Tremont Capital Management, Inc. ("Tremont"). Ms. Manzke established Tremont in October 1984 after serving as a Principal at Rogers, Casey & Barksdale, Inc., from 1976 to 1984. From 1974 to 1976, she worked as an independent consultant at Bernstein Macauley where she was responsible for reviewing the firm's products. She began her career at Scudder Stevens & Clark in 1969.

41. Defendants Maxam, Maxam Capital, Maxam Capital GP, MCML and Manzke are sometimes collectively referred to as the "Maxam Defendants."

42. Defendants Andover, Andover Associates, Beacon, Beacon Associates, Danziger, Markhoff, Maxam, Maxam Capital, Maxam Capital GP, MCML and Manzke are sometimes referenced collectively as the "Feeder Fund Defendants."

43. The FMC Defendants, the Feeder Fund Defendants, Ivy Asset Management and BONY are sometimes referenced collectively as the "Defendants."

44. Defendant John Does 1-100, whose true identities, roles and capacities have yet to be ascertained, but may include the immediate family members of Defendants Danziger and Markhoff, the members of the Investment Committee of the Fund, the members of the Advisory Boards for the Feeder Fund Defendants, and other potential control persons and employees of certain Defendants, including those of Ivy Asset Management and BONY, hedge funds, hedge fund managers, brokerage firms and fiduciaries to the Funds who participated, exploited and perpetrated the wrongdoing alleged herein. The identities of John Does 1-100 will be disclosed in amendments to this complaint when the true identities are discovered.

45. Each of the Defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on Fund investors by their actions.

46. Each of the Defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on the Fund and/or its limited partners by their actions.

## IV. PLAINTIFFS' CLASS ACTION ALLEGATIONS

47. Plaintiffs bring this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and (b)(3) on behalf of all those persons who were investors in the Fund during the Class Period and who suffered damages thereby. Excluded from the Class are the Defendants, the officers and directors of the Defendants, members of their immediate families

and their legal representatives, heirs, successors, or assigns, and any entity in which Defendants have or had a controlling interest.

48. The members of the Class are so numerous that joinder of all members is impracticable. While the exact number of Class members is unknown to Plaintiffs at this time and can only be ascertained through appropriate discovery, Plaintiffs believe there are approximately one hundred members in the proposed Class. Members of the Class may be identified from records maintained by the Fund or FMC and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

49. Plaintiffs' claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by Defendants' wrongful conduct in violation of the federal and state laws described herein.

50. Plaintiffs will fairly and adequately protect the interests of the members of the Class and have retained counsel competent and experienced in class and securities litigation.

51. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are:

(a) whether the federal securities laws were violated by Defendants' acts as alleged herein;

(b) whether statements made by Defendants during the Class Period misrepresented material facts about the business, operations, investments, and financial condition of the Fund;

(c) whether Defendants acted knowingly or recklessly in making materially

false and misleading statements during the Class Period;

(d) whether Defendants' conduct alleged herein was intentional, reckless, and/or grossly negligent and/or in violation of fiduciary duties owed to Plaintiffs and other Class members and therefore violated the statutory and common law of Delaware and/or New York**;** and

(e) to what extent the members of the Class have sustained damages and the proper measure of damages.

52. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

## V. PLAINTIFFS' DERIVATIVE ALLEGATIONS

53. Plaintiffs bring this action derivatively in the right and for the benefit of the Fund to seek redress for the injuries suffered, and to be suffered, by the Fund as a direct result of the violations of the Exchange Act, breach of fiduciary duties, gross negligence and mismanagement, malpractice and professional negligence and fraud alleged herein. The Fund is named as a Nominal Defendant solely in a derivative capacity.

54. Plaintiffs will adequately and fairly represent the interests of the Fund and its limited partners in enforcing and prosecuting its rights.

55. Plaintiffs are limited partners of the Fund and were limited partners of the Fund at all times relevant to Defendants' wrongful course of conduct alleged herein.

56. This is not a collusive action to confer jurisdiction that the Court would otherwise lack.

57. Plaintiffs have not made any demand upon the General Partner to bring an action on behalf of the Fund asserting the claims herein to recover damages for the injuries suffered by Fund, since such demand would have been a futile, wasteful and useless act, and therefore is excused for the following reasons.

58. Demand is excused because the unlawful acts and practices alleged herein cannot be defended by the General Partner, and are not subject to the protection of any independent business judgment since it would undoubtedly be to the benefit of the Fund to recover the damages caused by Defendants' wrongdoing and to assert these derivative claims.

59. Demand is excused because the wrongs alleged herein constitute violations of the fiduciary duties owed by the General Partner to the limited partners and the Fund. The General Partner is subject to liability for breaching its fiduciary duties to the Fund by, among other things, causing the Fund's assets to be invested with Madoff via the Feeder Funds without any oversight or supervision, causing or permitting the reckless investing practices alleged herein, failing to adequately monitor the investment vehicles in which it placed the Fund's assets, and failing to detect, prevent, or halt the misstatements and omissions of material fact alleged herein.

60. Demand is excused because the General Partner exercises ultimate authority over the Fund and profited at the expense of the Fund by receiving monthly management, administrative fees and other fees from the Fund while in possession of material, adverse, non-public information.

61. Demand is excused because the General Partner faces a substantial likelihood of liability in this action because of its acts and omissions alleged herein. The dramatic breakdowns

and gaps in the General Partner's internal controls were so widespread and systematic that the General Partner faces substantial exposure to liability under the "Caremark" or similar doctrine for total abrogation of its duty of oversight. The General Partner either knew or should have known that the Fund's assets were invested in Feeder Funds that were actually part of Madoff's massive Ponzi scheme, or otherwise generated purported results that would have been impossible to achieve under Madoff's split-strike conversion strategy, and took no steps in a good faith effort to prevent or remedy that situation, proximately causing millions of dollars of losses.

62. In addition, demand is also excused because the General Partner has ratified the egregious actions outlined herein, and the General Partner cannot be expected to prosecute claims against itself and persons or entities with whom it has extensive inter-related business, professional and personal entanglements, if Plaintiffs demanded that it do so. The General Partner, because of these relationships, has developed debilitating conflicts of interest that prevent it from taking the necessary and proper action on behalf of the Fund.

63. Demand is also excused because the General Partner participated in, approved, or permitted the wrongs alleged herein, concealed or disguised those wrongs, or recklessly or negligently disregarded them, and therefore is not a disinterested party and lacks sufficient independence to exercise business judgment as alleged herein.

64. Given the size, scope, and blatancy of the wrongdoing and the misrepresentations alleged above, the General Partner either knew of the financial risks to the Fund's assets or turned a willful blind eye to them. Such conduct is not protected by the business judgment rule and exposes the General Partner to a substantial threat of liability in this action.

65. The General Partner lacks sufficient independence to make a disinterested decision as whether to pursue the derivative claims alleged herein against Defendants.

66. In addition, demand would be a futile and useless for the additional following reasons:

(a) The General Partner, because of its inter-related business, professional and personal relationships, has developed debilitating conflicts of interest that prevent it from taking the necessary and proper action on behalf of the Fund as requested herein;

(b) The General Partner, as more fully detailed herein, participated in, approved and/or permitted the wrongs alleged herein to have occurred and participated in efforts to conceal or disguise those wrongs from the Fund's limited partners or recklessly and/or negligently disregarded the wrongs complained of herein, and is therefore not a disinterested party. The General Partner exhibited a sustained and systemic failure to fulfill its fiduciary duties, which could not have been an exercise of good faith business judgment and amounted to gross negligence and extreme recklessness;

(c) In order to bring this suit, the General Partner would be forced to sue itself and persons with whom it has extensive business and personal entanglements, which it will not do, thereby excusing demand;

(d) To disguise its disabling conflict of interest, the General Partner has, at the General Partner's own expense, retained an attorney purportedly to protect the Funds' interest, and to pursue claims on behalf of the Fund. The General Partner has thereby assured that the attorney will not pursue claims against the General Partner, its client, despite its role as the primary wrongdoer. In fact, the purported attorney for the Fund has not brought claims against the FMC Defendants or the Feeder Fund Defendants despite the obvious damage done to the Partnership by the Defendants' actions.

(e) The acts complained of constitute violations of the fiduciary duties owed

by the General Partner and these acts are incapable of ratification; and

(f) The Fund has been and will continue to be exposed to significant losses due to the wrongdoing complained of herein, yet, as set forth above, the General Partner has not filed any lawsuits against itself, its principals, or others who were responsible for that wrongful conduct to attempt to recover for the Fund any part of the damages the Fund has suffered and will continue to suffer.

67. Finally, Plaintiffs have not made any demand on the limited partners to institute this action since such demand would be a futile and useless act for the following reasons:

(a) The Fund has approximately one hundred or more limited partners;

(b) Making demand on such a number of limited partners would be impossible for Plaintiffs who have no way of finding out the names, addresses or phone numbers of the limited partners; and

(c) Making demand on all the limited partners would force Plaintiffs to incur huge expenses, even assuming all the limited partners could be individually identified.

68. The Fund has been directly and substantially injured by reason of the General Partner's intentional breach and/or reckless disregard of its fiduciary duties to the Fund. Plaintiffs, as limited partners and representatives of the Fund, seek damages and other relief for the Fund, in an amount to be proven at trial.

69. FMC, as General Partner of the Fund, violated its fiduciary duties to the Fund by failing to act with due care, loyalty and good faith when it failed to conduct due diligence, or, if conducted, adequate due diligence on the Feeder Funds in which it invested the Fund's assets. FMC allowed the Fund to invest with Madoff-related entities, or in conscious abrogation of its fiduciary duties, permitted it to occur.

## VI. SUBSTANTIVE ALLEGATIONS

### A. Madoff's $50 Billion Ponzi Scheme

70. On December 11, 2008, Madoff was arrested and charged with violations of the federal securities laws. The SEC filed an emergency action in this District seeking to cease all ongoing offerings of securities and investment advisory fraud by Madoff. The SEC alleged the following:

> Madoff is a resident of New York City and is the sole owner of BMIS.… BMIS is a broker-dealer and investment advisor registered in both capacities with the Commission. BMIS engages in three different operations, which include investment adviser services, market making services and proprietary trading. BMIS website states that is has been providing quality executions for broker-dealers, banks and financial institutions since its inception in 1960;" and that BMIS, "[w]ith more than $700 million in firm capital, Madoff currently ranks among the top 1% of US Securities firms." Since at least 2005, Madoff and BMIS have been conducting a Ponzi-scheme through the investment adviser services of BMIS. Madoff conducts certain investment advisory business for clients that are separate from the BMIS' proprietary trading and market making activities.
>
> Madoff ran his investment adviser business from a separate floor in the New York offices of BMIS. Madoff kept the financial statements for the firm under lock and key, and was "cryptic" about the firm's investment advisory business when discussing the business with other employees of BMIS. In or about the first week of December, Madoff told Senior Employee No. 2 that there had been requests from clients for approximately $7 billion in redemptions, that he was struggling to obtain the liquidity necessary to meet those obligations, but that he thought that he would be able to do so. According to the Senior Employees, they had previously understood that the investment advisory business had assets under management on the order of between approximately $8-15 billion.
>
> According to a Form ADV filed by Madoff, on behalf of BMIS, with the Commission on or about January 7, 2008, Madoff's investment advisory business served between 11 and 25 clients and had a total of approximately $17.1 billion in assets under management.

* * *

> At Madoff's Manhattan apartment, Madoff informed the Senior Employees, in substance, that his investment advisory business was a fraud. Madoff stated that he was "finished," that he had "absolutely nothing," that "it's all just one big lie," and that it was "basically, a giant Ponzi scheme." In substance, Madoff communicated to his Senior Employees that he had for years been paying returns to certain investors out of the principal received from other, different, investors. Madoff stated that the business was insolvent, and that it had been for years. Madoff also stated that he estimated the losses from this fraud to be at least approximately $50 billion. One of the Senior Employees has a personal account at BMIS in which several million had been invested under the management of Madoff. At Madoff's Manhattan apartment, Madoff further informed the Senior Employees that, in approximately one week, he planned to surrender to authorities, but before he did that, he had approximately $200-300 million left, and he planned to use that money to make payments to certain selected employees, family, and friends.

71. On March 12, 2009, Madoff pleaded guilty to securities fraud and other criminal charges in connection with his Ponzi scheme, and admitted, among other things, that despite his representations to his existing and prospective clients that he would invest their money in stocks and other securities, he, in fact, had not done so. Madoff was ultimately sentenced to 150 years in prison for his crimes.

72. In his criminal allocution in Court on March 12, 2009, Madoff recounted the genesis and the evolution of the fraud:

> To the best of my recollection, my fraud began in the early 1990s. At that time, the country was in a recession and this posed a problem for investments in the securities markets. Nevertheless, I had received investment commitments from certain institutional clients and understood that those clients, like all professional investors, expected to see their investments out-perform the market. While I never promised a specific rate of return to any client, I felt compelled to satisfy my clients' expectations, at any cost. I therefore claimed that I employed an investment strategy I had developed, called a "split strike conversion strategy," to falsely give the appearance to clients that I had achieved the results I

believed they expected.

Through the split-strike conversion strategy, I promised to clients and prospective clients that client funds would be invested in a basket of common stocks within the Standard & Poor's 100 Index, a collection of the 100 largest publicly traded companies in terms of their market capitalization. I promised that I would select a basket of stocks that would closely mimic the price movements of the Standard & Poor's 100 Index. I promised that I would opportunistically time these purchases and would be out of the market intermittently, investing client funds during these periods in United States Government-issued securities such as United States Treasury bills. In addition, I promised that as part of the split strike conversion strategy, I would hedge the investments I made in the basket of common stocks by using client funds to buy and sell option contracts related to those stocks, thereby limiting potential client losses caused by unpredictable changes in stock prices. In fact, I never made the investments I promised clients, who believed they were invested with me in the split strike conversion strategy.

To conceal my fraud, I misrepresented to clients, employees and others, that I purchased securities for clients in overseas markets. Indeed, when the United States Securities and Exchange Commission asked me to testify as part of an investigation they were conducting about my investment advisory business, I knowingly gave false testimony under oath to the staff of the SEC on May 19, 2006 that I executed trades of common stock on behalf of my investment advisory clients and that I purchased and sold the equities that were part of my investment strategy in European markets. In that session with the SEC, which took place here in Manhattan, New York, I also knowingly gave false testimony under oath that I had executed options contracts on behalf of my investment advisory clients and that my firm had custody of the assets managed on behalf of my investment advisory clients.

To further cover-up the fact that I had not executed trades on behalf of my investment advisory clients, I knowingly caused false trading confirmations and client account statements that reflected the bogus transactions and positions to be created and sent to clients purportedly involved in the split strike conversion strategy, as well as other individual clients I defrauded who believed they had invested in securities through me. The clients receiving trade confirmations and account statements had no way of knowing by reviewing these documents that I had never engaged in the transactions represented on the statements and confirmations. I knew those false confirmations and account statements would be and were sent to clients through the U.S. mails from my office here

in Manhattan.

Another way that I concealed my fraud was through the filing of false and misleading certified audit reports and financial statements with the SEC. I knew that these audit reports and financial statements were false and that they would also be sent to clients. These reports, which were prepared here in the Southern District of New York, among things, falsely reflected my firm's liabilities as a result of my intentional failure to purchase securities on behalf of my advisory clients.

Similarly, when I recently caused my firm in 2006 to register as an investment advisor with the SEC, I subsequently filed with the SEC a document called a Form ADV Uniform Application for Investment Adviser Registration. On this form, I intentionally and falsely certified under penalty of perjury that Bernard L. Madoff Investment and Securities had custody of my advisory clients' securities. That was not true and I knew it when I completed and filed the form with the SEC, which I did from my office on the 17th floor of 855 Third Avenue, here in Manhattan.

In more recent years, I used yet another method to conceal my fraud. I wired money between the United States and the United Kingdom to make it appear as though there were actual securities transactions executed on behalf of my investment advisory clients. Specifically, I had money transferred from the U.S. bank account of my investment advisory business to the London bank account of Madoff Securities International Ltd., a United Kingdom corporation that was an affiliate of my business in New York. Madoff Securities International Ltd. was principally engaged in proprietary trading and was a legitimate, honestly run and operated business.

Nevertheless, to support my false claim that I purchased and sold securities for my investment advisory clients in European markets, I caused money from the bank account of my fraudulent advisory business, located here in Manhattan, to be wire transferred to the London bank account of Madoff Securities International Limited.

There were also times in recent years when I had money, which had originated in the New York Chase Manhattan bank account of my investment advisory business, transferred from the London bank account of Madoff Securities International Ltd. to the Bank of New York operating bank account of my firm's legitimate proprietary and market making business. That Bank of New York account was located in New York. I did this as a way of ensuring that the expenses associated with the operation of the fraudulent

> investment advisory business would not be paid from the operations of the legitimate proprietary trading and market making businesses.
>
> In connection with the purported trades, I caused the fraudulent investment advisory side of my business to charge the investment advisory clients $0.04 per share as a commission. At times in the last few years, these commissions were transferred from Chase Manhattan bank account of the fraudulent investment advisory side of my firm to the account at the Bank of New York, which was the operating account for the legitimate side of Bernard L. Madoff Investment Securities — the proprietary trading and market making side of my firm. I did this to ensure that the expenses associated with the operation of my fraudulent investment advisory business would not be paid from the operations of the legitimate proprietary trading and market making businesses. It is my belief that the salaries and bonuses of the personnel involved in the operation of the legitimate side of Bernard L. Madoff Investment Securities were funded by the operations of the firm's successful proprietary trading and market making businesses.

73. On March 17, 2009, federal prosecutors brought criminal charges against David G. Friehling ("Friehling") of F&H, the auditor for BMIS. Friehling was charged with, among other things, securities fraud for deceiving investors by creating fraudulent certified financial statements for Madoff and his entities, and for aiding and abetting Madoff in his scheme.

74. According to a March 19, 2009 article in *The Wall Street Journal*, entitled "Accountant Arrested for Sham Audits," Friehling improperly issued unqualified audit reports on BMIS's financial statements without ever conducting a proper audit:

> In the criminal complaint against Mr. Friehling, a Federal Bureau of Investigation agent said the auditor didn't verify the existence of assets that Mr. Madoff said he held or securities trades Mr. Madoff said he made. The agent also said Mr. Friehling didn't examine a bank account through which billions of dollars of client funds flowed, among other things.
>
> Mr. Friehling, 49 years old, was the sole auditor at Friehling & Horowitz, a storefront accounting firm in New City, N.Y., a New York City suburb. The government said he audited Mr. Madoff's financial statements since 1991. Since Mr. Madoff's arrest, auditing experts not involved in the case have said they were

> skeptical that one individual could have audited such a big company. Mr. Madoff's firm, which had several businesses, including a division that facilitated securities trades between investors, had $1.1 billion in assets, according to 2007 financial statements prepared by Mr. Friehling that were reviewed by *The Wall Street Journal*.
>
> In a separate civil complaint that mirrored the criminal charges, the SEC also alleged that Mr. Friehling and his family had investment accounts at the Madoff firm worth more than $14 million, a "blatant" conflict of interest that violated auditing rules, according to the complaint. He and his family withdrew at least $5.5 million since 2000, the SEC said.

75. On July 17, 2009, Friehling waived his right to have a grand jury consider the charges against him, a step that often precedes a guilty plea. Then, at a hearing before U.S. District Judge Alvin K. Hellerstein on November 3, 2009, Friehling pleaded guilty to securities fraud, aiding or abetting investment adviser fraud, three counts of obstructing or impeding the administration of Internal Revenue laws, and four counts of making false filings with the SEC. Friehling, who is cooperating with prosecutors, faces a statutory maximum of 114 years in prison on the charges. Also, Friehling agreed to forfeit $3.18 million to the government as part of his plea.

76. On August 11, 2009, Frank DiPascali, the BMIS Chief Financial Officer ("CFO") and an employee of the firm since 1974, pleaded guilty to ten criminal charges ranging from conspiracy and securities fraud to perjury and falsifying records. At the hearing where he pleaded guilty, he stated that Madoff's operation "was all fake. It was all fictitious." DiPascali also stated that he, Madoff, and unnamed others created millions of pages of fake documents, lied to regulators and investors regularly, and shuffled funds between New York and London in order to evade regulatory oversight.

77. According to the *New York Times* article "DiPascali, Madoff's Aide, Holds Key to a Global Intrigue," dated August 13, 2009, while Madoff claimed to be employing a "split

strike conversion" strategy, Madoff in fact simply guaranteed that certain clients receive specific returns, and DiPascali's job was to make sure the clients received those returns.

### B. The State of Massachusetts Sues a Madoff Feeder Fund

78. On April 2, 2009, William Galvin, the Secretary of the Commonwealth of Massachusetts, brought charges against Fairfield Greenwich Group, the largest of the Madoff feeder funds. Galvin charged Fairfield Greenwich Group with fraud for ignoring numerous red flags of Madoff's fraud, and for nonetheless collecting hundreds of millions of dollars in management and administration fees. According to an article in *The Wall Street Journal* entitled "Madoff Feeder is Charged in Fraud," the Massachusetts regulatory complaint alleged that Fairfield Greenwich Group failed to perform the due diligence it had promised its investors:

> The complaint marks a new stage in the investigation of the Madoff fraud and could spark broader attempts by investors to reclaim lost money from firms and people who earned hefty fees for bringing investors to Mr. Madoff.
>
> * * *
>
> While there is no evidence in the complaint that New York based Fairfield Greenwich knew that Mr. Madoff was running a Ponzi scheme, as he has admitted, authorities say that Fairfield Greenwich failed to perform anything near the due diligence it promised its customers.
>
> The complaint also says Mr. Madoff coached officials at Fairfield Greenwich Group on how to deflect questions from Securities and Exchange Commission investigators.
>
> * * *
>
> The SEC is also investigating feeder funds. The SEC investigation is broad and looks at whether the funds told investors that their money was invested only with Madoff. It also looks into whether feeders disclosed to investors that they were receiving fees from Madoff for steering him business, people familiar with the matter say.
>
> The Massachusetts complaint, filed on Wednesday by Secretary of

> the Commonwealth William F. Galvin, marks the first government charges against a Madoff "feeder" fund -- firms that earned hefty fees for bundling money to invest with Mr. Madoff. Mr. Madoff pleaded guilty last month to perpetrating a massive Ponzi scheme.

79. On September 8, 2009, Fairfield Greenwich Group agreed to settle the case for $8 million dollars in restitution to Massachusetts investors who lost money in Madoff's Ponzi scheme.

### C. The Connecticut Superior Court Issues a TRO Freezing the Assets of Maxam and Manzke, Among Others

80. On March 30, 2009, the Retirement Program for Employees of the Town of Fairfield, Retirement Program for Police Officers and Firemen of the Town of Fairfield, and the Town of Fairfield (collectively, "Fairfield") brought an action against several feeder funds, including Maxam Capital, Maxam Capital GP, MCML and Manzke, and others in the Superior Court of the State of Connecticut: *Retirement Program for Employees of the Town of Fairfield, et al. v. Bernard L. Madoff, et al.*, FBT CV 095023735 (Conn. Sup. Ct.) (the "Fairfield Action"). In addition to asserting claims to recover money damages from the defendants, Fairfield made an application for a temporary restraining order ("TRO") freezing the assets of the defendants, which included Madoff and members of his family, as well as the managers of Maxam funds, who are defendants herein. On the basis of the complaint and affidavits presented in support of the motion, the court issued a TRO freezing the assets of all defendants, including the Maxam Defendants.[1]

81. The Fairfield Complaint alleges, with respect to the Sandra Manzke, as follows:

> At some time prior to 1997, defendant Manzke, acting in her own

[1] On April 13, 2009, the Court lifted the TRO, but assessed liens on the defendants' property, including the Maxam Defendants.

interests and on behalf of defendant Tremont Partners, entered into a business arrangement with Bernard L. Madoff, then a New York-based investment manager. Pursuant to their business arrangement with Madoff, defendants Manzke and Tremont Partners agreed to form a hedge fund, in the form of a limited partnership, that would solicit investment from individuals and entities that, pooled together, would comprise a substantial multi-million investment fund. Defendant Tremont Partners was to serve as the general partner of the hedge fund limited partnership and, as general partner, would retain Madoff to manage all of the limited partners' investments.

Pursuant to their arrangement with Madoff, defendant Tremont Partners would reap substantial annual payments as a result of its role as general partner and manager of the hedge fund. Although investment managers normally charge their clients on the basis of a percentage of the clients' annual investment, Madoff agreed that defendant Tremont Partners, rather than he, would be allowed to charge the hedge fund's investors such percentage fee and agreed that his compensation would be in the form of commissions on the trades he undertook, which would be processed through a broker-dealer company, Bernard L. Madoff Securities, Inc. ("BLMIS"), owned and controlled by Madoff. Defendant Tremont Partners would, further, be able to charge the limited partners an annual fee for administrative services. Pursuant to this business arrangement with Madoff, defendants Tremont Partners and Manzke were, thus, in a position to earn millions of dollars annually in return for raising money that would be placed with Madoff for his management.

In or about April 2005, defendant Manzke started a new entity, defendant Maxam Capital. Defendant Manzke caused defendant Maxam Capital to form a new hedge fund, the Maxam Absolute Return Fund, L.P. [the "Maxam Fund"], for the purpose of creating a new pool of investments for Madoff and a new source of fees for herself and her partners. Defendant Maxam Capital served as the investment manager for the Maxam Fund and received a fee for its investment management services. Another entity formed by defendant Manzke, defendant Maxam Capital GP LLC, served as general partner of the new MAXAM Fund, and yet another Maxam entity formed by defendant Manzke, defendant Maxam Capital Management Limited, served as administrator of the Maxam Fund. Each of these Maxam entities received fees for its services on behalf of the MAXAM Fund from fund investors.

82. In support of its motion for a TRO against the Maxam Defendants, among others, Fairfield submitted an affidavit from Edward H. Siedle (the "Siedle Affidavit" or "Siedle Aff."), an expert on the securities industry. Since 1983, Mr. Siedle has worked as a securities industry investigator, investigating non-traditional and alternative asset managers, including hedge funds. Mr. Siedle spent the last ten years investigating securities and money management abuses.

83. After conducting a thorough investigation, Mr. Siedle opined that "numerous financial analysts and hedge fund managers, without the enhanced access to information from Madoff enjoyed by . . . Maxam . . . had long been suspicious of Madoff's long-term investment performance." (Siedle Aff. ¶ 12.) The "red flags" that led these analysts and fund managers to conclude that Madoff was operating illegitimately included, *inter alia*:

> - First, ***the investment returns purportedly achieved by Madoff's stated investment strategy were too good to be true.*** Madoff represented that he was following a so-called "split-strike conversion" strategy that entailed the purchase of 30 to 40 large capitalization S&P 500 stocks and the simultaneous sale of out-of-the-money calls on the S&P 100 Index and the purchase of out-of-the-money puts on the S&P 100 Index. Managers that followed the same split-strike conversion strategy did not achieve comparable results. Professionals that specifically tried to replicate Madoff's results using the same strategy could not. As Harry Markopolos, a derivatives analyst in Boston who reviewed Madoff's investment strategy in a November 2005 letter to the SEC noted, the normal return from using the split-strike conversion strategy would approximate the return on Treasury Bills – far less that Madoff's claimed returns. Moreover, Madoff's claim to a positive return in virtually every month over a 15-year plus period is so unlikely as to be evidence of criminal activity of some kind in and of itself.
>
> - Second, critical to Madoff's purported investment strategy was the purchase and sale of put and call options on the billions of dollars of securities under his management. ***Given the enormous amount of the assets under management with Madoff purportedly invested in the strategy and the level of options trading required to implement the strategy, there were not enough listed and over-the-counter index options to support Madoff's level of trading.*** Further, the large volume of option

trades that the strategy would have generated would have had a profound impact upon the market. Market professionals purporting to review Madoff's trading activity – as the . . . Maxam . . . professional[s] all represented they were carefully doing – would have been immediately aware of these fundamental disparities between what Madoff said he was doing and what the marketplace data showed (to the contrary). Likewise, it would be apparent to any market professional reviewing Madoff's purported trades that there is no evidence of the substantial block trades of the billions of dollars of securities in Madoff's purported strategy that would have been required. Further, press accounts indicate that even a cursory analysis of the stock trades reported on the account statements issued by Madoff compared against the actual trading prices on the relevant dates would have shown that the prices did not match. Quite clearly, it would be fundamentally apparent to any market professional performing due diligence on Madoff's trading activity that he was not trading the securities or options necessary to implement his purported split-strike conversion strategy.

- Third, any market professional would have been very troubled by the way in which Madoff purported to verify his purported trading activity. ***Madoff's requirement that his investors custody their assets at BLMIS, as opposed to at a third party custodian, was unusual*** and posed real dangers, including lack of independent verification of assets within accounts and related returns. Moreover, the form of the BLMIS statements was outdated and lacking in detail, which was also both surprising and of concern from a verification standpoint. Annual audits of Madoff's trading activities and holdings by a qualified, national auditing firm might have allayed these concerns; however, ***Madoff's auditor was a three-person firm which did not have the qualifications or expertise to audit an advisor with $17 billion in reported assets.*** While start-up companies sometimes use small auditing firms, it is unheard of for an established firm with billions under management to use such an auditor.

- Fourth, ***other investment managers have noted inconsistencies between customer account statements and the audited BLMIS financial statements filed with the SEC.*** The stock holdings reported in the quarterly statements of BLMIS filed with the SEC appeared too small to support the size of the assets Madoff claimed to be managing.

- Fifth, ***the degree of secrecy insisted upon by Madoff was highly unusual and suspicious.*** While successful investment managers generally seek to tout their level of assets under management and

their investment strategy and to be responsive to increasing demands for transparency, Madoff's refusal to provide information raised serious concerns with some cautious managers and advisors.

– Sixth, the fee arrangement between Madoff and the "feeder firms" was the opposite of convention and counter-intuitive: ***Madoff the investment fund manager who generated the exceptional returns, was paid a low commissions-based fee, while the marketing firms received rich performance-like fees.*** Thus, … Maxam, which had $280 million with Madoff, was scheduled to receive over $2.8 million in 2008. . . ***All of these enormous fees were paid to the "feeder firms" for what was essentially marketing Madoff. Madoff's willingness to part with such rich fees, which ordinarily would be retained by the investment manager, not the marketer, was a blatant "red flag."*** (Siedle Aff. ¶12) (emphasis added).

* * *

It has further now been revealed that such major financial institutions as Goldman Sachs, Merrill Lynch, Credit Suisse and Societe Generale were so uncomfortable with Madoff's refusal to provide a satisfactory explanation for his claimed success and the numerous red flags raising suspicions about the legality of his operations that they prohibited investments with Madoff. Likewise, published reports document that a number of established financial advisors, including Aksia LLC, an independent hedge fund research and advisory firm, Acorn Advisory Capital, LP, an investment advisory firm, and others, refused to do business with Madoff for similar reasons. (Siedle Aff. ¶14).

* * *

In addition to those privately questioning Madoff's operations, there were financial industry publications on at least two occasions that publicly raised concerns with the legality of Madoff's operations. In the May 7, 2001 edition of Barron's, a respected financial publication, an article entitled, "Don't Ask, Don't Tell" raised concerns about Madoff and BLMIS. The author noted that some of Madoff's billion-dollar funds had never had a down year and reported on speculation on Wall Street that Madoff was using his market-making business to subsidize and smooth out the returns of the funds he was managing. The author suggested that investors seek greater transparency related to Madoff's investment strategy than Madoff was providing. In addition, in May 2001, Michael Ocrant raised many of the same concerns in an article that appeared in Institutional Investor and the MAR/Hedge report. In

> this article, Ocrant referred to over a dozen hedge fund professionals who questioned why others using the same "split-strike conversion" strategy were unable to achieve similar impressive results.
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> * * *
>
> These published reports are significant because, in my experience, while the financial press may comment on investment manager strategy or performance, there is an understandable reluctance to question the integrity of a manager. Consequently, when articles of such a nature do appear, it is exceptional and requires immediate attention on the part of fiduciaries responsible for safeguarding client assets. (Siedle Aff. ¶16).

### D. **<u>The SEC OIG Report</u>**

84. It is now well-known that, beginning in 2000, Harry Markopolos, a former money manager from Boston, Massachusetts, informed the SEC that Madoff was either front-running his clients' money or operating a Ponzi scheme. In November 2005, Mr. Markopolos sent the SEC a document entitled "The World's Largest Hedge Fund is a Fraud," which illustrated how it was impossible for Madoff to collect as much money as he did from feeder funds and still execute his split-strike strategy, and identified 29 "red flags" that should have raised doubts about Madoff's alleged investment strategy, including the red flags identified in the Siedle Affidavit. Mr. Markopolos' November 2005 document contained some additional red flags, including:

(a) Madoff's insular operations – only Madoff family members were privy to his investment strategy and the Madoff family has held important leadership positions with the NASD, NASDAQ, SIA, DTC and other prominent industry bodies. As a result, these organizations "would not be inclined to doubt or investigate Madoff or BMIS";

(b) Madoff's incomprehensible Form 13F filings – investment managers who manage over $100 million or more of assets are required to disclose in Form 13F filings with the

SEC, the class of securities, the CUSIP number, the number of shares owned and the total market value of each security. Madoff's Form 13F disclosures contained only a sampling of small positions in equities and his explanation for this was that his strategy was mostly in cash at the end of each quarter to avoid disclosing the securities he was trading. If Madoff was really going to cash at the end of each quarter, there would have been large movements in money markets at the end of each quarter, however, this was not the case; and

(c) BMIS's office in the Lipstick Building in New York – Madoff's Ponzi scheme operation was located on the 17th floor of the Lipstick Building, located at 885 Third Avenue, New York, New York. Most Madoff employees on other floors did not have access to the space. Anyone performing a proper due diligence would have questioned why all of the hedge fund's files were located in an inaccessible floor of the building. Additionally, in its regulatory filings, BMIS indicated that it had only between one and five employees managing approximately $17 billion of assets under management.

85. The SEC, despite having received multiple complaints about Madoff, including from Mr. Markopolos, did not conduct a thorough formal investigation of Madoff and did not bring charges against him.

86. After Madoff's arrest, the SEC was heavily criticized for failing to detect Madoff's fraud, and, indeed, Christopher Cox, SEC Chairman at the time the Madoff scandal broke, issued a press release admitting the SEC's "failures" in this regard:

> Our initial findings have been deeply troubling. The Commission has learned that credible and specific allegations regarding Mr. Madoff's financial wrongdoing, going back to at least 1999, were repeatedly brought to the attention of SEC staff, but were never recommended to the Commission for action. I am gravely concerned by the apparent multiple failures over at least a decade to thoroughly investigate these allegations or at any point to seek formal authority to pursue them.

87. The SEC's failure to detect Madoff's blatantly fraudulent acts have become a source of embarrassment for the agency. On August 31, 2009, the SEC Office of Inspector General released the SEC OIG Report, which came to the following conclusion:

> The SEC received more than ample information in the form of detailed and substantive complaints over the years to warrant a thorough and comprehensive examination and/or investigation of Bernard Madoff and BMIS for operating a Ponzi scheme, and that despite there examinations and two investigations being conducted, a thorough and competent investigation or examination was never performed. The OIG found that between June 1992 and December 2008 when Madoff confessed, the SEC received six substantive complaints that raised significant red flags concerning Madoff's hedge fund operations and should have led to questions about whether Madoff was actually engaged in trading. Finally, the SEC was also aware of two articles regarding Madoff's investment operations that appeared in reputable publications in 2001 and questioned Madoff's unusually consistent returns.
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> * * *
>
> [D]espite numerous credible and detailed complaints, the SEC never properly examined or investigated Madoff's trading and never took the necessary, but basic, steps to determine if Madoff was operating a Ponzi scheme. Had these efforts been made with appropriate follow-up at any time beginning in June of 1992 until December 2008, the SEC could have uncovered the Ponzi scheme well before Madoff confessed.

88. The SEC OIG Report further found that many investment professionals who conducted due diligence on Madoff, using customary methods for conducting due diligence in the industry, determined that investing with Madoff was too risky given the existence of the myriad red flags:

> Many private sector firms conducted their own due diligence of Madoff's operations while considering whether to invest with Madoff or Madoff feeder funds. While these firms did not have the authority that a regulator like the SEC has to compel the production of documents and information, in numerous cases their due diligence efforts were sufficient for the private entities to determine that investing with the Madoff firm was too risky, even with the limited

> information they were able to obtain…. [M]any of the firms that conducted due diligence were already aware of suspicions in the industry about Madoff, even before they began their analyses of Madoff's operations. Using ordinary due diligence methods, such as voluntarily requesting basic documents like financial statements, and asking pointed questions of Madoff or Madoff feeder funds, they determined that an investment would be unwise. Specifically, Madoff's description of both his equity and options trading practices immediately led to suspicions about Madoff's operations. With respect to his split-strike conversion strategy, many simply did not believe that it was possible for Madoff to achieve his returns using a strategy described by some industry leaders as common and unsophisticated. In addition, there was a great deal of suspicion about Madoff's purported options trading, with several entities not believing that Madoff could be trading options in such high volumes where there was no evidence of any counterparties which had been trading options with Madoff.
>
> In addition, these entities had suspicions concerning many of the same "red flags" that were discussed in the SEC examinations but which ultimately were not analyzed or were dismissed by the SEC, such as Madoff's fee structure and the small size of Madoff's auditor. Further, although some of these entities only had opportunities for a few brief conversations with Madoff or representatives of the feeder funds, they felt Madoff and his representatives simply did not provide satisfactory answers to their questions and left the meetings even more suspicious of Madoff's operations.

89. Had the Defendants, who are seasoned investment professionals and who, as the managers of funds whose assets were invested with Madoff, had greater access to Madoff, conducted the same "ordinary" due diligence that these investment professionals conducted, they too could not have failed to see the red flags of Madoff's fraud or, at a minimum, was involved in some kind of wrongdoing.

