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Santa Fe, Rio Arriba &
Los Alamos Counties
PO Box 2268
Santa Fe, NM 87504-2268

STATE OF NEW MEXICO
COUNTY OF SANTA FE
FIRST JUDICIAL DISTRICT COURT

STATE OF NEW MEXICO, *ex rel.* FRANK C. FOY
AND SUZANNE B. FOY,

Qui tam Plaintiffs,

v.

No.

D-101-CV-2008-01895

VANDERBILT CAPITAL ADVISORS, LLC;
VANDERBILT FINANCIAL, LLC;
VANDERBILT FINANCIAL TRUST;
OSBERT M. HOOD; RON D. KESSINGER;
ROBERT P. NAULT; JAMES R. STERN;
PATRICK A. LIVNEY; STEPHEN C. BERNHARDT;
KURT W. FLORIAN, JR.; ANTHONY J. KOENIG, JR.;
MARK E. BRADLEY; PIONEER INVESTMENT
MANAGEMENT U.S.A., INC.;
PIONEER GLOBAL ASSET MANAGEMENT S.P.A.;
UNICREDITO ITALIANO, S.P.A.;
KATTEN MUCHIN ROSENMAN LLP;
RICHARDS, LAYTON & FINGER, P.A.;
CLIFFORD CHANCE US, LLP; ERNST & YOUNG LLP;
PRICE WATERHOUSE COOPERS; BRUCE MALOTT;
MEYNER + CO; GARY BLAND; CITIGROUP;
CITIGROUP GLOBAL MARKETS INC.;
BEAR, STEARNS & CO. INC.; UBS INVESTMENT BANK;
UBS SECURITIES LLC ; CALYON CREDIT AGRICOLE CIB;
CREDIT AGRICOLE SA; JEFFERIES CAPITAL MANAGEMENT, INC.;
FORTIS SECURITIES LLC; FORTIS NV; ACA MANAGMENT, L.L.C.;
J.P. MORGAN CHASE BANK, N.A.; ABN AMRO, INC.;
STONE CASTLE SECURITIES, L.L.C.; AND JOHN DOE #1;
JOHN DOE #2; and JOHN DOE #3 THROUGH #50,

Defendants.

COMPLAINT UNDER THE FRAUD AGAINST TAXPAYERS ACT

I. INTRODUCTION

1. This is an action to recover damages for the State of New Mexico under the Fraud Against Taxpayers Act, NMSA 1978, § 44-9-1 through -14. The *qui tam* plaintiffs and relators are Frank C. Foy and Suzanne B. Foy. They are citizens and taxpayers of New Mexico. This action seeks to recover three times the amount of damages sustained by the State of New Mexico because of the violations of the Fraud Against Taxpayers Act, along with civil penalties, costs, and reasonable attorney fees, including the fees of the Attorney General, all as provided in § 44-9-3(C), plus pre- and post-judgment interest. In total, the amounts recoverable are in excess of \$300 million.

2. As a result of defendants' violations of the Fraud Against Taxpayers Act, the State of New Mexico lost \$90 million: \$40 million from the Educational Retirement Board and \$50 million from the State Investment Council. The Educational Retirement Board ("ERB") provides retirement benefits to public school teachers in New Mexico, and college professors, and employees of public schools and colleges. As of June 30, 2007, the ERB had 122,598 members, of whom 62,697 were active members, and 29,969 were retirees or beneficiaries. The State Investment Council ("SIC") invests the State's permanent funds for the benefit of public schools and colleges, and for the operations of the state. The ERB and the SIC lost substantially all of the \$90 million they invested in CDO-related products offered by Vanderbilt Capital, Citigroup, Bear Stearns, UBS, Calyon, and others. The proceeds from this action should be returned to the ERB and the SIC in accordance with § 44-9-7(D) and (E).

3. The defendants knowingly presented, or caused to be presented, to the State a false or fraudulent claim for payment or approval, in violation of § 44-9-3(A)(1).

4. The defendants knowingly made or used, or caused to be made or used, a false and misleading or fraudulent record or statement to obtain or support the approval of the payment on a false or fraudulent claim, in violation of § 44-9-3(A)(2).

5. The defendants conspired to defraud the state by obtaining approval or payment on a false or fraudulent claim, in violation of section § 44-9-3(A)(3).

6. The defendants conspired to make, use or cause to be made or used, a false, misleading or fraudulent record restatement to conceal, avoid or decrease an obligation to pay out or transmit money or property to the State, in violation of § 44-9-3(A)(4).

