



3. Epstein started his investment career at Bear Stearns, and after his departure, remained an important client and trusted friend to many senior executives at Bear Stearns.

4. In August 2006, FTC invested in excess of \$20 million in a hedge fund called the Bear Stearns High-Grade Structured Credit Enhanced Leverage Fund, L.P. (the "Enhanced Fund"). Tenth months later, this investment was wiped out when the Enhanced Fund, which in the interim had recklessly gorged itself on certain illiquid securities, failed. In November 2006, FTC also invested \$10 million in an additional Bear Stearns hedge fund called Bear Stearns Asset Backed Securities Partners, L.P. (the "ABS Fund"). About one month after the Enhanced Fund collapsed, the ABS Fund also collapsed. Although FTC has received back almost \$3 million from the subsequent liquidation of the ABS Fund, the remainder of its \$27 million of capital invested in both the Enhanced Fund and the ABS Fund is believed lost. In May 2004, COUQ invested in excess of \$10 million in Bear Stearns Asset Backed Securities Overseas, Ltd., the offshore sister to the ABS Fund which was managed exactly the same as and was virtually indistinguishable from the ABS Fund. Both will be referred to herein as the "ABS Fund." Fortunately, COUQ received \$3 million in distributions from the ABS Fund in early 2007, but the remainder of COUQ's investment, which was valued in excess of \$11 million at the time, was essentially lost when the ABS Fund collapsed. When prejudgment interest and other factors are considered, Claimants' loss exceeds \$45 million.

5. The Enhanced Fund now has been revealed as a massive fraud. The Fund's managers, both high-level Bear Stearns executives, are currently under indictment in the United States District Court for the Eastern District of New York for their roles at the Enhanced Fund and its sister fund, Bear Stearns High-Grade Structured Credit Strategies, L.P. (the "High-Grade Fund").

6. The Enhanced Fund fraud actually began with (and was designed in part to cover-up) huge problems with the original High-Grade Fund, which had been running for years before the Enhanced Fund was created. Claimant FTC invested in the High-Grade Fund in 2004. In 2006, Bear Stearns announced the creation of the Enhanced Fund, which Bear Stearns represented would function like the High-Grade Fund (as to which Bear Stearns had already been misleading investors by regularly reporting artificially inflated performance figures), but would use additional leverage to increase returns. However, the true but undisclosed purpose of the Enhanced Fund was to create a new mechanism for Bear Stearns to continue to provide phony market prices for the portfolios without detection. Having two funds to play with, Respondents would be better able to self-deal and enhance their ability to maintain the trading prices of securities in the Funds' portfolios at their already artificially high levels. If that were not enough, Respondents would be able to use bank loans to provide perceived liquidity to the otherwise illiquid positions in the Enhanced Fund. Thus, in reality, Respondents created the Enhanced Fund as part of a scheme both to alleviate the looming liquidity problems that the High-Grade Fund had begun to encounter and to facilitate the continued fraudulent manipulation of fund portfolio values already taking place in the High Grade Fund. The Enhanced Fund was purposely designed to mirror the High-Grade Fund's investment strategy, but allowed Bear Stearns to borrow money against otherwise illiquid securities, and create the appearance of a real market for the securities held by both the High-Grade and Enhanced Funds. Had Mr. Epstein been made aware of the true nature of what was transpiring, FTC would never have put any money into the newly-created Enhanced Fund, a more highly leveraged version of the very same High-Grade Fund that was already experiencing substantial problems.

7. Rather than confronting and adequately disclosing those problems in 2006 when investors, like FTC, could have extracted their investments, Bear Stearns lied to FTC and convinced Epstein to move FTC's investments from the High-Grade Fund into the Enhanced Fund. Respondent Spector, who at the time was President and Co-Chief Operating Officer of Bear Stearns, personally solicited FTC, through Epstein, to invest in the Enhanced Fund, providing clearly misleading and false assurances about the Fund and its investment safety. Spector repeatedly referenced the fact that the securities in the Fund would all be triple or double A rated and therefore would be all but immune from major market downturns. Spector bolstered this safety representation and secured Epstein's unsuspecting confidence in Respondents' scheme by falsely claiming to have made his own personal investment in the Fund.