90. The SEC OIG Report set forth its findings on why the SEC failed to uncover Madoff's fraud:

> Numerous private entities conducted basic due diligence of Madoff's operations and, without regulatory authority to compel information, came to the conclusion that an investment with Madoff was simply too risky. These decisions were made based

> upon the same "red flags" in Madoff's operations that the SEC considered in its examinations and investigations, but ultimately dismissed.
>
> An explanation of why these private entities were able to understand and appreciate the suspicious aspects of Madoff's strategies and operations may be related to the differing approaches utilized by these private sector individuals conducting the analysis as compared to SEC examinations. ***The private entities generally described an "iterative" approach to due diligence, focusing on basic items, such as independence and transparency, while many faulted the SEC examinations for being too "checklist oriented." Through this "iterative" approach, the private entities were able to better understand the matters they were analyzing, such as the improbability of Madoff achieving his returns using his split-strike conversion strategy and the fact that Madoff could not be trading options in such high volumes without affecting the market or having counterparties that could be located. In addition, private entities who conducted due diligence appreciated the "red flags" that the SEC personnel dismissed because they had a greater experience and knowledge base in the industry than many SEC examiners have.***
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> The SEC examination program should analyze the approaches utilized by private entities who conducted due diligence of Madoff's operations and apply these methods to strengthen their program. They should also seek to learn from these private entities through training mechanisms and in fact, several private entities informed the OIG that they would be willing to conduct training of SEC examiners in their due diligence approaches. Learning from private sector efforts would improve the SEC's ability to conduct meaningful and comprehensive examinations and detect potential fraud. (Emphasis added.)

## E. The FM Low Volatility Fund

91. During the Class Period, Defendant FMC offered limited partnerships in the FM Low Volatility Fund, LP to qualified investors such as Plaintiffs.

92. Participation in the Fund was offered through an offering memorandum dated on or about April 8, 2008 ("Offering Memorandum"). Attached to the Offering Memorandum was

a 2008 Form ADV for FMC ("Form ADV"), which FMC, as an investment adviser, filed with the SEC.

93. According to the Offering Memorandum, each limited partner in the Fund is given a "Book Capital Account" and a "Tax Capital Account." Limited partners are permitted to make additional capital contributions upon terms and conditions as may be set in the sole discretion of the general partner, and may make redemptions on December 31 of each calendar year, or on such other terms as conditions as my be set in the sole discretion of the general partner if a limited partner provides timely notice of withdrawal (90 days), provided that the interest being redeemed has been outstanding at least 12 months on the redemption date. Redemption charges and processing fees may be required for redemptions of partnership interests. The Fund's profits are automatically reinvested and distributions of capital and profits are made on a limited basis if at all. The General Partner receives a fixed management fee of 0.35% of the net asset value of each interest at the end of each quarter equaling an 1.4% annual fee.

94. According to its website, FMC's "mission is to preserve capital and achieve income and appreciation goals through the understanding of the risk/reward relationship of investing. Traditional investment vehicles are employed and are blended with more modern techniques of investing. Through a thorough process of analysis and planning, Family Management strives not only to protect your capital, but to help you take advantage of important trends and opportunities as they present themselves."

**1. The FMC Defendants Failed to Disclose They Were Investing Fund Assets in Feeder Funds to Madoff**

95. The FMC Defendants failed to disclose the material fact that the Fund was a sub-feeder fund the bulk of whose assets were ultimately invested with Madoff. The FMC

Defendants invested at least 60% of the Fund's assets in Andover, Beacon and Maxam, but neither the Offering Memorandum nor any other offering materials used to solicit investments in the Fund identified Andover, Beacon and Maxam as Fund investments or disclosed that they were, in turn, wholly or partially invested in Madoff or that any assets of the Fund were invested with Madoff.

96. According to FMC documents, Andover is:

> a multi-strategy hedge fund of funds. The majority of assets of Andover[] are managed directly by the General Partner by investing in a portfolio of large cap stocks while utilizing various hedging techniques involving options, with the primary objective of preservation of capital while achieving an above average consistent investment return. … The majority of the Fund's investment are in a Split Stock Conversion Strategy, Longacre Capital Partners and Elliot Associates, L.P.

97. According to FMC documents, Beacon is:

> a multi-strategy hedge fund of funds. Seventy four percent of the Fund will invest in a split-strike conversion strategy. This strategy entails the purchase of 35-50 large capitalization stocks from the S&P 500 Index and the simultaneous sale of out-of-the-money calls and the purchase of out-of-the-money puts on the S&P 500 Index. The transactions are undertaken on a hedged basis, such that the basket of stocks purchased is intended to correlate with the index options. Proprietary systems are designed to continuously optimize the basket of stocks and the index options.

98. According to FMC documents, Maxam is:

> a feeder fund that seeks long term capital appreciation with low volatility. The partnership will invest in equity securities, equity related derivatives, and in options. The Fund employs a split-strike conversion option strategy which entails the purchase of 35-50 large capitalization stocks from the S&P 500 Index and the simultaneous sale of out-of-the-money calls and the purchase of out-of-the-money puts on the S&P 500 Index. The transactions are undertaken on a hedged basis, such that the basket of stocks purchased is intended to correlate with the index options. Proprietary systems are designed to continuously optimize the basket of stocks and the index options.

99. The Offering Memorandum, however, together with its accompanying materials, nowhere identifies the feeder funds in which the Fund was invested and does not include the descriptions of Andover, Beacon and Maxam set forth the above paragraphs. Further, upon information and belief, the FMC Defendants never disclosed to prospective investors that Andover, Beacon and Maxam were in reality mere conduits that were wholly or partially invested with Madoff, or that the majority of the Fund's assets were being blindly entrusted to Madoff without adequate investigation or monitoring.

100. Upon information and belief, the FMC Defendants created the Low Volatility Fund for the express purpose of investing with Madoff via the Feeder Funds. Prior to the formation of the Low Volatility Fund, the FMC Defendants recommended investments in Feeder Funds like Beacon, which they knew were invested with Madoff, to FMC's investment advisory clients. By setting up the Low Volatility Fund as a sub-feeder fund to Madoff, the FMC Defendants not only collected advisory fees for recommending investments in their own Low Volatility Fund, but also collected another layer of fees from investors as the General Partner of the Fund.

101. By concealing Madoff's role in managing the Fund's investments, as well as the fact that the Fund was investing client assets in the Feeder Funds invested with Madoff, the FMC Defendants falsely led prospective investors and limited partners to believe that the Fund would be invested in legitimate investment vehicles.

102. Further, the Offering Memorandum falsely stated that the Fund's assets would be fully diversified. In fact, the Offering Memorandum represented that the Fund's investments would not be concentrated, and instead falsely stated that the Fund "***will allocate its assets to no***

***fewer than three Investments," and that "no single Investment Vehicle will comprise more than 35% of the Fund's Net Asset Value at the time of investment."*** (Emphasis added.)

103. In other words, while the Offering Memorandum sought to lull potential investors into believing the investments in the Fund would be diversified, thereby minimizing risk, in reality, at least 60% of the assets in the Fund were invested and concentrated in three Feeder Funds that ultimately were invested, in whole or in part, with Madoff.

104. These statements were materially false and misleading and failed to disclose that FMC, as the General Partner, allowed at least 60% of the Fund's assets to be funneled through Andover, Beacon and Maxam and invested in a single manager, Madoff.

### 2. The Offering Memorandum Contained False and Misleading Statements About the Fund's Investment Objectives

105. The Offering Memorandum stated that the Fund's objective was to:

> seek long-term capital appreciation with low volatility and low correlation to the U.S. equity markets primarily by investing in private investment funds that exhibit low volatility by engaging in single or multiple strategies (commonly referred to as "hedge funds") and/or hedge "fund-of funds" (collectively with hedge funds, the "Investment Vehicles"). The instruments to be invested in and traded by the Investment Vehicles will consist of securities, derivatives, and other financial instruments, as well as cash and cash equivalents. The Investment Vehicles will each be managed, directly or indirectly, by professional managers ("Managers"). To a limited extent, either through separate accounts directed by Managers or at the direction of the Fund's General Partner, the Fund also may engage in direct trading of the foregoing instruments.

106. The Offering Memorandum further provided that the investment objective of the Fund would be carried out using a variety of investment strategies, as follows:

> <u>Investment Strategies.</u> It is currently expected that the Investments selected by the Fund will employ low volatility strategies primarily (at least for the foreseeable future) within the equity long/short sector, and, to a lesser extent, in the relative value, the "event-driven" and the tactical trading sectors.

107. The Offering Memorandum described the "equity long/short sector" investment strategy as follows:

> Equity Long/Short Strategies typically are long-biased, involving skill based Managers focused on investing in equities and equity derivatives. They differ from traditional equity strategies in that they can go long and short securities, can lever or de-lever their portfolios, and do not manage to a benchmark. They are distinguishable from one another by the extent of their gross leverage and their normal net long or short exposure. In addition, while some employ a broad generalist approach, others tend to differentiate based on the market capitalization of companies in whose securities they invest and/or be sector, style, or geographically specific. Examples of some of these strategies are:
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> - Market Capitalization-Focused - This strategy concentrates on equity securities within particular size categories, such as large, mid, small and/or micro capitalization. This strategy may also involve the purchase of the equity securities and the concurrent use of equity or index options in order to hedge the equity portfolio. The General Partner expects that this strategy (involving large capitalization securities) will constitute a significant portion of the overall portfolio.
>
> - Style-Focused Investing - Strategies in this category include value investing (targeting equity securities perceived to be selling at a deep discounts to their intrinsic value or potential worth), growth investing (focusing. on equity securities expected to experience high or accelerating earnings growth), or the use of an opportunistic approach (investing in both value and growth opportunities, with a goal of picking the most attractive securities within each style).
>
> - Lone Term Equity Investing - These strategies focus on long-term equity-oriented situations, including private equity, venture capital, energy, and special situations, as opposed to short term trading and investment of equity securities and/or options thereon.
>
> - Sector-Focused Investing - This strategy concentrates equity investments within a particular market sector or sectors, such as consumer cyclicals, financials, healthcare, industrials, media, natural resources, real estate, technology and/or telecom.

- Geographically Focused - Strategies within this group tend to focus their investing on specific geographic regions of the world, such as the U.S., Asia, Europe, Emerging Markets, and/or are globally diversified.

108. In the Offering Memorandum, the FMC Defendants also described the "relative value" strategy, another purported means of achieving the Fund's investment objective, as follows:

> Relative Value Strategies seek to profit from mispricings of financial instruments, capturing spreads between related securities that deviate from their fair value or historical norms. Certain relative value strategies focus on particular sectors (e.g. financial institutions including banks and savings institutions, financial services companies involved in areas such as insurance or specialty lending - leasing, factoring, mortgage lending and consumer finance), while other strategies are more diversified. Representative strategies within this sector include statistical arbitrage, market neutral, convertible arbitrage and fixed income arbitrage.
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> - Statistical Arbitrage - These, typically highly quantitative, programs use proprietary computer models to evaluate equities, detect market-data signals and predict relative price movements over some short time frame, usually measured in days or weeks. Portfolios tend to be highly liquid, highly diversified, highly risk controlled, and have very high turnover.
>
> - Market Neutral - Like statistical arbitrage, these programs often rely on computer models to rank equities based on a number of proprietary factors. The factors and investment universes differ from program to program and there is typically some form of fundamental stock selection or de-selection input. Managers employing this strategy construct long and short baskets of equity securities with similar characteristics but different current valuations, with the view that the market will gradually realize these different valuations and correct the difference over days, weeks or months. Programs tend to be dollar, sector, and beta neutral.
>
> - Convertible Arbitrage - This investment approach attempts to exploit the mis-valuations between convertible bonds and their underlying equities. This strategy consists of

buying convertible bonds and shorting an appropriate number of shares of the issuer's common stock as a hedge at some predetermined spread. Managers adopting this strategy limit credit risk via quantitative tracking of individual credits and credit spreads, as well as with the use of credit hedges. These strategies range from highly quantitative to highly discretionary, from trading intensive to low turnover, from high credit quality to low credit quality.

- Fixed Income Arbitrage - Fixed income arbitrage strategies are non-directional and seek to exploit pricing anomalies that might exist across fixed income securities and their related derivatives. Like statistical arbitrage, these strategies are highly quantitative, relative value approaches and typically do not attempt to forecast the direction of interest rates. Instruments traded are often global in nature and may include everything from sovereign debt to mortgage-backed securities to high yield.

109. The Offering Memorandum described the "event driven" strategies allegedly used by the Fund, as follows:

> "Event Driven" Strategies seek to identify companies that are subject to periodic corporate events such as restructurings, mergers, takeovers, spin-offs and other special situations. Event Driven strategies seek to capitalize on the mispricings that occur due to market misconceptions about such events (either occurring or not occurring). Representative strategies within this sector include merger arbitrage, high yield/distressed, capital structure arbitrage, and special situations.

- Merger Arbitrage - Merger arbitrage involves investing to earn the difference between the price paid for securities of a company involved in an announced merger or acquisition and the anticipated value to be received for those securities upon consummation of the proposed transaction. The investment objective is to hedge all non-event risk in the securities and to be able to make an informed investment decision based on fundamental analysis and timing.

- High Yield/Distressed - High Yield Managers following this strategy invest in debt or equity securities of firms in or near bankruptcy. Distressed securities are often inefficiently priced due to their illiquidity, the existence of forced sellers and the uncertainty created by the restructuring process. Approaches to this area range from

being passive highly diversified investors to being very actively involved with company managements in negotiating the terms of the restructuring. Other Managers employ a variation of this strategy, focusing on identifying and exploiting credit opportunities, particularly in the market for secondary, and to a lesser extent, primary, bank loans.

- Capital Structure Arbitrage - This strategy involves the purchase and sale of different classes of securities of the same issuer when there is a relative mispricing between the two. A capital structure arbitrage trade might involve purchasing senior debt of an issuer and selling subordinated debt of the same issuer when the subordinated debt is believed to be overpriced relative to the senior debt.

- Special Situation Arbitrage, -- This strategy involves the purchase or sale of securities of companies that are the subject of corporate reorganizations, recapitalizations, restructurings, bankruptcies, spin-offs, split-offs, or liquidations. The investment objective is to use fundamental research to uncover anomalies in the pricing of various securities due to such events.

110. The Offering Memorandum also described the "tactical trading" strategies used by the Fund, as follows:

> Tactical Trading Strategies seek to capitalize on both relative and directional opportunities in global equities, fixed income, currencies, and commodities. These strategies tend to exhibit very low correlations to traditional asset classes, as well as the strategies within the relative value and event driven sectors. In addition, in past periods of global financial stress or financial illiquidity, where relative value and event driven managers have experienced challenges, many tactical trading Managers have had impressive returns.

111. These statements were false and misleading. The Offering Memorandum led investors to believe the Fund would be invested in a number of different investment vehicles and would employ different investment strategies, and therefore would be diversified minimizing risk of losses. The fact, however, was that the Fund was invested in the Feeder Funds, which, in turn, were invested in Madoff, who pursued the purported split-strike conversion strategy, which the

FMC Defendants knew or, but for their extreme recklessness, should have known could not generate the returns Madoff claimed.

112. According to the Offering Memorandum, FMC determined "the allocation of the Fund's assets to, and reallocation of the Fund's assets from, Investments based on the Investment Committee's evaluation of the Investments, relevant market conditions, and economic trends." Further, FMC had the discretion to "withdraw from current Investments that [FMC] determines are no longer consistent with the Fund's investment objectives. [FMC] through its Investment Committee, will monitor the performance of each Investment on an ongoing basis." Defendants Zises and Tessler made all investment, trading, allocation and reallocation decisions for the Fund. Indeed, the Offering Memorandum states that limited partners "will not be able to participate in the management of the Fund" and that FMC "has a responsibility to the Fund to exercise good faith and fairness in all dealings affecting the Fund."

113. These statements were also materially false and misleading because they conveyed the false impression that FMC was investing the Fund's assets in a manner to minimize volatility and minimize risk when it was effectively entrusting the majority of the Fund's assets to one investment manager – Madoff – whose investments were illusory. The FMC Defendants failed to disclose that the vast majority of the Fund's assets were placed with Madoff through the Feeder Funds, thereby undermining the Fund's purported investment objective to "seek long-term capital appreciation with low volatility and correlation to the U.S. equity markets." Had the FMC Defendants conducted any due diligence, or, if conducted, done so in an appropriate manner, they would have learned, if they did not already know, of the red flags identified herein, and that Madoff's investment advisory operation was nothing more than a fraud.

### 3. The Offering Memorandum Contained False and Misleading Statements About the FMC Defendants' Purported Due Diligence

114. The Offering Memorandum falsely stated that the FMC Defendants would: (i) endeavor to verify the integrity of each third party manager of a fund in which the Fund was invested; (ii) attempt monitor the performance of each such manager; and (iii) request detailed information regarding the historical performance and investment strategy of each of the selected investments for the Fund.

115. Indeed, in FMC's May 2008 Form ADV, which was an exhibit to the Offering Memorandum, the FMC Defendants touted the "initial and ongoing" due diligence they supposedly conducted on third party managers:

> We conduct initial and ongoing due diligence on all Third Party Managers and their investment vehicles. We have regular discussions and reviews with the Third Party Managers in connection with our clients' asset allocations and investment strategies. And, as part of our services, we advise our clients about increasing, decreasing, or terminating any such relationships.

116. The Offering Memorandum was materially misleading because it conveyed the false impression that FMC had conducted and would be conducting on an ongoing basis, a thorough investigation of third party managers like the Andover Beacon Defendants and the Maxam Defendants, and the investment strategies they purported to employ in managing the assets of their respective funds, which the FMC Defendants knew were being managed by Madoff. The Offering Memorandum contained a material omission by failing to disclose that, with no or inadequate due diligence or oversight, FMC abdicated its responsibilities and blindly entrusted the assets of the Fund to investment managers and investment vehicles that were invested in Madoff.

117. In representing that it would evaluate the investments of its chosen investment managers, and conduct initial and ongoing due diligence on such managers, FMC was

representing that it would evaluate the investments of the Feeder Funds, to which no less than 60% of the Fund's capital was entrusted. Contrary to the promises made in the Offering Memorandum and the Form ADV, the FMC Defendants failed to conduct any meaningful due diligence review into whether the Feeder Fund Defendants, directly or through Madoff, were in fact, actually performing the split-strike conversion strategy they purported to employ.

118. The scope of the due diligence promised by the FMC Defendants in the Form ADV included, among other strategies, reviewing information on potential and ongoing investment managers derived from "on-site due diligence of companies, issuers, and Third Party Managers (such as discussions with company management, visits to company offices or manufacturing facilities)," as well as "financial newspapers and magazines," "inspection of corporate activities," and "research material prepared by others."

119. This statement was materially false and misleading because (a) any on-site inspection of Madoff's activities would have revealed the glaring red flags that other investment professionals heeded, as set forth in the SEC OIG Report, including that Madoff kept his records on a floor that almost no one had access to, and (b) articles in "financial newspapers and magazines" expressed concern that Madoff's operation might be illegitimate. Had the FMC Defendants performed adequate due diligence and monitoring of the Feeder Fund Defendants, Andover, Beacon and Maxam, as well as Madoff, they would have seen significant red flags that would have alerted them to the dangers of entrusting the Fund's assets to Madoff.

120. Indeed, there were articles in publications directed at investment professionals that questioned the consistency of Madoff's returns and his insistence on secrecy. A May 2001 article in *MAR/Hedge* entitled "Madoff tops charts; skeptics ask how," reported:

> Those who question the consistency of [Madoff's] returns, though not necessarily the ability to generate the gross and net returns

reported, include current and former traders, other money managers, consultants, quantitative analysts and fund-of-funds executives, many of whom are familiar with the so-called splitstrike conversion strategy used to manage the assets.

These individuals, more than a dozen in all, offered their views, speculation and opinions on the condition that they wouldn't be identified. They noted that others who use or have used the strategy—described as buying a basket of stocks closely correlated to an index, while concurrently selling out-of-the-money call options on the index and buying out-of-the-money put options on the index—are known to have had nowhere near the same degree of success.

* * *

What is striking to most observers is not so much the annual returns—which, though considered somewhat high for the strategy, could be attributed to the firm's market making and trade execution capabilities—but the ability to provide such smooth returns with so little volatility.

* * *

In addition, experts ask why no one has been able to duplicate similar returns using the strategy and why other firms on Wall Street haven't become aware of the fund and its strategy and traded against it, as has happened so often in other cases; why Madoff Securities is willing to earn commissions off the trades but not set up a separate asset management division to offer hedge funds directly to investors and keep all the incentive fees for itself, or conversely, why it doesn't borrow the money from creditors, who are generally willing to provide leverage to a fully hedged portfolio of up to seven to one against capital at an interest rate of Libor-plus, and manage the funds on a proprietary basis.

* * *

As for the specifics of how the firm manages risk and limits the market impact of moving so much capital in and out of positions, Madoff responds first by saying, "I'm not interested in educating the world on our strategy, and I won't get into the nuances of how we manage risk." He reiterates the undisputed strengths and advantages the firm's operations provide that make it possible.

* * *

He also stresses that the assets used for the strategy are often

> invested in Treasury securities as the firm waits for specific market opportunities. He won't reveal how much capital is required to be deployed at any given time to maintain the strategy's return characteristics, but does say that "the goal is to be 100% invested."
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> Madoff readily dismisses speculation concerning the use of the capital as "pseudo equity" to support the firm's market making activities or provide leverage. He says the firm uses no leverage, and has more than enough capital to support its operations.
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> Still, when the many expert skeptics were asked by MAR/Hedge to respond to the explanations about the funds, the strategy and the consistently low volatility returns, most continued to express bewilderment and indicated they were still grappling to understand how such results have been achieved for so long.

121. Similarly, a May 7, 2001 article in Barron's entitled "Don't Ask, Don't Tell: Bernie Madoff is so secretive, he even asks his investors to keep mum," *Barron's* reported:

> When Barron's asked Madoff how he accomplishes this, he says, "It's a proprietary strategy. I can't go into it in great detail."
>
> Nor were the firms that market Madoff's funds forthcoming. "It's a private fund. And so our inclination has been not to discuss its returns" says Jeffrey Tucker, partner and co-founder of Fairfield Greenwich, a New York City-based hedge-fund marketer. "Why Barron's would have any interest in this fund I don't know." One of Fairfield Greenwich's most sought-after funds is Fairfield Sentry Limited. Managed by Bernie Madoff, Fairfield Sentry has assets of $3.3 billion.
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> Still, some on Wall Street remain skeptical about how Madoff achieves such stunning double-digit returns using options alone. Three option strategists for major investment banks told Barron's they could understand how Madoff churns out such numbers using this strategy. Adds a former Madoff investor: "Anybody who's a seasoned hedge-fund investor knows the split-strike conversion is not the whole story. To take it at face value is a bit naïve."
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> * * *

> Adding further mystery to Madoff's motives is the fact that he charges no fees for his money management services. Indeed, while fund marketers like Fairfield Greenwich rake of a 1.5% from investors, none of that goes back to Madoff. Nor does he charge a fee on money he manages in private accounts? Why not? "We're perfectly happy to just earn commissions on the trades," he says.
>
> The lessons of Long-Term Capital Management's collapse are that investors need, or should want, transparency in their money manager's investment strategy. But Madoff's investors rave about his performance – even though they don't understand how he does it. "Even knowledgeable people can't really tell you what he's doing," one very satisfied investor told Barron's. "People who have all the trade confirms and statements still can't define it every well. The only thing I know is that he's often in cash" when volatility levels go extreme. This investor declined to be quoted by name. Why? Because Madoff politely requests that his investors not reveal that he runs their money.
>
> "What Madoff told us was, 'If you invest with me, you must never tell anyone that you're invested with me. It's no one's business what goes on here,'" says an investment manager who took over a pool of assets that included an investment in a Madoff fund. "When he couldn't explain [to my satisfaction] how they were up or down in a particular month," he added, "I pulled the money out."

122. The FMC Defendants further represented in their Form ADV that "[a]ccount reviews are generally conducted quarterly or more frequently if requested by a client or if [FMC] believes market factors indicate. [Zises, Tessler], or an appropriate delegate reviews all accounts. . . . The review is performed to ascertain that the securities in the account are consistent with the investment strategy selected by the client, any client instructions, and that the investment strategy and asset allocation continue to be suitable for the client."

123. This statement was materially false and misleading because either no account reviews were performed, or, if performed, they were woefully inadequate. Any reasonable account review of the type described in the Form ADV would have identified the numerous red flags that warned other investment professionals to steer clear of Madoff.

124. As the Offering Memorandum states, "[l]imited [p]artners will not be able to readily participate in the management of the Fund, and will have limited voting rights, including no right to remove the general partner." Moreover, according to the Offering Memorandum, limited partners were only allowed to redeem their investments on December 31st of each year, subject to minimal exceptions and fees. For this reason the Plaintiffs and the Class were unable to readily redeem their investments in the Fund. Accordingly, Plaintiffs and other members of the Class were completely dependent on the FMC Defendants to fulfill their fiduciary duties to investigate all potential investment managers before retaining them and to continue monitoring such managers during their period of retention.

125. Nonetheless, the FMC Defendants, in breach of their fiduciary duties, failed to conduct even the most rudimentary due diligence on the Feeder Funds – in which they invested the proceeds of the subscriptions of Plaintiffs' and the Fund's other limited partners, and on Madoff – who was the ultimate manager of at least 60% of the Fund's assets. The FMC Defendants instead relied on the "reputation" of Madoff without conducting any investigation of the *bona fides* of Madoff or his operation, and/or an analysis of the trading strategies and investment returns reported by Madoff, which remained consistently high even during adverse market conditions.

126. Moreover, despite the representation in the Offering Memorandum that Defendants Zises and Tessler would make all investment, trading, allocation and reallocation decisions for the Fund, the reality was that the FMC Defendants gave carte blanche to Madoff, *via* Beacon, Andover, and Maxam, to manage the majority of the Fund's assets, and did not have any say in how those assets would be managed. The FMC Defendants, in blatant dereliction of their fiduciary duties, exercised no oversight whatsoever over Madoff, or over the Andover

Beacon Defendants and the Maxam Defendants, despite entrusting more than half of the Fund's assets the FMC Defendants controlled and were duty-bound to protect to these managers.

127. FMC abdicated its responsibilities as the General Partner of the Fund, and utterly failed to supervise, monitor and manage the investments of the Fund. As a result, FMC breached its fiduciary duty to the Fund and its limited partners.

**4. False and Misleading Account Summaries and Account Statements Sent to Limited Partners**

128. In addition to the false and misleading statements in the Offering Memorandum and other offering documents, the FMC Defendants also issued false and misleading quarterly capital account summaries ("Quarterly Account Summaries") to each of the limited partners. For example, on August 7, 2008, FMC sent each of the Fund's limited partners a letter enclosing a Quarterly Account Summary for the period ending June 30, 2008, stating, *inter alia*, the estimated capital account balance for both the limited partner and the Fund as a whole, and providing an update of the Fund's performance. The June 30, 2008 Quarterly Account Summary was false and misleading because it stated that the Fund had an estimated value of $5,446,012 as of June 30, and that the Fund had suffered only a 0.16% loss during its first quarter of existence. This statement was false and misleading because it failed to state that at least 60% of the Fund's were actually invested with Madoff and, as a result, were worthless.

129. Similarly, the Quarterly Account Summary for the period ending September 30, 2008 was false and misleading because it stated that the Fund had an estimated value of $10,446,877 as of September 30, and that the Fund had suffered only a 1.31% loss during the quarter. This statement was false and misleading because it failed to state that at least 60% of the Fund's assets were actually invested with Madoff and, as a result, had no value whatsoever.

130. Similarly, the monthly account statements issued to the Fund's limited partners were false and misleading because they too failed to disclose that at least 60% of the limited partners' investments in the Fund were actually invested in Madoff and, therefore, were worthless.

**5. Despite Their Utter Dereliction of Their Fiduciary Duties, the FMC Defendants Collected Hefty Fees**

131. Notwithstanding the FMC Defendants' egregious conduct in failing to properly conduct due diligence and failing to ensure that the Fund's assets were invested in accordance with the Offering Memorandum instead of in a Ponzi scheme orchestrated by Madoff, the FMC Defendants nevertheless collected advisory fees of 1.4% of the Fund's net asset value.

132. Moreover, the Fund's limited partners also paid management fees and performance fees to Andover Associates, Beacon Associates and Maxam Capital GP, which improperly allowed the Fund's assets to be invested with Madoff through Andover, Beacon and Maxam, respectively. As set forth in the Offering Memorandum:

> The Managers will charge management fees and performance compensation for their services to the Investment Vehicles in which the Fund will invest or to the Fund itself (in the case of a managed account). These fees will be in addition to the fees charged by the General Partner to the Fund. Such fees may be payable irrespective of profitability and may be substantial even during periods of loss. The Fund may be required to pay performance-based fees to certain Managers at times when the Fund as a whole has not realized a profit. Performance compensation payable to Managers may create incentives for the Managers to make investments that are riskier than would be the case in the absence of such arrangements.

133. As *The Wall Street Journal* reported in a December 12, 2008 article entitled "Hedge Funds Face By Losses in Madoff Case," investors in "so-called fund-of-hedge funds … entrust[ed] their wealth with fund managers who then spread it among several individual hedge funds – and pay two layers of fees for the privilege."

134. Similarly, a January 15, 2009 article in *Business Week* entitled "Madoff: Lawyers and Layers of Players" notes:

> The alleged fraud of Bernard Madoff has put the heat on so-called feeders, the giant hedge funds that funneled more than $20 billion to the now-disgraced money manager. But it turns out those players depended on another group of smaller funds and individuals to gather money in what looks like the Wall Street equivalent of a Russian nesting doll. The largely unregulated crowd, including accountants, lawyers, investment managers, even doctors, opened the exclusive world of hedge funds to more investors—and charged exorbitant fees for the privilege.
>
> The sprawling network of individuals and tiny funds, which operates across the entire hedge fund industry, presents a challenge for securities regulators as they consider crafting new rules for this huge slice of the investment world. It's not merely a matter of keeping tabs on 10,000 hedge funds but also on the myriad players on the margins—a far more costly and onerous task. "Sometimes there's no better place to hide than in plain sight," says Bill Singer, a lawyer and former regulator.
>
> The supporting cast in Madoff's alleged scheme is an extreme example of the industry's excess. Everyone wanted a piece of the action. A caddie in the Jupiter (Fla.) area purportedly referred golfers for a fee to firms that invested with Madoff. Donna McBride, a Boca Raton (Fla.) retiree, sank $700,000 into a fund managed by two practicing lawyers in White Plains, N.Y., Joel Danziger and Harris Markhoff. Many investors had no idea what they were buying since marketing documents rarely mentioned Madoff by name. A spokesman for the lawyers says the fund operated independently of their firm.
>
> The system allowed investors to gain entrée to Madoff with far fewer dollars, thereby expanding his clientele beyond big institutions and billionaires to wealthy individuals of more modest means. Consider the $175 million FutureSelect Prime Advisors II, which plowed its assets into Tremont Group's Rye family of funds, which channeled money to Madoff. Investors in FutureSelect needed to pony up only $250,000, compared with the $500,000 required by Rye and most large feeder funds. Over the years, some firms lowered that bar to as little as $50,000. "A lot of small investors got exposure to Madoff through subfeeders," says Reed R. Kathrein, a lawyer who's representing alleged victims of Madoff. FutureSelect didn't return calls for comment.

* * *

> Investors paid layer upon layer of fees with seemingly little regard for how they ate into gains. Those at the bottom paid the biggest tab and realized the smallest returns. Says New York lawyer Ross Intelisano, who represents Madoff investors: "The most fascinating part is the multiple layers of people glomming off Madoff."

### 6. <u>The FMC Defendants Immediately Disclaim Responsibility</u>

135. On December 11, 2008, after Madoff's Ponzi scheme was revealed to the public, the FMC Defendants wasted no time in writing to the Fund's limited partners, to express their "shock" over the situation:

> We want to bring to your attention some very troubling news that we learned late Thursday afternoon. Bernard L. Madoff was arrested and charged with criminal securities fraud by federal prosecutors in an alleged Ponzi scheme of massive proportions reported to be in excess of $50 billion.
>
> We, and the entire investment community, are completely shocked by these unfolding events. As you may be aware, Madoff was a highly respected and well known investor. Madoff founded his firm in 1960, and he has served as vice chairman of the NASD, a member of its board of governors, and chairman of its New York regional office.
>
> Through your investment in FM Low Volatility Fund, LP, you have exposure to Madoff and therefore we have retained counsel to investigate any possible recovery of your assets.
>
> We want you to know that we have significant personal investments with Madoff and will join together with you in a vigorous pursuit of these assets.
>
> Linda Chatman Thomsen, director of the SEC's Division of Enforcement, said, "We are alleging a massive fraud – both in terms of scope and duration" … "We are moving quickly and decisively to stop the fraud and protect remaining assets for investors and we are working closely with the criminal authorities to hold Mr. Madoff accountable."
>
> Please rest assured that we will keep you informed of any developments regarding this matter. However, please do not hesitate to contact any member of your Family Management team.

136. On December 12, 2008, the FMC Defendants wrote to the Fund's limited partners, informing them that the were "monitoring this situation closely," and developing a "legal strategy":

> In an effort to keep you fully informed of the developing events regarding the securities fraud involving Bernard L. Madoff, we will send you emails as we learn of new information.
>
> The Honorable Louis Stanton, U.S. District Court Judge for the Southern District of New York, has granted the U.S. Securities and Exchange Commission's request and has issued an order freezing all assets relating to Madoff and his firm.
>
> Please know that we are monitoring this situation closely and we are in constant contact with our attorneys developing a legal strategy.

137. On December 16, 2008, the FMC Defendants again wrote to the Fund's limited partners, informing them that the FMC Defendants had retained legal counsel for the Fund, but, tellingly, failed to inform the limited partners of the FMC Defendants' potential liability for limited partners' losses. The December 16, 2008 communication stated, in relevant part:

> We want to keep you up-to-date on the recent developments in connection with the alleged fraud by Bernard L. Madoff.
>
> Family Management Corporation is pleased to announce that it has retained Max Folkenflik as counsel to represent FM Low Volatility Fund, L.P. in connection with this matter. Mr. Folkenflik specializes in commercial litigation with a particular concentration in securities fraud and business torts, and matters involving complex business, accounting or financial issues, including accountants' liability and class actions. Mr. Folkenflik obtained his law degree from Georgetown University and his Bachelors of Science from Cornell University.

138. Not surprisingly, Mr. Folkenflik, who was retained and is being compensated by FMC, has failed to bring any suit on behalf of the Fund against its General Partner, FMC, or against Zises and Tessler. Indeed, because Mr. Folkenflik's fees are being paid by FMC, he would have an irremediable conflict of interest if he brought suit on behalf of the Fund against

FMC, Zises or Tessler, his *de facto* clients. He would be faced with the same conflict if he were to bring suit against the Andover Beacon Defendants or the Maxam Defendants, because they could claim over against the FMC Defendants for causing the losses suffered by the Fund, Plaintiffs and the Class.

139. On January 2, 2009, the FMC Defendants informed the Fund's limited partners that FMC was dissolving the Fund. The letter stated in relevant part:

> As you know, the Fund was designed around a core investment strategy that had historically exhibited a low correlation with the broader markets. The fraud allegedly perpetrated by Bernard L. Madoff however has forced us to dissolve the Fund.
>
> The dissolution is a complex process that will take many months, if not a year or more to complete. The Fund has already filed redemption notifications with its underlying investments and it is working with the managers of these investments to create a liquidity schedule. The schedule will determine how quickly the Fund can make distribution.

### F. The Andover and Beacon Funds

140. The Andover Fund and the Beacon Fund were two of the feeder funds to Madoff the FMC Defendants knowingly chose as investment vehicles for the Low Volatility Fund. The Andover and Beacon Funds are managed by Andover Associates and Beacon Associates, respectively, which, because of their common ownership, are referred to as the Andover Beacon Defendants. Ivy Asset Management was the investment consultant and administrator for both Funds.

141. Participation in the Andover Fund was offered through an offering memorandum dated June 2, 2008 (the "Andover Offering Memorandum"). According to the Andover Offering Memorandum, the Fund conducted its investment and trading activities through Andover Associates (QP) LLC, an affiliated investment fund. Andover Associates, as the "Managing

Member" of Andover, made "all investment allocation and reallocation decisions on behalf of the Fund" with advice from Ivy Asset Management.

142. Participation in the Beacon Fund was offered through an offering memorandum dated August 9, 2004 (the "Beacon Offering Memorandum"). According to the Beacon Offering Memorandum, Defendant Beacon Associates, with the assistance of Ivy Asset Management, made all investment allocation and reallocation decisions on behalf of the Fund.

143. In addition, according to the Beacon Offering Memorandum, which is substantially the same in all relevant respects to the corresponding sections of the Andover Offering Memorandum, Beacon Associates established a capital account and tax account for each member of the Beacon Fund. Members are permitted to make additional capital contributions on terms and conditions as the Managing Member may impose. There are significant restrictions on a member's right to withdraw its interests, and transfers and assignments must be approved by the managing member. The managing member is paid management fees of 1/8 of 1% of the value of each member's capital account at the end of the prior months equaling a 1.5% annual fee. The managing member also receives 1% of each year's net profits.

144. The Andover and Beacon offering memoranda did not disclose that a significant portion of Andover's and Beacon's assets were blindly entrusted to Madoff, without any, or, at least, adequate, due diligence or monitoring. No less than 74% of the Beacon's assets and 23% of the Andover's assets were invested with Madoff.

145. The October 1, 2009 consolidated amended class action and derivative complaint in *In re Beacon Associates,* No. 09-cv-0777-LBS, a case in which Plaintiffs' counsel represents a

plaintiff, shed light on the roles Ivy Asset Management, and its founder, Larry Simon, played in how Beacon came to be invested with Madoff.

146. Indeed, the Beacon Defendants formed Beacon specifically to act as a feeder fund to BMIS and Madoff. Larry Simon, the president and CEO of Ivy Asset Management, had personal relationships with Madoff and Defendants Danziger and Markhoff, and wanted to capitalize on those relationships. Simon, Danziger and Markhoff agreed that Beacon Associates would form the Beacon Fund in order to meet Madoff's increased minimum net worth requirements for investing directly with BMIS, which would allow each of them to collect hefty fees for managing and advising the fund. Beacon Associates and Ivy Asset Management entered into a "consultant agreement" in February 1995, under which Ivy Asset Management was compensated for introducing Beacon Associates to Madoff and was to receive 50% of the management fees collected by Beacon Associates for investing Beacon's assets with Madoff. At all relevant times, the Andover Beacon Defendants and Ivy Asset Management knew that Madoff would not allow access to his operations or allow any investigation of his supposed trading strategy or any other aspect of his asset management business. In fact, in the consultant agreement, each party disclaimed responsibility for any act or failure to act by Madoff or any losses that may result from investing fund assets with him.