7. When in possession, custody or control of property or money to be used by the State, the defendants knowingly delivered or caused to be delivered less property or money than the amount indicated on a certificate or receipt, in violation of § 44-9-3(A)(5).

8. When authorized to make or deliver a document certifying receipt of property used by the State, the defendants knowingly made or delivered a receipt that falsely represented a material characteristic of the property, in violation of § 49-9-3(A)(6).

9. The defendants knowingly made or used, or caused to be made or used, a false, misleading or fraudulent record or statement to conceal, avoid or decrease an obligation to pay or transmit money or property to the State, in violation of § 44-9-3(A)(8).

10. As beneficiaries of an inadvertent submission of the false claim and having subsequently discovered the falsity of the claim, the defendants failed to disclose a false claim to the State within a reasonable time after discovery, in violation of § 44-9-3(A)(9).

11. As used in this complaint, “claim” means a request or demand for money, property or services when all or a portion of the money, property or services requested or demanded issues from or is provided or reimbursed by the State. In this case all or some of the money issued from the State of New Mexico, or was provided or reimbursed by it.

12. As used in this complaint, “knowingly” (or related words like “knew” or “knowledge”) has the meaning provided in § 44-9-2(C): that a person, with respect to information, acted: (1) with actual knowledge of the truth or falsity of the information; (2) in deliberate ignorance of the truth or falsity of the information; or (3) in reckless disregard of the truth or falsity of the information.

13. As used in this complaint, “CDO” or “CDO-related” refers to collateralized debt obligations and related products, including ABS (asset-backed securities), CLO (collateralized loan obligations), synthetic CDOs, and including all tranches or levels thereof, from the most senior to the most junior, including the so-called “equity tranche,” and including such features as leverage (borrowing), repurchase agreements, total return swaps, credit default swaps, warehouse facilities, and hedging and interest rate strategies, and related services.

II. PARTIES

14. The plaintiffs are the State of New Mexico, *ex rel.* Frank C. Foy and Suzanne B. Foy. The real party plaintiffs in interest are the State of New Mexico and state educational institutions and educational employees or retirees covered by the Educational Retirement Board and/or the State Investment Council.

15. Vanderbilt Financial Trust (the “Trust”) is a Delaware Statutory Trust organized by Vanderbilt Capital Advisors, LLC (“Vanderbilt Capital”), to own substantially all of the common membership interests of Vanderbilt Financial, LLC (“Vanderbilt Financial”).

16. Patrick A. Livney is the Chief Executive Officer and a director of Vanderbilt Financial, and Senior Managing Partner of the Structured Finance Group of Vanderbilt Capital.

17. Osbert M. Hood is a director of Vanderbilt Financial, and the President and Chief Executive Officer and a director of Pioneer Investment Management USA; and a Director of Pioneer Global Asset Management S.P.A. (the Italian parent company of Pioneer).

18. Stephen C. Bernhardt is Chief Investment Officer of Vanderbilt Financial and Senior Portfolio Manager of the Structured Finance Group of Vanderbilt Capital.

19. Ron D. Kessinger, Robert P. Nault, and James R. Stern are independent directors of Vanderbilt Financial.

20. Kurt W. Florian, Jr. is the Chief Operating Officer and Counsel of Vanderbilt Financial, and the Chief Operating Officer and Counsel of the Structured Finance Group of Vanderbilt Capital.

21. Anthony J. Koenig Jr is the Interim Chief Financial Officer of Vanderbilt Financial.

22. Mark E. Bradley is the Interim Chief Accounting Officer of Vanderbilt Financial.

23. Pioneer Investment Management U.S.A., Inc is the parent of Vanderbilt Financial and Vanderbilt Capital.

24. Pioneer Global Asset Management S.P.A. is the immediate parent of Pioneer Investment Management U.S.A.

25. Unicredito Italiano, S.P.A. is the parent of Pioneer Investment and Pioneer Global Asset Management.

26. Katten Muchin Rosenman LLP; Richards, Layton & Finger, P.A.; Clifford Chance U.S. LLP are law firms that acted on behalf of the Vanderbilt defendants.

27. Ernst & Young LLP; and Price Waterhouse Coopers are accountants who acted on behalf of the Vanderbilt defendants.

28. Citigroup and Citigroup Global Markets Inc. are entities that provided banking, investment banking, and other services and products.