8. In his capacity as Bear Stearns' risk manager, it was Spector's responsibility to make sure that all fund portfolios were properly valued. This is the very heart of risk management. This included the standard accounting practice of taking a "haircut" on the illiquid positions in those portfolios, which required Spector to discount the value of each such position to account for its illiquidity, based, among other things, on the size of the position compared to the daily trading volume of the securities in that position or on the scarcity of demand for those securities. But for what was, at best, Spector's willful disregard of his responsibility and possibly his intentional fraud, the Funds' portfolios would have been valued properly and investors would have been timely provided with an accurate picture as to Fund performance. However, as management fees, incentive fees and performance bonuses were all based solely on the reported value of the Funds, Spector and the other Respondents ignored these basic required accounting procedures and falsely reported higher numbers.

9. With its huge accumulation of these particular types of illiquid securities in its portfolio, and an increasingly limited supply of such securities trading freely in the marketplace, the Enhanced Fund ran into serious difficulty, which Respondents concealed, almost as soon as the Enhanced Fund was created. By early 2007, unbeknownst to the public, the Enhanced Fund, with Warren Spector being integrally responsible for the fund's risk management, faced serious liquidity problems and substantial losses in the increasingly likely event that real prices would ultimately be attached to the Fund's portfolio. Bear Stearns responded by engaging in a desperate cover-up. As the real market started to decline, it became more and more difficult to conceal the fraud. The misleading prices at which Bear Stearns had valued the Enhanced Fund's portfolio became impossible to justify. The cascading effect of this fraud was not merely a result of the financial problems on Wall Street, but stood as the keystone to the collapse of Bear Stearns and billions of dollars of losses to firms around the world. The two Bear Stearns executives most directly involved in managing the funds, Ralph Cioffi and Matthew Tannin, have been indicted for repeatedly lying to investors about the Enhanced Fund's condition from February to June 2007, when the Fund ultimately collapsed. In the Spring of 2007, when Epstein tried to redeem FTC's entire investment in the Enhanced Fund, Respondent Spector directly misled Epstein by reassuring him that Spector, a senior member of the Bear Stearns Executive Committee, was on top of it, it was his baby and all was fine with the Enhanced Fund. In fact, Spector specifically told Epstein that Spector was so enthusiastic about the Fund's prospects that he was going to invest additional personal capital. But for Spector's false, self-serving and misleading statements, FTC would never have invested in the Enhanced Fund in the first place. Moreover, at the time, month's before the Enhanced Fund failed, that Epstein tried to redeem FTC's entire investment, had Epstein known of Spector's ulterior motives (*i.e.*, an internal

conflict over his own personal compensation), Epstein never would have accepted Spector's reasoning and been persuaded to delay FTC's redemption demand.

10. Pointing to Respondents' purported success in the management of their funds, in November 2006, Respondents also mislead FTC when they solicited Epstein to make a \$10 million investment on behalf of FTC in the ABS Fund. As with the Enhanced Fund, FTC's investment in the ABS Fund was solicited personally by Spector. The ABS Fund invested almost exclusively in mortgage-backed securities. By November 2006, Respondents were well-aware of the extreme distress facing this Fund, but Respondents concealed this fact from Epstein. In furtherance of Respondents' fraud, Spector solicited FTC's investment at a time when Respondents knew there were already problems with their valuation methods.