147. According to their respective offering memoranda, the investment objective of both the Andover and Beacon Fund was to "provide above average rates of return while attempting to minimize risk by utilizing trading and investment strategies, both directly and indirectly, including through investment pools."

148. These statements were false and misleading because they conveyed the false impression that the Andover Beacon Defendants were investing Andover's and Beacon's assets

in a manner to minimize risk when they were entrusting portions of the funds' assets to Madoff, whose reported results were illusory. The Andover Beacon Defendants failed to disclose that a portion of the funds' assets were placed directly with Madoff, which subverted the funds' purported investment objective to "provide above average rates of return while attempting to minimize risk by utilizing trading and investment strategies, both directly and indirectly, including through investment pools." If the Andover Beacon Defendants had conducted appropriate diligence, they, like the hedge fund managers referenced in the SEC OIG Report, could not have missed the red flags that warned that Madoff's investment strategy and his investment advisory operation was a sham.

149. In fact, the Beacon Offering Memorandum falsely stated that:

> ***A significant portion of the Company's assets are allocated to a strategy adopted by the Managing Member involving a portfolio of Large Cap Stocks hedged with options ("Large Cap Strategy").*** The balance of the Company's assets are allocated among independent investment managers ("Managers") indirectly through investment in other investment funds ("Investment Pools") which the Managers manage. . . . The Company's assets are allocated and reallocated among strategies and to and from Managers by the Managing Member, following consultation with Ivy Asset Management Corp. . . . and the Managing Member's Advisory Board.

(Emphasis added).

150. In addition, the Andover Offering Memorandum falsely stated that:

> As of the date of this Memorandum, the Fund's assets are allocated (i) among eight Managers, seven of which invest the assets allocated to it through separate Investment Pools and one through a managed account, and (ii) to ***the Managing Member's Large Cap Strategy.*** The Fund has no current allocation with any Manager engaged in market timing of mutual fund shares and has no intention to do so. A brief description of the strategies of the current Managers and the Managing Member's Large Cap Strategy is set out below.

151. The offering memoranda for Andover and Beacon also described the investment strategy of each of the managers who would be managing fund assets that were not allocated to the "Managing Members' Large Cap Strategy," as follows:

> The strategies employed by the Manager trading one Investment Pool in which a minority of the Company's assets currently is invested include:
>
> - Hedge/arbitrage activities, consisting of related securities arbitrage, closed-end fund arbitrage, convertible arbitrage, merger arbitrage, Reg D custom convertibles, and fixed income arbitrage. This group of activities is designed to be unaffected by stock and bond market fluctuations and to provide an extra measure of profitability in times of market adversity;
>
> - Long-term equity-oriented situations, including private equity, venture capital, energy, and special situations;
>
> - Distressed securities, emphasizing process-driven and activist situations which are expected to be uncorrelated with the stock and bond markets; and
>
> - Short stocks and other portfolio protection trades, such as index put options or volatility swaps.
>
> The strategies currently employed by the Manager trading another Investment Pool with a minority of the Company's assets involves the use of a long/short strategy of investing in securities of publicly traded companies believed to be under valued (long positions) or overvalued (short positions), with an emphasis on the small-cap sector (defined as companies with a capitalization of at least $400,000,000) with the rest of the portfolio invested in larger cap stocks. The median capitalization of stocks in this Manager's portfolio is $2.5 billion. This Investment Pool seeks to manage risk and to enhance portfolio returns through the flexible use of hedging, including selling stocks short. The Investment Pool's portfolio is concentrated in a relatively small number of equity positions and therefore this Investment Pool is not diversified. Moreover, this Manager has historically utilized a greater percentage of long positions than short positions.
>
> The Strategies currently employed by the Manager trading another Investment Pool with a minority of the Company's assets involved investment in a portfolio of securities of distressed and out-of-favor companies, including corporate bonds, convertible

bonds, high-yield bonds, bank debt, trade claims, and equities. To minimize risk, the Investment Pool diversifies its portfolio across a broad spectrum of securities, companies and industries. Distressed securities are found among companies that are currently in a reorganization under applicable bankruptcy laws, companies that are restructuring debt obligations outside of court, companies that are liquidating assets to pay creditors, and companies that have recently been restructured. Securities of out-of-favor companies are found among companies in out-of-favor industries, and situations where the market has overreacted to an event or series of events, such as the potential for (or initiation of) significant litigation. An important part of the strategy involves shorting the securities of companies that the Manager believes may become distressed in the future.

The strategies currently employed by the Manager trading another Investment Pool with a minority of the Company's assets include "event driven investing." Event driving investing involves the purchase or sale of securities of companies which are undergoing substantial changes. Among other opportunities, the Company invests in securities of companies that are selling assets, leaving or entering new businesses, changing their capital structures or that are the subject of a publicly announced acquisition, merger, tender offer, exchange offer, liquidation or other corporate reorganization.

The Manager seeks to achieve absolute returns from event driven investing which are not dependent on overall stock market advances or declines or fluctuations in interest rates or currencies. Generally, the Manager will seek to reduce or eliminate such market or other risks inherent in its portfolio by employing a variety of hedging techniques including the purchase or sale of, among other things, options on market or sector indices, futures contracts, or structured derivative products.

152. Thus, while the offering memoranda for Andover and Beacon sought to lull potential investors into believing that the assets of the Fund would not be concentrated, but, instead, would be invested in a number of different vehicles, including the "Large Cap Strategy" adopted by Beacon Associates itself, in reality, the vast majority of the assets of Beacon and a significant portion of the assets of Andover were invested with Madoff. Indeed, the Andover

Beacon Defendants falsely represented that the "Large Cap Strategy" was their own, when, in fact, it was Madoff's split-strike conversion strategy.

153. Andover's offering memoranda also contained false and misleading statements concerning the Andover Beacon Defendants' due diligence and monitoring of outside managers, and their monitoring and review of the funds' investments and performance. The Andover Offering Memorandum, which is substantially the same in all relevant respects to the corresponding section of the Beacon Offering Memorandum, provides as follows:

> The Fund's assets are allocated and reallocated among strategies and to and from Managers by [Andover Associates] following consultation with the [Andover Associates'] Advisory Board. In addition, [Andover Associates] consults with [Ivy Asset Management, the investment consultant for Andover] with regard to a portion of the Fund's assets…as well as one or more independent outside consultants.
>
> [Andover Associates] is responsible for (i) selecting the Fund's strategies and for selecting the Managers and the Investment Pools they manage to implement those strategies, (ii) reviewing the Fund's portfolio of investments on a regular basis and monitoring the Fund's performance, (iii) monitoring the Managers' adherence to their stated investment strategies and objectives; and (iv) allocating and reallocating the Fund's assets.
>
> * * *
>
> ***Both quantitative and qualitative criteria are factored into the evaluation of Managers, including analyses of: type of trading program; risk control; duration and speed of recovery from drawdowns; experience; organizational infrastructure; and degree of correlation with traditional investments such as stocks and bonds.***
>
> Analysis of the performance records of existing and prospective Managers is combined with evaluation of a number of less tangible qualitative factors in an effort to identify Managers whose (i) collective trading results have historically demonstrated substantial returns while making use of various hedging techniques in an attempt to limit risk and, (ii) strategies and/or investments which have a low degree of cross-correlation with each other, with [Andover Associates'] Large Cap Strategy, and with the broad

equity and bond indices.

* * *

> [Andover Associates] after consulting with [its] Advisory Board, and with the Investment Consultant [Ivy Asset Management] with respect to a portion of the Fund's assets…as well as with one or more other independent outside consultants, selects strategies and Managers that are not generally available to the investing public (the access to which and whom might otherwise be limited or unavailable), and in the case of Managers, which satisfy one or more criteria including, but not limited to, extensive management experience; consistent and/or superior historical performance for the investment style and strategies employed by the Manager; the use of hedging strategies as part of the Manager's investment approach; diversification benefits relative to other Managers; ***a quality and stable organization;*** a market independent (market neutral) investment approach; and an ability to consistently and effectively apply its investment approach. Certain criteria may be emphasized above others in the selection and retention of particular Managers and strategies. (Emphasis added).

154. In stark contrast to the representations in the offering memoranda, the Andover Beacon Defendants failed to conduct adequate due diligence on Madoff before funneling at least 74% of Beacon's assets and 23% of Andover's assets, which the Andover Beacon Defendants knew included the Low Volatility Fund's assets, to Madoff. In addition, the Andover Beacon Defendants utterly failed to "monitor the Manager's adherence to their stated investment strategies and objectives," and did not exercise adequate oversight of the funds' investments and performance.

155. In addition to the false and misleading statements in the offering memorandum and other offering documents, the Andover Beacon Defendants issued investors like the Fund annual and quarterly reports concerning the company's activities. These reports were fraudulently inaccurate because they failed to disclose that large portions of the funds' assets were invested with Madoff, and were therefore worthless.

156. Despite the Andover Beacon Defendants' egregious conduct in failing to properly conduct due diligence and failing to ensure that the assets of Andover and Beacon were invested in accord with their respective offering memoranda – instead of in a Ponzi scheme orchestrated by Madoff – Andover Associates and Beacon Associates nevertheless collected "Managing Member" fees from the value of each member's capital account at an annual rate of 1.5%.

157. The Andover Beacon Defendants' investment of their respective fund's assets gave rise to duties owed by them to the funds and investors in the funds. The Andover Beacon Defendants knew that their funds' assets were entrusted to their care and owed fiduciary duties of good faith, fair dealing and due care to their funds and their members. They knew, or, in the exercise of due care in discharging their fiduciary duties were reckless, in not knowing that Madoff was engaged in a massive Ponzi scheme, or, at a minimum, was reporting results that could neither be verified nor explained. Nonetheless, they knowingly and willfully invested their funds' assets with Madoff. They had a fiduciary obligation to protect the assets of the funds, which they utterly failed to fulfill.

158. The Andover and Beacon offering memoranda placed significant restrictions on its investors' ability to withdraw their investments. The Andover Offering Memorandum states that investors in Andover could withdraw their investments only on June 30th and December 31st of each year, and then with thirty days notice, subject to minor exceptions. The Beacon Offering Memorandum, in turn, states that investors in Beacon could withdraw their investments with 60 days notice at the end of each quarter, subject to minor exceptions. Accordingly, the Low Volatility Fund could not easily extract itself from its investments in Andover and Beacon, imbuing the Andover Beacon Defendants with an additional duty of care over the Fund's investment.

159. Andover Associates and Beacon Associates retained Ivy Asset Management to provide investment advice regarding the selection of fund managers and the allocation of fund assets. For example, the Beacon Offering Memorandum provides in relevant part:

> Pursuant to an agreement between the Managing Member and [Ivy Asset Management] the Investment Consultant provides advice to the Managing Member with respect to Manager selection and allocation of the Company's assets among Managers and Investment Pools, and also provides certain administrative and accounting services to the Managing Member.

The Andover Offering Memorandum includes substantially similar language.

160. These statements in Andover's and Beacon's offering memoranda were false and misleading because they omitted the material fact that the Andover Beacon Defendants and Ivy Asset Management, with no or inadequate due diligence or oversight, abdicated their responsibilities and entrusted the assets of the Andover and Beacon Funds to Madoff. The Andover Beacon Defendants, and Ivy Asset Management, relied on Madoff's reputation, did not investigate or monitor Madoff or his split-strike conversion strategy, and turned a willful blind-eye to the panoply of warning signs that both his strategy and his operation was a fraudulent enterprise.

161. Further, the Andover Beacon Defendants, and Ivy Asset Management, as the Funds' investment consultant, violated their fiduciary duties to the funds and their members by failing to disclose that a majority of the funds' assets were invested with Madoff, as opposed to being largely invested in a "Large Cap Strategy" as set forth in the Andover and Beacon Offering Memoranda. These material misrepresentations and omissions caused Andover and Beacon to lose much of their value.

162. On or about December 18, 2008, the Andover Beacon Defendants began the process of liquidating Beacon.

163. In or about August 2009, Beacon Associates notified investors in the Beacon Fund that it had established a reserve fund of 9% of Beacon's remaining assets purportedly to pay for the administrative fees and expenses of Beacon's operations, and the legal fees and expenses incurred by the Beacon Defendants (the "Litigation Reserve").

164. On August 5, 2009, Beacon Associates brought a declaratory judgment captioned *Beacon Associates Management Corp. v. Beacon Associates LLC I* , 09 Civ. 6910, in the United States District Court for the Southern District of New York (the "Declaratory Judgment Action"), seeking a declaration as to the correct method of valuing Beacon's assets.

165. On August 26, 2009, plaintiffs in the class action captioned *Plumbers Local 112 Health Fund v. Beacon Associates Management Corp., et al.*, 09 Civ. 3202 (LBS) (the "Beacon Action"), made a motion to intervene and submitted a compliant-in-intervention ("Complaint-in-Intervention") in the Declaratory Judgment Action seeking a declaration, among other things, that the Litigation Reserve would be void and any further payments from the Litigation Reserve would be disallowed. On September 18, 2009, Beacon Associates moved to dismiss the Complaint-in-Intervention arguing, among other things, that it is entitled to the Beacon Fund's assets to pay for its operating, administrative and legal fees based on the Fund's operating agreement. The operating agreement provides that Beacon Associates shall be held harmless for certain losses provided that such losses are not found to be a result of fraud, gross negligence or willful misconduct – the very claims asserted against Beacon Associates in this action and in the Beacon Action also pending before this Court. In short, Beacon Associates seeks to deplete the assets of Beacon to, among other things, defend itself in these actions such that the Beacon Fund would have fewer assets to distribute to aggrieved members even if this Court were to find the Beacon Defendants liable for their wrongdoing.

166. The Beacon Defendants' establishment of a Litigation Reserve from the Beacon Fund's assets, which will diminish any distributions to Beacon's investors like the Low Volatility Fund, is a violation of the Beacon Defendants' fiduciary duties to the Beacon Fund and its investors.

**G. Ivy Asset Management and BONY**

167. In marketing the Beacon and Andover Funds to potential investors, the Andover Beacon Defendants sought to capitalize on the reputations of Ivy Asset Management and BONY to attract investors. For example, Beacon's offering materials highlight that Ivy Asset Management is a wholly owned subsidiary of BONY, and is a global leader in alternative investments portfolio management with $13 billion of assets under management. As set forth in the Beacon Offering Memorandum:

> The Managing Member has engaged the Investment Consultant, Ivy Asset Management Corp., a wholly owned subsidiary of The Bank of New York Company, Inc., to provide advice to the Managing Member with respect to Manager selection and allocation of the Company's assets among Managers and Investment Pools, and to provide certain administrative services to the Managing Member. The Investment Consultant is a registered Investment Adviser under the Advisers Act, with approximately $13 billion of assets under management. The Investment Consultant is a global leader in alternative investment fund of funds portfolio management. Since 1984, the Investment Consultant's clients have participated in niche styles and sophisticated strategies of investing. The Investment Consultant's clientele includes Fortune 500 companies, global investment banking firms, foundations and endowments, Taft-Hartley pension plans, private family businesses, offshore investors and corporate entities, professional money managers, registered investment companies, and the Investment Consultant's principals and employees.

168. Ivy Asset Management gave the Andover Beacon Defendants advice relating to the value of securities entrusted to Madoff, the advisability of entrusting assets to Madoff and the advisability of investing in, purchasing and selling securities pursuant to the strategy purportedly

pursued by Madoff knowing their advice would serve as the primary basis for the investment decisions made by the Andover Beacon Defendants, Andover's and Beacon's investment policies or strategies, diversification of the assets of the funds, and the allocation of the funds' assets among mangers and strategies. Ivy Asset Management had control over the investment of the assets of Andover and Beacon, including the decision to entrust portions of assets of the funds to Madoff. In fact, Ivy Asset Management, through Simon, together with Danziger and Markhoff, created Beacon to be a feeder fund to Madoff.

169. Further, while Ivy Asset Management is an investment consultant for Andover and Beacon, and therefore, has fiduciary obligations to the funds and its members, its services go beyond what a traditional investment consultant would provide. In fact, Ivy Asset Management also provided administrative and accounting services to Andover Associates and Beacon Associates, and split the fees generated. As a provider of administrative and accounting services to the Andover and Beacon Funds, Ivy Asset Management was required to conduct an independent determination of the funds' assets and liabilities.

170. Thus, Ivy Asset Management was in the ideal position to discover Madoff's fraud, because it maintained the books and records of the funds, including its assets, daily trading activity with respect to such assets, and reconciled those books and records with confirmations and statements received from Madoff. As recounted in the SEC OIG Report, while many investment professionals who saw Madoff's account statements recognized that the trades reflected on the statements were suspect, Ivy Asset Management filed to identify and report inconsistencies between these records and publicly available pricing and trading information, as well as between what these records showed and the results being claimed by Madoff.

171. Despite the fact that it conducted virtually no due diligence on Andover's and Beacon's investments, and utterly failed to fulfill its administrative and accounting duties independently, Ivy Asset Management collected fees from Andover's and Beacon's investors, like the Low Volatility Fund (and its investors, like Plaintiffs), for its services as investment consultant to the funds. In addition, Andover and Beacon, and their investors, were also responsible for paying fees for "administrative services" performed by Ivy Asset Management.

172. Andover and Beacon, and their members, were also required to pay a fee to each of the other managers who traded their respective assets.

173. BONY acquired Ivy Asset Management in October 2000 for an undisclosed sum. At the announcement of the merger on August 9, 2004, Newton P.S. Merrill, the senior executive vice president of BONY boasted that the "Ivy Asset Management offers complementary products which will provide our individual and institutional clients with expanded investment alternatives. Ivy offers unique structure product capability in the alternative investment arena. At the same time, Ivy's clientele will now be able to avail themselves of the full array of The Bank of New York's products and services."

174. As a result of standard due diligence conducted in acquisitions of a companies of Ivy's size, BONY would have known about Ivy Asset Management's relationship with the Andover Beacon Defendants (the Beacon Fund was created in 2000) and Madoff, the lucrative fees flowing to Ivy from those relationships, and that Ivy was collecting these fees without conducting reasonable, if any, due diligence on Madoff for the Andover or Beacon Funds (or for anyone else). Further, because BONY itself held the operating account for BMIS's broker dealer business, upon information and belief, BONY knew there were suspicious transfers in and out of BMIS's account and that monies were ultimately being funneled.

175. As part of its acquisition of Ivy Asset Management in 2000, BONY gave Simon, who had the personal relationship with Madoff, and Howard Wohl, the co-founder of Ivy Asset Management, five year contracts to continue to run the company as a wholly owned subsidiary of BONY. In 2005, BONY extended their contracts through 2009. In 2006, Simon and Wohl ceded the day-to-day management of the firm and Sean Simon (Larry Simon's son) and Michael Singer took on advisory roles, while continuing as vice chairmen of the firm.

176. BONY's acquisition of Ivy broadened BONY's asset management business by adding an important portfolio manager to its asset management team. As set forth in a January 12, 2006 press release announcing the appointment of Sean Simon and Michael Singer as co-presidents of Ivy Asset Management, Steven Pisarkiewicz announced that "Ivy is a critical component of our growing investment management business and is strategically important to the Bank of New York."

177. As a critical component and strategically important part of BONY's business, Ivy's earnings, which were reported as part of BONY's earnings, were repeatedly emphasized as a significant source of BONY's successful financial results. BONY's SEC filings between 2000 and 2007, consistently mention Ivy Asset Management by name and tout its positive results, describing in glowing terms the growth of its assets under management and attraction of new investments.

178. Like BONY, following the merger, Ivy Asset Management touted the benefits of its relationship with BONY. Ivy's website boasts that it has the "resources to deliver the best quality work and produce the highest quality products," which is "enhanced" by its relationship with its parent, BONY. Ivy states that BONY is a "leading financial institution with the resources" to support Ivy's "institutional enterprise," that BONY is "equally committed to

maintaining [Ivy's] entrepreneurial and performance-driven culture," and that the "result has been a mutually beneficial, synergistic affiliation."

179. In 2007, The Bank of New York Company, Inc. and Mellon Financial Corporation of Pittsburgh merged, creating the Bank of New York Mellon Corporation, *i.e.,* BONY. The post-acquisition asset management business part of the business was called Bank of New York Asset Mellon Management ("BNY Mellon Asset Management"). According to BONY's website, BNY Mellon Asset Management is "the 'umbrella organization' for all of the company's affiliated investment management firms and is responsible for U.S. and non-U.S. retail, intermediary and institutional distribution of investment management and related services." Ivy Asset Management was one of BONY's subsidiaries that was part of the BNY Mellon Asset Management umbrella organization.

180. According to its website, BNY Mellon Asset Management and its affiliated firms, like Ivy Asset Management, "provide asset management service that is responsible to our clients' needs, transparent in its processes, and consistently working to pursue strong performance and results for our clients." Further, according to BONY's public disclosures, "[a]s a subsidiary of BONY, Ivy is subject to multiple corporate compliance policies and benefits from corporate wide training around compliance and ethics matters," and "Ivy has a robust management oversight infrastructure, which ensure policies and procedures are regularly reviewed and updated to reflect the development of the business and changes in industry practice."

181. Ronald P. O'Hanley, as the Vice Chairman of BONY, President and CEO of BNY Mellon Asset Management, and a board member of Ivy Asset Management, was in a position to control and participate in Ivy Asset Management's business, including the performance of its duties as the investment advisor to the Beacon and Andover Funds. O'Hanley

has publicly stated the following about BNY Mellon Asset Management, the umbrella organization that included Ivy Asset Management, that:

> Founded on the principle of independent thought, research, and entrepreneurship, we believe there is no other assert management business in the world that has BNY Mellon Asset Management's breadth of product offering. We also recognize the need to bring out clients the right product at the right time, and the importance of supporting our clients and their advisors throughout their relationship with us. Our structure allows us to bring our capabilities to our clients individually or through strategic combinations.

182. The co-presidents of Ivy Asset Management, Simon and Singer, report to O'Hanley. A March 2008 article in *Euromoney Institutional Investor, PLC* entitled "Sean Simon and Michael Singer are Trying to Reignite Growth at One of the U.S.'s Oldest Fund-of –hedge-fund Firms," reports that O'Hanley, who ran Mellon's asset management business prior to the merger, has stated that "[o]ne of the things that was attractive to this merger was Ivy."

183. Upon information and belief, a number of senior executives of BNY Mellon Asset Management and BONY served on Ivy Asset Management's board of directors, and, accordingly, were in a position to control and participate in the management of Ivy Asset Management's business, including in its role as the provider of investment advisory services to the Andover and Beacon Funds.

184. Kevin Bannon, the Executive Vice President and Chief Financial Officer of BONY served on the board of directors of Ivy Asset Management.

185. Steven Pisarkiewicz, the Executive Vice President of BONY, was the chairman of Ivy Asset Management's board of directors.

186. Ronald O'Hanley, the Vice Chairman of BNY Mellon Asset Management and a member of its Executive Committee, was a member of Ivy Asset Management's board of directors.

187. Jonathan Little, a member of BNY Asset Management's Executive Committee, also served on Ivy Asset Management's board of directors.

188. BONY's ownership of Ivy and its installment of its own officers, as well as officers of BNY Mellon Asset Management as directors of Ivy, gave BONY control over all aspects of Ivy's business.

189. After the Madoff debacle, BONY stated in its 2008 10-K that:

> On Dec. 11, 2008, Bernard L. Madoff was arrested by the FBI and sued by the SEC for engaging in a massive "Ponzi-scheme" investment fraud through his broker dealer and investment advisory company, [BMIS]. [BONY] has no direct exposure to the Madoff fraud. ***[Ivy], a subsidiary that primarily manages funds-of-hedge-funds has not had any funds-of-funds investments with Madoff since 2000.*** Several investment managers contracted with Ivy as sub-advisor and one pension fund contracted with Ivy as investment manager; a portion of these funds were invested with Madoff and likely suffered losses as a result of the Madoff fraud.

190. This is an admission that BONY was aware that Ivy, as a manager of FOFs, had investments with Madoff in 2000, when it acquired Ivy.

191. BONY was well-acquainted with Madoff and BMIS because it also provided administrative valuation and custodial services to some of the funds managed by Tremont Partners Inc. owned by parent company Tremont Capital Management, Inc., including certain Rye Select funds that were 100% managed by Madoff. In addition, as alleged in the first amended complaint dated October 20, 2009, in *Wexler v. KPMG*, et al., Index No. 101615/09, pending in the Supreme Court of the State of New York, County of New York, which is based, in part, on an exclusive interview with Madoff on July 28, 2009, at the Butner, North Carolina prison where he is serving his 150-year sentence, BONY's Investment Management Division had conducted due diligence on Madoff and declined to recommend investments in BMIS to its own clients.

192. Despite knowledge of the red flags of potential fraud by Madoff, and despite knowing that its wholly-owned subsidiary was investing the Andover and Beacon Funds' assets with Madoff, BONY was happy to profit from the fees Ivy Asset Management collected for the investment advisory and administrative/accounting services it provided to the Andover and Beacon Funds.

**H. The Maxam Fund**

193. The FMC Defendants also invested the Low Volatility Fund's assets in Maxam, a fund formed by Defendant Manzke in 2006, for an express purpose of investing with Madoff. All of the assets of the Maxam Fund, approximately $250 million at year end 2008, were funneled to Madoff.

194. Participation in the Maxam Fund was offered through an offering memorandum dated July 1, 2006 (the "Maxam Offering Memorandum"). According to the Maxam Offering Memorandum, the Fund's capital was invested by its investment manager, MAXAM Capital Management LLC. Also, according to the Maxam Offering Memorandum, a capital account was established for each partner and reflected each partner's interest in the Fund. The opening balance of the capital account is the partner's initial contribution, but can be further adjusted in accordance with the principles set forth in the controlling partnership agreement. The aggregate amount of any and all management fees payable is charged to that partner's capital account, and any net capital appreciation or depreciation is allocated to all partners in proportion to each partner's ownership percentage. Moreover, limited partners have the right, upon thirty-five (35) days' prior written notice to the general partner to make a partial or total withdrawal from their capital accounts, subject to certain restrictions. The investment manager is paid a monthly management fee in arrears equal to 0.083% of the new asset value of each limited partner's

capital account. The management fee is assessed on a pro rata basis for a limited partner's actual period of ownership during a calendar month. The annual rate is approximately 1%.

195. Sandra Manzke's close relationship with Madoff dates back to the early 90's, and has been a source of steady profits for her fund and her companies, including Tremont and Maxam Capital and its affiliates. According to the complaint filed in the Fairfield Action, in or about 1995, when Defendant Manzke was a principal at Tremont she began funneling her clients' investments to Madoff through several feeder funds in exchange for enormous fees. Manzke left Tremont in or about 2005, and formed her own investment management and consulting firm, Maxam Capital. At Maxam Capital, she continued to funnel her clients' funds to Madoff and, as the principal of Maxam Capital, enjoyed even greater financial success by requiring higher minimum investments than those at Tremont. The minimum subscription for investing in the Maxam Fund was $1 million, and Maxam Capital charged management and administrative fees of over 1% of the net asset value of each investor's account. The minimum investment in the Rye funds managed by Tremont was $500,000.

196. As a result of her longstanding and lucrative relationship with Madoff, Manzke knew or, but for her extreme recklessness, should have known, Madoff was operating a Ponzi scheme, or, at a minimum, was engaged in some sort of fraudulent activity.

197. The expert affidavit of Mr. Siedle in the Fairfield Action sets forth the basis for his belief that Manzke and her affiliates knew about Madoff's fraud:

> It is my opinion, for the reasons discussed below, that Maxam Capital, and its principal, [Sandra] Manzke, and affiliated companies, Maxam Capital GP, LLC and Maxam Capital Management Limited . . . were all aware that Bernard L. Madoff was engaging in illegal conduct in connection with his purported money management operations and intentionally chose to participate in and support Madoff's illegal conduct in order to reap enormous illicit financial benefits. (Siedle Aff. ¶4).

* * *

In rendering my opinions about Maxam Capital, Manzke and Maxam Capital's affiliated companies, it is my understanding that Maxam Capital formed and has served as investment manager of the Maxam Absolute Return Fund, L.P., a hedge fund that placed all of its limited partners' investments (approximately $280 million as of 2008) under the management of Bernard L. Madoff.

It is my understanding that Sandra L. Manzke formed Maxam Capital in 2005-06, shortly after leaving Tremont Partners, and acted as a principal on behalf of Maxam Capital, and as a principal of Maxam Capital GP, LLC, the general partner of the Maxam hedge fund referred to above, and Maxam Capital Management Limited, the administrator of the Maxam hedge fund.

It is my understanding that Maxam Capital solicited investor contributions to the Maxam hedge fund through representations that the hedge fund's investment manager (Madoff) had achieved consistent investment gains in the range of 8-12% throughout the 1990's and 2000's through use of a purported "split-strike conversion" investment strategy, and that the Maxam entities represented that they performed appropriate due diligence with respect to Madoff's investment activities.

It is further my understanding that these Maxam entities charged the limited partners in the Maxam hedge fund referred to above annual management and administration fees in excess of 1% the limited partners' investments and arranged with Bernard Madoff to compensate him on the basis of brokerage commissions on the trades he placed with hedge fund monies. (Siedle Aff. ¶ 8).

* * *

It is my opinion that, as experienced industry professionals monitoring Madoff's reported investment results and claimed investment activity (and performing due diligence on Madoff's purported investment activity), the principals of . . . Maxam . . . knew (or deliberately closed their eyes so that they could claim they did not know) that Madoff was engaged in illegal conduct. My opinion is based on a number of factors, including the following:

* * *

Manzke, Hammond and Sweeney all subsequently performed investment manager due diligence for the Maxam Absolute Return Fund. Assisting them at Maxam as the Chief Compliance Officer

was Spottswood Dudley, a seasoned lawyer with substantial business experience in consulting and brokerage matters. (There is no requirement that Compliance Officers of registered investment advisers or securities brokerages possess legal credentials, and indeed, Compliance Officers with substantial legal credentials are not commonplace in the industry.) Maxam's Chief Financial Officer, Richard Phelan, was also a seasoned corporate treasurer.

* * *

Maxam . . . [was] phenomenally successful in convincing investors to entrust their assets to them because they did, in fact, possess all the requisite experience for conducting due diligence reviews of money managers.

Further, as firms with substantial institutional assets to place with investment managers they had unique access to public and non-public information regarding money managers and securities brokerages, such as BLMIS. It is customary in the investment management industry that money managers and securities brokerages seeking to be hired provide financial advisers to pensions and other large institutional investors with information regarding their businesses that is not generally available, such as the results of their most recent regulatory compliance examinations, pending litigation and customer complaints. (Siedle Aff. ¶12).

* * *

Given the enormously rich fees – totaling in the hundreds of millions – that th[is] firm[] derived from the funds [it] placed with Madoff, there is simply no question that . . . Maxam … had the financial resources, in addition to the intellectual capital and experience, to undertake the rigorous due diligence examination of Madoff that the red flags discussed above and noted by market professionals and the market media demanded. And, Maxam . . . ha[s] . . . acknowledged that [it] undertook such rigorous due diligence. . . . [Maxam] touted [its] exhaustive due diligence procedures to [its] prospective investors. In my over 25 years of experience, I have never seen such impressively elaborate due diligence review schemes, both with respect to the scope and depth of the procedures. Certain of the procedures are, in my opinion, far beyond what is necessary or practical, especially in the fiduciary context. (Siedle Aff. ¶18).

* * *

> There are three other important factors I rely upon in forming my opinions that . . . Maxam . . . knew of Madoff's illegal activity. First, Madoff's investment management operation was a Ponzi scheme and was a total fraud. Thus, there were no legitimate transactions or records that could have confused a party engaged in a due diligence of the firm. Second, the duration of the fraud spanned approximately two decades and involved tens of billions in dollars in thousands of client accounts and millions of trades, providing a vast and continuing opportunity for detection in the face of the due diligence that these professionals represented they were performing. And third, and perhaps most important of all, these "feeder firms" that earned rich fees for supposedly searching for talented investment managers globally placed all or virtually all of their assets with Madoff and even indicated in their offering documents that it was "likely" that they would continue to use this single broker or manager executing this same investment strategy. Thus, despite the existence of thousands of money management firms globally, many with impressive investment performance and assets under management, these "feeder firms" made no effort to retain managers with investment performance competitive with Madoff. As fiduciaries, they did not provide their investors with diversification against single manager risk. Why? Because they knew or believed that no other manger could legitimately compete with Madoff's illegal or fraudulent performance. This, in my opinion, is a very telling fact. (Siedle Aff. ¶21).

198. The Maxam Absolute Return Fund, L.P. referenced in the Siedle Affidavit is the Maxam Fund, in which the FMC Defendants and the Maxam Defendants knowingly invested assets of the Low Volatility Fund.

199. The Maxam Confidential Private Placement Memorandum dated March 21, 2008 ("Maxam PPM"), and its attached Form ADV dated March 5, 2008, contained numerous misrepresentations and omissions. The Maxam PPM "designates Maxam Capital as the investment manager and administrator of Maxam," with the responsibility "for allocating assets among the various Broker Dealers and monitoring their performance."

200. The Maxam PPM states that the Fund's investment strategy is to seek: "long term capital appreciation with low volatility. The Investment Manager attempts to achieve the objective by allocating the Partnership's assets to Broker Dealers who will invest such assets in equity

securities, option strategies and other equity related derivatives," and that "Broker Dealers are selected by the Investment Manager based upon their trading strategy, their ability to implement the trading strategy and efficiently trade the assets of the Partnership on a time and price basis."

201. These statements were false and misleading because, contrary to the representations in the Maxam PPM, Maxam Capital did not select brokers dealers based upon their trading strategy, their ability to implement the strategy and to efficiently trade the Partnerships' assets "on a time and price basis." Instead, Maxam Capital, through Manzke, simply handed over the Partnership's assets to Madoff unconditionally, without due diligence and oversight. If Maxam Capital had bothered to check whether Madoff, the unidentified "present Broker Dealer" referenced in the Maxam PPM, had a trading strategy that could produce the results claimed and whether he even implemented the strategy, Maxam Capital would face the facts that it knowingly or recklessly ignored, *i.e.*, that Madoff had no trading strategy, was not engaged in any trading, and the Partnership's assets therefore could not been efficiently traded "on a time and price basis."

202. The Maxam Defendants failed to disclose in the Maxam PPM the material fact that all of Maxam's assets, which the Maxam Defendants knew included the assets of the Low Volatility Fund, were funneled directly into Madoff's Ponzi scheme. Further, the Maxam PPM is materially false and misleading because it conveyed the false impression that Maxam Capital GP was investing Maxam's assets in a manner to seek "long term capital appreciation with low volatility," when it was really entrusting all of Maxam's assets to one investment manager – Madoff – whose investments were illusory. Had the Maxam Defendants conducted adequate due diligence, or, if conducted, did not turn a willful blind-eye to the red flags identified herein, they

would have known – if they did not already know – that Madoff's investment advisory operation was a fraudulent enterprise.

203. According to the Maxam PPM, in selecting its Broker Dealers Maxam Capital:

> may also consider such factors as price, the ability of the Broker Dealers to effect transactions, as well as the Broker Dealer's facilities, reliability and financial responsibility. Accordingly, if the Investment Manager determines in good faith that the amount of commissions charged by a Broker Dealer is reasonable in relation to the value of the foregoing, the Partnership may pay commissions to such Broker Dealer in an amount greater than the amount another broker might charge.

204. These statements were false and misleading because Maxam Capital could not have considered price and the ability of the Broker Dealer to effect transactions because Madoff was not effecting transactions. Moreover, Maxam Capital could not have considered Madoff's facilities, reliability and financial responsibility, because it blindly turned over Maxam's assets to Madoff without conducting any due diligence. If Maxam had done any real due diligence on Madoff, the red flags that responsible investment professionals heeded – *e.g.*, that Madoff's investment business was located on an inaccessible floor of BMIS's offices and, as Manzke later admitted, Madoff's insistence on absolute secrecy – could not have been ignored by Manzke, unless she was knowingly part of the fraud or willfully ignored it.

205. In order to lure investors, Maxam Capital consistently – and falsely – assured potential investors that it conducted a thorough and informed investigation of the investment managers it employed. For example, the Form ADV, filed by Maxam Capital on January 31, 2008, falsely represented that:

> MAXAM recommends investment advisors to its clients and makes and/or recommends investments in private placement vehicles. In this process, MAXAM's staff evaluates investment management organizations. MAXAM analyzes, in detail, the philosophy, investment professionals, decisional processes and performance of the organization and the investment products

> offered. MAXAM's staff also visits investment organizations to evaluate back office operations and internal staff, among other things.

206. The Form ADV further represented that Maxam Capital used other strategies to conduct due diligence, which included:

> utiliz[ing] databases, wire services, performance measurement publications and other business journals as information sources. MAXAM has a license to utilize the information included in Pertrac, and Eurekahedge databases. In addition, MAXAM sources data on new investment organizations through referrals by other investment managers, its clients and financial service providers. MAXAM relies on the underlying investment manager reports and documents (private placement memoranda, annual reports, shareholder reports and monthly and/or quarterly manager letters).

207. Maxam Capital's representations to assure potential investors that the Maxam Defendants conducted exhaustive due diligence on Maxam's outside managers were false and misleading. The Maxam Defendants clearly failed to conduct adequate, if any, due diligence on Madoff because, among other things, Madoff would not permit it and they did not want to endanger their lucrative income stream from investing the Partnership's assets with Madoff. For example, had they visited Madoff's "investment organization to evaluate back office operations and internal staff" or had they used "performance measurement publications and other business journals as information sources," they could not have ignored – unless they were complicit - the red flags that kept other hedge fund managers from investing their clients' assets with Madoff. Nor could they have missed the red flags if they, as they falsely represented in the Maxam PPM, actually were monitoring the performance of the Fund's assets that were invested with Madoff.