29. UBS Investment Bank and UBS Securities LLC are entities that provided banking, investment banking, and other services and products. These entities are subsidiaries or affiliates of UBS AG, formerly known as Union Bank of Switzerland. UBS AG also provided banking, investment banking, and other services and products.

30. Bear, Stearns & Co. Inc. is an entity that provided investment banking and other services and products.

31. Citigroup and Citigroup Global Markets Inc. acted as “Joint Book-Running Managers” on the investment, along with Bear, Stearns & Co. Inc. UBS acted as Co-Manager. All of them acted as initial purchasers/placement agents.

32. Bruce Malott is a Certified Public Accountant who lives and works in New Mexico. He is the Managing Principal of Meyners + Co., a public accounting firm with its principal place of business in Albuquerque, New Mexico. Meyners + Co. is a member of the BDO Seidman Alliance.

33. Gary Bland is the State Investment Officer. He acts as the chief staff executive of the State Investment Council.

34. Calyon, also known as Calyon Credit Agricole CIB, is a subsidiary of Credit Agricole SA. Calyon and/or Credit Agricole provided banking, investment banking, and other services and products.

35. Defendants John Does are additional individuals or entities who have participated and conspired with the defendants to perform the unlawful acts or omissions alleged herein, but their identities and actions are unknown or inadequately known at this time. These defendants are referred to in the masculine, although they may be feminine or artificial persons. Discovery in this case will provide information about these unidentified defendants, so that they can then be identified as named defendants.

36. ACA Management, L.L.C. is a wholly-owned subsidiary of ACA Risk Solutions, L.L.C. ("Risk Solutions") and Risk Solutions is wholly-owned by ACA Service L.L.C. ("ACA Services"), the holding company for the structured finance businesses of ACA Capital Holdings, Inc. ("ACA Capital Holdings"). ACA Services is wholly-owned by ACA Financial Guaranty Corporation ("ACA Guaranty"), and ACA Guaranty is wholly-owned by ACA Holding, L.L.C., a wholly-owned subsidiary of ACA Capital Holdings, Inc.

37. JPMorgan Chase Bank, National Association is a national bank or bank holding company. It provided banking and investment banking and other services and products.

38. ABN AMRO Incorporated is a subsidiary or affiliate of Fortis NV, which is a Belgian holding company. Fortis Securities, L.L.C. is also a subsidiary or affiliate of Fortis NV. These entities provided investment banking, banking and other services and products.

39. StoneCastle Securities L.L.C. is a subsidiary or affiliate of StoneCastle Partners LLC. These entities provided investment and investment banking services.

40. John Doe #2 is a citizen of New Mexico. His name and identity are set forth in sealed Exhibit A, which is attached and incorporated as part of this complaint. This exhibit is not to be unsealed without the written permission of the *qui tam* plaintiffs.

41. Most of the defendants are out-of-state entities which have not appointed registered agents in the State of New Mexico.

42. Some of the defendants are subsidiaries or affiliates of other defendants, or are effectively controlled by, or are under common control or ownership with other defendants. The purported distinctions between these entities should be disregarded for purposes of this case, for the following reasons: The subordinate or affiliate entities acted as the mere alter ego or instrumentality of the superior or controlling entity. The subordinate or affiliate entities were mere shells, without actual independent management or governance of their own. The subordinate or affiliate entities were used by the other defendants for their own purposes, not the purposes of the subordinate or affiliate entities. The subordinate or affiliate entities were not adequately capitalized, did not hold proper meetings, did not

establish proper management structures and committees, did not maintain proper records, and did not act through the entity's own officers, employees, and directors. The subordinate or affiliate entities did not act as independent and separate entities. The superior or controlling entities disregarded the separate existence and purpose of the subordinate or affiliate entities. The management and employees of the superior or controlling entities participated in, directed, ordered, approved, or ratified the wrongful conduct of the subordinate or affiliate entities, and of the other defendants.

43. All of the defendants have transacted or presently transact and conduct business within New Mexico. All of the defendants have committed wrongful and tortious acts within New Mexico. All of the defendants benefitted from and were unjustly enriched by the false claims made by other defendants and co-conspirators.

44. All of the foreign defendants named above participated in offering CDO products in which the ERB and SIC invested.

45. All of the defendants are jointly and severally liable for any act in violation of the Fraud Against Taxpayers Act committed by other defendants, or other persons not yet named as defendants, as provided in § 44-9-13.