11. Obviously, had Respondents come clean about the problems in the Enhanced Fund and the High-Grade Fund and the extreme distress facing the ABS Fund, and had Epstein been aware of Spector's blatant, personally-motivated misrepresentations regarding Spector's own personal investment in the Enhanced Fund, Epstein never would have caused FTC to invest in the ABS Fund to begin with and would in any event have caused both FTC and COUQ to liquidate their positions in the ABS Funds while there was an opportunity to do so.

#### **Arbitration Provision**

12. Pursuant to the Customer Agreements between Bear Stearns and FTC and Bear Stearns and COUQ, "... controversies arising between [Claimants] and your introducing broker and/or Bear Stearns, and any of your or their control persons, predecessors, subsidiaries, affiliates, successors, assigns and employees, shall be determined by arbitration." Furthermore, the arbitration is required to be "held at the facilities and before an arbitration panel appointed by the New York Stock Exchange, Inc., the American Stock Exchange, Inc. or the National

Association of Securities Dealers, Inc. or, if the transaction which gives rise to such controversy is effected in another United States market which provides arbitration facilities, before such other facilities.” The NASD is now known as the Financial Industry Regulatory Authority (“FINRA”), and the NYSE has merged its arbitration program into FINRA’s.

### **The Parties**

#### **Claimants**

13. At all relevant times, Claimant FTC was a corporation organized and existing pursuant to the laws of the United States Virgin Islands. FTC is a financial consulting firm. FTC, through the work of Jeffrey Epstein, provides financial consulting services to third-parties, and FTC also invests its own funds--the ultimate beneficial owner of which is Jeffrey Epstein. FTC invested \$20,155,344 in the Enhanced Fund on August 1, 2006. The Enhanced Fund investment is now worthless and the entire investment was lost without any recovery. Additionally, FTC invested \$10,000,000 in the ABS Fund on November 29, 2006. FTC has received \$2,964,196 in distributions since the ABS Fund went into liquidation in early 2008. The timing and amounts of any additional recovery by FTC is unclear, and the majority of FTC’s investment in the ABS Fund has not been recovered

14. At all relevant times, Claimant COUQ was a private foundation incorporated in Delaware with offices located in New York, New York. In 2004, COUQ invested \$10,000,000 in Bear Stearns Asset Backed Securities Overseas, Ltd. (As noted previously, this Fund was the offshore sister to Bear Stearns Asset Backed Securities Partners, [REDACTED], and both Funds were managed exactly the same and were virtually indistinguishable from each other, so both will be referred to herein as the “ABS Fund.”) COUQ redeemed \$3,000,000 of this investment in February 2007. After the ABS Fund collapsed, COUQ transferred its shares in the ABS Fund to

another charitable foundation, but COUQ did not transfer its legal claims. COUQ has not received any additional recovery from the ABS Fund.

### **Respondents**

15. At all relevant times, Respondent The Bear Stearns Companies was a corporation organized under the laws of the State of Delaware with its principal place of business located at 383 Madison Avenue, New York, New York, and was the parent of Bear, Stearns & Co. Inc. and BSAM. Bear Stearns, a global investment bank, securities trading, and financial services firm, marketed itself as having particular expertise in the securitization of mortgage loans and the trading of resulting securities. On May 30, 2008, a wholly-owned subsidiary of JPMorgan Chase & Co. merged with and into The Bear Stearns Companies, with The Bear Stearns Companies continuing as the surviving corporation and as a wholly-owned subsidiary of JPMorgan Chase & Co.

16. At all relevant times, Respondent Bear, Stearns & Co. Inc. was a corporation organized under the laws of the State of Delaware with its principle place of business located at 383 Madison Avenue, New York, New York. It was the investment banking, securities trading and brokerage arm of Bear Stearns.

17. At all relevant times, Respondent BSAM was a corporation organized under the laws of the State of New York with its principal office located at 383 Madison Avenue, New York, New York. BSAM was the asset management arm of Bear Stearns and an SEC-registered investment advisor, with purported expertise in risk management and proprietary methods for portfolio management.