208. Indeed, Defendant Manzke has publicly admitted that she knew of the red flags other investment professionals saw and heeded, but invested with Madoff anyway. In a interview with the PBS channel's documentary program "Frontline," which first aired on May

12, 2009, ***Manzke admitted that she agreed not to use Madoff's name in her fund's prospectuses as a condition of obtaining an account with him.*** To explain why she accepted Madoff's conditions, while simultaneously championing transparency in the mutual fund industry, Manzke claimed that "many funds and investors were very secretive. They didn't mention that they had money with Madoff. It was something you didn't talk about."

209. Further, when Manzke was asked in the interview whether she was bothered by the tiny size of Madoff's accounting firm, she replied that "***[o]f course, it bothered you. I mean, every- you know, those are the kind of things that it would bother you. But that was one of the conditions of doing business, that you accepted that***. And part of that was his, you know, proprietary trading model, the black box that he used, ***that he wasn't going to disclose what was in it.***" (Emphasis added.)

210. That the Maxam Defendants failed to conduct reasonable due diligence on Madoff before funneling 100% of Maxam's assets to Madoff on blind faith is made clear by Manzke's admissions in the above paragraphs. Manzke admitted on national television that she invested her clients' assets with Madoff despite knowing that Madoff's operation was completely opaque and was audited by Madoff's tiny accounting firm, and that she had no clue what Madoff's true investment strategy was, and didn't even bother to ask – which is the opposite of due diligence.

211. In November 2008, Manzke sent a letter to hedge fund investors stating that she was "appalled and disgusted by the activities of a number of hedge fund managers," especially those "attempting to get their money out ahead of investors." She called for greater transparency in the hedge fund industry and called investors to join with her to reform the industry. During this same period, Manzke successfully withdrew $30 million for Maxam Capital from BMIS.

The letter was a preemptive strike that Manzke could use in defending her actions to investors in the Maxam Fund, who she knew would soon learn of the true value of their investments in the Maxam Fund – zero.

212. In order to further divert attention from her own wrongdoing, in January 30, 2009, Manzke, on behalf of the Maxam Fund, sued McGladrey & Pullen LLP and Goldstein Golub Kessler, the Fund's auditors, for ignoring the very red flags that Maxam Capital, which boasted about its thorough due diligence, itself knowingly ignored (the "Maxam Action").

213. For example, the complaint in the Maxam Action accuses the auditors of negligence because, among other things, they "failed to identify certain indicia of fraud," which they should have been concerned about because they knew BMIS was the single broker-dealer and had sole custody of the Fund's assets. Then, the complaint lists many of the red flags identified herein, including that: (a) the trading confirmations and the account statements were generated by Madoff, and there was not an independent custodian, so that the auditors "should have either tried to verify the existence of the assets or, at the very least, flagged that they did not have the capability to verify such assets, prompting the investment manager to take additional steps to try and prove the existence of assets;" (b) the auditors should have confirmed the existence of the T-bills Madoff purported to purchase when he supposedly liquidated the assets; (c) the auditors did not seek electronic access to Madoff or never questioned why such electronic access was unavailable (a fact known to the Maxam Defendants); (d) the paper documentation provided by Madoff gave him the ability to manufacture trade tickets and other documents, and did not include time stamps; (e) BMIS's comptroller was based in Bermuda, which is not common; (g) Madoff used Friehling & Horowitz, a small three-man accounting shop, as its accountant – which Manzke later said "would have bothered you" but was the price of doing

business with Madoff; (h) BMIS traded in the same securities it recommended to advisory clients, and that it had custody of the assets, creating a "conflict of interest," (i) BMIS's quarterly SEC statements of its stock holdings were too small to support the $17 billion BMIS claimed to be managing.

214. While accusing Maxam's auditors of wrongdoing, Manzke did not disclose that, in addition to Maxam Capital, MCML, the administrator of the fund, was in the same if not better position to discover the red flags that signaled Madoff's fraud. According to Maxam Capital's Form ADV, Maxam, as the funds' administrator, prepared and maintained accounting records, prepared "books and records in appropriate form to support independent audit," and computed "investment vehicle net asset value." If MCML was actually performing those duties, as the Maxam Defendants claimed in soliciting investors, they could not be deaf to the warning bells of Madoff's fraud.

215. Despite the Maxam PPM's representations that Maxam Capital GP would have sole control over the management, operations and investment decisions made on behalf of the Maxam Fund, Maxam Capital GP abdicated its responsibility as the General Partner of Maxam, which the Maxam Defendants knew included the assets of the Low Volatility Fund and its limited partners, and utterly failed to supervise, monitor and manage the investments of Maxam. As a result, Maxam Capital GP breached its fiduciary duty to the Low Volatility Fund.

216. The Maxam PPM states that investors in Maxam were only able to withdraw their investments with 35 days notice at the end of each calendar month, subject to minor exceptions. Accordingly, the Low Volatility Fund was essentially locked into its investment with Maxam, imbuing Maxam Defendants with an additional duty of care to safeguard the Fund's investment.

217. In exchange for the Maxam Defendants' alleged investing expertise and due diligence, Maxam Capital received management fees of up to 0.5% of the investments of the limited partners of Maxam, including the Low Volatility Fund and its limited partners.

218. As set forth above, Maxam Capital, GP, through MCML, provided administrative and accounting services to Maxam including but not limited to maintaining books and records with respect to the assets of Maxam entrusted to Madoff, including daily trading activity with respect to such assets, and reconciling those books and records with confirmations and statements received from Madoff or his affiliated entities. By failing to identify and report inconsistencies between these records and publicly available pricing and volume information and Madoff's reported but fictitious results, among other things, MCML breached its duties to the Low Volatility Fund and its members.

219. In exchange for MCML's administrative services, it received administrative fees of 0.20% of the net asset value of each limited partner's capital account.

220. Between 1999 and 2003, Manzke was also a director of the Kingate Global Fund, which was co-sponsored by Tremont Bermuda Limited, a subsidiary of Tremont. Irving Picard, the Madoff Trustee, sued the Kingate Global Fund, Ltd. and Kingate Euro Fund, Ltd., among others, to recover $155 million that BMIS transferred to Kingate Funds between October 3, 2008 and November 28, 2008, within the 90 days preceding Madoff's December 11, 2008 confession that he was running a Ponzi scheme. As set forth above, Manzke also withdrew $30 million from BMIS (or other Madoff-controlled entities) for Maxam Capital shortly before Madoff's confession.

221. The Madoff Trustee has announced that he may seek to recover $100 million from Maxam Capital. The Madoff Trustee requested and Bank of America, N.A. ("BOA")

agreed to freeze Maxam Capital and the Maxam Fund's bank accounts at BOA. On May 1, 2009, Maxam Capital and the Maxam Fund filed an action in the Connecticut Superior Court, Judicial District of Fairfield (the "Connecticut Action"). On application of BOA, which commenced an interpleader action, the Connecticut Action was transferred to the United States Bankruptcy Court for the Southern District of New York. By Order dated June 17, 2009, plaintiffs in the Connecticut Action were enjoined from prosecuting the Connecticut Action pending the resolution of the Interpleader Action, and Manzke was directed to appear for a deposition at the Madoff Trustee's offices in early July.

## I. The Feeder Fund Defendants' Duties to the Fund

222. The FMC Defendants' investing of the Fund's assets in Andover, Beacon, and Maxam gave rise to duties owed by the Feeder Fund Defendants to the Fund and its investors. Defendants Andover Associates, Beacon Management Corp., Maxam Capital and Maxam Capital, as the Managers of Andover, Beacon, and Maxam, respectively, knew that the Fund's assets were entrusted to their care and owed fiduciary duties of good faith, fair dealing and due care to the Fund and its limited partners. They knew, or, in the exercise of due care in discharging their fiduciary duties, were reckless in not knowing that Madoff was engaged in a massive Ponzi scheme, or, at a minimum, was reporting results that could not be verified, duplicated or explained. Nonetheless, they knowingly and willfully invested the assets of the Fund with Madoff. They owed fiduciary obligations of good faith, loyalty and due care to safeguard the Fund's assets, which they utterly failed to fulfill.

223. Further, the Feeder Fund Defendants violated their fiduciary duties to the Fund and its limited partners by failing to disclose that some or all of their assets were invested with Madoff. The majority of Andover's investments reportedly were in the "split-strike conversion strategy," 74% of Beacon's assets were allegedly in a "Large Cap Strategy" (which, in reality

was the split-strike conversion strategy), and Maxam also reportedly employed a split-strike strategy that sought long term capital appreciation with low volatility. The Feeder Fund Defendants failed to disclose that, in reality, Andover, Beacon and Maxam were blindly invested with Madoff without any oversight by the Feeder Fund Defendants. These material misrepresentations and omissions caused the Fund to lose over 60% of its value, or approximately $15 million.

224. Upon information and belief, Defendants knew that the Fund's investments in Andover, Beacon, and Maxam were ultimately being invested with Madoff. As stated above, Defendant Manzke began investing her clients' assets with Madoff as early as 1995, and in 2006, she formed Maxam as a feeder fund that funneled 100% of its assets to Madoff. Similarly, the Beacon Defendants, falsely stated that Beacon Management Corp. would employ a strategy "involving a portfolio of Large Cap Stocks hedged with options," but instead, funneled monies that were supposed to be invested in this strategy, which was actually Madoff's strategy, to Madoff. The Andover Beacon Defendants similarly funneled a large portion of Andover's and Beacon's assets to Madoff, in contrast to Andover's stated investment strategy. Finally, the FMC Defendants knowingly allowed over 60% of the Fund's assets to be funneled to Madoff, without conducting any due diligence on him.

### J. There Were Numerous Red Flags Concerning Madoff's Fraudulent Activities That Could Not Have Been Missed if the Management Defendants Conducted the Due Diligence and Oversight They Promised to Fund Investors

225. Hedge funds are inherently complex investments and often lack transparency. The disclosure of a hedge fund's investment holdings alone, is not enough to reveal the type and magnitude of risks that the hedge fund manager undertakes. As a result, hedge funds require a

higher level of due diligence than what is necessary for more transparent investments that are heavily regulated.

226. Greater care must be used in performing due diligence on hedge fund managers and hedge funds, because: (i) the hedge fund's investment strategies are generally more complicated; (ii) there is the possibility of concentrated exposure to both market and counterparty risks; (iii) hedge funds generally use more leverage and there are risks associated with this higher level of leverage; and (iv) there is minimal regulation of hedge funds. Managers of FOFs, such as some of the Defendants here, have a fiduciary duty to understand how a hedge fund or hedge fund manager they are investing in, may perform under various scenarios and they review the fund's internal economic incentives and conflicts-of-interests.

227. Monitoring a hedge fund or a hedge fund manager must be a continuous process. While the initial due diligence is performed to determine if the hedge fund is a proper investment, the ongoing monitoring process reconfirms that the conclusions and assumptions used in the initial due diligence review remain accurate. Fund managers, such as the FMC Defendants and the Feeder Fund Defendants, should take reasonable steps to identify any events or circumstances that may result in the hedge fund or hedge fund manager failing to meet the standards and expectations that were originally set forth in the initial selection process.

228. The manner in which fund managers vetted and selected outside managers was of paramount importance to the success of the Low Volatility Fund and the Feeder Funds.

229. If the investors in the funds here knew that the fund managers were not following these basic tenets of investing with outside managers and were knowingly or recklessly disregarding the numerous red flags of Madoff's fraud, they would not have entrusted their assets in the Fund or the Feeder Funds.

### K. Other Investment Professionals Who Conducted Due Diligence on Madoff Did Not Invest or Stopped Investing With Madoff

230. Numerous investment advisors, investment banks and pension funds who took the time and effort to conduct comprehensive and proper due diligence reviews of Madoff chose not to invest or to maintain their earlier investments with Madoff. The Defendants here, however, failed to conduct a rudimentary due diligence review that would have alerted them to Madoff's fraudulent scheme. Investment managers who chose not to entrust their clients' funds to Madoff were not supernaturally prescient. Reasonable due diligence was all that was required to expose the illusory nature of Madoff's returns. The SEC OIG Report describes how many other investors avoided Madoff through their due diligence:

> Many of the private entities that conducted due diligence of Madoff and declined to invest with him because of significant red flags that arose during the routine review of his operations felt that the SEC could have uncovered the fraud. [One investor] thought a regulator could have verified whether Madoff was trading by asking Madoff who his counterparty was and then verifying with the counterparty that the trade took place. . . . [Another investor named] Broder would have performed the same verification process whether Madoff claimed his counterparty was in the United States or in Europe. . . .
>
> Broder explained his reasoning as follows:
>
> [S]omewhere in the marketplace, either in an exchange-traded marketplace or an OTC marketplace, exactly those trades which were on the client account statement should exist on someone else's books, you know. . . Somewhere in the marketplace, either OTC or exchange-traded, those trades were taking place. And it seems to me a very simple set of steps to verify that those volumes [existed]. . . . I don't see how that could have possibly been missed. I mean, this is a very simple verification. I mean this guy is trading – this is a cash account. So he's turning over $10 billion of stocks each particular month. I mean, you've got to be [able to see it] in the marketplace.

* * *

> [Another investor stated that if he] were investigating Madoff, he . . . would have asked Madoff to show me the other side of your trades whether he claimed to trade in the United States or Europe: "I need to see the other side of those trades in Europe. If they're in Europe, that's fine, but you're doing them with someone. There's got to be somebody on the other side of the trade."

231. The SEC OIG Report discussed the decisions of the managers of certain funds of funds, which were basically in the same position as the FMC and Feeder Fund Defendants, to avoid investing in Madoff, and his feeder funds, after looking into his organization:

> [One] registered fund of funds evaluated potential investments with Madoff feeder funds in 1998 and 2003. It considered an investment with Fairfield in 1998. As part of their standard due diligence process, the Hedge Fund Manager and his unidentified CIO met with Madoff. The CIO former options trader, pressed Madoff for information about his options trading. To the CIO's surprise, Madoff claimed to trade options through the Chicago Board of Options Exchange (CBOE). The CIO stated: "Well I found something exceptionally odd about that …. [I]mmediately what I asked Madoff was: How are you doing that? Because I don't think there's enough volume on the Chicago Board of Options Exchange for you to get that sort of coverage for the amount that you're managing."
>
> The CIO's suspicions triggered, he called CBOE to find out how much daily volume traded on the exchange. He described his call to CBOE, as follows: "And the problem is . . . that the volume was never there for Madoff. So that was problem No. 1 for me. Problem No. 2 was . . . I called up buddies of mine around the street who were now running the equity derivatives departments of a number of firms, and I asked them all if they were trading with Madoff. And nobody was. Nobody was doing these OEX options. And in fact, the funny part about it was they all said, yeah. You know, I hear that he's doing all these trades but, you know, we don't see it anywhere . . . And so things just began to, you know, not match up. And so for me, the biggest issue was – the biggest issue was the fact that I couldn't reconcile a big part of that strategy. And the information that was being told to me on the surface seemed to be false." Because of the unanswered questions, they passed on the investment.

232. Another FOF manager, George Stahl, whose firm considered a Madoff feeder fund for a possible investment in 2005, stated that he found it odd that the strategy that the Madoff feeder fund described "was a relatively common strategy."

> According to Stahl, the split-strike conversion strategy Madoff purportedly was using "usually produces a pretty consistent return," but in Madoff's case, the "level of consistency exhibited by [Madoff's] strategy relative to other strategies we knew that did similar things was much, much better." Stahl said that strategy worked well for several years, but in 2004 and 2005, because the "volatility levels in the market had fallen off so dramatically" the returns from that strategy fell off. Stahl said Madoff's "strategy has been around forever" and he knew of a mutual fund that adopted the same strategy, but while that mutual fund's returns got weaker as the overall market got weaker, Madoff's returns "remained very high."

233. The portfolio manager for Renaissance's Meritage fund, a FOF, expressed concern in a November 13, 2003 email as to why Madoff was charging so little for his services:

> Another point to make here is that not only are we unsure as to how [Madoff] makes money for us, we are even more unsure as to how [Madoff] makes money from us; i.e. why does [Madoff] let us make so much money? Why doesn't he capture that for himself? There could well be a legitimate reason, but I haven't heard any explanation we can be sure of. Additionally, there is a $4 billion Madoff pass-through fund (Fairfield Sentry) that charges 0 and 20% and it's not clear why Madoff allows an outside group to make $100 million per year in fees for doing absolutely nothing (unless he gets a piece of that). The point is that as we don't know why he does what he does we have no idea if there are conflicts in his business that could come to some regulator's attention. Throw in that his brother-in-law is his auditor and his son is also high up in the organization and you have the risk of some nasty allegations, the freezing of accounts, etc. To put things in perspective, if [Madoff's fund] went to zero it would take out 80% of this year's profits.

234. Moreover, an unidentified CEO of a FOF, who was interviewed by the SEC during the course of its investigation into Madoff stated that:

> when it came to Madoff, "[m]arket's down, markets didn't really matter," explaining that "[y]ou can construct a strategy like that

> where you'll make money most of the time but you cannot construct a strategy where you make money all the time." The CEO said he had seen consistent strategies before, but "every once in a while, they trip up, while Madoff "didn't have that every once in a while."
>
> The CEO was suspicious and obtained copies of an investor's last few account statements from Madoff Securities, and compared a sample of trades on the statements with what was actually going on in the markets on the day Madoff was trading. The CEO stated he found this "pattern which really seemed weird where the -- where the purchases were all at or close to the lows of the day and the sales were at or close to the highs of the day," noting that "of course, nobody can do that." His "suspicion was that the fact pattern that [he] had seen seemed consistent with a Ponzi scheme." The CEO said he "didn't conclude that that was the case, but [he] certainly thought there was enough of a risk that that was the case that, you know, *[he] certainly wouldn't touch it with a 10-foot pole.*"

235. The FMC and Feeder Fund Defendants, who stood in a similar posture to Madoff as the FOFs mentioned in the paragraphs above, possessed, or, at a minimum, had access to more information about Madoff, and, after investing their clients' assets with Madoff, received account statements and audited financial statements, and had direct access to Madoff.

236. The SEC OIG Report described the due diligence of other investors who subsequently avoided Madoff. One investor, James Hedges, IV, stated that:

> he utilized a due diligence questionnaire, which sought basic information about the firm, the principals and the assets under management that the firm had. . . . Hedges explained that he looked at the inception of the business, the product lines, the different types of funds or separate accounts or other investment vehicles that were offered, the stated investment philosophy as well as the peer group and competition. . . . Hedges also stated that he looked at the business strategy, not just the investment strategy, including associated entities, and the various directors, officers, staff, their respective backgrounds, tenures and responsibilities. . . . Hedges stressed that his due diligence was "an iterative multi-phased process" to be contrasted with what he termed "a box-checking consultant" that asks "question 1, 2, 3, down to question 653, and then get all the answers and then have a yes or no answer on making an investment." . . . Hedges also explained the

> necessity of speaking with "people throughout all aspects of the organization," noting that "meeting CFOs, back office people, traders, analysts, et. cetera [are important], because they give you perspective on the business that you don't get from just meeting the boss."
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> * * *
>
> The investment professionals interviewed by the OIG, who conducted due diligence immediately had significant questions about Madoff's trading strategy. Hedges stated that a "substantial red flag" was the "consistency of [Madoff's] returns that was not in keeping with the type of strategy that we understood him to be implementing because we felt that there were -- that the track record did not correlate to what we saw as either market factors, volatility factors, or other exogenous factors that would have otherwise affected the track record one way or another." The CEO of the research firm stated immediately he was "cynical" because, "The returns were impossible. Absolutely impossible in my opinion. No financial strategy could produce those sort of returns."

237. The SEC OIG Report further described a statement given to them in an interview by Michael Ocrant, a financial journalist who authored the article entitled, "Madoff tops Charts; Skeptics Ask How." Ocrant described how he:

> gave the terms and strategies [utilized by Madoff] to a guy who ran a quantitative analysis with a Japanese bank for a Fund to funds they ran and I said can you take this data and can you -- have you crunch it and let me know what you think and I didn't give any further information and I said this is the strategy. He got back to me like a week to 10 days later and he said, "Well, the team came back and they said this could be done by a market-maker, probably have to use front money to do it," and I said, "Oh, that's interesting," and I said, "What would you say if I told you this guy was managing maybe $5-6-7 billion?" He said, "Impossible. It has to be a Ponzi scheme."

238. An article entitled "Look Back at Wall St. Wizard Finds Magic Had Its Skeptics," published in *The New York Times* on December 12, 2008, quoted Robert Rosenkranz, a principal at Acorn Partners, an investment advisory firm, who stated:

> "Our due diligence, which got into both account statements of his

> customers, and the audited statements of Madoff Securities, which he filed with the S.E.C., made it seem highly likely that the account statements themselves were just pieces of paper that were generated in connection with some sort of fraudulent activity." . . .

239. An article entitled "European Banks Tally Losses Linked to Fraud," published in *The New York Times* on December 17, 2008, stated, in relevant part, that:

> Société Générale, itself the victim of an apparent scam early this year when unauthorized bets by a trader, Jérôme Kerviel, caused a $7 billion loss, was not the only financial firm to think Mr. Madoff's unfailing record was too good to be true, said Drago Indjic, a project manager at the Hedge Fund Center of the London Business School.
>
> **"Madoff did not pass due diligence for many European hedge fund companies," Mr. Indjic said. "Experienced people know there are many ways to provide the kind of return stream offered by Madoff, almost like a bank account, and one of them is a Ponzi scheme."**
>
> **Smaller American investment advisory firms like Acorn Partners and Aksia also spotted problems with Mr. Madoff's strategy early on, but Société Générale is the first major investment player known to have steered clients away him.**
>
> Mr. Indjic said the scheme revealed not only faulty due diligence, but also a basic failure to diversify. "If you had half a percentage point of total assets under management with one firm, that is more typical," he said. "But some had much, much more than that with Madoff, so their due diligence failure was compounded by poor portfolio management."

(Emphasis added.)

240. There were also reports that, prior to the disclosure of Madoff's Ponzi scheme, Simon Fludgate, head of operational due diligence at Aksia, concluded that the stock holdings reported in the quarterly statements of BMIS filed with the SEC appeared too small to support the size of the assets Madoff claimed to be managing.

241. Simon Ruddick, the managing director of Albourne Partners, a London due diligence firm, has said that Albourne had steered its customers away from BMIS for almost a

decade. A Fort Worth pension fund that received advice from Albourne voted unanimously to discontinue its investments in BMIS in July 2008.

242. Robert Rosenkranz of Acorn Partners, an investment advisor for high net worth individuals, performed due diligence of BMIS and found it likely that BMIS's account statements were created as part of a fraudulent scheme.

243. A December 13, 2008 article in *The Wall Street Journal*, entitled "Redflags in Bernard Madoff's Alleged Ponzi Scam," quoted Chris Addy, founder of Castle Hall Alternatives and an investor in hedge funds, as follows:

> There was no independent custodian involved who could prove the existence of assets... There's clear and blatant conflict of interest with a manager using a related-party broker-dealer. Madoff is enormously unusual in that this is not a structure I've seen.

244. On December 15, 2008, investigators working at Madoff's offices revealed that Madoff was, in fact, operating a secret, unregistered investment vehicle from his office.

245. As a result of their failure to conduct any due diligence on Madoff, the Feeder Fund Defendants breached their fiduciary duties to the Fund and its limited partners.

**COUNT I**
**Violation of Section 10(b) of the Exchange Act and**
**Rule 10b-5 of the Securities and Exchange Commission**
**(Against the FMC Defendants)**

246. Plaintiffs repeat and re-allege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

247. This Count is asserted against all the FMC Defendants and is based upon Section l0(b) of the Exchange Act, 15 U.S.C. §78j(b), and Rule l0b-5 promulgated thereunder.

248. During the Class Period, the FMC Defendants directly engaged in a common plan, scheme, and unlawful course of conduct, pursuant to which they knowingly or recklessly engaged in acts, practices, and courses of business which operated as a fraud and deceit upon

Plaintiffs and the other members of the Class, and made various deceptive and untrue statements of material fact and omitted to state material facts in order to make the statements made, in light of the circumstances under which they were made, not misleading to Plaintiffs and the other members of the Class. The purpose and effect of the scheme, plan, and unlawful course of conduct was, among other things, to induce Plaintiffs and the other members of the Class to purchase limited partnership investment interests in the Fund.

249. During the Class Period, the FMC Defendants, pursuant to said scheme, plan, and unlawful course of conduct, knowingly and recklessly issued, caused to be issued, participated in the issuance of, and the preparation of deceptive and materially false and misleading statements to Plaintiffs and the other Class members as particularized above.

250. In ignorance of the false and misleading nature of the statements described above and the deceptive and manipulative devices and contrivances employed by said FMC Defendants, Plaintiffs and the other members of the Class relied, to their detriment, on such misleading statements and omissions in purchasing limited partnerships in the Fund. Plaintiffs and the other members of the Class have suffered substantial damages as a result of the wrongs alleged herein in an amount to be proven at trial.

251. By reason of the foregoing, the FMC Defendants directly violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in that they: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon Plaintiffs and the other members of the Class in connection with their acquisitions of limited partnership interests in the Fund.

252. As a direct and proximate result of the FMC Defendants' wrongful conduct, Plaintiffs and other members of the Class suffered damages in connection with their purchases of limited partnership interests in the Low Volatility Fund.

**COUNT II**
**Violation of Section 20(a) of the Exchange Act**
**(Against Zises and Tessler)**

253. Plaintiffs repeat and re-allege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

254. Defendants Zises and Tessler acted as controlling persons of FMC within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high level positions, participation in and/or awareness of the Fund's operations, and/or intimate knowledge of the Fund's products, sales, accounting, selection of investment advisors and managers, they had the power to influence and control and did influence and control, directly or indirectly, the decision-making of FMC, including the content and dissemination of the various statements that Plaintiffs contend are false and misleading. Defendants Zises and Tessler had the ability to prevent the issuance of the statements or cause the statements to be corrected.

255. Zises and Tessler also had direct and supervisory involvement in the day-to-day operations of the Fund and, therefore, are presumed to have had the power to control or influence the particular statements giving rise to the securities violations as alleged herein, and exercised the same.

256. By virtue of their positions as controlling persons, Zises and Tessler are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of their wrongful conduct, Plaintiffs and the other members of the Class suffered damages in connection with their acquisitions of limited partnership interests in the Fund.

**COUNT III**
**Common Law Fraud**
**(Against the FMC Defendants)**

257. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

258. Plaintiffs and other members of the Class in reasonable and justifiable reliance upon the statements, misrepresentations and omissions made by the FMC Defendants, as previously set forth herein, purchased limited partnership investment interests in the Fund. Plaintiffs and other members of the Class would not have purchased their limited partnership investment interests in the Fund except for their reliance upon the representations made by the FMC Defendants in the Offering Memorandum and other documents provided to the Fund's prospective investors, and would not have purchased them had they been aware of the material omissions and concealment by the FMC Defendants that FMC, as the General Partner of the Fund, had entrusted over 60% of the Fund's assets to Madoff, via the Feeder Funds, had misrepresented the Fund's investment objectives and strategies, and failed to conduct any or conducted inadequate due diligence on Madoff.

259. At the time of these statements, misrepresentations and omissions, the FMC Defendants knew or should have known them to be false and intended to deceive Plaintiffs and other members of the Class by making such statements, misrepresentations, and omissions in the Offering Memorandum and other offering documents.

260. At the time of the false statements, misrepresentations and omissions set forth above, each of the FMC Defendants intended that Plaintiffs and other members of the Class would act on the basis of the statements, misrepresentations and omissions contained in the Offering Memorandum and other documents provided to limited partners in determining whether

to purchase limited partnership interests in the Fund. Plaintiffs and other Class members reasonably relied thereon to their detriment in making such decisions.

261. Had Plaintiffs and other members of the Class known of the material facts that the FMC Defendants wrongfully concealed and misrepresented, and the falsity of the FMC Defendants' representations, Plaintiffs and other Class members would not have purchased their limited partnership investment interests in the Fund.

262. Plaintiffs and other members of the Class, as a result of their purchase of limited partnership investment interests in the Fund and by reasons of the FMC Defendants' material misrepresentations and omissions, have sustained damages, suffered mental and emotional distress and have lost a substantial part of their investments in an amount yet to be determined, and to be proven at trial.

263. By reason of the foregoing, the FMC Defendants are jointly and severally liable to Plaintiffs and other Class members.

264. The FMC Defendants' fraudulent acts were willful and wanton and Plaintiffs and other Class members are entitled to punitive damages.

**COUNT IV**
**Negligent Misrepresentation**
**(Against the FMC Defendants )**

265. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

266. The FMC Defendants owed to Plaintiffs and other Class members a duty: (a) to act with reasonable care in preparing and disseminating the Offering Memorandum and other documents, including the Quarterly Account Summaries and monthly account statements, which were relied upon by Plaintiffs and other Class members in deciding to purchase and/or retain their limited partnership investment interests in the Fund; and (b) to use reasonable diligence in

determining the accuracy of and preparing the information contained in the Offering Memorandum, Quarterly Account Summaries, monthly statements, and other materials.

267. The FMC Defendants breached their duties to Plaintiffs and other Class members by failing to investigate, confirm, prepare and review with reasonable care, the information contained in the Offering Memorandum as well as in the Quarterly Account Summaries and monthly account statements.

268. Neither the Offering Memorandum nor any other offering material used in soliciting investments in the Fund, the Quarterly Account Summaries, monthly account statements, or other materials provided to the limited partners ever disclosed that over half of the Fund's assets were ultimately invested with Madoff.

269. Moreover, the Offering Memorandum contained the material misrepresentation that the Fund's assets would be diversified such that the Fund, at all times, would be invested in at least three investment vehicles and that no more than 35% of the Fund's assets would be invested in a single investment vehicle. As alleged above, this was patently untrue because at least three of the investment vehicles in which the Fund invested – Andover, Beacon and Maxam – were investments ultimately managed in whole or in part by Madoff, and accounted for more than 60% of the Fund's assets, far higher than the 35% set forth in the Offering Memorandum.

270. As a direct, foreseeable and proximate result of this negligence, Plaintiffs and other Class members have sustained damages, suffered mental and emotional distress and have lost a substantial part of their respective investments in an amount yet to be determined, and to be proven at trial.

271. By reason of the foregoing, the FMC Defendants are jointly and severally liable to Plaintiffs and other Class members.

**COUNT V**
**Breach of Fiduciary Duty**
**(Against the FMC Defendants and the John Doe Defendants)**

272. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

273. The FMC Defendants and the John Doe Defendants (collectively, the "Count V Defendants") owed and owe Plaintiffs and the Class fiduciary obligations. By reason of their fiduciary relationships, the Count V Defendants owed and owe Plaintiffs and the Class the highest obligation of good faith, fair dealing, loyalty and due care.

274. As a result of the Count V Defendants' abrogation of their duties in the management of the assets of the Fund for the benefit of its limited partners, as well as participation, exploitation and perpetration of the wrongdoing, as alleged herein, the Count V Defendants violated and breached their fiduciary duties of care, loyalty, reasonable inquiry, oversight, good faith, and supervision owed to Plaintiffs and the Class. They acted in bad faith, with gross negligence and with complete disregard of their obligation to use due care, and employ reasonable and prudent investment standards.

275. As a proximate result of the Count V Defendants' bad faith breaches of their fiduciary duties, Plaintiffs and other Class members have sustained damages, suffered mental and emotional distress and have lost a substantial part of their respective investments in an amount yet to be determined, and to be proven at trial.

276. By reason of the foregoing, the Count V Defendants are liable to Plaintiffs and other members of the Class.

**COUNT VI**
**Gross Negligence and Mismanagement**
**(Against the FMC Defendants and the John Doe Defendants)**

277. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs, as though set forth fully herein.

278. The FMC Defendants and the John Doe Defendants (collectively, the "Count VI Defendants") were retained by and on behalf of the Fund and its limited partners to manage their assets in a manner consistent with the Fund's investment objectives as set forth in the Offering Memorandum.

279. As the General Partner of the Fund and the co-heads of the Fund's Investment Committee, as well as immediate family members of Defendants Danziger and Markhoff, members of the Investment Committee of the Fund, members of the Advisory Boards for the Feeder Funds, and other potential control persons and employees of certain Defendants, including those of Ivy and BONY, hedge funds, hedge fund managers, brokerage firms and fiduciaries to the Funds, the Count VI Defendants owed fiduciary duties to Plaintiffs and the Class to conduct, manage and supervise the Fund's investments in good faith and with due care an in accordance with their stated investment strategies. As set forth above, the Count VI Defendants, consisting of FMC, Zises, Tessler, and the John Doe Defendants, breached their fiduciary duties to the Fund by acting in bad faith and failing to exercise due care in the performance of their duties..

280. The Count VI Defendants should have prevented, through the exercise of reasonable diligence, the improper investing of a majority of the Fund's assets solely with Madoff.

281. The Count VI Defendants authorized, approved, participated in, failed to disclose, and improperly concealed the improper conduct described herein.

282. Plaintiffs and the Class relied to their detriment on the Count VI Defendants to discharge their duties as the General Partner of the Fund and the co-heads of the Fund's Investment Committee, and, with respect to the John Doe Defendants, as fiduciaries in various roles, in a careful and prudent manner.

283. As a direct and proximate result of result of the gross negligence and misconduct of the Count VI Defendants, Plaintiffs and the Class have been harmed. The Count VI Defendants are liable to Plaintiffs and the Class in an amount yet to be determined, and to be proven at trial.

**COUNT VII**
**Unjust Enrichment**
**(Against All Defendants)**

284. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

285. As a result of the misconduct alleged herein, the Fund is in the process of dissolving and the Plaintiffs' and the other Class members' investments have been decimated; yet all Defendants have reaped substantial benefits and, in particular, fees, including management and performance fees, and other pecuniary benefits at the expense of Plaintiffs and the Class.

286. Defendants, therefore, been unjustly enriched and equity and good conscience require that these defendants disgorge to Plaintiffs and the Class, all such unjust enrichment in an amount to be determined at trial.

**COUNT VIII**
**Malpractice and Professional Negligence**
**(Against the FMC Defendants and the John Doe Defendants)**

287. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

288. The FMC Defendants consisting of Defendants FMC, Zises and Tessler, and the John Doe Defendants (collectively, the "Count VIII Defendants") were responsible for investing Class members' assets in accordance with their stated investment strategy, as set forth in the Offering Memorandum, and had a duty to exercise prudence and due professional care in doing so.

289. The Count VIII Defendants failed to exercise prudence and due professional care in investing, managing, monitoring and safeguarding the assets under their management.

290. The Count VIII Defendants ignored the numerous red flags associated with allowing the Class's funds to be funneled to investments with Madoff. The Count VIII Defendants also failed to conduct the proper due diligence of the investments they placed the Class's assets in and utterly failed to monitor the Class's investments.

291. As a direct and proximate result of the negligence and/or gross negligence committed by the Count VIII Defendants, the Class lost over 60% of their investments in the Fund, and thereby suffered damages in an amount to be proven at trial.

**COUNT IX**
**Aiding and Abetting Breach of Fiduciary Duty**
**(Against the Feeder Fund Defendants, Defendant Ivy Asset Management and the John Doe Defendants)**

292. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

293. The FMC Defendants owed Plaintiffs and the Class fiduciary duties as alleged herein.

294. By committing the acts alleged herein, the FMC Defendants breached their fiduciary duties to the Plaintiffs and the Class.

295. The Feeder Fund Defendants, Defendant Ivy Asset Management, and the John Doe Defendants (collectively, the "Count IX Defendants") aided and abetted the FMC Defendants in breaching their fiduciary duties to the Plaintiffs and the Class by issuing false and misleading statements about the investment strategies of the Andover, Beacon and Maxam funds and failing to disclose that the assets of these funds were actually, in whole or in part, being funneled to Madoff without any, or inadequate due diligence or oversight.

296. In addition, the Count IX Defendants had actual knowledge of the breaches of fiduciary duties alleged herein. As the managers and/or investment consultants of the Feeder Funds funneling monies to Madoff, the Count IX Defendants knew that the FMC Defendants were not investing Plaintiffs' and the Class' assets in a legitimate trading strategy or conducting the required due diligence and monitoring.

297. As described above, Plaintiffs and the Class have suffered substantial damages as a result of the Count IX Defendants' aiding and abetting the FMC Defendants' breaches of fiduciary duties.

**COUNT X**
**Derivative Claim for Breach of Fiduciary Duty**
**(Against the FMC Defendants and the John Doe Defendants)**

298. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs, as though set forth fully herein.

299. The FMC Defendants and the John Doe Defendants (collectively, the "Count X Defendants") owed and owe the Fund fiduciary obligations. By reason of their fiduciary relationships, the Count X Defendants owed and owe the Fund the highest obligation of good faith, fair dealing, loyalty and due care.

300. As a result of the Count X Defendants' abrogation of their duties in the management of the assets of the Fund, as alleged herein, the Count X Defendants violated and

breached their fiduciary duties of care, loyalty, reasonable inquiry, oversight, good faith, and supervision owed to the Fund. They acted in bad faith, with gross negligence and with complete disregard of their obligation to use due care, and employ reasonable and prudent investment standards.

301. As a proximate result of result of the Count X Defendants' bad faith breaches of their fiduciary duties, the Fund has sustained damages and has lost a substantial part of its value.

302. By reason of the foregoing, the Count X Defendants are liable to the Fund in an amount yet to be determined, and to be proven at trial.

**COUNT XI**
**Derivative Claim for Violation of Section 10(b) of the Exchange Act and Rule 10b-5 of the Securities and Exchange Commission**
**(Against The Feeder Fund Defendants and Ivy Asset Management)**

303. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs, as though set forth fully herein.

304. This Count is asserted against the Feeder Fund Defendants and Ivy Asset Management and is based upon Section l0(b) of the Exchange Act, 15 U.S.C. §78j(b), and Rule l0b-5 promulgated thereunder.

305. During the Class Period, the Feeder Fund Defendants and Ivy Asset Management directly engaged in a common plan, scheme, and unlawful course of conduct, pursuant to which they knowingly or recklessly engaged in acts, practices, and courses of business which operated as a fraud and deceit upon the Fund, and made various deceptive and untrue statements of material fact and omitted to state material facts in order to make the statements made, in light of the circumstances under which they were made, not misleading to the Fund. The purpose and effect of the scheme, plan, and unlawful course of conduct was, among other things, to induce the Fund to purchase interests in the Feeder Funds.