III. FALSE AND MISLEADING CLAIMS BY THE DEFENDANTS

46. In order to obtain \$90 million from the State of New Mexico for investment in CDO-related securities issued by Vanderbilt, the defendants made, or caused to be made, numerous false and misleading or fraudulent statements about the investment, including but not limited to:

- 1. That the investment would have a high level of risk adjusted earnings;

- 2. That the interests of Vanderbilt and the other defendants were closely aligned with the interests of the ERB and SIC as equity investors;
- 3. That they had eliminated any conflicts of interests between their interests and the interests of the ERB and the SIC as investors;
- 4. That the CDOs were backed by high quality residential mortgages;
- 5. That Vanderbilt would throw out problem mortgages before they bought them from the CDO originators, so that Vanderbilt would invest in the very best quality loans;
- 6. That the value of the shares was demonstrated by the fact that Vanderbilt, Citigroup, Bear Sterns and UBS were buying shares along with the ERB and SIC;
- 7. That the investment provided strong collateral performance, attractive spreads, experienced collateral managers, consistent returns, and improved liability and transparency in a variety of market and economic conditions;
- 8. That the defendants had the expertise and proprietary methods to understand and control and minimize the risks of the investment;
- 9. That the shares in Vanderbilt Financial would be listed on European exchanges within 2 weeks after the State bought them, so that the State would have the ability to sell the shares sooner than had been expected;
- 10. That Vanderbilt would register the shares with the SEC within 190 days so that the State would be able to resell the shares;
- 11. That Vanderbilt had special computer programs and expertise to spot problem mortgages before they became a problem;

- 12. That the investment is protected by regular on-site due diligence of ABS issuers and servicers and of the issuers origination channels;
- 13. That the CDOs will be protected by numerous criteria for credit quality, and that Vanderbilt's ability to source opportunities distinguishes it from its competitors;
- 14. That the investment would use only high quality CDO managers;
- 15. That the investment was designed to minimize defaults;
- 16. That the risks were adequately covered by insurance or credit swaps or hedges with solid insurers or counterparties;
- 17. That Citigroup and Bear Stearns would waive their fees and commissions on this investment;
- 18. That other outside investors would also be investing in these securities;
- 19. That the investment is protected by a proprietary collateral enhancement risk database;
- 20. That the investment is protected by an understanding of the underlying collateral;
- 21. That each CDO portfolio will be constructed with strict sector and diversification parameters and rigorous credit processes, focusing on principal preservation;
- 22. That the information about the investment had been obtained from independent sources;
- 23. That the expectations and projections for the investment were based on reasonable assumptions;

- 24. That the promoters of the investment had special core competencies and resources and skill and expertise;
- 25. That the investment would implement a business strategy differentiated from others;
- 26. That the investment in Vanderbilt was protected by appropriate safeguards;
- 27. That the investment was based on diversification;
- 28. That the investment was based on rigorous analysis of credit and credit fundamentals;
- 29. That Vanderbilt was backed by Pioneer and Unicredito, its parent companies;
- 30. That Vanderbilt was a research driven firm;
- 31. That the investment was based on an ability to identify opportunities;
- 32. That the investment would benefit from a large and diverse group of investment banks and mortgage loan originators;
- 33. That the managers had a depth of experience with the targeted asset classes;
- 34. That the investment would be managed by a board of directors with an independent majority;
- 35. That the directors would owe fiduciary duties to the equity investors;
- 36. That the directors would fulfill their fiduciary duties;
- 37. That the directors will supervise the activities of the investment;
- 38. That the directors will establish an audit committee, compensation committee, and a nominating and corporate governance committee;
- 39. That the directors will implement and carry out a code of ethics;

- 40. That the State could rely on the diligence and skill of the managers and servicers selected by Vanderbilt Capital;
 - 41. That the investment would benefit from special steps taken to minimize the potential for misrepresentation of loan quality or terms by the loan originators, or misrepresentation of the nature and quality of the assets;
 - 42. That the investment vehicle was bankruptcy remote;
 - 43. That the investment will maximize for the State the spread between cost of borrowing, and the return on the underlying investments;
 - 44. That the defendants understood how these investments would behave under all market conditions, due to their sophisticated computer modeling techniques;
 - 45. That the investment is protected by the independent directors, and a compliance department, and Vanderbilt’s conflict resolution system;
 - 46. That the managers and servicers would provide adequate credit review and scrutiny to the underlying portfolio of mortgages, loans, and other investments;
 - 47. That the value of the CDOs and the underlying loans and assets was substantially greater than it actually was;
 - 48. That the Vanderbilt investment would yield a return of 20% per annum, and perhaps more.
47. These claims, statements, and representations were false and misleading.
48. In reality, the Vanderbilt investment was not backed by high-quality underlying assets that had been carefully analyzed and screened by the defendants, and defendants knew this.