16. Respondent Spector, until he was forced to resign on August 5, 2007, was President and Co-Chief Operating Officer of Bear Stearns. Spector was a member of both the Executive Committee and Board of Directors of Bear Stearns and was the key individual responsible for developing Bear Stearns' hedge funds business at issue. Spector had direct supervisory responsibility over BSAM, its reputation tied directly to Spector's. Spector was an integral part of Bear Stearns' risk management and oversaw the management of the Funds at issue in particular. The BSAM portfolio managers for these Funds all were ultimately responsible to Spector. Moreover, the majority of Spector's compensation was tied to the growth and purported performance of these Funds.

#### **Statement of the Claim**

18. Epstein's relationship with Bear Stearns began 32-years ago when he was personally recruited as a trader by Bear Stearns' former Chairman of the Board of Directors, Alan Greenberg. After leaving in 1981, Epstein continued to do business with Bear Stearns.

19. Epstein was considered a "VIP" client of Bear Stearns. In order to assure that Epstein was kept fully informed of both ongoing and potential future investments, Spector was assigned the role of liaison between Bear Stearns and Epstein. Over the years, Epstein came to rely upon Spector for honest, concise and accurate information and advice about investments. For more than 26 years, Epstein invested millions of dollars in various Bear Stearns' sponsored investments, relying principally on the assurances, advice and representations of Spector and other executives at the highest levels of Bear Stearns' management.

20. In August 2003, Bear Stearns, through BSAM, formed the High-Grade Fund, a fund designed to provide modest, safe and steady returns, with a 10 – 12 % per year target. According to the Private Placement Memorandum ("PPM") distributed to potential investors in

the High-Grade Fund, the Fund's primary objective was to "seek high current income and capital appreciation" and securities that are "rated from AAA to AA," and the Fund committed to invest in "approximately 90%" securities rated "AAA to AA."

21. FTC initially invested \$15 million in the High-Grade Fund in 2004. By 2006, this investment had grown to in excess of \$20 million. But unbeknownst to FTC, the High-Grade Fund was already experiencing significant problems, and was forced to create and report misleading performance figures. In order to prevent investor withdrawals, Spector and the other Respondents needed to show investors consistent and safe returns. They did this, among other ways, by creating fictitious prices, accomplished through self-dealing, at which trading in the Fund's securities could be seen to occur. This, in turn, provided justification for Bear Stearns to provide investors with artificially inflated valuations of the securities in the High Grade Fund's portfolio. In an effort to further conceal these problems from investors and to secure sorely needed cash to perpetuate Bear Stearns' fraud, Spector solicited FTC and convinced it to roll-over its High Grade Fund investment into a new version of the High-Grade Fund called the Enhanced Fund.

22. The Enhanced Fund engaged in the identical investment strategy as the High-Grade Fund. In fact, investments in the High Grade Fund that were transferred to the Enhanced Fund were transferred, not in cash, but in-kind. As a result, the Enhanced Fund held in its portfolio securities that were previously held in the High Grade Fund portfolio. Moreover, unlike the High Grade Fund, the Enhanced Fund was now able to borrow money against its securities, the very same securities for which the Respondents could find no willing arms-length buyer to engage in transactions at the artificially high prices maintained by Respondents. Hence, to the extent the High-Grade Fund experienced problems, the Enhanced Fund would be able to

delay any downturn by having bank cash available. Had Respondents told investors the truth about the status of the underlying investments, FTC would have withdrawn its investment and would not have invested in the Enhanced Fund, which collapsed ten months later.

23. As noted above, the High-Grade Fund was already experiencing significant liquidity issues by 2006. Contrary to initial representations made to investors, BSAM had loaded the High-Grade Fund with investments in collateralized-debt obligations (“CDOs”) and CDO<sup>2</sup>s, continually buying the same securities to artificially inflate and support their fictitious prices.