306. During the Class Period, the Feeder Fund Defendants and Ivy Asset Management, pursuant to said scheme, plan, and unlawful course of conduct, knowingly and recklessly issued, caused to be issued, participated in the issuance of, the preparation of deceptive and materially false and misleading statements to the Fund as particularized above.

307. In ignorance of the false and misleading nature of the statements described above and the deceptive and manipulative devices and contrivances employed by said defendants, the Fund relied, to its detriment, on such misleading statements and omissions in purchasing investment interests in the Feeder Funds. The Fund has suffered substantial damages as a result of the wrongs alleged herein in an amount to be proven at trial.

308. By reason of the foregoing, the Feeder Fund Defendants and Ivy Asset Management directly violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in that they: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the Fund in connection with its investment of capital in the Feeder Funds.

309. As a direct and proximate result of the Feeder Fund Defendants' and Ivy Asset Management's wrongful conduct, the Fund suffered damages in connection with its purchases of investment interests in the Feeder Funds.

**COUNT XII**
**Derivative Claim for Violation of Section 20(a) of the Exchange Act**
**(Against Danziger, Markhoff, MCML, Manzke and BONY)**

310. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs, as though set forth fully herein.

311. Defendants Danziger and Markhoff acted as controlling persons of Andover Associates and Beacon Associates within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high level positions, participation in and/or awareness of Andover's and Beacon's operations, and/or intimate knowledge of these funds' products, sales, accounting, selection of investment advisors and managers, they had the power to influence and control and did influence and control, directly or indirectly, the decision-making of Andover Associates and Beacon Associates, including the content and dissemination of the various statements that Plaintiffs, derivatively, on behalf of the Low Volatility Fund, contend are false and misleading. Defendants Danziger and Markhoff had the ability to prevent the issuance of the statements or cause the statements to be corrected.

312. Defendant BONY, as the parent of Ivy Asset Management, was in a position of control over Ivy Asset Management. By virtue of its position, participation in and/or awareness of Ivy Asset Management's operations, it had the power to influence and control and did influence and control, directly or indirectly, the decision-making of Ivy Asset Management, including the content and dissemination of some of the statements that Plaintiffs, derivatively, on behalf of the Low Volatility Fund, contend are false and misleading.

313. MCML and Manzke were in positions of control over Maxam Capital GP and Maxam Capital. By virtue of their ownership and high level positions, participation in and/or awareness of Maxam's investments, MCML and Manzke had the power to influence and control and did influence and control, directly or indirectly, the decision-making of Maxam Capital GP, and Maxam Capital, including the content and dissemination of some of the statements that Plaintiffs contend are false and misleading. MCML and Manzke had the ability to prevent the issuance of the statements or cause the statements to be corrected.

314. By virtue of their positions as controlling persons, Danziger, Markhoff, BONY, MCML and Manzke, are liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of their wrongful conduct, the Low Volatility Fund and its limited partners, Plaintiffs suffered damages in connection with their acquisitions of limited partnership interests in the Fund.

**COUNT XIII**
**Derivative Claim for Common Law Fraud**
**(Against The Feeder Fund Defendants and Ivy Asset Management)**

315. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

316. The Fund, in reasonable and justifiable reliance upon the statements and representations made by the Feeder Fund Defendants and Ivy Asset Management, as alleged herein, purchased investment interests in Andover, Beacon and Maxam.

317. The Fund would not have purchased investment interests in Andover, Beacon and Maxam had it been aware of the material misrepresentations and omissions and concealment by the Feeder Fund Defendants and Ivy Asset Management of the fact that the Feeder Fund Defendants and Ivy Asset Management had entrusted assets of the Feeder Funds to Madoff, had misrepresented the Feeder Funds' investment objectives and strategies, and failed to conduct any or conducted inadequate due diligence on Madoff.

318. At the time of these statements, misrepresentations and omissions, the Feeder Fund Defendants and Ivy Asset Management knew or should have known them to be false, and intended to deceive the Fund by making such misrepresentations and omissions.

319. At the time of the false statements, misrepresentations and omissions set forth above, the Feeder Fund Defendants and Ivy Asset Management each intended that the Fund would rely on the misrepresentations and omissions when determining whether to purchase

investment interests in Andover, Beacon and Maxam. The Fund reasonably relied thereon to its detriment in making such decisions.

320. Had the Fund known of the material facts that were wrongfully concealed and misrepresented, the Fund would not have purchased investment interests in Andover, Beacon and Maxam.

321. The Fund, as a result of its purchase of interests in Andover, Beacon and Maxam, and by reasons of the Feeder Fund Defendants' and Ivy Asset Management's wrongful misrepresentations and omissions, has sustained damages and has lost a substantial part of its investment in an amount yet to be determined, and to be proven at trial.

322. By reason of the foregoing, the Feeder Fund Defendants and Ivy Asset Management are jointly and severally liable to the Fund.

323. The Feeder Fund Defendants' and Ivy Asset Management's fraudulent acts were willful and wanton and the Fund is entitled to punitive damages.

**COUNT XIV**
**Derivative Claim for Negligent Misrepresentation**
**(Against The Feeder Fund Defendants and Ivy Asset Management)**

324. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs, as though set forth fully herein.

325. The Feeder Fund Defendants and Ivy Asset Management owed to the Fund a duty: (a) to act with reasonable care in preparing and disseminating their offering memoranda and other offering materials, which were relied upon by the Fund in deciding to purchase investment interests in the Feeder Funds; and (b) to use reasonable diligence in determining the accuracy of and preparing the information contained in the offering memoranda and other offering materials.

326. The Feeder Fund Defendants and Ivy Asset Management breached their duties to the Fund by failing to investigate, confirm, prepare and review with reasonable care, the information contained in the Feeder Funds' offering memoranda and other offering materials.

327. Neither the Feeder Funds' offering memoranda nor any other offering material used in soliciting investments in the Feeder Funds and provided to the Fund, ever disclosed that a substantial amount of the Feeder Funds' assets, or, in the case of Maxam, all of the fund's assets were entrusted to Madoff, without adequate due diligence or monitoring, as described herein.

328. As a direct, foreseeable and proximate result of this negligence, the Fund has lost a substantial part of its investments in an amount yet to be determined, and to be proven at trial.

329. By reason of the foregoing, the Feeder Fund Defendants and Ivy Asset Management are jointly and severally liable to the Fund.

**COUNT XV**
**Derivative Claim for Breach of Fiduciary Duty**
**(Against The Feeder Fund Defendants, Defendant Ivy Asset Management and the John Doe Defendants)**

330. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs, as though set forth fully herein.

331. The Feeder Fund Defendants, Defendant Ivy Asset Management, and the John Doe Defendants (collectively, the "Count XV Defendants") owed and owe fiduciary obligations to the Fund. By reason of their fiduciary relationships, the Count XV Defendants owed and owe the Fund a highest obligation of good faith, fair dealing, loyalty and due care.

332. As alleged herein, the Count XV Defendants breached their fiduciary duties to the Fund by their acts and omissions to act.

333. As a result of the Count XV Defendants' abrogation of their duties in the management of the assets of their respective funds for the benefit of their investors, as alleged

herein, these defendants violated and breached their fiduciary duties of care, loyalty, reasonable inquiry, oversight, good faith, and supervision owed to the Fund. They acted in bad faith, with gross negligence and with complete disregard of their obligation to use due care, and employ reasonable and prudent investment standards.

334. As a direct and proximate cause of the Count XV Defendants' failure to exercise due care in the performance of their duties, including by their failure to disclose that the assets of the Andover, Beacon and Maxam funds were invested in Madoff, the Fund has sustained damages.

335. By reason of the foregoing, Count XV Defendants are liable to the Fund in an amount yet to be determined, and to be proven at trial.

**COUNT XVI**
**Derivative Claim for Gross Negligence and Mismanagement**
**(Against The Feeder Fund Defendants, Defendant Ivy Asset Management and the John Doe Defendants)**

336. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs, as though set forth fully herein.

337. The Feeder Fund Defendants were retained by and on behalf of the Fund to manage the Fund's assets in a manner consistent with the Fund's investment objectives as set forth in the Offering Memorandum.

338. The Feeder Fund Defendants, Defendant Ivy Asset Management and the John Doe Defendants (collectively, the "Count XVI Defendants") owed fiduciary duties to the Fund to conduct, manage and supervise the Fund's investments in good faith and with due care and in accordance with their stated investment strategies. As set forth above, Count XVI Defendants breached their fiduciary duties to the Fund by acting in bad faith and failing to exercise due care

in the performance of their duties as managers and/or investment consultants and/or administrators of the Fund.

339. The Count XVI Defendants should have prevented, through the exercise of reasonable diligence, the improper investing of some or all of the Feeder Funds' assets solely with Madoff.

340. The Count XVI Defendants authorized, approved, participated in, failed to disclose, and improperly concealed the improper conduct described herein.

341. The Fund relied to its detriment on the Count XVI Defendants to discharge their duties as managers and/or investment consultants and/or administrators of the Fund in a careful and prudent manner.

342. As a direct and proximate result of result of the gross negligence and misconduct of the Count XVI Defendants, the Fund has been harmed. These Defendants are liable to the Fund in an amount yet to be determined, and to be proven at trial.

**COUNT XVII**
**Derivative Claim for Unjust Enrichment**
**(Against All Defendants)**

343. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs, as though set forth fully herein.

344. As a result of the misconduct alleged herein, the Fund is in the process of dissolving and its investments have been decimated; yet Andover Associates, Beacon Associates, Ivy Assets Management, Maxam Capital GP, Maxam Capital and MCML have reaped substantial benefits, in particular, fees, including management and performance fees, and other pecuniary benefits at the expense of the Fund.

345. Andover Associates, Beacon Associates, Ivy Asset Management, Maxam Capital GP, Maxam Capital and MCML have, therefore, been unjustly enriched and equity and good

conscience require that these defendants disgorge to the Fund, all such unjust enrichment in an amount to be determined at trial.

**COUNT XVIII**
**Derivative Claim for Malpractice and Professional Negligence**
**(Against Defendants Andover Associates, Beacon Associates, Ivy Asset Management, Danziger, Markhoff, Maxam Capital GP, Maxam Capital, MCML, Manzke and the John Doe Defendants)**

346. Plaintiffs repeat and reallege each and every allegation contained in the foregoing paragraphs as if fully set forth herein.

347. Defendants Andover Associates, Beacon Associates, Ivy Asset Management, Danziger, Markhoff, Maxam Capital GP, Maxam Capital MCML, Manzke and the John Doe Defendants (collectively, the "Count XVIII Defendants") were responsible for investing the Fund's assets in their respective funds in accordance with their stated investment strategies, and had a duty to exercise prudence and due professional care in doing so.

348. The Count XVIII Defendants failed to exercise prudence and due professional care in investing, managing, monitoring and safeguarding the Fund's assets under their management.

349. The Count XVIII Defendants ignored the numerous red flags associated with investing the Fund's assets with Madoff through their respective funds, and also failed to conduct the proper due diligence of the investments they placed the Fund's assets in and utterly failed to monitor the Fund's investments.

350. As a direct and proximate result of the negligence and/or gross negligence committed by the Count XVIII Defendants, the Fund lost over 60% of its value and has been forced to dissolve. The Fund has thereby suffered damages in an amount to be proven at trial.

**PRAYER FOR RELIEF**

WHEREFORE, Plaintiffs pray for relief and judgment, as follows:

A. determining that this action is a proper class action and certifying Plaintiffs as Class Representatives under Rule 23 of the Federal Rules of Civil Procedure and appointing Plaintiffs' counsel as Class Counsel;

B. awarding compensatory damages in favor of Plaintiffs and the other Class members against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing (including the return of all management, performance and other fees paid by the limited partners), in an amount to be proven at trial, including both pre-judgment and post-judgment interest thereon, to the extent allowed by law;

C. awarding compensatory damages in favor of the Fund against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing, in an amount to be proven at trial, including both pre-judgment and post-judgment interest thereon, to the extent allowed by law;

D. awarding punitive damages in favor of Plaintiffs and the other Class members, as well as the Fund for Defendants' willful and wanton acts, in an amount to be determined at trial, including both pre-judgment and post-judgment interest thereon, to the extent allowed by law;

E. awarding Plaintiffs and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

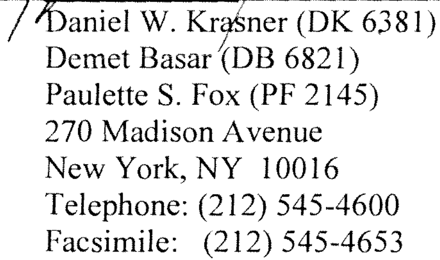
F. such other and further relief as the Court may deem just and proper.

**JURY TRIAL DEMANDED**

Pursuant to Federal Rule of Civil Procedure 38(a), Plaintiffs hereby demand a trial by jury of all issues so triable.

Dated: December 16, 2009

WOLF HALDENSTEIN ADLER
FREEMAN & HERZ LLP



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**CERTIFICATE OF SERVICE**

I, James Cirigliano, hereby certify the following:

I am over the age of eighteen years and am not a party to this action. I am employed by Wolf Haldenstein Adler Freeman & Herz LLP, attorneys for Plaintiffs in this matter. On the 16th day of December 2009, I served the foregoing Second Amended Class Action and Derivative Complaint upon the parties named below, by depositing a true copy thereof securely enclosed in a postpaid wrapper in a depository regularly maintained and exclusively controlled by the United States Government in the County, City and State of New York.

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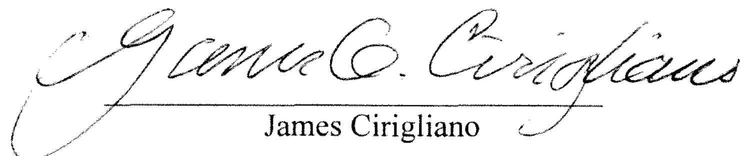

James Cirigliano

# TAB C

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK
-----------------------------------------------------------------------x

G. PHILIP STEPHENSON, as Trustee of the
PHILIP STEPHENSON REVOCABLE LIVING TRUST,

Plaintiff, 09 CV 00716 (RJH)

-against- JURY TRIAL DEMANDED

CITCO GROUP LIMITED;
CITCO FUND SERVICES (EUROPE) BV;
CITCO (CANADA), INC.; and
PRICEWATERHOUSECOOPERS, LLP
(an Ontario limited liability partnership),

Defendants.

-----------------------------------------------------------------------x

# CORRECTED AMENDED COMPLAINT

DEUTSCH, METZ & DEUTSCH, LLP
18 East 41st Street, Sixth Floor
New York, New York 10017
(212) 684-1111

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Plaintiff by its attorneys, Deutsch, Metz & Deutsch, LLP for its complaint alleges, upon knowledge as to itself and the actions it took, and upon information and belief as to all other matters, as follows:

## OVERVIEW

1. This is a direct action by G. Philip Stephenson ("Stephenson"), as Trustee of the Philip Stephenson Revocable Living Trust (the "Stephenson Trust", and collectively "Plaintiff"), which is a limited partner in Greenwich Sentry, LP ("Greenwich Sentry"). Plaintiff invested $60 million in Greenwich Sentry on or about April 2008. Greenwich Sentry is a "feeder fund" which placed almost all of the funds invested by its limited partners (the "Limited Partners") with Bernard Madoff and his firm in the recently discovered "Ponzi scheme" which he ran (which has failed and resulted in billions of dollars in losses). Plaintiff's investment has been essentially, and unnecessarily (but for the failures of defendants), wiped out. This action seeks to recover damages from various entities responsible owing to their breach of duty and/or negligence.

2. On or about December 10, 2008, it was disclosed that Bernard L. Madoff ("Madoff"), acting through Bernard L. Madoff Investment Securities, LLC (together with Madoff, "the Madoff Firm") had at all times been running a Ponzi scheme so that "profits" reported to some persons whose funds were managed by them (particularly the earlier investors), were in fact nonexistent, and the payment of such "profits" to those persons was in fact being made from the capital of newer investors. On December 11, 2008, the Securities and Exchange Commission sought the appointment of a receiver for the Madoff Firm and filed charges against The Madoff Firm, and on that same day, the United States Attorney brought criminal charges against Madoff.

## THE PARTIES AND RELEVANT ENTITIES

### A. The Plaintiff

3. The Stephenson Trust is formed under the laws of the State of Texas. Stephenson is the sole trustee of the Stephenson Trust and is empowered pursuant to the Trust Agreement to bring this action. The Stephenson Trust is a Limited Partner in Greenwich Sentry, having initially invested $60 million in Greenwich Sentry in or about April 2008.

### B. The Fairfield Entities (Non-Parties)

4. Greenwich Sentry is a Delaware limited partnership organized in or about December 1990 as Aspen/Greenwich Limited Partnership. It changed its name to "Greenwich Sentry, LP" on or about December 4, 1992.

5. Greenwich Sentry is registered with the State of New York as authorized to transact business in the State of New York. Greenwich Sentry maintains its offices in the State and County of New York and does business in the State and County of New York. Greenwich Sentry's principal place of business is in the State and County of New York. Greenwich Sentry transacted business in and from the State and County of New York in connection with the matters at issue. Greenwich Sentry maintained its bank accounts in connection with the Fund at issue in the State of New York.

6. Fairfield Greenwich (Bermuda) Ltd. ("FGB") is, and since 2006 has been, the General Partner of Greenwich Sentry.

7. Fairfield Greenwich Group ("FGG") is a Delaware limited liability company with its principal place of business in the State and County of New York. It holds itself out as a

leading asset investment specialist, managing its own funds and, *inter alia*, selecting external managers for funds, and had its subsidiaries, affiliates and/or officers act as general partners.

**C. The Citco Defendants**

8. Defendant Citco Group Limited ("Citco Group") is an independent financial services organization with approximately 46 offices in 27 countries around the world, including in New York. Citco Group is an integrated financial services holding company that operates through numerous "subsidiaries", including defendants Citco Fund Services (Europe) BV and Citco (Canada), Inc. Citco Group is a Cayman Islands corporation. Citco Group holds itself out as having two "offices and locations" in the State and County of New York.

9. Defendant Citco Fund Services (Europe) BV ("Citco Europe") is a limited liability company formed under the laws of the Netherlands and is a wholly owned subsidiary of Citco Group. Its principal place of business is in Amsterdam, The Netherlands. As is described further herein, Citco Europe has been Greenwich Sentry's fund administrator since September 1, 2006.

10. Defendant Citco (Canada), Inc. ("Citco Canada") is a Canadian corporation and is a wholly owned subsidiary of Citco Group. Its principal place of business is in Ontario, Canada. As is described further herein, Citco Canada, by delegation from Citco Europe, has functioned as a sub-administrator of Greenwich Sentry's funds since September 1, 2006.

11. Citco Group holds itself out as the world's top provider of hedge fund administration services. Citco Group represents that its services and those of its "subsidiaries" and affiliates include corporate and fiduciary services, fund administration and shareholder services,

custody and banking services, fund advisory and brokerage services, and international pension services. Citco Group has no independent revenues of its own; it acts through its "offices and locations", including Citco Europe and Citco Canada, which serve as its agents. Citco Group and its "subsidiaries" are referred to collectively as "Citco".

12. Citco's website represents to the public that:

> Our Hedge Fund Service offering includes fund accounting and net asset value calculations, investor relations services, anti-money laundering compliance, corporate & legal services, . . . tax reporting and financial statement preparation. Citco's on-line reporting tools, . . . offer both investment managers and investors an extensive suite of online reports to provide them with the tools they need to operate efficiently and effectively.
> Citco also offers a complete front-to-back offering for single manager funds, combining portfolio capture and real-time position monitoring technology . . . with middle and back office operations support. * * *

13. Substantially all information as to Citco's clients and the funds it administers is maintained in a centralized computer database located in the United States by Citco Technology Management, Inc., which is held out by Citco as its "dedicated Information Technology Group", and is a Florida corporation registered as authorized to transact business in the State and County of New York.

## D. PricewaterhouseCoopers

14. Defendant PricewaterhouseCoopers, LLP (an Ontario Partnership) ("PWC") is a limited liability partnership organized under the laws of the province of Ontario, Canada with its principal place of business in Ontario, Canada.

15. PWC is a member firm of PricewaterhouseCoopers International Limited ("PWC

Int'l"). PWC Int'l and all of its member firms, including PWC, operate as a self-described network of inter-connected member firms providing auditing, accounting and other investment and advisory services across an international platform by which means they are globally operational. PWC Int'l and the member firms maintain centralized control over information, training, standards of care, marketing, and quality of accounting and auditing work throughout the world. PWC Int'l and its member firms hold themselves out as and operate as a unified business entity.

16. As is described further herein, PWC was the accountant and auditor of Greenwich Sentry for a period of years, including at least 2006 through 2008. Prior to 2006, Greenwich Sentry's auditor was a sister office of PWC in Rotterdam, the Netherlands ("PWC Netherlands"). As is described further herein, during the entire period, PWC reported upon the financial statements and results of operations of Greenwich Sentry and issued unqualified reports thereon.

17. PWC Netherlands, was at relevant times also the auditor and/or accountant for Fairfield Sentry.

**JURISDICTION AND VENUE**

18. This Court has subject-matter jurisdiction pursuant to 28 U.S.C. 1332(a). The Stephenson Trust is formed under the laws of the State of Texas and Stephenson, the sole trustee of the Stephenson Trust, is a citizen of the State of Texas. Defendant Citco Group is a citizen of the Cayman Islands-British West Indies. Citco Europe is a citizen of the Netherlands. Citco Canada is a citizen of Canada. PWC is a citizen of Canada. The matter in controversy exceeds $75,000.00.

19. The exercise of personal jurisdiction over the Defendants by this Court is appropriate and will not offend traditional notions of fair play and substantial justice because each of the Defendants has sufficient minimum contacts with the State of New York.

20. Jurisdiction is appropriate against Defendant Citco Group because it has sufficient minimum contacts with the State and County of New York. Citco Group is a worldwide company with offices located throughout the world, including at least one in the State and County of New York itself, through which it conducts regular, systematic and continuous business activities resulting in the derivation of substantial revenues from the United States and New York. Citco Europe and Citco Canada are wholly owned and controlled subsidiaries of Citco Group. Citco Group has no independent revenues of its own; all of its revenues are derived from its subsidiaries, including defendants Citco Europe and Citco Canada. Citco Group specifically authorized its subsidiaries, including Citco Europe and Citco Canada to act for it as its operational arm. Each of the subsidiaries support each other in the performance of their obligations and all of them take ultimate direction from and are under the control of Citco Group. Indeed, as alleged herein, Citco Europe and Citco Canada, report to the Global Director of Fund Services for Citco Group who is employed by a Citco Group subsidiary incorporated in the State of New York and who, in turn, reports to the executive committee of Citco Group. Further, Citco Europe and Citco Canada share one centralized computer database maintained by another subsidiary (a corporation authorized to do business within the State of New York) and under the control of Citco Group. Thus, not only does Citco Group itself maintain profitable direct contacts with the United States and the State and County of New York, but as alleged herein defendants Citco Europe and Citco Canada, are the agents and/or alter egos of Citco Group, and

as such their substantial, direct, continuous and systematic contacts with the United States and the State and County of New York should be imputed to Citco Group.

21. Jurisdiction is appropriate against Defendant Citco Europe because it has sufficient minimum contacts with the State of New York. Citco Europe purposefully entered into a contract to act as fund administrator and to provide the services alleged herein to Greenwich Sentry, whose business was within the State and County of New York and who was actively doing business within the State and County of New York. Citco Europe, as alleged more fully herein, provided those services to Greenwich Sentry, including, *inter alia*, creating the NAV ("Net Asset Value") reports which form a part of Plaintiff's claim. Citco Europe purposefully sent monthly financial documents, *inter alia*, the NAVs it created, to Greenwich Sentry in New York. Citco Europe purposefully undertook, as one of the services it was to provide to Greenwich Sentry, to communicate to Greenwich Sentry's Limited Partners and as part of those services, *inter alia,* purposefully and regularly sent financial documents, including the NAVs it created, to Greenwich Sentry Limited Partners in New York. The NAVs sent to New York to Greenwich Sentry and its Limited Partners were all on Citco Europe letterhead. Citco Europe needed to have, and did in fact have, regular and systematic contact with Greenwich Sentry and the Greenwich Sentry General Partners (all of whom were located in New York) in order to perform the services which it contracted to and did perform as Greenwich Sentry's fund administrator. Citco Europe maintained a bank account at HSBC Bank in the State and County of New York through the Citco Group into which Greenwich Sentry's Limited Partners were directed, and did, send their investments to that bank account for ultimate use by Greenwich Sentry. Citco Europe had regular and systematic communications with HSBC Bank in the State

and County of New York in regards to that account and the Limited Partners funds in order to perform its services as Greenwich Sentry's funds administrator. Citco Europe maintained these contacts on a regular and systematic basis from September 2006 to the present. Citco Europe derived significant income from Greenwich Sentry and/or the Greenwich Sentry General Partners due to its contacts with New York in that it collected significant fees for performing the hereinafter described services for Greenwich Sentry. The acts of Citco Canada as agent, which it performed by delegation of responsibility by Citco Europe, are attributable to Citco Europe as principal, for purposes of assessing Citco Europe's contacts with New York. Citco Europe does substantial other business in the State and County of New York as a fund administrator. The claims against Citco Europe spring directly from and are directly related to its contacts within the State and County of New York. The State and County of New York has a direct and substantial interest in seeing that the persons and/or entities contracting to provide and actually providing financial services to entities doing business in New York (including the partners and/or investors in those New York entities) perform those services in a professional and/or non-negligent way and that they do so within the bounds of the fiduciary duties which they owe.

22. Jurisdiction is appropriate against Defendant Citco Canada because it has sufficient minimum contacts with the State of New York. Citco Canada purposefully entered into a contract to act as fund sub-administrator and to provide the services alleged herein to Greenwich Sentry, whose business was within the State and County of New York and who was actively doing business within the State and County of New York. Citco Canada, as alleged more fully herein, provided those services to Greenwich Sentry, including, *inter alia*, providing all of the financial and services required to allow Citco Europe to create the NAVs which form a

part of Plaintiff's claim. Citco Canada purposefully created the monthly financial documents, *inter alia*, the information contained with the NAVs, for Citco Europe which Citco Europe then sent to Greenwich Sentry in New York. Citco Canada purposefully undertook to create the financial documents and information knowing that it would be sent to Greenwich Sentry in the State and County of New York. Citco Canada purposefully undertook to create the financial documents and information knowing that it would be, *inter alia,* sent in the form of monthly financial documents, including, the NAVs, to Greenwich Sentry Limited Partners in New York. The NAVs sent to New York to Greenwich Sentry and its Limited Partners, all on Citco Europe letterhead, were created from financial documents and information generated by Citco Canada specifically for that purpose. Citco Canada needed to have, and did in fact have, regular and systematic contact with Greenwich Sentry and the Greenwich Sentry General Partners (all of whom were located in New York) in order to perform the services which it contracted to and did perform as Greenwich Sentry's fund sub-administrator. Citco Canada had regular and systematic communications with HSBC Bank in the State and County of New York, at which Citco Europe maintained a bank account through the Citco Group and into which Greenwich Sentry's Limited Partners were directed, and did, send their investments to that bank account for ultimate use by Greenwich Sentry, in order to perform its functions as Greenwich Sentry's funds sub-administrator. Citco Canada maintained these contacts on a regular and systematic basis from September 2006 to the present. Citco Canada derived significant income from Greenwich Sentry and/or the Greenwich Sentry General Partners due to its contacts with New York in that it collected significant fees for performing the hereinafter described services for Greenwich Sentry. Citco Canada does significant other business in the State and County of New York as a funds sub-

administrator. The claims against Citco Canada spring directly from and are directly related to its contacts within the State and County of New York. The State and County of New York has a direct and substantial interest in seeing that the persons and/or entities contracting to provide and actually providing financial services to entities doing business in New York (including the partners and/or investors in those New York entities) perform those services in a professional and/or non-negligent way and that they do so within the bounds of the fiduciary duties which they owe.

23. Jurisdiction is appropriate against Defendant PWC because it has sufficient minimum contacts with the State of New York. PWC purposefully entered into a contract to act as auditor and/or accountants for Greenwich Sentry and to provide the services alleged herein to Greenwich Sentry whose business was within the State and County of New York and who was actively doing business within the State and County of New York. PWC, as alleged more fully herein, provided those services to Greenwich Sentry, including, *inter alia*, issuing unqualified audited reports attesting to the accuracy of Greenwich Sentry's financial statements which form a part of Plaintiff's claim. PWC purposefully sent financial documents, *inter alia*, the audited financial reports and other documents to Greenwich Sentry in New York. PWC purposefully communicated with Greenwich Sentry's Limited Partners as part of its services to Greenwich Sentry's Limited Partners in New York. PWC needed to have, and did in fact have, regular and systematic contact with Greenwich Sentry, the Greenwich Sentry General Partners and any banks holding Greenwich Sentry's investor funds (all of whom were located in New York) in order to perform the services which it contracted to and did perform as auditors of and accounts to Greenwich Sentry. PWC maintained these contacts on a regular and systematic basis from at

least 2006 to the present. PWC derived significant income from Greenwich Sentry and/or the Greenwich Sentry General Partners due to its contacts with New York in that it collected significant fees for performing the hereinafter described services for Greenwich Sentry. The claims against PWC spring directly from and are directly related to its contacts within the State and County of New York. The State and County of New York has a direct and substantial interest in seeing that the persons and/or entities contracting to provide and actually providing financial services to entities doing business in New York (including the partners and/or investors in those New York entities) perform those services in a professional and/or non-negligent way and that they do so within the bounds of the fiduciary duties which they owe.

24. Further, personal jurisdiction over the defendants by this Court is appropriate:

(a) pursuant to CPLR § 302(a)(1) because each transacted business and/or contracted to provide services within the State of New York and the claims against it arise from that business and/or services; and/or

(b) pursuant to CPLR § 302(a)(3)(i) because each committed tortious acts outside the State of New York which caused injury within the State and it regularly does or solicits business in the State and derives substantial revenue from services rendered in the State; and/or

(c) pursuant to CPLR § 302(a)(3)(ii) because each committed tortious acts outside the State of New York which caused injury within the State and it reasonably should have expected those acts to have consequences in the State and it derives substantial revenue from interstate or international commerce.

25. Venue is proper in this District pursuant to 28 U.S.C. § 1391(a) because:

(a) all defendants are aliens, and are therefore amenable to venue in any District;

(b) a substantial part of the events or omissions giving rise to the claims herein occurred in this District; and/or all of the defendants are subject to personal jurisdiction in this District at the time the action was commenced and there is no other jurisdiction in which the action may otherwise be brought.

(c) Greenwich Sentry has its office and principal place of business in this District;

(d) the trading and valuations underlying Plaintiff's claims originated in and were executed in this District;

(e) all defendants, directly or indirectly through subsidiaries and affiliates, transacted business in this District in connection with the matters at issue;

(f) many of the documents were distributed to actual or potential investors in this District; and

(g) the majority of the evidence and witnesses are located in this District.

## FACTS COMMON TO ALL COUNTS

### A. THE OPERATIONS OF GREENWICH SENTRY

26. Greenwich Sentry operated as a "feeder fund" and placed all or substantially all of its Limited Partners' investments in a brokerage account in the custody of the Madoff Firm. The Madoff Firm was the trader and broker of the Greenwich Sentry accounts, and purportedly traded the account on a discretionary basis using a "Split Strike Conversion Strategy" as described

herein. The stated results for Greenwich Sentry's account were based on Madoff's reports of his trading, which in turn were reported upon by Greenwich Sentry's administrator and auditor. The Madoff Firm served as custodian for the securities and funds in the Greenwich Sentry account.

27. Additionally, FGB or Citco maintained a bank account or accounts outside of the Madoff Firm, in which they held investment funds of incoming limited partners which were "netted out" to satisfy pending redemption or withdrawal requests of other existing limited partners.

28. The Confidential Offering Placement Memorandum dated as of August 2006 for Greenwich Sentry (the "Greenwich Sentry PPM") described how the Limited Partners' funds would be invested:

> The Partnership seeks to obtain capital appreciation of its assets principally through the utilization of a nontraditional options trading strategy described as "split strike conversion", to which the Partnership allocates the predominant portion of its assets. ***
>
> The establishment of a typical position entails (i) the purchase of a group or basket of equity securities that are intended to highly correlate to the S&P 100 Index, (ii) the purchase of out-of-the-money S&P 100 Index put options with a notional value that approximately equals the market value of the basket of equity securities, and (iii) the sale of out-of-the-money S&P 100 Index call options with a notional value that approximately equals the market value of the basket of equity securities. * * * The basket typically consists of between 35 to 50 stocks in the S&P 100 Index.
>
> The primary purpose of the long put options is to limit the market risk of the stock basket at the strike price of the long puts. The primary purpose of the short call options is to largely finance the cost of the put hedge and to increase the stand-still rate of return.
>
> This position in its entirety could be characterized as a bull spread which, presuming the stock basket highly correlates to the S&P 100 Index, is intended to work as follows: (i) it sets a floor value below which further declines in the value of the stock basket is offset by gains in the put

> options, (ii) it sets a ceiling value beyond which further gains in the stock basket are offset by increasing liability of the short calls, and (iii) defines a range of potential market gain or loss, depending on how tightly the options collar is struck.
>
> The degree of bullishness of the strategy can be expressed at implementation by the selection of the strike prices in the S&P 100 Index put and call options. The farther away the strike prices are from the price of the S&P 100 Index, the more bullish the strategy.
>
> The Split Strike Conversion strategy is implemented by Bernard L. Madoff Investment Securities LLC ("BLM"), a broker-dealer registered with the Securities and Exchange Commission, through accounts maintained by the Partnership at that firm. The accounts are subject to certain guidelines which, among other things, impose limitations on the minimum number of stocks in the basket, the minimum market capitalization of the equities in the basket, the minimum correlation of the basket against the S&P 100 Index, and the permissible range of option strike prices. Subject to the guidelines, BLM is authorized to determine the price and timing of stock and option transactions in the account. The services of BLM and its personnel are essential to the continued operation of the Partnership, and its profitability, if any.
>
> The options transactions executed for the benefit of the Partnership may be effected in the over-the-counter market or on a registered options exchange.

Greenwich Sentry PPM, at 8-9.

29. Until the Ponzi Scheme was disclosed in December 2008, Limited Partners could withdraw any portion of the funds they invested at the end of any month. Limited Partners regularly withdrew stated "profits" and or "capital", in whole or in part. Redemption and withdrawal requests were honored throughout the period of plaintiff's investment in Greenwich Sentry, until early December 2008. As is alleged further herein, Plaintiff never withdrew or received any funds from his account.

30. Greenwich Sentry charged each Limited Partner a management fee of approxi-

mately 1% of the Limited Partner's monthly capital account balance (the "Management Fee") and a quarterly fee of 20% of the realized and unrealized net capital appreciation, subject to adjustment (the "Incentive Fee"), which fees were paid to the Greenwich Sentry General Partners. Greenwich Sentry generated millions of dollars in fees annually to the Greenwich Sentry General Partners.

31. FGB's sole business function was to monitor Greenwich Sentry's investments and other similar funds of FGG. FGB stated in its ADV form that its "core product business model is the investment management and oversight of the split strike conversion strategy, implemented through . . . [Greenwich Sentry, Fairfield Sentry and Greenwich Sentry Partners]", and described in detail its purported procedure for a due diligence and risk monitoring process. FGB was obligated to carry out its due diligence in accordance with the highest standards.

32. Numerous documents prepared by FGG, FGB and/or Greenwich Sentry explained in detail how FGB would and did purportedly implement its due diligence for Greenwich Sentry and its limited partners, including with respect to its oversight of the Madoff Firm. These representations were not sales puffery.

33. In a public document describing the due diligence process it purported to apply to its various Funds (including Greenwich Sentry), FGG described:

> Operational failures, including misrepresentation of valuations and out-right fraud, constitute a majority of instances where massive investor losses occur. Other operational risks include staff processing errors, technology failure, and poor data.

"Due Diligence And Risk Monitoring: FGG's Value-Added Investment Process" ("FGG Due Diligence") at 5.

34. FGG Due Diligence (at 2) also represented how FGB conducted due diligence:

> FGG employs an in-depth multi-faceted due diligence and risk monitoring process which is designed to uncover these risk issues. . . . For FGG to be successful in its approach, it must deploy an adequate level of resources, per manager, to the due diligence and ongoing risk monitoring process. . . . FGG conducts detailed analysis of such important issues as liquidity management, market and credit risks, management quality, and operational compliance, and regulatory risks . . . . At FGG this work is performed by experienced professionals . . . intimately familiar with the business, operational, and legal aspects of running a hedge fund firm. . . .
>
> FGG's business model enables the firm to have privileged access to all aspects of a manager's operation and investment process, including security level transparency which is employed on a confidential basis. **Only by receiving full transparency from its managers can FGG assure itself and its clients that every FGG fund continues to act according to the principles, agreements, and strategies that are specified to FGG and investors**.

35. Under the section entitled "On Going Risk Monitoring and Oversight" (at 7) FGG made further specific representations about FGB's due diligence process:

> Once FGG begins a relationship . . . FGG's due diligence process evolves into a similarly multi-faceted risk monitoring process. Simply stated, the purpose of this ongoing activity is to ensure that the fund continues to follow its investment methodology --and constraints -- and otherwise acts in accordance with the operational and risk framework that was approved during the due diligence phase. Any divergences are discussed with the manager . . . ; on several occasions, the arrangements with a manager have been terminated as a result of this ongoing review and analysis.
>
> It is important to monitor how a manager's investment and operational behavior, as well as the risks presented by the markets around it, change or evolve over time. Independent sources aid FGG's review of portfolios down to the individual security level. . . . *** While FGG has an ongoing due diligence relationship with the manager, . . . a formal annual due diligence review is conducted after the initial twelve months of investment and thereafter to address administrative and operational issues.