49. Defendants had a mutual agreement, or understanding, or course of conduct to tout the other defendants' CDO products and jointly promote each others' products and include them in their own CDOs and portfolios. The defendants jointly acted to conceal the falsity of their claims about the products they jointly promoted, as they all profited from the sale of these unsound products. The defendants jointly acted to inflate the prices of these products.

50. All of the financial defendants made false claims about their products as described above.

51. Although the defendants falsely claimed that their interests were closely aligned with the interests of the State, in reality the defendants' interests were not aligned with the State's. The defendants had a strong interest in unloading these overvalued securities on the ERB and SIC. The defendants concealed and failed to disclose the conflicts between their interests and the State's interest as an investor.

52. Through their false claims and representations, the defendants sold the State of New Mexico a worthless combination of liars' loans, lethal leverage, and toxic waste.

53. "Toxic waste," as the term is used in the CDO trade, refers to the first loss position or equity tranche in a CDO. The holder of toxic waste suffers the first loss, because the equity tranche receives funds only after all of the senior tranches have been paid in full. It is called toxic waste because it is the riskiest position, and because it is the residue left over after investment banks assemble and securitize a CDO. Toxic waste is a byproduct of the lucrative process whereby the defendants and others in the CDO business assemble assets and securitize them, taking large fees and commissions in the process. The

defendants wanted to rid themselves of this toxic waste, and they made false and misleading statements in order to peddle it to the ERB and SIC. The Vanderbilt toxic waste was worthless, but the defendants managed to sell it to the State of New Mexico for \$90 million, thereby enriching themselves at the expense of the State and ridding themselves of toxic risks associated with this first loss tranche. In order to accomplish this, the defendants told the State of New Mexico that it would be protected by the fact that the defendants would also invest in the equity tranche, while concealing the fact that their investments in this equity tranche is far outweighed by the revenue they made from selling most of nonexistent “equity” to the State. In fact, there was no “equity” in the Vanderbilt shares; these securities were virtually worthless from the beginning.

54. “Liars’ loans,” as the term is used in the CDO trade, refers to loans, usually residential mortgage loans, made to borrowers who provide little or no documentation or verification of the statements they made on their loan applications, including their income, assets, ability to repay, and whether they are actually residing in the home as their primary residence, or acquiring their second or third property, or a speculative investment. The defendants represented that they carefully screened the loan applications to weed out liars, but in fact they knew that many of these borrowers were making false statements on their applications, and did not have the ability to repay the loans. Indeed, the defendants or their loan originators actively encouraged and solicited persons to borrow money based on false representations, because the defendants made huge profits from packaging the loans, while passing the underlying risk of default on to the CDO investors.

55. “Exception loans,” as the term is used in the CDO trade, refers to loans that do not even meet the minimal documentation requirements or lending standards set by the loan originator or lender. The defendants knew that many of the underlying CDO assets were exception loans, but they misrepresented and concealed this fact. The defendants made huge sums from packaging and securitizing these exception loans while passing the risks on to the CDO investors, like the State of New Mexico.

56. The defects in the Vanderbilt CDO product were compounded by leverage. The defendants made repeated misrepresentations about the amounts of leverage in this investment, and the increased risks created by leverage. They falsely stated that they had the special expertise and ability to control the adverse effects of leverage. In reality, these securities were designed in such a way that they were destined to fail if there were any adverse movements in interest rates on the borrowings which had to be paid before the ERB and SIC received anything on their investment.

57. The defendants also misrepresented and concealed the nature of the underlying mortgages. Many of them were adjustable rate mortgages that forced the borrowers to pay much higher interest rates after a short introductory period. The defendants knew that many of these borrowers would not be able to meet their mortgages after the interest rates reset, but they falsely stated otherwise in order to induce the State to invest.

58. Without these false claims, statements, and representations, the State of New Mexico would not have made this investment.