36. The document (at 7) further set forth a specific list of the ways and subjects that

FGB purportedly continuously monitored the investments and risk:

| DUE DILIGENCE, AS IMPLEMENTED BY FGG, EMPLOYS A VARIETY OF TECHNIQUES THAT PROBE DEEPLY INTO ALL KEY ELEMENTS OF RISK, INCLUDING: | |
|---|---|
| Manager Style: | • Performance and volatility consistent with strategy objectives<br>***<br>• An examination of performance under varying market conditions. . . .<br>*** |
| Market Risk: | • Identification of strategy-specific risk exposures and schedule of relevant risk factors<br>***<br>• Review of adherence to concentration and risk limits and compliance with Operating Guidelines |
| Operational Risk: | • Review of audited financials and auditor's management letter comments<br>***<br>• Review accounting controls: from trade executions; to trade capture; to trade reconciliation with the Street, administrator, and fund; to fund's books and records<br>• Review bank reconciliations . . .<br>• Review pricing procedures and valuation procedures and inquire about frequency of pricing disputes; review revenue recognition policies<br>• Review broker reconciliations to ensure completeness and existence of all securities<br>• Infrastructure Adequacy Evaluation and disaster recovery plans |
| Credit Risk: | • Credit mitigants: swaps, derivatives • Letters and lines of credit<br>• Financial Guarantees • Exposure limits |
| Legal Risk: | • Anti-money laundering policies and procedures<br>• Regulatory exams and results |

37. Another document entitled "Fairfield Greenwich Group: The Firm and its Capabilities" (at page 16) stated:

> FGG carefully assesses the controls and procedures that managers have in place and seeks to determine actual compliance with those procedures, often suggesting modifications, separation of responsibilities, and remedial service provider, technology, or staff additions.

This document also represented that "our investment philosophy requires that . . . Single

Manager funds [*e.g.*, Greenwich Sentry] . . . adhere to the following principles: Full Transparency – To securities level, for FGG portfolio analysis and risk monitoring." (*id*. at page 8). The "pitch book" for Fairfield Sentry (at page 8), given to plaintiff before its investment as representative likewise of Greenwich Sentry, described among the "value added by FGG" "maintain[ing] full transparency to [Madoff] accounts" and "independent verification of prices and account values".

38. In a due diligence questionnaire response ("DDQR") prepared by FGG regarding FGB's purported due diligence and risk monitoring procedures, titled "Fairfield Sentry Limited" but given to plaintiff prior to its investments and represented as applicable to Greenwich Sentry, FGG stated that:

(a) FGB conducts "detailed daily compliance monitoring of portfolio activity against all risk limits";

(b) FGB maintained a list of [known] approved counter parties [which are] well capitalized investment banks, with respect to counter parties for OTC options;

(c) FGB assured that, with respect to primary back office functions (trading, accounting, settlement and custody), back office professionals could not execute jobs they were not authorized to perform;

(d) "The Fund's NAV is computed independently by Citco. . . . [who] independently verifies pricing and trading and reconciles with the broker and FGB on a monthly basis[, and that] [t]he Finance Group of FGB also recalculates the NAV and verifies for accuracy";

(e) the Madoff Firm confirmed trades back to FGB, and FGB manually reviewed all written confirms;

(f) the Madoff Firm possessed the sophisticated algorithmic technology and trade order execution systems required for the implementation of the SSC Strategy.

39. The Managed Funds Association ("MFA") is the leading hedge fund industry trade group. MFA leads the alternative investment industry in the development of standards of operational practices that promote investor protection and the prevention of systemic risk. In connection therewith since 2002 the MFA has published industry standards entitled "Sound Practices for Hedge Fund Managers" ("Sound Practices") .

40. FGG, Citco Fund Services (USA) Inc. and PWC are members of the MFA:

(a) Douglas Reid, a member of FGG's investment committee, co-authored the original "Sound Practices for Hedge Fund Managers" which was updated in 2003, 2005, 2007 and 2009 by the MFA;

(b) Citco is a member of the Strategic Partners Group of the MFA and William Keunen, head of Citco Fund Services (USA), Inc. sits on the board of directors the MFA; and

(c) PricewaterhouseCoopers, LLP is a member of the Strategic Partners Group of the MFA and Mark Casella, the alternative investment fund/real estate assurance leader sits on the board of directors the MFA.

41. In 2007 Sound Practices required FGB to do the following:

3.1 A Hedge Fund Manager should establish procedures to inde-

> pendently verify the existence of financial assets and liabilities
>
> The existence of financial assets and liabilities is a critical element in the computation of NAV. A Hedge Fund Manager should develop practices to ensure trades are processed accurately and on a timely basis. A Hedge Fund Manager should establish these practices based on a review and understanding of the Hedge Fund Manager's business structure. A Hedge Fund Manager should establish, implement, and enforce robust policies, procedures, and internal controls for each stage of the trading cycle, including: trade initiation; execution; confirmation; settlement; reconciliation; and accounting.

42. The 2007 Sound Practices required FGB to have in place a risk management structure (§ 4.3) and "controls to protect the integrity of information used in its risk measurement, monitoring, and management processes." In that regard §4.16 states (emphasis added):

> A Hedge Fund Manager should seek to limit a Hedge Fund's exposure to potential operational risks, including reconciliation errors, data entry errors, **fraud**, system failures, and errors in valuation or risk measurement models.

43. Any material departure from FGB's represented practices would call into question the due diligence and internal controls at FGB so that Citco and/or PwC could not rely on the services performed by FGB as a basis for their respective services.

44. Additionally, in operating Greenwich Sentry, the Greenwich Sentry General Partners were expected, as a matter of industry practice and the understanding of the Limited Partners based upon representations of and acknowledgments by Greenwich Sentry and the Greenwich Sentry General Partners, and/or were required by standards of due care and fiduciary principles, to, *inter alia*:

(a) have a defined risk policy in place to actively monitor and manage risk relating to asset protection, trading, counter party risk and operational risk;

(b) maintain and verify records of trading procedures, including detailed information on all trades, and with respect to OTC derivatives, establishing a basis to track the trading documentation and key provisions such as events of default; and

(c) secure accuracy in financial reporting and asset valuation of the Fund and the investors' assets.

## B. THE ROLE OF CITCO

45. Citco held itself out as having highly specialized expertise, policies and procedures to ensure that the reports it issued, including those issued by Citco as to Greenwich Sentry's portfolio and limited partners' NAV valuations, would be verified and accurate, and that any issues or questions pertaining thereto would be investigated and resolved internally or in discussions with management, or if not resolved, Citco would cease to issue unqualified NAV reports.

46. Citco held itself out to the public as a fiduciary to investors in a fund when acting as its administrator. Citco knew that it was a fiduciary to investors when acting as a fund administrator, and knew that investors relied upon it as such and encouraged that reliance. For example, the Citco Fund Services website states that:

> By providing fully independent services, we act as a reliable fiduciary to safeguard the interests of investors. We train our staff to provide specialist accounting and valuation support, investor relations, corporate services and day to day management.

47. With respect to NAV reports to investors, William Keunen, the Global Director of Fund Services for Citco Group wrote, "the administrator's primary responsibility is as a fiduciary

agent to a fund's investors. In addition, the administrator should be relied upon for an independent verification role that is efficient and accurate."

48. By virtue of the position of trust and confidence which Citco undertook and represented that it had undertaken, and by virtue of the trust and confidence which Plaintiff placed in Citco as detailed herein, Citco was a fiduciary to Plaintiff.

49. The Greenwich Sentry PPM represented, *inter alia*, that Citco Europe was:

> to provide certain financial accounting, administrative and other services [as well as] . . . registrar and transfer agent services. [Citco Europe] . . . has delegated the accounting, registrar and transfer services to Citco (Canada) Inc. (the "Sub-Administrator"). ***
>
> [T]he Administrator will be responsible, *inter alia*, for the following matters for the Partnership under the general supervision of the General Partner:
>
> • communicating with Limited Partners;
>
> • maintaining the record of accounts;
>
> • processing subscriptions and withdrawals;
>
> • preparing and maintaining the Partnership's financial and accounting records and statements;
>
> • calculating each Limited Partner's capital account balance (on a monthly basis);
>
> • preparing financial statements;
>
> • arranging for the provision of accounting, clerical and administrative services; and
>
> • maintaining corporate records.

Greenwich Sentry PPM at 11-12.

50. The Greenwich Sentry PPM was sent to each Limited Partner by Greenwich

Sentry in advance of the partner's investment. The Greenwich Sentry PPM was approved by Citco prior to its circulation.

51. Pursuant to the Greenwich Sentry PPM, Citco's fees in relation to Greenwich Sentry were a percentage of the stated Net Asset Value of the Fund. Citco had a financial motive to inflate or overstate Greenwich Sentry's NAVs, and/or had a financial motive to overlook, disregard, minimize, or fail to disclose information which would decrease Greenwich Sentry's stated NAVs.

52. Citco Europe and Citco Canada undertook to be mutual agents for one another with respect to their duties as Administrator and Sub-Administrator of Greenwich Sentry. Citco Europe and Citco Canada, as detailed herein, were acting as agents for Citco Group.

53. As a fund administrator, Citco was required to perform its duties with due care based upon industry standards and practices, including without limitation the standards and practices which Citco itself touted that it adhered to in fund administration.

54. As a fiduciary, Citco was required to perform its duties with utmost care and loyalty to plaintiff.

55. In light of its status as the "world's top hedge fund administrator", participation in hedge fund administration regulatory organizations, experience in the hedge fund industry, and familiarity with the operations of FGG, Greenwich Sentry and Fairfield Sentry, Citco knew that:

(a) its central obligation as administrator was the accurate valuation of the NAV's of plaintiff and other investors in Greenwich Sentry;

(b) owing to the lack of transparency of the Madoff Firm's operations to investors in Greenwich Sentry, Citco's role in investigating, confirming and

verifying the existence and accuracy of the Madoff Firm's reported results was a critical source of primary accurate information for plaintiff and others in making decisions to invest in, and/or maintain investment in, Greenwich Sentry;

(c) the limited partnership interests in Greenwich Sentry were not publically traded, there was no independent market evidence to value or support plaintiff's NAV statements, and that Citco's responsibilities in independently investigating, confirming and verifying the value of plaintiff's investment were heightened;

(d) as John M.S. Verhooren, a Citco officer, told the publication Hedge Funds Review in May 2003, aside from verifying NAV's, monitoring operational risk was the single most important responsibility of a fund administrator, and that "in those cases where the finger can be pointed at fraud and misrepresentation, water-tight operational standards can either reduce the size of losses or enable them to be uncovered at a much earlier stage";

(e) as Verhooren further acknowledged, "[i]nstitutional investors want an institutional quality administrator with experienced and appropriately qualified staff, independent pricing and valuation procedures, and the technology to support its enhanced role";

(f) its status as Fund Administrator, including the expectation that careful execution of its responsibilities would assure the integrity and safety of the investment and accuracy of financial reporting, would be of critical importance to a sophisticated investor deciding to make an investment in Greenwich Sentry or to retain an existing investment (just as plaintiff did herein);

(g) the Greenwich Sentry PPM would be sent to prospective investors, and that such investors would know or expect that Citco had approved the PPM prior to circulation, and that such investors would draw comfort from and rely upon Citco's approval of that document as verifying its accuracy, including the description of FGB's and Citco's procedures; and

(h) FGG and/or FGB had represented in writing to potential or existing investors that: "Citco independently verifies pricing and trading and reconciles with the broker and [FGB] on a monthly basis"; Citco "independently calculates the final monthly NAV of the Fund"; and "Citco independently computes monthly performance and NAVs for FGG funds as well as separate accounts".

56. With respect to plaintiff's funds, Citco was obligated to:

(a) maintain true and accurate financial books and records of Greenwich Sentry;

(b) receive, request, evaluate, confirm and verify information from the Madoff Firm sufficient to verify the reported results;

(c) investigate, confirm and verify the trading activity of the Madoff Firm and its pricing;

(d) investigate, confirm and verify the NAVs reported by the Madoff Firm;

(e) investigate, confirm and verify the data in Greenwich Sentry's monthly fund reports before circulation to plaintiff;

(f) accurately compute and verify the NAVs and capital account balances of Greenwich Sentry and each of its Limited Partners including plaintiff and advise

them of such, as well as any "profit" or "appreciation" or lack thereof;

(g) confirm the implementation, execution, and success of the investment strategy described in the Greenwich Sentry PPM;

(h) determine whether any operational risk at FGB or the Madoff Firm affected the reliability of the reported results;

(i) determine whether FGB had conducted the due diligence required to assure the integrity of the reported results, and whether it had conducted the due diligence it represented it would conduct;

(j) ensure that FGB complete any due diligence which Citco determined had not been completed, and itself perform any due diligence which FGB ultimately did not perform, prior to issuing NAVs to plaintiff;

(k) communicate directly with the limited partners including plaintiff;

(l) oversee the subscription process, and receive and process investments by new and existing Limited Partners;

(m) calculate and administer redemptions, withdrawals, and/or distributions of "capital", "profits" and "appreciation" to Limited Partners, and communicate with Greenwich Sentry, its Limited Partners, and others (including without limitation the Madoff Firm) with respect thereto;

(n) supervise the payment of Greenwich Sentry's expenses, and perform day-to-day administrative services for Greenwich Sentry and its Limited Partners; and

(o) undertake reconciliations, and review the accounts and securities of Greenwich Sentry at the Madoff Firm.

57. Citco played a further critical role as liaison with PWC in connection with its audit of Greenwich Sentry's annual financial statements. Citco knew that the financial statements and bookkeeping records of Greenwich Sentry were to be maintained and prepared in accordance with GAAP in order for PWC to report thereon in accordance with GAAS.

58. Citco represented to the public that since 2003, it had obtained a SAS 70 Type II unqualified audit from Ernst & Young, LP. An SAS 70 Type II report represents that a service organization has been through an in-depth audit of their control objectives and control activities by an independent accounting and auditing firm.

59. Citco Europe and Citco Canada acted as Fund Administrators for Greenwich Sentry in the capacity of agents, express or implied, for Citco Group, inasmuch as :

(a) Citco Group holds itself out to the public as a fully integrated company comprised of approximately 46 offices in 27 countries around the world, including Citco Europe, Citco Canada, and two "offices and locations" in New York City.

(b) Citco's website describes its "subsidiaries" as parts of its operating divisions, and the whole is collectively referred to thereon as a single entity, "Citco". All Citco Group "subsidiaries" use the same Citco logo on their letterhead – emphasizing the global, integrated nature of Citco Group. Citco Group holds itself out as an integrated corporate structure and represents that it, with its "subsidiaries", constitutes a "global fund administrator" and that the combined enterprise provides a "consistent service platform".

(c) The managing director of each Citco office providing fund administration services, including defendants Citco Europe and Citco Canada, report to and take

direction from William Keunen ("Keunen"), who was or is the Global Director of Fund Services for Citco Group, and operates from its Miami office. Keunen, in turn, reports to and takes direction from the executive committee of Citco Group.

(d) Citco maintains substantially all information as to its worldwide clients and the funds it administers in a single, centralized computer database and manages such through a single "dedicated Information Technology Group".

(e) Citco Group holds itself out as the world's top provider of hedge fund administration services. Since Citco Group has no independent revenues of its own, and all of its revenues are derived from its operations through its "subsidiaries", it could only be the "world's top provider" if its operations are considered aggregated as one entity, with each "office" or "subsidiary" as an arm and agent of Citco Group.

(f) Brian Francoeur was or is the Managing Director of Citco Fund Services (Bermuda) Limited, yet another of Citco Group's "offices and locations". After joining Citco, he was appointed by Citco as a Director of FGB, further demonstrating the agency relationship existing between and among the Citco "offices", and between each of them and Citco Group. The knowledge acquired by Francoeur in this capacity is imputed to Citco. As a director of FGB, Francoeur had an obligation to fully familiarize himself with the business, operations, and standards of FGB, and bring to bear his experience and learning in fund administration in acquiring such knowledge. Citco knew that no board oversight was being conducted of FGB.

(g) In collecting and managing funds for Greenwich Sentry, Citco required investors to make wire transfers or checks payable to the account of Citco Banking Corp., N.V., yet another "office or location" of Citco, which was acting as the agent of Citco Group, Citco Europe and Citco Canada.

(h) In its normal business practice, in each of its engagements, any of Citco's offices would report to and take direction from, ultimately, the risk reporting and global monitoring personnel at Citco Group, and be subjected to the oversight and control of Citco Group.

## C. THE ROLE OF PWC

60. PWC and its sister offices hold themselves out as a leading accounting and auditing firm with specialized expertise in hedge funds and investment vehicles.

61. PWC consented to FGB identifying it as the auditor and accountants for Greenwich Sentry.

62. PWC knew that the Greenwich Sentry PPM was to be used as the basis for continued solicitation of limited partners into Greenwich Sentry. PWC knew and intended that the Limited Partners, including Plaintiff, would rely on PWC to perform its services in accordance with the highest professional standards applicable thereto and also knew that, because of its standing in the financial community, its decision to become the auditor of Greenwich Sentry added to the purported safety and quality of the Greenwich Sentry offering.

63. Each year, PWC conducted an audit which it stated it had conducted in accordance with auditing standards generally accepted in the United States, and issued an unqualified

audit report attesting to the accuracy of Greenwich Sentry's financial statements in accordance with accounting principles generally accepted in the United States. These reports were addressed "to the partners of Greenwich Sentry, LP".

64. The Greenwich Sentry PPM which PWC reviewed and approved stated that:

> The Partnership's independent certified accountants (selected by the General Partner) will audit the Partnership's books and records as of the end of each fiscal year. Within 90 days after the end of each fiscal year the Partnership will mail to the Limited Partners the Annual Report prepared by its independent certified public accountants setting forth a balance sheet of the Partnership, a profit and loss statement showing the results of operations of the Partnership and its Net Capital Appreciation or Net Capital Depreciation, a statement of such Partner's Capital Account and the manner of its calculation and the Partnership Percentage as of the end of the prior fiscal year. At the end of each fiscal year, each Partner will be furnished the required tax information for preparation of their respective tax returns. Within 30 days following the end of each fiscal quarter in each fiscal year, each Partner will be mailed unaudited financial information setting forth, inter alia, a statement of its Net Capital Appreciation or Net Capital Depreciation; provided, however, that the General Partner may send out reports on a more frequent basis and has elected to provide monthly reports within 30 days following the end of each month.

Greenwich Sentry PPM at 36-37.

65. PWC had complete access to Greenwich Sentry's books and financial records and was fully familiar with the management, business practices and procedures of Greenwich Sentry.

66. PWC was also the auditor for FGB. As the auditor for FGB, PWC had an obligation to understand the business of FGB and the environment in which it operated. As such, PWC had a broader and deeper knowledge of FGB's business, organization, and operating characteristics than would have been available to it if it was only the auditor for Greenwich Sentry. PWC understood or should have understood the standards, practices and procedures both Greenwich Sentry and FGB and the nature and extent of the interactions between them. As a

result of the foregoing, PWC knew or should have known that FGB was not conducting its due diligence for Greenwich Sentry in the manner it and FGG represented that it would be or was doing. PWC knew that there were no internal controls in place to assure the capture of accurate information about the Madoff Firm and plaintiff's investment.

67. Under GAAS, PWC had an obligation to obtain an understanding of the internal control of Greenwich Sentry and FGB sufficient to assess the risks of material misstatements of GS's financial statements. A significant component of the risks of material misstatement is the control risk: the risk that controls will fail to prevent or detect a material misstatement of financial statements.

68. AU 325.32 defines internal control as the

> .03 [] process—effected by those charged with governance, management, and other personnel—designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives.
>
> .06 A significant deficiency is a control deficiency . . . that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably. . . . A material weakness is a significant deficiency . . . , that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

69. The Appendix to AU 325.32 states that among the deficiencies in the design of internal controls and failures of the operation of internal control which may reflect a significant deficiency or material weaknesses are: "absent or inadequate controls over the safeguarding of assets . . . [or a] "failure of controls designed to safeguard assets. . . ."

70. For audits of financial statements for calendar year 2007, the second standard of

field work of GAAS states:

> The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and design the nature, timing, and extent of further audit procedures.

AU 314.01, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.

71. For audits of financial statements for calendar years prior to 2007, the second standard of field work of GAAS states: "A sufficient understanding of internal control is to be obtained to plan the audit and to determine the nature, timing and extent of tests to be performed." AU 150.02, Generally Accepted Auditing Standards.

72. While the wording of these standards differs to some extent, the basic concept and implications for performance of the audit are the same. In every audit, the auditor needs to learn enough about internal control to know what can go wrong, in a material way, in preparing the financial statements and plan and perform the audit to obtain reasonable assurance that those potential material misstatements will be detected.

73. This means that PWC needed to understand the components of the internal control of Greenwich Sentry and FGB sufficiently to identify the potential material misstatements of financial statements permitted by those controls. Under the standards, both for calendar year 2007 and before, internal control consists of the five interrelated components of control environment, risk assessment, control activities, information and communication systems, and monitoring. AU 319.07, Internal Control in a Financial Statement Audit and AU 314.41.

74. Thus, in order to conduct an audit in accordance with GAAS, PWC was obligated

to understand GS's and FGB's business and the industry since the nature of GS's business and the industry affects GS's business risk and the risk of material misstatement in the financial statements.

75. Greenwich Sentry and FGB had no effective controls in place in their control environment, risk assessment, or control activities for selecting and monitoring Greenwich Sentry or any of the Funds' investments. This resulted in a significant risk that the financial statements of Greenwich Sentry would be materially misstated. PWC had an unequivocal obligation to identify this material weakness in controls, recognize the implications for the reliability of the financial statements, and plan and perform an audit to obtain reasonable assurance of detecting any material misstatements that had occurred. PWC failed to plan and perform audit procedures that were necessary in the circumstances to satisfy its obligations under GAAS and under the circumstances an unqualified report could not be issued.

76. PWC should have known that there was a material likelihood that there was "a material misstatement of the financial statements will not be prevented or detected." As alleged hereafter FGB's monitoring of the assets of Greenwich Sentry at the Madoff Firm was so deficient so as to make the data reported totally unreliable. In addition PWC knew that FGB had a material conflict of interest in that FGB's income was tied to the results reported and the greater the profits the greater FGB's income.

77. The Madoff Firm was a "service organization" pursuant to AU 332.12. AU 332.16 states:

> the auditor should identify specific controls relevant to the assertions that are likely to prevent or detect material misstatements and that have been placed in operation by either the entity or the service organization, and

> gather evidential matter about their operating effectiveness.
>
> * * *
>
> Confirmations of balances or transactions from a service organization do not provide evidential matter about its controls.

78. AU 332.20 states that if a service organization

> initiates transactions as an investment adviser and also holds and services the securities, all of the information available to the auditor is based on the service organization's information. The auditor may be unable to sufficiently limit audit risk without obtaining evidential matter about the operating effectiveness of one or more of the service organization's controls.

79. PWC did not follow AU 332. PWC never met with Friehling & Horowitz, the accountants for the Madoff Firm, or reviewed their work papers, and never had contact with the Madoff Firm except for two informal meetings which PWC told FGB were not "an audit nor an investigation of the internal controls of/at [the Madoff Firm]." Letter from PWC (Netherlands) to Fairfield Greenwich Advisors, LLC March 15, 2005.

80. In addition to the lack of compliance with GAAS, PWC did not comply with their own requirements. In 2007 PWC published "Auditing Alternative Investments A Practical Guide for Investor Entities, Investee Fund Managers and Auditors" ("Guide") in which stated:

> because the investments presented in an investor entity's financial statements represent the investor entity's assertion, **the auditor should not rely exclusively on information obtained from the investee fund manager while ignoring the investor entity's controls, including its monitoring process.**

Guide at 2 (emphasis added)

81. PWC continued: "**ongoing due diligence should be documented and maintained in management's files.**" Id. at 6 (emphasis added). PWC was clear: the "design and effectiveness of these controls are particularly important because they can effect the nature,

timing and extent of audit procedures performed by the investor entity's auditor over alternative investments." Id. at 4. PWC further stated that management should

> expect – and prepare for in advance – the external auditor's request for supporting documentation related to the investor entity's due diligence and valuation practices. **Good internal controls include strong documentation related to initial due diligence, on going monitoring and financial reporting controls.** * * * To the extent that management does not have sufficient information on its underlying investments, and/or sufficient evidence of such information, the auditor needs to consider the reporting implications.

Id. at 8 (emphasis added).

82. PWC knew no such documentation existed in the files of FGB to remotely support the representations made by FGB as required by GAAS and PWC.

83. Moreover it was not sufficient for PWC to merely confirm year end balances, since it was reporting on the results of operations, and PWC had to at least test that the trades and the results had actually taken place. AU 332.19-21.

84. PWC was required under GAAS to actively consider whether there was a risk that the financial statements it was auditing contained material misstatements due to fraud, to identify the risks thereof and to communicate those concerns, if any, to the management of Greenwich Sentry. Two types of fraud are of particular concern under GAAS: misstatements of financial condition and misappropriation of assets and their concealment by management and/or third parties. PWC was required to exercise "Professional Skepticism":

> The auditor should conduct the engagement with a mind set that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity. In exercising professional skepticism in gathering and evaluating evidence, the auditor should not be satisfied with less-than-persuasive evidence because

of a belief that management is honest.

AU 316, .13.

85. In order to perform its functions PWC's audit team is required to "brainstorm" about:

> how and where they believe the entity's financial statements might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent reporting and how assets of the entity could be misappropriated.

Id. at .14.

86. In that regard PWC was required to consider any unusual or unexpected relationships identified and to understand the entity's business and the industry in which it operates.

87. With respect to the audit work it performed for Greenwich Sentry, PWC was required by GAAS as well as the ethics of the auditing profession, to satisfy itself that:

(a) the financial statements of Greenwich Sentry on which it reported had been audited in accordance with GAAS; and

(b) the financial statements of Greenwich Sentry presented fairly its financial positions, and that they:

(i) gave a true and fair view in all material respects of the state of affairs of Greenwich Sentry, and the profits or losses and the source and application of funds of Greenwich Sentry; and

(ii) did not misstate or omit information which was material to truthful and fair presentation and understanding thereof;

(c) maintain independence and due professional care in performing the

examination and preparing the audit report;

(d) perform a proper study and evaluation of existing internal controls and additional testing procedures to serve as a basis of reliance for audit procedures;

(e) obtain sufficient competent evidence to afford a reasonable basis for an opinion regarding the financial statements under audit;

(f) fulfill its responsibilities for the detection and reporting of errors and irregularities;

(g) consider, evaluate and disclose the entity's ability to continue as a going concern;

(h) provide a statement that informative disclosure in the financial statements is to be regarded as reasonably adequate unless otherwise stated;

(i) appropriately qualify its opinion when an unqualified opinion on the financial statements as a whole cannot be expressed; and

(j) disclose sufficient information to enable the reader to appreciate the nature of the transactions reported upon;

(k) consider the materiality of and likelihood of significant error in the information supplied to it;

(l) evaluate such information to determine whether it was sufficiently relevant and reliable for PWC to draw reasonable conclusions from it;

(m) consider whether there were any alternative sources of audit evidence;

(n) consider the relationship among Greenwich Sentry, Citco, and the Madoff Firm;

(o) issue a qualified audit report if it believed that such information was insufficient to enable it to draw reasonable conclusions;

(p) obtain relevant and reliable evidence to enable it to prepare the financial information to be included in its report;

(q) form an opinion on that information, satisfy itself that all relevant information has been considered with due care; and

(r) disclose details of any contingent liabilities.

88. PWC undertook to, and was obligated to, communicate directly with plaintiff and the other limited partners with respect to the value of income realized on investments in Greenwich Sentry for tax purposes and in other respects.

89. With respect to accounting work it performed for Greenwich Sentry, PWC was required by GAAP to satisfy itself that the statements, reports and analyses which it compiled, presented, reported upon did not contain material misstatements or omissions of fact.

90. With respect to accounting work it performed for Greenwich Sentry, PWC was required to adhere to the following principles of GAAP:

(a) disclosure should be adequate and fair;

(b) the financial information presented should be complete and show a "true and fair view";

(c) the commercial effect of the transactions should be analyzed; and

(d) all of the entity's transactions should be considered as a whole.

91. With respect to the accounting and auditing work it performed for Greenwich Sentry, PWC was required to withdraw and/or correct any opinion it had previously issued on the

financial statements of Greenwich Sentry, and/or to correct any statements, forecasts, reports and analyses (or assumptions relating thereto) which it compiled, presented, reported upon, or assisted as to, upon learning that such materially misstated and/or omitted material facts.

92. PWC knew and intended that the audit reports, statements, reports and analyses which it compiled, presented, reported upon, or assisted as to, were material to the true and fair presentation and understanding of the financial position and affairs of Greenwich Sentry, and intended that they would be relied upon by Greenwich Sentry and the Limited Partners.

93. PWC knew that the limited partnership interests in Greenwich Sentry were not publically traded, that there was no independent market evidence to value or support plaintiff's NAV statements, and that its oversight and audit responsibilities were therefore heightened.

94. Further, Citco and PWC knew, because the limited partnership interests in Greenwich Sentry were not publically traded and no other independently verified third-party financial information about Greenwich Sentry was available to Limited Partners or prospective Limited Partners of Greenwich Sentry other than Citco's NAVs and PWC's audit reports and audited financial statements, their NAVs and unqualified audit reports and audited financial statements would be the primary sources of information to Plaintiff and would be relied upon in making investment decisions with respect to its investment in Greenwich Sentry. The Limited Partners, including Plaintiff, reasonably and foreseeably did in fact so rely.

95. PWC issued unqualified reports and permitted the annual financial statements of Greenwich Sentry to contain such reports.

96. PWC represented that its annual examinations had been made in accordance with GAAS and that the financial statements presented fairly the financial positions of Greenwich

Sentry at the respective dates, and in conformity with GAAP. PWC further represented that its examinations "gave a true and fair view of the state of affairs of Sentry as at [the respective date] and of the results and source and application of funds for the [year/period] then ended ".

97. PWC knew or should have known of any infirmities in the methods of operation or presentation of financial statements of any FGG entity discovered in the course of audit by any other PWC office.

98. PWC undertook, upon becoming the accountants and auditors for Greenwich Sentry, to "prepare and annual audited financial report setting forth a balance sheet of [Greenwich Sentry], a profit and loss statement showing the results of operations of [Greenwich Sentry] and its net capital appreciation or net capital depreciation, a statement of such Partner's closing capital account and the manner of its calculation and the Partner's opening capital account and partnership percentage for the then current fiscal year." These statements were addressed to and prepared for the individual benefit of each partner, including plaintiff. These statements were not required to be furnished by statute.

99. PWC knew that the only activity of Greenwich Sentry was to serve as a vehicle for the investments of individual partners to be aggregated and placed with the Madoff Firm. PWC knew that Greenwich Sentry was prohibited from borrowing money, and that therefore the sole or primary purpose of the financial statements and its opinions was for existing and prospective partners and not outside parties.

100. PWC knew, at the time that it undertook to perform these services, that they were being rendered for the benefit of the individual partners, including plaintiff. PWC knew that the partners, including plaintiff, would rely upon the financial information and opinions it did and

would provide. PWC placed no restrictions upon the use or application of its reports or opinions.

101. PWC knew that no potential investor would invest in Greenwich Sentry if PWC's opinions on its financial statements were qualified. PWC knew that existing investors would demand redemption if it issued qualified opinions on its financial statements, or refused to issue an opinion or withdrew from engagement.

102. PWC knew that its affiliation with Greenwich Sentry would increase the reputability and marketability of Greenwich Sentry, and that issuance by it of unqualified opinions were necessary for the marketability of Greenwich Sentry.

103. Membership in Greenwich Sentry was statutorily limited to being under 500 partners and was limited to an aggregate investment of $500 million. PWC knew that the financial statements and its opinions were being used to market Greenwich Sentry to prospective partners until those limits were reached and raised no objections. The investors and potential investors in Greenwich Sentry were a small, known and discrete group, including plaintiff. Plaintiff's investment represented approximately 20% of the entire capital of Greenwich Sentry at the time it was made.

## D. PLAINTIFF'S INVESTMENTS IN GREENWICH SENTRY

104. The Stephenson Trust is a Limited Partner in Greenwich Sentry, by having invested $60 million in Greenwich Sentry in 2008 and by executing one or more subscription agreements in 2008.

105. Plaintiff made its investments in Greenwich Sentry, pursuant to the instructions of FGB, FGG and Citco, and under a procedure approved by PWC, by wire transferring its funds to

a bank account in the name of Citco Banking Corp., N.V. at HSBC Bank in the State and County of New York, for the purpose of transfer to an account in the name of Greenwich Sentry and eventual transfer to an account maintained by Greenwich Sentry with the Madoff Firm for management and investment. In receiving and/or transmitting those funds, Citco Banking Corp., N.V. was acting as the agent of Citco Group, Citco Europe and Citco Canada.

106. On or about February 20, 2008, prior to making any investment in Greenwich Sentry, Plaintiff received documents with respect to the structure and operation of Greenwich Sentry's sister fund, Fairfield Sentry, and was explicitly told that similar documents for Greenwich Sentry were not yet available, but that Plaintiff could rely upon the information in the Fairfield Sentry documents as accurate and representative of the structure, operation, and performance results of Greenwich Sentry, including the fact that Citco was the fund administrator and a PWC office was the auditor. These documents included:

(a) the Private Placement Memorandum of Fairfield Sentry;

(b) a "pitch book", i.e., a printout of a Powerpoint presentation, for Fairfield Sentry;

(c) two "tearsheets" of net historical performance data, dated February 2007 and January 2008, based on NAV reports prepared by Citco, for the Fairfield Sentry Fund as a whole, showing a track record of consistent and impressive positive gains or "profit"; and

(d) a "due diligence questionnaire" describing in detail the operation of and protections in FGG's funds, and the roles of Citco and PWC.

107. On or about February 27, 2008, again prior to making any investment in Green-

wich Sentry, Plaintiff received a "return attribution analysis" for the Fairfield Sentry fund, showing net profits of 9.38% in 2006 and 7.34% in 2007. Based upon discussions with FGG, plaintiff understood that these results, like others received for Fairfield Sentry, reflected the results of the Madoff Firm's strategy and were therefore representative of results for Greenwich Sentry as well.

108. In addition, during March 2008, and prior to making any investment in Greenwich Sentry, Plaintiff received *inter alia* the following written information with respect to Greenwich Sentry:

(a) an estimated monthly fund report for Greenwich Sentry for February 2008, showing a gain of .12% and a YTD gain of .89% (the latter being an annualized gain of 5.34%), and comparing Greenwich Sentry's performance against losses in the Dow Jones Industrial Average of -3.04% in February and -7.53% year-to-date), and against losses in the S&P 500 Index of -3.25% in February and -9.05% year-to-date;

(b) a final monthly fund report for Greenwich Sentry for February 2008, showing substantially the same information as the estimated report previously transmitted;

(c) estimated weekly fund reports for Greenwich Sentry for each week in March 2008 showing, in each week, month-to-date and year-to-date gains, as against month-to-date and year-to-date losses in the S&P 500 Index (including, for the month-to-date ending March 24, 2008, Greenwich Sentry gains of 0.28% month-to-date and 1.17% year-to-date, as against S&P 500 Index losses of -1.16%

month-to-date and -10.43% year-to-date);

(d) the Greenwich Sentry Limited Partnership Agreement;

(e) the Greenwich Sentry PPM; and

(f) the Greenwich Sentry Subscription Agreement.

109. Plaintiff knew prior to its initial investment, from the documents it received and its discussions with FGG, that Citco was the administrator for the Greenwich Sentry and Fairfield Sentry funds. From plaintiff's previous investment experience and the documents given to it by FGG, plaintiff knew that Citco was a global "blue chip" fund administrator, with a reputation for and stated approach of diligence in verifying the accuracy of investment valuations and monitoring the performance and risk of investment vehicles. Plaintiff understood that the documents given to it by FGG were approved by Citco on the basis of its discussions with FGG, as well as its understanding that in a fund of this type, it is the norm for fund administrators to actively review, monitor, comment upon and approve the fund's offering and marketing documents, particularly those in which the fund administrator's name appears.

110. Plaintiff knew prior to its initial investment that PWC was the auditor for the Greenwich Sentry and Fairfield Sentry funds. From plaintiff's previous investment experience and the documents given to it by FGG (which it understood had been approved by PWC), plaintiff knew that PWC was an internationally-known and reputed "Big Four" accounting and auditing firm, again with a reputation for and stated approach of diligence in verifying the accuracy of investment valuations, monitoring the performance and risk of investment vehicles, and verifying that the general partner in a fund was following its own stated procedures. Plaintiff understood that some or all of the documents given to it by FGG were approved by PWC on the

basis of its discussions with FGG, as well as its understanding that in a fund of this type, it is the norm for auditors and accountants to actively review, monitor, comment upon and approve the fund's offering and marketing documents, particularly those in which their name appears.

111. Based upon plaintiff's previous investment experience, plaintiff knew and believed that when investing in a hedge fund, particularly one which employs a strategy where there is little or no transparency in the trading methodology, a reputable and diligent administrator and auditor were critical to protect the investment and make certain that the fund manager is performing its duties properly. The importance of the administrator's and auditor's role was heightened in plaintiff's decision making by the fact that FGB received substantial fees based upon the success of the fund, which may give it a conflicting motive in approving the fund's performance figures. The due diligence, monitoring and investigation which Citco and PWC would perform was a critical factor in plaintiff's decision to invest.

112. The engagement of nationally- or internationally-known fund administrators and accountant/auditors, *i.e.*, Citco and PWC, was a prerequisite to plaintiff's decision to invest in Greenwich Sentry. Plaintiff would never have invested in Greenwich Sentry without the presence of a prominent accounting firm as auditor for Greenwich Sentry and similarly renowned fund administrator.

113. Plaintiff specifically asked, and was informed by FGG, that: both Greenwich Sentry and Fairfield Sentry had an impressive track record of results; that their NAVs and other financial documents had been prepared and approved by Citco without qualification or reservation; that the financial statements of the funds had been audited and approved unqualifiedly by PWC; that neither had expressed concerns about any material issues with respect to the invest-

ments or operational risk associated therewith; and that PWC's opinion would be issued shortly. These representations were confirmed by documents contemporaneously or later received by Plaintiff. This information was critical to plaintiff's decision to initially invest in Greenwich Sentry, and it would not have invested if it did not have this understanding and information.

114. Plaintiff knew and understood that the "tearsheets" of financial results for the substantially similar Fairfield Sentry fund which it received in February 2008 were based upon performance which had been confirmed and approved by Citco without qualification, and were based upon unqualified audited results by PWC, inasmuch as such tearsheets conventionally in the industry would have indicated thereon if such were NOT the case. Plaintiff relied upon the accuracy and completeness of these figures, and the absence of any qualification to such figures, as demonstrating that Citco and PWC had completed due investigations and determined the valuations and underlying transactions were accurate and valid.

115. In making its decision to invest in Greenwich Sentry in or about April 1, 2008, Plaintiff received, read, reviewed and foreseeably and reasonably relied upon the accuracy of the information contained in the foregoing documents and conversations.

116. The Subscription Agreement for Greenwich Sentry executed effective April 1, 2008 was in the name of G. Philip Stephenson as an individual. By letter dated May 1, 2008, Stephenson requested that his account be transferred to his revocable inter vivos trust, he was advised by Citco and FGG that a new and separate subscription agreement would have to be entered.

117. On or about May 23, 2008, Stephenson executed a new subscription agreement effective June 1, 2008, in the name of the Stephenson Trust, and the stated funds in the prior

account were transferred by Citco to a new account.

118. After execution of the original subscription agreement dated as of April 1, 2008 and prior to execution of the subscription agreement dated as of June 1, 2008, Plaintiff received, read, and foreseeably and reasonably relied upon the accuracy of the following documents in order to determine to execute said latter document and to continue its investment:

(a) the financial statements for Greenwich Sentry for 2006 and 2007, which had been audited by PWC, together with PWC's unqualified opinion;

(b) from Citco, an NAV statement for Plaintiff's account for April 2008 computed and prepared by Citco, showing significant stated "appreciation"**;** and

(c) monthly fund reports for Greenwich Sentry for March and April 2008 computed and prepared by Citco, showing consistent gains and stable year-to-date performance.

119. Between April 1, 2008 and December 11, 2008, Plaintiff received monthly NAV statements from Citco which ostensibly showed that Plaintiff's investment was increasing in value. Citco advised Plaintiff that, between April 1 and October 31, 2008, in the course of the seven monthly NAV statements which it transmitted under its letterhead:

(a) the equity of Plaintiff's $60 million had risen by more than $2½ million, to $62,540,565 (even net of Management Fees, Incentive Fees, and other "operational expenses");

(b) Plaintiff had net appreciations in equity within each and every month, of between .08% and .86%, even in the face of a declining market;

(c) Plaintiff had a net appreciation in equity of 4.23% on its investment over a

mere seven months;

(d) based upon the foregoing, Plaintiff's investment had annualized net gains of between 7.14% and 9.12% at the conclusion of each month from April through October 2008, even in the face of a declining market.

120. No qualifications or reservations were noted on the statements received from Citco.

121. During the period from June 1 to December 11, 2008, plaintiff regularly received estimated and final monthly Fund Reports for Greenwich Sentry which consistently showed month-to-date and year-to-date gains for Greenwich Sentry, as against losses for the Dow Jones Industrial Average and the S&P 500 Index. By the end of November 2008, these Fund Reports showed year-to-date gains for Greenwich Sentry of 6.59%, as opposed to year-to-date losses for the Dow Jones Industrial Average of -33.44%, for the MSCI World Index of -43.80%, and for the S&P 500 Index of -37.65%.

122. Plaintiff foreseeably and reasonably relied upon the accuracy of these statements in determining to allow its funds to remain invested in Greenwich Sentry.

## E. GREENWICH SENTRY IS DISCOVERED TO BE PART OF A PONZI SCHEME

123. In December 2008, the Madoff Firm admitted to operating funds which he and it managed (which includes Greenwich Sentry) as part of a Ponzi scheme under which profits were falsely reported from the trading activities. In fact, there were no profits, and the Madoff Firm was using investments made by newer Limited Partners to pay fictitious profits to earlier Limited Partners, in essence “robbing Peter to pay Paul”.

124. To avoid detection of the Ponzi scheme, retain existing investors, and obtain new victims (until early December 2008, when the scheme fell apart), the Madoff Firm honored requests by existing investors to redeem all or part of their stated "profits" and/or capital.

125. Thus, requests by Limited Partners in Greenwich Sentry for such redemptions or return, which could be made at the end of any month pursuant to the governing agreement, were made to Greenwich Sentry and/or Citco, which then forwarded such requests to the Madoff Firm. Madoff acted on those requests and forwarded the funds to Greenwich Sentry and/or Citco, which in turn returned funds to the requesting Limited Partners. These redemptions were an integral and essential element of scheme in order to avoid collapse and disclosure of the Ponzi Scheme.

126. In December 2008, Madoff was indicted for running this Ponzi scheme.

127. Madoff's actions were a classic "Ponzi" or "pyramid" scheme. Greenwich Sentry's funds were handled pursuant to and as part of this "Ponzi scheme".

128. As a direct result of this Ponzi scheme:

(a) Greenwich Sentry reported fictitious results;

(b) any Limited Partner that withdrew "profits" or "capital" had either no "profits" and/or "capital" or less capital than was stated; and

(c) any Limited Partners that increased their "capital" by "reinvesting profits" or making fresh capital contributions had a "capital" account and share of "profits" that was falsely increased.

129. On or about December 11, 2008, upon learning of the Madoff Ponzi Scheme, Plaintiff requested withdrawal of the entirety of its capital account effective immediately.

Plaintiff's request was ignored by FGB and Citco. Instead, Plaintiff subsequently learned that redemptions and/or withdrawals from Greenwich Sentry had been suspended. Plaintiff has received back none of its original investment of $60 million, or any profits, dividends, returns or distributions of any kind on that investment.

130. Plaintiff's investment in Greenwich Sentry has been essentially, and unnecessarily (but for the failures of defendants), wiped out completely.

131. The failure of the defendants to acquit their respective obligations, as alleged herein, was a cause of both inducing Plaintiff to invest and thereafter to continue to maintain its investment in Greenwich Sentry and but for their breaches it would not have invested and thereafter continued its investment.

132. On March 12, 2009 Madoff pled guilty to running a Ponzi scheme and acknowledged that no securities were ever traded, there were never any "profits"and any payment of "profits" was made from the capital of other, newer, investors:

> THE COURT: Mr. Madoff, would you tell me what you did, please.
>
> MADOFF: Your Honor, for many years up until my arrest on December 11, 2008, I operated a Ponzi scheme through the investment advisory side of my business, Bernard L. Madoff Securities LLC. . . .
>
> ***
>
> The essence of my scheme was that I represented to clients and prospective clients . . . that I would invest their money in shares of common stock, options . . . and upon request, would return to them their profits and principal. Those representations were false for many years. Up until I was arrested on December 11, 2008, I never invested these funds in the securities, as I had promised. Instead, those funds were deposited in a bank account at Chase Manhattan Bank. When clients wished to receive the profits they believed they had earned with me or to redeem their principal, I used the money in the Chase Manhattan bank account that belonged to them or other clients to pay the requested funds.

> * * *
>
> To the best of my recollection, my fraud began in the early 1990s
>
> ***
>
> In fact, I never made those investments I promised clients, who believed they were invested with me in the split strike conversion strategy. To conceal my fraud, I misrepresented to clients, employees, and others that I purchased securities for clients in overseas markets.
>
> * * *
>
> [] I knowingly caused false trading confirmations and client account statements that reflected the bogus transactions and positions to be created and sent to clients purportedly involved in the split strike conversion strategy. . . .
>
> * * *
>
> Your Honor, I hope I have conveyed with some particularity in my own words the crimes I committed and the means by which I committed them.

(United States v. Madoff, Hearing Transcript, March 12, 2009 at 23-30).

133. FGB failed to adhere to standards of due care, fiduciary principles, standards of industry practice, and its own representations and acknowledgments of its undertakings and duties, by, *inter alia*, failing to follow any of the practices procedures it represented it undertook as set forth in Section A supra. and instead FGB relied upon the representations Madoff made without any independent verification of trading by and assets held by the Madoff firm. In addition FGB did not:

(a) reconcile and verify prices with the broker and Investment Manager;

(b) adhere to the Sound Practices detailed herein;

(c) implement risk oversight and monitoring, resulting in a material failure of internal control at FGB, and making any results reported by Greenwich Sentry subject to a high risk that such results were unreliable and subject to material misstatement;

(d) perform any due diligence to independently corroborate whether the

Madoff Firm was making the trades which it represented it was making or holding the assets it said it was holding on behalf of Greenwich Sentry, and instead relied upon the representations of the Madoff Firm;

(e) receive or insist upon contemporaneous trade confirmations from the Madoff Firm, instead receiving hard-copy "trade confirmations" days after the trades were purportedly made which made daily monitoring of positions impossible;

(f) confirm or verify the trading records of Madoff Securities International Ltd. ("MSIL") (a company owned by Madoff) or ensure that the assets of Greenwich Sentry were segregated at MSIL, although the Madoff Firm represented that many trades were made through MSIL on the Over-the-Counter market, after hours, in London;

(g) confirm or verify the trading of options which the Madoff Firm claimed were made through the Options Clearing Corporation ("OCC") in the U.S., as such investigation would have disclosed that the OCC had no records of such trades;

(h) confirm or verify that the volume of purchases and sales of options on the CBOE represented by the Madoff Firm to have taken place did not actually exceed the entire volume actually traded on that date;

(i) confirm or verify that the number of put and call options bought and sold on the US market represented by the Madoff Firm to have taken place on various days did not actually exceed the entire volume bought and sold in the market on

those days;

(j) confirm or verify that the trades reported on monthly account statements actually occurred at the reported prices;

(k) confirm the validity of the Split Strike Conversion strategy, and make periodic inspection of the Madoff Firm to acquire familiarity with its personnel and operations;

(l) confirm or verify the existence of any counter party transactions because the Madoff Firm refused to disclose to FGB the names of any of the counter parties it used, thus making any analysis impossible. Indeed, the only counter party document that FGB ever saw was an unsigned, undated form which was represented by the Madoff Firm to be a "master agreement";

(m) confirm or verify whether the assets of Greenwich Sentry were kept in segregated accounts to protect them from potential claims by creditors of the Madoff Firm;

(n) while Greenwich Sentry represented that it had a proxy voting policy for its securities which was "voted in a manner that best serves the interests of the Partnership", (PPM at 40) no policy existed and no votes were ever cast. FGB represented that they had reviewed the proxy voting policies of the Madoff Firm, but it never received a single proxy from the Madoff Firm nor reviewed any proxy voting by the Madoff Firm;

(o) match any "trade confirmations" from the Madoff Firm with actual trades executed through any exchange;

(p) know anything about the Madoff Firm's auditors -- Friehling & Horowitz ("F&H") -- despite the fact that Greenwich Sentry had all of its assets with the Madoff Firm and the Funds had over $7 billion with the Madoff Firm -- indeed FGB had only one conversation with F&H where it learned that F&H consisted of one accountant with an office in upstate New York and thereafter FGB made no further inquiries;

(q) made no inquires into the publically available reports the Madoff Firm was required to file with the SEC in 2006, despite the fact that almost all of the assets of Greenwich Sentry were held by the Madoff Firm. The publically filed reports represented that the Madoff Firm had 13 "clients" and managed $ 23 billion of assets and did not show the Madoff Firm holding securities in custody of a value nearly approaching the amounts purportedly placed by the FGB and FGG with the Madoff Firm;

(r) seek to have the Madoff Firm issue a request for confirmation to Depository Trust Corporation ("DTC") to confirm directly to FGB the purported holdings of Greenwich Sentry at the DTC – despite the fact that DTC maintained daily reports for the Madoff Firm showing the activity by security, the money balance on deposit and a statement of the balance of all security positions;

(s) seek to review trade blotters or stock records of the Madoff Firm which would have purportedly recorded the details of all purchases and sales in the accounts of Greenwich Sentry nor did they seek to review the records of any "fails" although such records were required to maintained by the Madoff Firm

under SEC rules;

(t) regularly visit the Madoff Firm as part of its on going due diligence despite representing to investors and potential investors that its CFO has accompanied PWC's auditors on a biannual basis to review [the Madoff Firm's] internal accounts for Greenwich Sentry -- indeed the one and only time the CFO of FGB visited The Madoff Firm was in 2002 and the only other visit by FGB officers to the Madoff Firm was in 2001; and

(u) submit a due diligence questionnaire to the Madoff Firm -- the most basic of due diligence practices -- until the fall of 2008 and then received incomplete responses from the Madoff Firm.

## F. THE RED FLAGS

134. Each of the Red Flags, as hereafter alleged, were material and required Citco and PWC respectively to investigate and resolve under their respective duties, responsibilities and representations independently of the others' duties to Plaintiff, but neither did. Further, each knew the other had not. Each of these Red Flags and all together, during the time that Citco and PWC provided services to Greenwich Sentry and the Limited Partners, would and/or should have placed them on notice of the Ponzi Scheme, including but not limited to at least the following:

**Red Flag No. 1**

**<u>Operational Risk Was At A High Level At the Madoff Firm</u>**

135. In a typical investment fund there is a segregation of investment management, executing broker and custodian functions to protect against operational risk. In the case of the

Madoff Firm, it performed all these functions: the securities of Greenwich Sentry were held by the Madoff Firm and not by an independent custodian, the Madoff Firm executed the trading strategy, it was the executing broker and it reported the results. As a result there was no segregation of duties among independent reporters and thus a lack of internal control which resulted in a lack of investment transparency such that risk management was materially compromised.

136. It is generally accepted in the financial industry that the potential impact of operational risk greatly exceeds that of investment strategy risk (*i.e.*, trading results). Among the most critical elements in protecting against operational risk are segregation of assets from the manager of the fund to reduce the risk of misappropriation, transparency of reporting to prevent the manager from issuing false reports on trading, and robust controls at each stage of the trading cycle over trade authorization, execution, confirmation, settlement reconciliation and accounting. Yet in each of these areas the Madoff Firm had exclusive control.

**Red Flag No. 2**

**The Madoff Firm's Transactions Were At Variance With Market Evidence**

137. Despite the fact that the Madoff Firm was acting as an investment advisor, it did not register as an investment advisor with the SEC until it was required to do so in September 2006, under a settlement with the SEC. The ADV Report of the Madoff Firm then disclosed that it had over $17 billion in assets under management in 23 accounts and that between 1 and 5 people "performed investment advisory functions."

138. The Madoff Firm and Madoff had one investment model, the Split Strike Conversion Strategy ("SSC") which they utilized for all 23 accounts under management. The

execution of SSC would have been done in the same manner for all accounts, based on the same methodology and market timing signals. In many cases, the positions Madoff claimed to have placed using the SSC methodology were in excess of the actual open interest in the S&P 100 Put & Call market in those securities and the entry and exit of over $17 billion would have overwhelmed the S&P 100 Put and Call market.

139. There are, broadly, two forms of options in the U.S.:

(a) Exchange traded options, such as the S&P 100, ("listed options") which have standardized contracts, and are settled through a clearing house with fulfillment guaranteed by the credit of the exchange. Since the contracts are standardized and marked to market each day, accurate pricing is available. Listed options can be exercised at any time between the date of purchase and expiration; and

(b) Over-the-counter options ("OTC options") which are by private contract between two private parties, are not listed on an exchange, and are not standardized. The terms of an OTC option are individually negotiated, fulfillment is not guaranteed by the credit of any exchange, depends on the credit worthiness of the counter-party to avoid a default, and can only be exercised pursuant to the negotiated terms. In general, the counter parties to an OTC option are well-capitalized institutions.

140. In contrast to the fact that most registered investment advisory firms (as the Madoff Firm was) use third-party custodians to protect against operational risk, the Madoff Firm required that it maintain custody of the securities in the accounts it traded and that custody not be with an independent custodian, raising questions about the integrity of the reported results and

documents supplied by Madoff.

141. The Greenwich Sentry PPM states that "[a] significant portion of the options transactions effected [will] utilize the over-the-counter market. . [which] is subject to counter party risk. . . ." (Greenwich Sentry PPM at 16). Any transaction in OTC option markets would have been made by a non-standard contract with the terms individually negotiated between the counter-parties and would have resulted in extensive documentation of the trades, counter-party risk and the specific terms of the transaction, but little or no documentation existed. As a result all such OTC option agreements would have been more expensive than if placed in the S&P 100 Put & Call market and would have materially reduced profits because of the time required to negotiate and the fees involved and because the prices were not uniform.

**Red Flag No. 3.**

**The Evidence That the Madoff Firm Had A Proprietary System To Execute The SSC Was Contradicted By The Trading Records Of the Madoff Firm**

142. Despite claiming to have an automated order and execution process for the SSC and that Madoff's reputation was made as an early and enthusiastic proponent of electronic trading, many of the Madoff Firm's trades for Greenwich Sentry were supported only by manual trade tickets and the Madoff Firm refused Citco or PWC access to his trading by computer (itself a Red Flag). Because the Madoff Firm was a broker dealer, it had the ability to generate whatever trading tickets it wanted, and because it maintained custody of the securities in the Greenwich Sentry account there was no independent verification that such trading had actually occurred.

143. Nevertheless, another Madoff Firm feeder fund controlled by Greenwich Sentry,

BBHF Emerald, Ltd (“Emerald”), and audited by PWC, represented to investors that the Madoff Firm and Madoff utilized “proprietary models and algorithms and [a] sophisticated trade execution platform” and thus there should have been no need for paper tickets.

144. The Madoff Firm refused to permit any “due diligence reviews” or “performance audits” of his trading and results to verify the represented trading and results.

145. Many of the individual trades reported by Madoff would have shown that they could not have taken place as represented in that many were at reported prices higher than the price that the security in question traded at for the entire day the trade was claimed to have been executed.

146. The Financial Industry Regulatory Authority ("FINRA") has preliminarily suggested that there is no record of trades through the Madoff Firm for the fund accounts: "Our exams showed no evidence of trading on behalf of the investment advisor, no evidence of any customer statements being generated by the broker-dealer," said Herb Perone, spokesman for FINRA. If the foregoing is borne out, a proper and thorough review of trading in Greenwich Sentry’s account by Citco and/or PWC in execution of their responsibilities at the time would have determined this fact and thereby, discovered the Ponzi scheme.

**Red Flag No 4.**

**The Cash In the Greenwich Sentry Account Did Not Exist**

147. Greenwich Sentry represented that it "typically spends more than half of the trading days in each year exposed to movements in the S&P 100 Index [and for] the rest of the year [is in cash]." Confirmation of Greenwich Sentry's trading and cash positions was materially easier and less expensive to verify than a typical trading strategy because the number of trades

would have been materially less and in publically traded securities or cash.

148. A review of where the cash for Greenwich Sentry was placed would have shown that it was reported to be in accounts and/or T-bills that did not exist. For example, some of Madoff's brokerage statements showed transactions in Fidelity Investments' Spartan Fund, however, Fidelity had no investments by Madoff in its funds on behalf of his clients and neither Madoff nor his firm was a client of Fidelity's Institutional Wealth Services business, their clearing firm National Financial or a financial intermediary client of its institutional services arm.

149. Before the calculation and issuance of NAVs, Greenwich Sentry's books had to be reconciled with the results reported by the Madoff Firm and any discrepancies resolved which required both a cash reconciliation and a position reconciliation. A cash reconciliation requires the comparison of the record of Greenwich Sentry's cash movements in and out of the account with the Madoff Firm's record of cash movements. Each difference is called a "cash break." Position reconciliations require a comparison of Greenwich Sentry's positions in its portfolio (*i.e.*, securities, contracts, puts and calls, *etc.*) with the Madoff Firm's trading record. Each difference is called a "position break". If such reconciliations had taken place, they would have revealed material cash and position breaks.

**Red Flag No. 5.**

**<u>If Securities Lending Had Been Verified, It Would Have Shown No Lending</u>**

150. The Greenwich Sentry PPM states that Greenwich Sentry through the Madoff Firm may lend its portfolio of securities and that Greenwich Sentry was to obtain interest on such loans. Any review of the securities lending would have required an analysis of transmissions to borrowers of the identity of customers who had lent the securities and an analysis of operational

risk which would include settlement, monitoring and billing.

151. Any review of securities lending would have revealed that no securities were being loaned because there were not sufficient securities in the account or that lending was not being done thus forgoing a significant amount of income, or to the extent it was being undertaken, the portfolio was at material risk.

**Red Flag No. 6**

**The Results Reported By the Madoff Firm Were At Odds With the Results Of Other Firms Using the Same Trading Method**

152. Madoff was reporting abnormally stable and high investment returns.

153. Studies of Madoff's strategy by persons experienced in this area (as PWC and Citco represented themselves to be) have shown that:

> assuming that the split-strike conversion strategy was implemented within the confines of market liquidity (~ 3% of Madoff's actual AUM) , that the true volatility would have been seven times higher than that reported by Fairfield Sentry of the Madoff trading results
>
> While a portfolio manager with consistently average or median stock picking aptitude could, in theory, have actually delivered an 18-year cumulative return that exceeded that of both the S&P-500 outright and a 5% OTM collared S&P-500 position, the flip side is the volatility needed to incur in order to generate these returns, making it impossible to deliver returns claimed by Madoff, while incurring the low volatility reported by Madoff and Greenwich Sentry.
>
> Collared strategies do not typically have Sharpe ratios[1] that are nearly an order of magnitude higher than that of the asset underly-

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[1] The Sharpe Ratio is a risk-adjusted measure of performance. The ratio compares the return of the portfolio to the risk-free rate as well as the risk generated by the portfolio. It is calculated by taking the return of the portfolio and subtracting the risk-free rate of return. The result is then divided by the standard deviation of the portfolio.

> ing the options used. Over the last 18 years, for example, the S&P-500 had a Sharpe ratio of 0.43. By comparison, the Sharpe ratio for an average split-strike conversion strategy would have been 0.55. As one writer has said "the calculation of a Sharpe ratio, should therefore serve as the first and easy sanity check to gauge the validity of any collared strategy."
>
> Despite the growth in the volatility market over the last decade, the markets would only have been able to accommodate ~$1.5B in short-dated options trades before incurring severe market impact.

Credit Suisse, "Split Strike Conversions, How Madoff Should Have Made Out," January 14, 2009.

154. Other investment advisors and financial publications had publically stated that the Madoff Firm's trading results could not be replicated based on the model he was purportedly using.

155. The trading results reported by the Madoff Firm were not consistent with publically traded funds that followed the same trading strategy, all of which had much lower returns and greater volatility than reported by the Madoff Firm.

156. Other investment advisors that invested funds with the Madoff Firm, including at least one audited by PWC, had stated to its investors that assets invested with Madoff could have "misappropriated" funds and "information supplied by the Madoff Firm may be inaccurate or even fraudulent".

**Red Flag No. 7**

**<u>The Auditor's Report For the Madoff Firm Could Not Be Relied Upon</u>**

157. Madoff Securities International, Ltd ("MSI") -- a Madoff Firm affiliate in London -- was audited by KPMG (UK), one of the big four accounting firms, despite the fact that

the business of the Madoff Firm dwarfed that of MSI, while the financial statements of the Madoff Firm were audited each year by a three person accounting firm -- Friehling & Horowitz ("F&H").

158. Under the regulations of the American Institute of Certified Public Accountants ("AICPA") every accounting firm that does auditing work is required to enroll in the AICPA's peer review program under which experienced auditors assess such firm's audit quality yearly. While F&H was a member of the AICPA, it had not been subjected to a peer review since 1993 because F&H had represented to the AICPA, in writing, that it did not perform any audits. Whether a firm has been subject to a peer review, and the results of that review, are on public file at the AICPA. There was no basis for PWC or Citco, in the circumstances, to conclude that: a) the work of F&H was acceptable based on knowledge of the professional standards and competence of F&H, or that b) the work F&H had performed was not material in relation to matters at issue.

159. Nevertheless, neither took sufficient steps to obtain satisfaction as to the audit performed by F&H, including, but not limited to:

(a) visiting F&H to discuss the audit procedures followed and results thereof;

(b) reviewing the audit programs and/or working papers of F&H; or

(c) gaining an understanding of the internal control structure and the assessment of control risk of the Madoff Firm.

160. The audited financial reports filed by the Madoff Firm with the SEC represented that certain information was attached to the report, but it was not attached, including but not limited to F&H's report on the Madoff Firm's internal accounting controls.

**Red Flag No. 8**

**The Manner In Which Profits Were Divided Between**
**the Madoff Firm And the Feeder Funds Was Irrational**

161. Unlike any other hedge fund and/or investment advisor, the Madoff Firm claimed to make its profits solely from commissions generated from trading which trading took place during limited periods of time and not consistently. As a result the Madoff Firm forewent any part of the incentive fees being generated.

162. Moreover, Madoff went to cash in Greenwich Sentry's account near year end and thus had no open positions, which was highly unusual and which resulted in the closing out of "profitable" positions, and which had the effect of shielding the Madoff Firm's purported trading activities from scrutiny.

163. The Madoff Firm chose not to obtain funding from commercial lenders at lower interest rates than it paid out. The Madoff Firm customer accounts, received far higher purported annual rates of return on their investments with the Madoff Firm, as compared to the interest rates the Madoff Firm would have had to pay commercial lenders during the relevant time period. As such, the Madoff Firm accepted the investment capital in lieu of other available alternatives that would have been more lucrative for The Madoff Firm.

## G. CITCO'S WRONGFUL ACTS AND FAILURES

164. Citco failed to properly utilize its specialized knowledge, expertise and experience in fund administration, and the public and non-public information it possessed with respect to FGG's and FGB's business practices and operations, Greenwich Sentry and the Madoff Firm,

including without limitation the knowledge that Brian Francoeur possessed by virtue of his position as a Director of FGB.

165. Citco failed to investigate and/or act upon the Red Flags, singly, multiply, or in combination, so as to recognize that the Madoff Firm was engaging in a Ponzi scheme to the detriment of Plaintiff.

166. Citco failed to investigate and confirm the accuracy of the purported account statements which the Madoff Firm prepared with respect to Plaintiff.

167. Citco failed to investigate and confirm the accuracy of representations by the Madoff Firm as to trades it represented it had made on behalf of Plaintiff.

168. Citco failed to investigate and confirm the accuracy of representations by the Madoff Firm as to the status of Plaintiff's funds.

169. Citco failed to accurately calculate plaintiff's NAVs and/or plaintiff's capital account balances.

170. Citco materially misstated and/or overstated the capital, profit, appreciation and/or funds remaining in Plaintiff's accounts in the NAVs, account statements, fund reports and other documents which it prepared, disseminated and/or approved.

171. Citco failed to advise Plaintiff that the Madoff Firm was engaging in a Ponzi scheme, and that the Madoff Firm and/or Greenwich Sentry was or would become insolvent.

172. Citco failed to advise Plaintiff that capital of newer Limited Partners was being used to pay other (particularly earlier-investing) Limited Partners their "capital" and stated "profits" and "appreciation".

173. Citco failed to investigate and confirm whether the information received from,

and representations made by, the Madoff Firm were accurate.

174. Citco failed to determine whether the obligations of the Madoff Firm to Greenwich Sentry and its Limited Partners were being fully, accurately and honestly discharged.

175. Citco permitted Greenwich Sentry to have the Madoff Firm act as both broker for and custodian of plaintiff's funds and knew this was a material operational risk for Greenwich Sentry.

176. Citco permitted FGB to disseminate information to Plaintiff which contained materially incorrect information as to the status of its funds, the success of the Fund's investment strategy, and the reliability of the controls and oversight of the Madoff Firm.

177. Citco failed to comply with its own internal and published standards for oversight and control of the broker and custodian of Plaintiff's funds, i.e., the Madoff Firm.

178. Citco failed to maintain true and accurate financial books and records of Greenwich Sentry.

179. Citco failed to accurately calculate and administer distributions of "capital", "profits" and "appreciation" to the Limited Partners of Greenwich Sentry.

180. Citco failed to accurately supervise the payment of the expenses of Greenwich Sentry, including fees it owed to others.

181. Citco failed to: independently compute the NAVs and monthly performance of Greenwich Sentry and plaintiff's account; independently verify pricing and trading; and reconcile between the Madoff Firm and FGB on a monthly basis.

182. Citco knew FGB falsely represented to plaintiff that Citco was independently computing the NAVs and monthly performance of Greenwich Sentry and plaintiff's account,

independently verifying pricing and trading, and reconciling between the Madoff Firm and FGB on a monthly basis, and failed to correct those misrepresentations or advise plaintiff of such.

183. Citco failed to adhere to the SAS 70 Type II procedures which they touted that they followed, including without limitation: failing to require electronic trading access to the Madoff Firm and accepting mere physical trading records; and failing to perform trade by trade confirmation, instead accepting only a bottom line monthly confirmation.

184. Citco knew that FGB conducted no substantial due diligence to independently verify the trading, results or assets of Greenwich Sentry and the plaintiff's account, and instead was merely relying upon the representations of the Madoff Firm. Citco concealed this fact from plaintiff.

185. Citco knew that FGB did not establish or maintain procedures to adequately monitor and minimize risk, particularly operational risk. Citco concealed this fact from plaintiff.

186. Citco knew that FGB's operations lacked appropriate internal controls, was not following Sound Practices or standards which FGB had itself undertaken and represented to limited partners including plaintiff. Citco concealed this fact from plaintiff.

187. Citco issued financial reports and NAV statements to plaintiff without disclosing that the information contained therein was or likely was inaccurate, and that it was not based upon a reliable and verified method of investigation and confirmation.

188. Citco knew that FGB's due diligence together with properly operated internal controls at Greenwich Sentry were essential to confirm the accuracy of the results reported by Greenwich Sentry and to protect plaintiff's investment and that FGB was soliciting investors in Greenwich Sentry premised on their purported due diligence and proper operation of internal

controls at Greenwich Sentry. Citco knew FGB was not conducting the due diligence and failed to properly operate internal controls at Greenwich Sentry and was instead relying on the Madoff Firm's representations. Citco knew that this was not in compliance with Sound Practices because FGB was the only entity with direct access to the Madoff Firm. Citco concealed this fact from plaintiff.

189. Citco knew that it had no basis to rely upon Greenwich Sentry's reported results in issuing their reports and NAV's because Citco knew that FGB failed to perform its represented due diligence and to properly operate the necessary internal controls at Greenwich Sentry to verify the otherwise uncorroborated results reported by the Madoff Firm.

190. Citco knew or was reckless in not knowing that it had no basis to conclude that the financial statements and NAV reports, it prepared and issued were truthful or accurate because neither it nor FGB were independently verifying the results reported by the Madoff Firm, nevertheless, Citco continued to issue unqualified reports and NAV's to plaintiff.

191. Citco had no basis to issue its reports and NAV's to plaintiff because it knew that FGB had not established or maintained internal controls to monitor risk in the Madoff Firm and strategy; nevertheless, Citco continued to issue unqualified reports and NAV's to plaintiff.

192. Citco knew that plaintiff would rely on its unqualified reports and NAV's in making decisions to make, re-invest and hold its investment in Greenwich Sentry.

193. Citco knew that public disclosure of this would raise serious questions about the accuracy and reliability of the results reported and make Greenwich Sentry materially less attractive to investors because the results reported for Greenwich Sentry would be seen as less reliable and the risks of Greenwich Sentry would be seen to be higher.

194. There was no basis for Citco to rely on Greenwich Sentry or FGB's internal controls with respect to monitoring the results reported by the Madoff Firm.

195. FGB, Citco and PWC were relying on the Madoff Firm's reported results without any independent cross-check or verification taking place relative to custody, execution and reporting with respect to the assets of Greenwich Sentry or any of the Funds.

196. Citco had no basis to rely upon the Madoff Firm's uncorroborated reported results as to Greenwich Sentry in issuing its NAV's and reports to plaintiff because Citco knew that way in which the Madoff Firm conducted its business represented a materially high operational risk to Greenwich Sentry because, *inter alia*, the Madoff Firm did not provide for a separation of functions in that it was custodian, trader and was responsible for reporting the trades to Greenwich Sentry's account.

197. Citco knew that FGB was operating Greenwich Sentry without a proper risk policy" and in a manner with did not comply with "Sound Practices" and, that in doing so FGB materially increased investor risk. Citco further knew FGB concealed this from plaintiff because public disclosure of this would raise serious questions about the reliability of Greenwich Sentry's reported results and make Greenwich Sentry materially less attractive to investors, nevertheless Citco continued to issue unqualified reports and NAV's to plaintiff.

198. Citco failed to confirm whether or in what manner Greenwich Sentry's assets were being segregated once they had been transferred to the Madoff Firm and merely relied upon uncorroborated reports from the Madoff Firm.

199. Citco received trading information in hard copy "confirmations" that trades had taken place days after the alleged trades had taken place and failed to investigate those "trades"

when doing so would have shown that the trades took place at prices outside of the trading band for the days in question and/or that the settlement date fell on days the markets were not open or on holidays.

200. Citco did not follow generally accepted bookkeeping practices. It recorded information on Greenwich Sentry's records in the face of discrepancies in the information supplied to Citco which called into question the accuracy of that information that Citco recorded. As the party preparing and maintaining the books and records of Greenwich Sentry in accordance with GAAP, Citco could not ignore these material discrepancies. It had to advise FGB and Greenwich Sentry of such discrepancies and satisfy itself that Fairfield Sentry and FGB had resolved these discrepancies in order to record that information and issue financial reports and NAV reports or undertake procedures to resolve them itself. It did none of these thing and continued to issue financial statements and reports and NAV statements.

201. Citco's actions knowingly violated Sound Practices and its contract (as to which investors were third party beneficiaries).

202. As a result (of being the auditor for FGB and having other roles with FGG), PWC knew or should have known that FGB was not conducting its business in the manner in which Greenwich Sentry represented that FGB performing its business.

203. Citco was the administrator for many of the other funds of FGG, and was among the most significant of Citco's clients. Citco knew that if refused to issue unqualified reports with respect to Greenwich Sentry, there was a substantial likelihood that its services would be terminated with respect to all funds offered by FGG and that it would lose a substantial source or revenue.

## H. PWC'S WRONGFUL ACTS AND FAILURES

204. PWC had specialized knowledge, expertise and experience in auditing and accounting with respect to funds such as Greenwich Sentry, and had access to public and non-public information with respect to practices in performing those functions, and as to the operation and results of Greenwich Sentry, and the Madoff Firm.

205. PWC failed to exercise due care and diligence, and/or was grossly negligent and reckless, in conducting its examination of Greenwich Sentry and Plaintiff's funds in numerous ways, including *inter alia*:

(a) PWC failed to conduct its audit in accordance with the standards of GAAS, including without limitation those set forth above.

(b) PWC failed to present Greenwich Sentry's financial statements in accordance with principles of GAAP, including without limitation those set forth above.

(c) PWC failed to investigate and/or resolve the Red Flags.

(d) PWC failed to investigate and confirm the accuracy of representations by the Madoff Firm as to trades it claimed it had made on behalf of Greenwich Sentry and the Limited Partners, including Plaintiff.

(e) PWC failed to investigate and confirm the accuracy of representations by the Madoff Firm as to the status of Plaintiff's and other Limited Partners' funds.

(f) PWC failed to determine whether the obligations of the Madoff Firm to Greenwich Sentry and its Limited Partners were being fully, accurately and honestly discharged.

(g) PWC knew that to have the Madoff Firm act as both broker for and custodian of the Limited Partners' funds increased operational risks but did not extend its audit procedures.

(h) PWC permitted Greenwich Sentry to disseminate information to its Limited Partners, including Plaintiff, which contained materially incorrect information as to the status of their funds, the success of the Fund's investment strategy, and the reliability of the controls and oversight of the Madoff Firm and permitted the name of PWC to be associated therewith.

(i) PWC failed to comply with its own internal and published standards for oversight and examinations.

(j) PWC issued unqualified reports which, inter alia, attested to the accuracy of Greenwich Sentry's financial statements and NAVs, which in turn were materially misleading and overstated as alleged herein.

(k) PWC transmitted, and/or permitted the transmission of, those unqualified reports to the Limited Partners, including Plaintiff.

(l) PWC failed to satisfy the minimum acceptable standards of professional conduct in each of its audits of Greenwich Sentry, including but not limited to GAAS, and failed to ensure that Greenwich Sentry's financial statements were presented consistent with GAAP, and but for those failures the Ponzi scheme would not have been able to continue.

(m) PWC failed to perform sufficient fieldwork by neglecting to obtain competent evidence to afford it a reasonable basis for forming an opinion regard-

ing Greenwich Sentry's financial statements but regularly issued unqualified audit opinions.

(n) PWC could not accept assurances at face value and was required to conduct itself at all times with a high degree of professional skepticism, and failed to do so.

(o) PWC failed, contrary to GAAS requirements, to satisfy itself that Greenwich Sentry had implemented adequate safeguards in the face of clear operational risk, and clear "red flags" for auditors to consider that PWC knew and/or consciously avoided knowing were present in this case, including those heretofore alleged;

(p) PWC failed to consider, and/or appreciate the significance of, any unusual or unexpected relationships identified and to understand the entity's business and the industry in which it operates. Approximately 95% of Greenwich Sentry's assets were in the custody of and traded by Madoff, who reported the trading results. In this circumstance neither a confirmation in the aggregate nor on a security-by-security basis by the Madoff Firm is adequate audit evidence of the existence of either the assets in or the results of trading in the Greenwich Sentry account.

206. An audit properly performed in accordance with GAAS would have uncovered the Ponzi scheme alleged herein.

207. Nevertheless, for 2006 and 2007 PWC improperly issued unqualified reports on the financial statements of Greenwich Sentry addressed "to the Partners of Greenwich Sentry,

LP" which stated:

> In our opinion, the accompanying statements of assets, liabilities and partners' capital, including the schedule of investments, and the related statements of operations, changes in partners' capital and cash flows present fairly, in all material respects, the financial position of Greenwich Sentry, LP. (the "Partnership") as of December 31, [2006 and] 2007 and the results of its operations, the changes in its partners' capital and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Partnership's management; our responsibility is to express an opinion on these financial statements based upon our audit. We have conducted our audit of these financial statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the Partnership's management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/S/ PricewaterhouseCoopers, LLP

208. In the circumstances, PWC had to either issue a qualified opinion, or refuse to issue an opinion at all and withdraw its previous opinions. It did none of these things. Instead it issued unqualified reports and tax information in the face of clear knowledge that FGB had no internal controls and was not conducting its represented due diligence.