59. Because they occupied the first loss position, the ERB and the SIC were especially dependent on having high-quality underlying assets with low default rates. The ERB and the SIC were especially vulnerable to liars' loans, exception loans, and lethal leverage, and losses on credit default swaps, counterparty risk, and mistaken hedging strategies. Holders of the more senior position could still be paid in full if the CDOs did not perform as well as expected, because they had a greater cushion if the assets and strategies were as good as the defendants represented.

60. Vanderbilt Capital breached its management agreement with Vanderbilt Financial. Vanderbilt Capital acted in bad faith or in reckless disregard toward the State of New Mexico. It committed wilful misconduct. It acted with gross negligence.

IV. FRANK FOY AND HIS FIGHT AGAINST KICKBACKS AND ILLEGAL INDUCEMENTS.

61. The *qui tam* plaintiff Frank Foy joined the ERB in 1992 as the Manager of the Fixed Income Portfolio, after working more than 20 years in banking and investment in the private sector in New Mexico. In 1996 he became the ERB's Chief Investment Officer, and continued in that position until the events stated below. As Chief Investment Officer, he had overall responsibility for all of ERB's investments.

62. As Chief Investment Officer, Frank Foy instituted a strict policy against political contributions by persons doing business with the ERB. This policy was necessary to fulfill strict fiduciary duties which the ERB owed to educational retirees. This policy against political contributions was also necessary to ensure that the ERB awarded contracts for investment services to the best, most competent, and most honest contractors, not the ones who paid people in power. Further, the policy was necessary so that New Mexico

could attract the most competent investment advisors, because a reputation for “pay to play” discourages the honest advisers from competing vigorously for the State’s business, since they believe that the business will be awarded to less qualified advisors who are willing to provide illegal or improper inducements and kickbacks in order to obtain the State’s business.

63. Beginning in 2003, the ERB was pressured to award contracts and make investments with persons or entities based upon political considerations. These pressures were exerted by Bruce Malott on instructions from John Doe #2 (and perhaps others). This was a plain violation of the fiduciary duties owed by the ERB to its members.

64. Similar pressures were exerted on the SIC. Gary Bland and others at the SIC carried out instructions from John Doe #2 (and perhaps others) to invest State money in exchange for political contributions or other illegal or improper inducements. This was a plain violation of the fiduciary duties of board members and staff at the SIC.

65. Until 2003, the ERB Board had a majority of directors who took their fiduciary duties seriously, and acted in the best interests of the educational retirees who depend on the ERB for their retirement benefits. After 2003, the situation began to change, and the Board came to be controlled by persons who were willing to make investments and award contracts for political or other improper reasons, following the lead of Bruce Malott and the instructions of John Doe # 2 and perhaps others.

66. In 2005 Bruce Malott told Frank Foy that John Doe # 2 said that Foy could keep his job at the ERB, but warned that Foy had better become a “team player,” meaning

that Foy needed to cooperate with awarding business as directed by Malott and John Doe #2.

67. By 2006, it had become apparent to Frank Foy and the professional staff of ERB that in some instances the decisions of the ERB and the SIC and the State Board of Finance were being tainted by political considerations and contributions. Frank Foy was particularly outspoken in his attempts to prevent this from happening. He insisted on enforcing the ERB prohibition on political contributions by vendors and advisors.

68. As a result, Bruce Malott and John Doe # 2 and perhaps others wanted to get rid of Mr. Foy, and they looked for excuses and opportunities to do so. As Chief Investment Officer, Mr. Foy was an exempt employee who could be terminated without cause, and without civil service protections. Because it was clear that he was being targeted for elimination, Mr. Foy was forced to protect himself by taking a demotion to Deputy Chief Investment Officer, a classified position. He arranged this with the ERB's Executive Director, Evalynne Hunemuller.

69. In early 2006 Patrick Livney of Vanderbilt began to call Frank Foy, and Bruce Malott began to pressure Mr. Foy and the ERB staff to buy CDO products from Vanderbilt. The Vanderbilt CDO product was not a good investment, and it did not fit in ERB's portfolio, so Frank Foy vigorously resisted the idea. Other ERB staff and advisers also concluded that it was not a good idea, and recommended against the investment. However, Bruce Malott absolutely insisted that the ERB invest in this particular product from this particular vendor. In May 2006 the Board voted 4-2 to invest in Vanderbilt. The directors selected by public school teachers voted against the investment. The directors who voted for

the investment were swayed by improper considerations. They voted for the Vanderbilt investment on instructions from Malott and/or John Doe #2 (and perhaps others).