209. PWC knew that FGB's due diligence and internal controls were essential to confirm the accuracy of the results reported, and to protect the limited partners' investments, and that FGB was soliciting investments premised on these reported results.

210. PWC knew FGB was relying on the Madoff Firm's representations and was not in compliance with Sound Practices, had no effective internal controls and FGB was the only entity

with direct access to the Madoff Firm.

211. PWC knew that the failure of FGB to perform its represented due diligence was a material failure of internal control and, as a result knew there was no basis for them to rely on procedures performed by FGB and issue the reports they each issued since the only basis for their respective reports were the uncorroborated representations of the Madoff Firm. PWC had no basis to conclude that the financial statements and reports, it prepared and issued were truthful or accurate. Nevertheless it continued to issue unqualified reports in the face of knowledge that FGB was not conducting due diligence and had no internal controls that were working. PWC knew or was reckless in not knowing that their respective reports had no basis.

212. Independently of the "red flags" as alleged above, there was such a patent lack of internal controls at FGB, and there existed sufficient information contradicting the representations by the Madoff Firm, that PWC could not have issued its reports unless it chose to remain willfully blind or to represent knowledge when it had none. In the circumstances, the actions of PWC were so reckless as to lead to the conclusion that its conduct was fraudulent.

213. PWC did not place any restrictions or caveats on the use of its reports.

214. PWC and/or its sister offices were the auditor for many of the other funds of FGG. PWC knew that if refused to issue an unqualified report with respect to Greenwich Sentry, there was a substantial likelihood that its services would be terminated with respect to all the other funds offered by FGG and that it would lose a substantial source or revenue.

**COUNT I**

**BREACH OF FIDUCIARY DUTY AGAINST CITCO**

215. Plaintiff repeats and realleges the preceding allegations as if fully set forth herein and further alleges as follows.

216. Plaintiff reposed trust and confidence in Citco as to the duties it undertook with respect to Greenwich Sentry and Plaintiff's funds and were induced by Citco to do so.

217. Citco possessed superior and confidential information as to the status, use and trading of Plaintiff's funds, and was in a superior position to assess the status, use and trading of Plaintiff's funds. As a result, Plaintiff was required to repose trust and confidence in Citco.

218. Citco held itself out to the public and to Plaintiff as having superior information and skills with respect to administration of Greenwich Sentry and funds of its type and with respect to valuation of NAVs of Greenwich Sentry and funds of its type. The final NAVs and monthly statements were within the control of Citco and were the only contemporaneous measures by which the limited partners could evaluated their potential or existing investment and therefore Plaintiff is entitled to a presumption of reliance.

219. As part of its duties as fund administrator, and in furtherance of its superior information and skills, Citco had responsibility for communicating with Greenwich Sentry's Limited Partners, including Plaintiff, and as part of its communications Citco made or approved representations directly to the Limited Partners attesting to the quality of its services.

220. As a fund administrator, Citco was inherently vested with discretion in its methods and standards, and was obligated to use its best efforts, due care, and independent judgment on behalf of the Limited Partners.

221. Citco held itself out to the public and to Plaintiff as a fiduciary when acting as administrator of Greenwich Sentry or a fund of its type.

222. Citco knew that the Limited Partners of Greenwich Sentry including Plaintiff would rely upon it for its best efforts, due care, and independent judgment, particularly in confirmation, valuation and review of NAVs and reporting trading results.

223. By virtue of the foregoing, Citco was a fiduciary to Plaintiff. It therefore had a duty to Plaintiff to: deal fairly and honestly with Plaintiff; act with utmost loyalty and good faith toward Plaintiff; and manage, safeguard and verify Plaintiff's funds in the best interest of Plaintiff.

224. Plaintiff placed trust and confidence in Citco, and relied upon Citco as the administrator of Greenwich Sentry to confirm and verify the trading results and NAV of its account. In light of Citco's superior information and skill, its undertaking to so act, and the other matters alleged herein, this trust, confidence and reliance was foreseeable and reasonable.

225. By virtue of the failures alleged herein, Citco breached its fiduciary duties to Plaintiff.

226. Plaintiff has been damaged by the wrongful conduct of Citco in that it was induced to purchase and/or hold shares in Greenwich Sentry, and as a result the value of Plaintiff's $60 million investment has been completely or substantially destroyed.

227. If Citco had not acted in manner alleged above, and had not failed to detect and/or advise Plaintiff of the Ponzi scheme as alleged above, and/or had not issued the materially inaccurate NAVs and monthly reports as to the fund and plaintiff's investment, Plaintiff would not have suffered its loss.

228. Citco failed to follow its own stated policies of independent review of valuations and proceeded in the face of known dangers without any meaningful attempt to reconcile obvious and material discrepancies regarding Greenwich Sentry's portfolio and Plaintiff's investment. Citco was reckless in that it failed to review conflicting information that it had a duty to reconcile and monitor, and unreasonably and recklessly ignored the Red Flags.

229. Plaintiff is entitled to an award of compensatory damages against Citco in an amount to be determined at trial.

230. As a fiduciary and trustee, Citco is liable to Plaintiff not only for its losses, but for any gains which Citco received while acting as fiduciary. Citco is liable to Plaintiff for any fees it received in its role as administrator and/or sub-administrator of Greenwich Sentry on plaintiff's behalf.

231. Owing to the flagrant nature of its conduct as outlined herein, Citco is liable to Plaintiff for punitive damages of not less than three times the compensatory damages awarded.

**COUNT II**

**GROSS NEGLIGENCE AGAINST CITCO**

232. Plaintiff repeats and realleges the preceding allegations as if fully set forth herein and further alleges as follows.

233. As is more fully set forth above, Citco had a special relationship with Plaintiff giving rise to a duty to exercise due care and diligence with respect to the administration and safeguarding of Plaintiff's funds, including without limitation a duty to independently confirm, value and report on the NAVs of Greenwich Sentry and the Limited Partners including Plaintiff.

The reported NAVs and financial statements were figures within the control of Citco and were the only measures by which limited partnership interests in Greenwich Sentry could be evaluated and purchased and therefore Plaintiff is entitled to a presumption of reliance.

234. As is alleged above, Citco knew or should have known that Plaintiff was relying upon it to fulfill those obligations with reasonable care, including without limitation a duty to independently confirm, value and report on the NAVs of Greenwich Sentry and the Limited Partners including Plaintiff.

235. Plaintiff foreseeably and reasonably relied on Citco to fulfill its obligations with reasonable care, by entrusting its funds to Citco and allowing its funds to remain in Greenwich Sentry for administration by Citco.

236. For the reasons alleged above, Citco failed to exercise due care and diligence in the administration and safeguarding of Plaintiff's funds.

237. Plaintiff was injured by Citco's conduct. If Citco had exercised its duties with due care, Citco would have discovered and advised Plaintiff of the infirmities alleged above, and Plaintiff either would not have invested funds in Greenwich Sentry or would have withdrawn them promptly upon being so advised.

238. Citco did not utilize the requisite skill and knowledge to perform their duties, woefully failed to exercise ordinary and reasonable care in the application of their professional knowledge and skill, and woefully failed to use their best professional judgment in the application of their knowledge and skill. Citco woefully failed to inquire into many crucial facts, which, in the exercise of ordinary care, they should not have ignored and should have investigated. Citco demonstrated a complete disregard for the rights of Plaintiff and the security of its

investment.

239. As is alleged above, Citco breached its duties of due care and was grossly negligent.

240. As is alleged above, Plaintiff has suffered damage as a proximate result of the breaches and gross negligence by Citco.

241. Plaintiff is entitled to an award of compensatory damages against Citco in an amount to be determined at trial.

**COUNT III**

**NEGLIGENCE/PROFESSIONAL MALPRACTICE AGAINST PWC**

242. Plaintiff repeats and realleges the preceding allegations as if fully set forth herein and further alleges as follows.

243. PWC was engaged by FGB to act as Greenwich Sentry's independent certified accountants to audit Greenwich Sentry's book and records.

244. PWC performed an audit of Greenwich Sentry's books and records and prepared and issued an independent auditor's report based on the financial statements of Greenwich Sentry for at least the years ended 2006 and 2007, and prepared and issued tax information for the limited partners of Greenwich Sentry.

245. As is more fully set forth above, PWC had a close relationship with Plaintiff approaching that of privity sufficient to give rise to a duty on the part of PWC to exercise due care and diligence with respect to PWC's obligations to Plaintiff in PWC's audit of Greenwich Sentry's books and records, in that, *inter alia*:

(a) PWC consented to Greenwich Sentry identifying it as the auditor and accountants for Greenwich Sentry;

(b) PWC knew and intended that the limited partners, including Plaintiff, would rely on PWC to perform its services in accordance with the highest professional standards applicable thereto and also knew that, because of its standing in the financial community, its decision to become the auditor of Greenwich Sentry added to the purported safety and quality of the Greenwich Sentry offering and consented to the associating of its name as auditor with Greenwich Sentry and knew and consented to the use of its name and reputation as a device to market Greenwich Sentry to potential investors, including Plaintiff;

(c) PWC knew and consented to the distribution of its annual audit report attesting to the accuracy of Greenwich Sentry's financial statements to the limited partners, including plaintiff;

(d) PWC addressed its audit reports and audited financial statements "To the Partners of Greenwich Sentry, L.P.";

(e) PWC's audited reports and audited financial statements were not required to be furnished by statute;

(f) PWC knew that Greenwich Sentry was prohibited from borrowing money, and that therefore the sole or primary purpose of the financial statements and its opinions was for existing and prospective partners and not outside parties;

(g) PWC knew, at the time that it undertook to perform these services, that they were being rendered for the benefit of the individual partners, including

plaintiff;

(h) PWC knew that the limited partnership interests in Greenwich Sentry were not publically traded and no other independently verified third-party financial information about Greenwich Sentry was available to limited partners or prospective limited partners of Greenwich Sentry other than Citco's NAVs and PWC's audit reports and audited financial statements, PWC knew and intended that its audit reports and audited financial statements would be the primary sources of information to plaintiff and would be relied upon in making investment decisions with respect to its investment in Greenwich Sentry;

(i) PWC placed no restrictions on the use of its report;

(j) PWC obligated itself to communicate with the limited partners in material respects; and

(k) PWC knew that the partners of Greenwich Sentry were a small, known and discrete group, including plaintiff, whose investment represented approximately 20% of the entire capital of Greenwich Sentry at the time it was made.

246. PWC represented that its used reasonable and professional care in auditing and examining the books and accounts of Greenwich Sentry and PWC's report further represented that Greenwich Sentry's financial statements were a fair presentation in all material respects of the financial status of Greenwich Sentry and there were no qualifications to its statement in its report.

247. Plaintiff did not know and had no reason to know that the audits completed by PWC and the reports attesting to those audits in fact differed from true financial status of

Greenwich Sentry.

248. Plaintiff foreseeably and reasonably relied on PWC to fulfill its obligations with reasonable professional care by trusting PWC to exercise due care and diligence in performing its audits and by allowing its funds to remain in Greenwich Sentry in reliance on those audits. PWC knew that Plaintiff would rely upon its audits and that Plaintiff did so in purchasing and then maintaining its investment with Greenwich Sentry and in determining whether or not to redeem its interest in Greenwich Sentry.

249. PWC knew or should have known, and with the exercise of reasonable care could have known, that the books and records of Greenwich Sentry were inaccurate and did not represent its true financial condition and that they should not have issued their audit reports or should have issued them in a qualified manner.

250. PWC did not utilize the requisite skill, knowledge, and accepted standards of practice to perform its duties as accountants/auditors, failed to exercise ordinary and reasonable care in the application of their professional knowledge and skill, and failed to use their best professional judgment in the application of their knowledge and skill and performed its duties in a negligent manner in the following ways, *inter alia,* as set forth at greater length above:

(a) PWC failed to conduct its audit in accordance with the standards of GAAS;

(b) PWC failed to present Greenwich Sentry's financial statements in accordance with principles of GAAP;

(c) PWC knew or should have known FGB operated Greenwich Sentry in such a way that it lacked proper internal controls, lacked a proper risk policy, did

not follow Sound Practices and did not perform the necessary due diligence so that FGB was not verifying the results reported to it by the Madoff Firm but merely adopting them wholesale, nevertheless, and in violation of all reasonable professional standards of care, PWC issued the unqualified audit reports and audited financial statements while its knew or should have through a reasonable exercise of professional care and diligence that it basis for its reports or audits because there had been no independent verification of the reported results which its was provided;

(d) PWC knew or should have known that Citco was aware that FGB operated Greenwich Sentry in such a way that it lacked proper internal controls, lacked a proper risk policy, did not follow Sound Practices and did not perform the necessary due diligence so that FGB was not verifying the results reported to it by the Madoff Firm but merely adopting them wholesale, nevertheless, and in violation of all professional standards, PWC issued the unqualified audit reports and audited financial statements while its knew or should have through a reasonable exercise of professional care and diligence that it basis for its reports or audits because there had been no independent verification of the reported results which its was provided;

(e) PWC knew or should have known through an exercise of reasonable professional care and diligence that neither Citco nor FGB were performing the necessary due diligence or operational risk management and were not complying Sound Practices and thus were not verifying the results reported by the Madoff

Firm and should have in the exercise of reasonable professional care and diligence extended its extend its audit procedures prior to issuing its audit report, nevertheless, and in violation of reasonable care and professional diligence, it did not and issued its unqualified audit report in violation of professional care and diligence;

(f) Upon learning of the failures of due diligence, operational risk management, adherence to Sound Practices by FGB and Citco, as alleged more fully above, PWC should have, and failed in the exercise of professional care and diligence by not, prior to the issuance of its audit reports expanding its audit procedures to, *inter alia*:

(i) investigate and confirm the accuracy of representations by the Madoff Firm as to trades it claimed it had made on behalf of Greenwich Sentry and the Limited Partners, including Plaintiff;

(ii) investigate and confirm the accuracy of representations by the Madoff Firm as to the status of Plaintiff's and other Limited Partners' funds prior to issuing its audit reports; and

(iii) determine whether the obligations of the Madoff Firm to Greenwich Sentry and its Limited Partners were being fully, accurately and honestly discharged.

(g) PWC failed to investigate and/or resolve the Red Flags prior to issuing its audit reports;

(h) PWC permitted Greenwich Sentry to disseminate information to its Limited Partners, including Plaintiff, which contained materially incorrect

information as to the status of their funds, the success of the Fund's investment strategy, and the reliability of the controls and oversight of the Madoff Firm and permitted the name of PWC to be associated therewith when PWC knew or should have known through the exercise of reasonable professional diligence that this was not the case;

(i) PWC failed to comply with its own internal and published standards for oversight and examinations;

(j) PWC issued unqualified reports which, *inter alia*, attested to the accuracy of Greenwich Sentry's financial statements and NAV's, which in turn were materially misleading and overstated as alleged herein;

(k) PWC failed to perform sufficient fieldwork by neglecting to obtain competent evidence to afford it a reasonable basis for forming an opinion regarding Greenwich Sentry's financial statements but regularly issued unqualified audit opinions;

(l) PWC accepted assurances at face value and when it was required to conduct itself at all times with a high degree of professional skepticism and with an independence in mental attitude and failed to do so;

(m) PWC failed, contrary to reasonable professional standards and requirements, to satisfy itself that Greenwich Sentry had implemented adequate safeguards in the face of clear operational risk, and clear "red flags" which PWC knew, should have known and/or consciously avoided knowing were present in this case, including those heretofore alleged; and

(n) PWC failed to extend its audit procedures prior to issuing its audit report when it knew that contrary to industry practice that the Madoff Firm was acting as broker for, custodian and reporting entity with regard to of the Limited Partners' investment in Greenwich Sentry.

251. The facts misrepresented in the reports of PWC caused the loss to Plaintiff. The audits and audit reports represented that Greenwich Sentry had assets and had earned returns. In fact, Greenwich Sentry had few, if any, assets had not earned a return. The unqualified reports induced Plaintiff to invest, continue its investment and permitted the Ponzi scheme to survive and caused plaintiff to lose its money. Indeed, if PWC had not issued its audits and audit reports or had issued them in a qualified manner, Plaintiff would not have invested or maintained its investment in Greenwich Sentry.

252. There is a direct causal connection between PWC's audits and audit reports and the loss Plaintiff suffered in that once the Ponzi scheme was disclosed Plaintiff's investment became worthless. This was the direct result of the misrepresented financial condition of Greenwich Sentry and its trading with the Madoff Firm which PWC's negligent audits and audit reports concealed from Plaintiff and the loss was not the result of any subsequent independent event that had no connection with the represented financial condition presented by PWC in its audits and audit reports. Plaintiff's loss is directly traceable to the misrepresentation of the character of the investment Plaintiff was induced to make by the presence of PWC's audits and audit reports. Plaintiff's loss was foreseeable and caused by the materialization of the concealed risk.

253. PWC's negligent audits and audit reports were a substantial factor in the sequence

of responsible causation leading to Plaintiff's injury and Plaintiff's injury was reasonably foreseeable or anticipated and natural consequence of PWC's negligence. PWC's audits and audit reports falsely represented as accurate the trading results of Greenwich Sentry through the Madoff Firm when those results were fictitious and PWC in an exercise of reasonable professional care and diligence could have and should have determined and revealed that they were fictitious. It was the exposure of the lack of fictitious trading that caused Plaintiff's loss. If not the exclusive cause of Plaintiff's loss then PWC's audits and audit reports were a substantial factor leading to the loss.

254. Plaintiff has suffered damage as a proximate result of the breaches and gross negligence by PWC.

255. Plaintiff is entitled to an award of compensatory damages against PWC in an amount to be determined at trial.

## COUNT IV

## FRAUD AGAINST PWC

256. Plaintiff repeats and realleges the preceding allegations as if fully set forth herein and further alleges as follows.

257. PWC was engaged by FGB to act as Greenwich Sentry's independent certified accountants to audit Greenwich Sentry's book and records.

258. PWC performed an audit of Greenwich Sentry's books and records and prepared issued a Report of Independent Auditors dated April 24, 2007 on the financial statements of Greenwich Sentry for the year ended 2006 (the "2006 Audit Opinion").

259. The 2006 Audit Opinion stated that "[i]n our opinion, the accompanying statement of assets, liabilities and partners' capital, including the schedule of investments, and the related statements of operations, changes in partners' capital and cash flows presents fairly, in all material respects, the financial position of Greenwich Sentry, L.P. . . . as at December 31, 2006 and the results of its operations, the changes in its partners' capital and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America." The 2006 Audit Opinion was unqualified.

260. PWC performed an audit of Greenwich Sentry's books and records and prepared issued a Report of Independent Auditors dated April 18, 2008 on the financial statements of Greenwich Sentry for the year ended 2007 (the "2007 Audit Opinion").

261. The 2007 Audit Opinion stated that "[i]n our opinion, the accompanying statement of assets, liabilities and partners' capital, including the schedule of investments, and the related statements of operations, changes in partners' capital and cash flows presents fairly, in all material respects, the financial position of Greenwich Sentry, L.P. . . . as at December 31, 2007 and the results of its operations, the changes in its partners' capital and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America." The 2007 Audit Opinion was unqualified.

262. At the time that PWC issued the 2006 and 2007 Audit Opinions it knew that the 2006 and 2007 Audit Opinions would be circulated to Greenwich Sentry's limited partners for their use in evaluating their investment in Greenwich Sentry and that FGB intended to use the 2006 and 2007 Audit Opinions in obtaining additional investors for Greenwich Sentry who would use the 2006 and 2007 Audit Opinions in making their investment decisions.

263. The 2006 and 2007 Audit Opinions contained substantially identical wording and both made the following material misstatements of fact:

(a) Greenwich Sentry's financial statements "present fairly, in all material respects, the financial position of Greenwich Sentry, L.P. . . . as at December 31, 2007 [or December 31, 2006 for the 2006 Audit Opinion] and the results of its operations, the changes in its partners' capital and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.";

(b) PWC "conducted [its] audit of [Greenwich Sentry's] financial statements in accordance with auditing standards generally accepted in the United States of America.";

(c) PWC "plan[ned] and perform[ed] [its] audit to obtain reasonable assurance about whether [Greenwich Sentry's] financial statements are free of material misstatement.";

(d) PWC "examined, on a test basis, evidence supporting the amounts and disclosures in [Greenwich Sentry's] financial statements"; and

(e) PWC's "audit provides a reasonable basis for [its] opinion."

264. The representations made by PWC in the 2006 and 2007 Audit Opinions were in fact false, and PWC in fact had no reason to believe that the financial statements of Greenwich Sentry corresponded with Greenwich Sentry's actual financial position.

265. PWC's representations in the 2006 and 2007 Audit Opinions were made in an intentionally false, reckless and/or grossly negligent manner, and PWC issued the 2006 and 2007

Audit Opinions in an intentionally false, grossly negligent and/or reckless manner without regard to or knowledge of the true facts or without an opinion formed in good faith.

266. PWC knew or should have known that its examination of the financial statements and records of Greenwich Sentry had not been made with reasonable care and was done in an intentionally false, grossly negligent and/or reckless manner and its 2006 and 2007 Audit Opinions were not based upon an examination made with reasonable care and were issued in an intentionally false, grossly negligent and/or reckless manner for the following reasons, *inter alia*, as alleged more fully above:

(a) PWC failed, in a grossly negligent or reckless manner, to conduct its audit in accordance with the standards of GAAS;

(b) PWC failed, in a grossly negligent or reckless manner, to present Greenwich Sentry's financial statements in accordance with principles of GAAP;

(c) PWC knew or should have known FGB operated Greenwich Sentry in such a way that it lacked proper internal controls, lacked a proper risk policy, did not follow Sound Practices and did not perform the necessary due diligence so that FGB was not verifying the results reported to it by the Madoff Firm but merely adopting them wholesale, nevertheless, and in violation of all reasonable professional standards of care, PWC issued the unqualified audit reports and audited financial statements while its knew or should have through a reasonable exercise of professional care and diligence that it basis for its reports or audits because there had been no independent verification of the reported results which its was provided;

(d) PWC knew or should have known that Citco was aware that FGB operated Greenwich Sentry in such a way that it lacked proper internal controls, lacked a proper risk policy, did not follow Sound Practices and did not perform the necessary due diligence so that FGB was not verifying the results reported to it by the Madoff Firm but merely adopting them wholesale, nevertheless, and in violation of all professional standards, PWC issued the unqualified audit reports and audited financial statements while its knew or should have through a reasonable exercise of professional care and diligence that it basis for its reports or audits because there had been no independent verification of the reported results which its was provided;

(e) PWC knew or should have known through an exercise of reasonable professional care and diligence that neither Citco nor FGB were performing the necessary due diligence or operational risk management and were not complying Sound Practices and thus were not verifying the results reported by the Madoff Firm and should have in the exercise of reasonable professional care and diligence extended its extend its audit procedures prior to issuing its audit report, nevertheless, and in violation of reasonable care and professional diligence and in a grossly negligent and/or reckless manner, it did not and issued its unqualified audit report in violation of professional care and diligence;

(f) Upon learning of the failures of due diligence, operational risk management, adherence to Sound Practices by FGB and Citco, as alleged more fully above, PWC should have, and failed in a grossly negligent and/or reckless manner

in the exercise of professional care and diligence by not, prior to the issuance of its audit reports expanding its audit procedures to, *inter alia*:

(i) investigate and confirm the accuracy of representations by the Madoff Firm as to trades it claimed it had made on behalf of Greenwich Sentry and the Limited Partners, including Plaintiff;

(ii) investigate and confirm the accuracy of representations by the Madoff Firm as to the status of Plaintiff's and other Limited Partners' funds prior to issuing its audit reports;

(iii) determine whether the obligations of the Madoff Firm to Greenwich Sentry and its Limited Partners were being fully, accurately and honestly discharged.

(g) PWC failed in a grossly negligent and/or reckless manner to investigate and/or resolve the Red Flags prior to issuing its audit reports;

(h) PWC permitted Greenwich Sentry to disseminate information to its Limited Partners, including Plaintiff, which contained materially incorrect information as to the status of their funds, the success of the Fund's investment strategy, and the reliability of the controls and oversight of the Madoff Firm and permitted the name of PWC to be associated therewith when PWC knew or should have known through the exercise of reasonable professional diligence that this was not the case;

(i) PWC failed in a grossly negligent and reckless manner to comply with its own internal and published standards for oversight and examinations;

(j) PWC issued unqualified reports in a reckless and/or grossly negligent manner without any basis which, *inter alia*, attested to the accuracy of Greenwich Sentry’s financial statements and NAV’s, which in turn were materially misleading and overstated as alleged herein;

(k) PWC failed to perform sufficient fieldwork by neglecting to obtain competent evidence to afford it a reasonable basis for forming an opinion regarding Greenwich Sentry's financial statements but regularly issued unqualified audit opinions;

(l) PWC accepted assurances at face value and when it was required to conduct itself at all times with a high degree of professional skepticism and with an independence in mental attitude and in a grossly negligent and/or reckless manner failed to do so;

(m) PWC failed in a grossly negligent and/or reckless manner and contrary to reasonable professional standards and requirements, to satisfy itself that Greenwich Sentry had implemented adequate safeguards in the face of clear operational risk, and clear "red flags" which PWC knew, should have known and/or consciously avoided knowing were present in this case, including those heretofore alleged; and

(n) PWC failed in a grossly negligent and/or reckless manner to extend its audit procedures prior to issuing its audit report when it knew that contrary to industry practice that the Madoff Firm was acting as broker for, custodian and reporting entity with regard to of the Limited Partners' investment in Greenwich

Sentry.

267. PWC issued the 2006 and 2007 Audit Opinions recklessly, knowing they would be distributed to existing and potential Greenwich Sentry limited partners who would use the 2006 and 2007 Audit Opinions as their basis for making investment decision about Greenwich Sentry including whether to invest and hold on to their investment in Greenwich Sentry.

268. Plaintiff was made aware prior to its investment in Greenwich Sentry on or about February 26, 2008 when its representatives were told by FGG that PWC had issued its 2006 Audit Opinion and that the 2006 Audit Opinion was unqualified. Plaintiff would not have made its initial investment in Greenwich Sentry if it had been informed that PWC had not issued its 2006 Audit Opinion or that it had issued its 2006 Audit Opinion in a qualified manner.

269. Plaintiff received the 2007 Audit Report in April 2008 and reasonably and foreseeably relied upon it in deciding to make the decision to execute a new subscription agreement in Greenwich Sentry in May 2008. If PWC had not issued the 2007 Audit Report or had issued the 2007 Audit Report in a qualified fashion, Plaintiff would not have entered into the new subscription agreement.

270. Plaintiff reasonably and foreseeably relied upon PWC's issuance of the 2007 Audit Opinion in making the decision to maintain and hold its investment in Greenwich Sentry and if PWC had not issued the 2007 Audit Report or had issued the 2007 Audit Report in a qualified fashion then Plaintiff would not have maintained or held its investment in Greenwich Sentry.

271. Plaintiff was damaged as a direct and proximate result of PWC's misstatements the 2006 and 2007 Audit Opinions in the amount of its investment in Greenwich Sentry in an

amount to be determined at trial and not less than three times that amount as punitive damages as are determined at trial.

**COUNT V**

**BREACH OF CONTRACT (THIRD PARTY BENEFICIARY) AGAINST CITCO**

272. Plaintiff repeats and realleges the preceding allegations as if fully set forth herein and further alleges as follows.

273. Citco Europe entered into a binding and valid contract with Greenwich Sentry and/or with FGB to provide fund administration services for the benefit of Greenwich Sentry and for the benefit of the investors in Greenwich Sentry, including plaintiff.

274. Citco Europe entered into a binding and valid contract with Citco Canada pursuant to which Citco Europe subcontracted some or all of Citco Europe's responsibilities for fund administration to Citco Canada and Citco Canada was named the sub-administrator.

275. Citco Europe and Citco Canada acted at the behest of, pursuant to the instructions of, and as agent for Citco Group, as more fully set forth above. At all times, Citco Europe, Citco Canada, and Citco Group acted for each other and as agent for one another with respect to the administration and sub-administration agreements, as more fully set forth above.

276. The services pursuant to the fund administration contract, as alleged more fully above, included, but were not limited to: communicating with Limited Partners; maintaining the record of accounts; processing subscriptions and withdrawals; preparing and maintaining the Partnership's financial and accounting records and statements; calculating each Limited Partner's capital account balance (on a monthly basis); and preparing financial statements.

277. These services were uniquely provided to and for the benefit of the specifically identified group of investors, including plaintiff. Plaintiff was specifically identified to Citco as a beneficiary of this contract.

278. Plaintiff understood that Citco would be providing these services for its benefit and would not have invested in Greenwich Sentry were it not for the existence of the contractual obligations Citco undertook to furnish it with information.

279. Citco understood that plaintiff and any investor in Greenwich Sentry would be relying on Citco to perform its contractual obligations for the benefit of plaintiff and plaintiff is entitled to a presumption of reliance.

280. As set forth more fully above, Citco undertook to communicate directly with plaintiff and did so communicate regarding plaintiff's subscription agreements, regarding plaintiff's personal information contained in plaintiff's subscription agreement, regarding plaintiff's unique capital balance and accounts maintained with respect to the investment in Greenwich Sentry, and with respect to the NAVs for that investment. Citco knew that plaintiff would rely on it specifically to perform these contractually obligated tasks on plaintiff's behalf and for the benefit of plaintiff.

281. Citco knew that with respect to certain of the financial information it maintained on behalf of plaintiff, Citco was the only source for that information and knew that plaintiff relied on it so as to permit plaintiff to form decisions with respect to maintaining its investment in Greenwich Sentry.

282. Plaintiff had a right, under the circumstances of the contract, to expect Citco's performance for plaintiff's benefit and Citco understood that plaintiff was the immediate object

of the performance of the contractual obligations such that Citco has a duty to compensate plaintiff for Citco's failure to perform its obligations to plaintiff as set forth above more fully.

283. As is alleged more fully above, Citco was in a close relationship with Plaintiff approaching that of privity.

284. Plaintiff is entitled to an award of compensatory damages against Citco in an amount to be determined at trial.

## COUNT VI

## BREACH OF CONTRACT (THIRD PARTY BENEFICIARY) AGAINST PWC

285. Plaintiff repeats and realleges the preceding allegations as if fully set forth herein and further alleges as follows.

286. PWC entered into a binding and valid contract with Greenwich Sentry and/or with FGB to perform services as auditors/accountants for Greenwich Sentry and for the benefit of the investors in Greenwich Sentry, including plaintiff as more fully alleged above. These services included but are not limited to the auditing of financial statements in accordance with GAAP and GAAS and/or the preparation of other financial reports, including but not limited to preparing and furnishing to plaintiff the individual tax return information required by plaintiff for filing tax returns for the year ended 2008.

287. Plaintiff was an intended third party beneficiary of the services provided by PWC pursuant to its contract with Greenwich Sentry. The services provided by PWC were uniquely provided to and for the benefit of the Partners of Greenwich Sentry, including plaintiff.

288. PWC communicated directly with plaintiff by virtue of the April 18, 2008 Report

of Independent Auditors. PWC understood that plaintiff was a direct beneficiary of PWC's contractual obligations and that PWC issued its report directly to and for plaintiff.

289. Plaintiff also expected that PWC would communicate directly with it regarding plaintiff's K1 tax information, information that would be unique to plaintiff.

290. These services were uniquely provided to and for the benefit of the specifically identified group of investors, including plaintiff. Plaintiff was specifically identified to PWC as a beneficiary of this contract.

291. Plaintiff understood that PWC would be providing these services for its benefit and would not have invested in Greenwich Sentry were it not for the existence of the contractual obligations PWC undertook, as more fully set forth above.

292. PWC understood that plaintiff and any investor in Greenwich Sentry would be relying on PWC to perform its contractual obligations for the benefit of plaintiff.

293. PWC knew that plaintiff would rely on it specifically to perform these contractually obligated tasks on plaintiff's behalf and for the benefit of plaintiff. Plaintiff is entitled to a presumption of reliance on PWC.

294. PWC knew that with respect to certain of the financial information it maintained on behalf of plaintiff, PWC was the only source for that information and knew that plaintiff relied on it so as to permit plaintiff to form decisions with respect to maintaining its investment in Greenwich Sentry.

295. Plaintiff had a right, under the circumstances of the contract, to expect PWC's performance for plaintiff's benefit and PWC understood that plaintiff was the immediate object of the performance of the contractual obligations such that PWC has a duty to compensate

plaintiff for PWC's failure to perform its obligations to plaintiff as set forth above more fully.

296. As is alleged more fully above, PWC was in a close relationship with Plaintiff approaching that of privity.

297. PWC, as more fully set forth above, breached its contract and failed to perform its contractual obligations. This failure was a direct cause of damage to plaintiff.

298. In breaching its contract, PWC has caused damage to Plaintiff in a way that was directly foreseeable.

299. Plaintiff is entitled to an award of compensatory damages against PWC in an amount to be determined at trial.

**COUNT VII**

**AIDING AND ABETTING BREACH OF FIDUCIARY DUTY**

**AGAINST ALL DEFENDANTS**

300. Plaintiff repeats and realleges the preceding paragraphs as if fully set forth and further alleges as follows.

301. FGB was a fiduciary to the limited partners, including plaintiff, since:

(a) FGB was the general partner of Greenwich Sentry, and by operation of law owed fiduciary duties to the limited partners;

(b) FGB possessed, and held itself out as possessing, superior information as to the Madoff Firm, the Split Strike Conversion strategy, and the other matters alleged herein;

(c) FGB encouraged plaintiff to place trust and confidence in it, by touting its

expertise, track record of success, relationship with the Madoff firm, and purported operational safeguards; and

(d) Plaintiff did reasonably place trust and confidence in FGB.

302. As a result of FGB's status as a fiduciary to plaintiff, FGB was obligated to perform the services which it represented it would provide, under the highest standards of care and loyalty, and to provide full and accurate disclosure.

303. FGB breached its fiduciary duties to the limited partners by virtue of the failures, affirmative acts, and nondisclosures set forth herein, including without limitation:

(a) its failure to conduct due diligence into the Madoff Firm and its operations;

(b) its failure to establish and maintain internal controls;

(c) its failure to adequately monitor risk;

(d) its failure to adhere to the standards and procedures which it represented to Plaintiff that it would employ in managing Greenwich Sentry; and

(e) its failure to investigate and reconcile, and/or its failure to disclose, the matters set forth herein as "red flags".

304. Citco and PWC knew that FGB was a fiduciary to the limited partners, including plaintiff.

305. Citco and PWC knew that FGB breached its fiduciary duties to the limited partners, including plaintiff, by virtue of the acts set forth herein.

306. Both PWC and Citco knowingly rendered substantial assistance to this breach of fiduciary duty in the manners set forth herein, including without limitation:

(a) Citco computed and circulated to limited partners, including plaintiff, NAVs reports which it knew were the product of a system which lacked internal controls, due diligence and risk monitoring, and were based solely on the unverified reporting of results by the Madoff Firm, and were therefore inherently unreliable;

(b) Citco as fund administrator failed to require that FGB implement and maintain internal controls, due diligence and risk monitoring; and,

(c) PWC issued unqualified opinions on the financial statements of Greenwich Sentry, although it knew that such statements were the product of a system which lacked internal controls, due diligence and risk monitoring, and were based solely on the unverified reporting of results by the Madoff Firm, and were therefore inherently unreliable.

307. The issuance of NAVs by Citco was essential to the continuation of Greenwich Sentry, as reports which either reflected the actual and declining values of the limited partners' investments, or which identified the lack of internal controls and other protections in FGB's operations, would have caused limited partners to rush to redeem their investments and deter prospective investors from investing, as they had the right to do. As an experienced fund administrator, Citco knew that this was the case.

308. The issuance of unqualified opinions by PWC was essential to the continuation of Greenwich Sentry, as opinions which either identified the actual and declining values of the limited partners' investments, or which identified the lack of internal controls and other protections in FGB's operations, or the refusal to issue any opinion or withdrawal from engage-

ment, would have caused limited partners to rush to redeem their investments and deter prospective investors from investing, as they had the right to do. As an experienced auditing firm, PWC knew that this was the case.

309. As is alleged herein, if plaintiff had been informed of the lack of internal controls, or the actual value of the fund and its investment or prospects therefor, it would not have invested in Greenwich Sentry, and/or would not have signed the new subscription agreement, and/or would have withdrawn and redeemed its investment prior to sustaining any loss.

310. Plaintiff is entitled to an award of compensatory damages and not less than three times that amount as punitive damages as are determined at trial against PWC and Citco in an amount to be determined at trial.

**PRAYER FOR RELIEF**

WHEREFORE, Plaintiff demands as follows:

(a) a trial by jury on all counts;

(b) granting judgment:

(i) on Count I against Citco for compensatory damages and not less than three times that amount as punitive damages as are determined at trial;

(ii) on Count II against Citco for compensatory damages as determined at trial;

(iii) on Count III against PWC for compensatory damages as determined at trial;

(iv) on Count IV against PWC for compensatory damages as determined at trial and not less than three times that amount as punitive damages as are determined at trial;

(v) on Count V against Citco for compensatory damages as determined at trial;

(vi) on Count VI against PWC for compensatory damages as determined at trial; and,

(vii) on Count VII against all defendants for compensatory damages and not less than three times that amount as punitive damages as are determined at trial, all together with

(c) reasonable attorneys fees and expert witness fees, costs, and disbursements of this action; and

(d) such other and further relief as this Court deems just and proper.

Dated: New York, New York
June 26, 2009 (corrected pursuant to agreement of counsel July 1, 2009)

DEUTSCH, METZ & DEUTSCH, LLP
Attorneys for Plaintiff

By ___/s/___________________________
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**CERTIFICATE OF SERVICE**

I hereby certify that on July 2, pursuant to agreement among counsel, I electronically filed the annexed CORRECTED AMENDED COMPLAINT in this matter with the Clerk of Court using the CM/ECF System, in compliance with the rules of filing which advise that notice of such filing will be automatically sent to all attorneys of record and will constitute service of said pleading and also sent a copy to counsel.

/s/ Christian V. Cangiano

CHRISTIAN V. CANGIANO (CC 1200)