70. There were other instances in which Bruce Malott and others pressured the ERB to hire investment managers who were not the best qualified candidates, or to make investments. Frank Foy and other staff members resisted these actions, but Malott had enough votes on the ERB board to push them through.

71. Malott's actions were intended to gain business and political favor for himself and Meyners, as part of Meyners' efforts to develop its accounting business. Malott's actions were a deliberate breach of the strict fiduciary duties which he owed to the ERB and ERB retirees. Malott's actions were not within the scope of his duties as an ERB board member; those duties do not include raising political contributions and developing business for his CPA firm.

72. In December 2006 Bruce Malott spoke with Evalynne Hunnemuller, the ERB's Executive Director. Malott demanded that she submit her resignation before the next day's board meeting, or she would be fired. As grounds for firing her, Malott offered the pretext that she had organized a Board retreat without consulting him about the agenda. This pretext was false. After Ms. Hunemuller submitted her resignation, Malott told her the real reason he had fired her was because she would not fire Frank Foy. Malott had become irate when he had found out that Foy had been reclassified to a protected position, where firing him would be difficult.

73. Frank Foy continued as Deputy Investment Officer during 2007, and continued to speak out against "pay to play."

74. In April 2007, Mr. Foy reviewed the federal campaign contribution report filed by the Richardson for President campaign. The report showed a contribution of \$2,300, the maximum amount allowed by law, from Patrick A. Livney, 365 Elder Lane, Winnekta, IL 60093, on February 15, 2007. It also showed a contribution of \$2,300 on the same day from Stephanie R. Livney, at the same address. Mr. Foy called Mr. Livney to verify these contributions. This confirmed Mr. Foy's earlier belief that the pressure to invest in Vanderbilt was motivated by illegal and improper inducements – kickbacks or bribes in the form of campaign contributions in exchange for the \$90 million obtained from the State of New Mexico.

75. On numerous occasions after the State invested in Vanderbilt, the defendants knowingly made false statements about the investment and the underlying assets and liabilities. These false statements were designed to conceal and misrepresent the fact that the State's investment was virtually worthless, and the fact that the value of the CDOs was grossly overstated, and the fact that many of the mortgage borrowers were in default on their loans.

76. In August 2007, Vanderbilt issued a financial report to investors on the second quarter of 2007. The report included the following statements: "The performance of the CDOs owned by Vanderbilt Financial has been good from a cash flow point of view" "Vanderbilt Financial's CLOs are likely to continue their positive performance" "[W]e expect to build cash at Vanderbilt Financial, and will reinstate dividend payments as soon as our cash levels and outlook for future cash flows are at levels that allow us to pay

dividends.” “Our return on equity continues to exceed previous expectations.” These statements were false and misleading, and known to be false and misleading.

77. In December 2007, Vanderbilt issued audited financial statements for the period since inception to December 31, 2006. These financial statements were audited and certified by PriceWaterhouseCoopers. These financial reports stated that Vanderbilt Financial had assets of \$ 6, 265,419,000 and liabilities of \$6,109,452,000, for a net worth or net equity of \$140,281,000. These statements were false and misleading, and known to be false. In reality, Vanderbilt Financial’s net worth was zero or almost zero.

78. In December 2007, Frank Foy was falsely accused of “sexual harassment” and “hostile work environment.” These accusations were plainly pretextual and clearly contrived to force Mr. Foy to retire. He was demoted from Deputy Investment Officer to Portfolio Manager. He was ordered to move his office from Albuquerque, a few minutes from his home, to Santa Fe, so that he was forced to commute hours each day without being reimbursed for mileage. In Santa Fe he was given very little to do, and no office. In March 2008, Mr. Foy was instructed that he could no longer attend meetings of the ERB Board or the ERB Investment Committee. Ultimately these retaliatory actions forced Mr. Foy to retire.

79. All these actions were taken because Mr. Foy stood as an obstacle to “pay to play.” Malott and others retaliated against Mr. Foy because he had vigorously resisted the investment in Vanderbilt, as well as other investments that were based on improper and illegal considerations, such as bribes, kickbacks, and other illegal inducements.

80. Often these illegal inducements were disguised as political or charitable contributions. In most instances, the defendants were careful to conceal their real intentions and agreements, so as to maintain deniability if the “contributions” were challenged. Underneath the concealments and denials, there was an agreement or understanding, either express or tacit, that the SIC and ERB would invest in the Vanderbilt CDO in exchange for political contributions by Vanderbilt.

81. But for these illegal inducements, the investments in Vanderbilt would not have been made.

82. Mr. and Mrs. Foy reserve their rights to bring an action under § 44-9-11 and other applicable laws to redress these injuries which they have personally suffered, either in this lawsuit or in a separate action. However, they bring this lawsuit at present only on behalf of the State of New Mexico, and only to redress the present injuries suffered by the State and by the public school and college employees who depend on the State for their retirement income.

V. DAMAGES SUFFERED BY THE STATE OF NEW MEXICO.

83. The Vanderbilt investment was virtually worthless. Except for two dividends It generated no other income, and the entire principal amount was lost. The State of New Mexico lost its entire investment of \$90,000,000. In addition, the State lost the income it could have earned if the false claims and representations had been true, or that money had been invested elsewhere.

84. On August 8, 2006, the State wired \$ 90,000,005 to Vanderbilt. In December 2006 the State received a dividend of \$ 1,800,000.10, and a dividend of \$ 1,920,000.44 in

May 2007. Vanderbilt has informed the ERB and the SIC not to expect any more from its investment.

85. As of August 8, 2008, the State of New Mexico has suffered actual damages as follows:

Loss of investment principal	\$ 90,000,000
Loss of investment income (calculated at 20% per annum, less dividends received, compounded quarterly)	\$ 31,791,480
Total	\$121,791,480

86. The foregoing amount is trebled pursuant to § 44-9-3(C)(1), so the damages recoverable as of August 2008 are in excess of \$365,000,000, exclusive of penalties, costs, and attorneys' fees.

VI. CLAIM UNDER UNFAIR TRADE PRACTICES ACT.

87. In addition to violating the Fraud Against Taxpayers Act, by the acts and omissions set forth in this complaint, the defendants have also violated the Unfair Trade Practices Act, §§ 57-12-1 *et seq.*, including but not limited to: §§ 57-12-3; 57-12-2(D)(1), (2), (3), (5), (7), (12), (14), (15), (16), (17); and 57-12-2(E).

PRAYER FOR RELIEF

88. WHEREFORE, the State of New Mexico, *ex rel.* Frank C. Foy and Suzanne B. Foy, prays for:

- A. An award of actual damages in the amount of \$ 90,000,000 in lost principal;
- B. Actual damages for lost income;

- C. Pre- and post-judgment interest under §§ 56-8-4 and 56-8-3, and as otherwise provided by law;
- D. Trebling of the foregoing amounts as provided in § 44-9-3(C)(1).
- E. A civil penalty of not less than five thousand dollars (\$ 5,000) and not more than ten thousand dollars (\$ 10,000) for each violation;
- F. The costs of this civil action;
- G. Reasonable attorney fees, including the fees of the attorney general and counsel for the *qui tam* plaintiffs;
- H. Awards distributing the proceeds of this action or any related settlement in accordance with § 44-9-7;
- I. Judgment that each of the defendants is jointly and severally liable to the State of New Mexico;
- J. Equitable, declaratory, and injunctive decrees requiring the ERB and the SIC to implement and enforce policies against political contributions, direct or indirect, by any person doing business with the ERB or the SIC;
- K. Damages and other relief under the Unfair Trade Practices Act, §§ 57-12-1 *et seq.*; and
- L. Such other and further relief as may be necessary or appropriate.

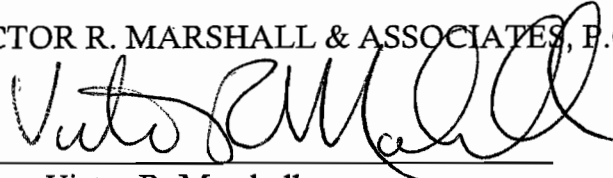
JURY DEMAND

Pursuant to Rule 1-038, NMRA 2008, plaintiffs hereby demand a trial by a twelve (12) member jury in the above entitled cause.

Respectfully submitted,

VICTOR R. MARSHALL & ASSOCIATES, P.C.

By

A handwritten signature in black ink, appearing to read "Victor R. Marshall", written over a horizontal line.

Victor R. Marshall
Attorneys for *Qui tam* Plaintiffs
12509 Oakland NE
Albuquerque, New Mexico
505/332-9400
505/332-3793 FAX