24. Bear Stearns had enormous incentive to maintain artificial prices for these securities. Bear Stearns was, itself, a massive underwriter of mortgage-backed CDOs and CDO<sup>2</sup>s. Bear Stearns also functioned as a major “manager” of the CDOs once they were sold to investors, and as such was responsible for maintaining an orderly market for the CDOs. However, Bear Stearns, itself, also was a huge investor in these very same securities for Bear Stearns’ own account. Bear Stearns’ balance sheet contained billions of dollars worth of such securities.

25. During 2004 and 2005, Bear Stearns helped create a market for such securities. Bear Stearns invested heavily in creating the infrastructure to underwrite, market, and manage such securities, its profits from these activities making up most of its publicly reported earnings.

26. The High-Grade Fund was an easy target on which to unload these CDOs and CDO<sup>2</sup>s. Bear Stearns controlled the High-Grade Fund as its general partner, and so Bear Stearns caused the High-Grade Fund to load up on such securities at artificially inflated prices in order to give the appearance of an orderly market at such prices.

27. Respondents’ incentive to artificially inflate the market for CDOs and CDO<sup>2</sup>s was magnified by the flexibility Bear Stearns maintained in “valuing” these securities. Because there

is no public market for CDOs and CDO<sup>2</sup>s, these securities are valued using a mark-to-market methodology, which depends on finding comparable transactions. This valuation methodology was open to manipulation by Spector and the other Respondents. It gave Bear Stearns a huge incentive to trade additional, similar securities at a high price in order to create the appearance of stability in the public's perception of their price.

28. By 2006, Bear Stearns routinely engaged in providing inflated values for CDOs and CDO<sup>2</sup>s, including those held by the High-Grade Fund. This obviously had the impact of inflating the value of the High-Grade Fund and its performance as reported to its investors, including FTC, on a monthly basis. The compensation of the Fund's management as a percentage of assets and a participation in its paper profits, gave Spector and the other Respondents a *raison d'être* for maintaining artificially high trading prices and reporting inflated performance figures to the High Grade Fund's investors.

29. Bear Stearns also caused the High-Grade Fund to engage in buying and selling CDOs and CDO<sup>2</sup>s with Bear Stearns, itself. These related-party transactions allowed Bear Stearns to more easily create artificial mark-to-market valuations. Moreover, Bear Stearns engaged in these transactions without getting approval from the Fund's "independent directors," as required by the Fund's governance documents, by internal Bear Stearns rules, and by law. As of 2006, fully 70% of such transactions occurred without getting proper approvals.

30. In 2006, Bear Stearns's internal compliance department finally took action in response to the repeated failure of the High-Grade Fund to obtain approval of related-party transactions. The response was provided to limit the likelihood of fraud. (It was obviously insufficient to overcome the manipulation by the now indicted fraudsters.) In 2006, the compliance department imposed a complete moratorium on trading between Bear Stearns and the

High-Grade Fund. This cut the High-Grade Fund off from a source of liquidity and should have limited the ability to craft false reported values -- i.e., by not allowing securities to be sold to the firm and recorded as a fair market trade. But this decision also placed additional stress on the High-Grade Fund by cutting off a potential trading partner.

31. Respondents did not reveal any of these problems to investors.

32. Instead, Respondents launched a plan to start a new fund, the Enhanced Fund. The Enhanced Fund was managed by the very same individuals who managed the High-Grade Fund and was marketed by Respondents as mirroring the investments made by the High-Grade Fund. The relevant documents describing the Enhanced Fund concealed all of the above problems already being experienced with the High Grade Fund.

33. The disclosed justification for creating the Enhanced Fund was to increase returns by merely using additional leverage. Supposedly, the Enhanced Fund would carry only limited additional risk, because the Fund would invest in an even higher proportion of the least risky securities, and, according to Respondents, the increased returns would result from increased leverage rather than increased risk.

34. In reality, Respondents knew that the risk of not being able to sell the Funds' securities at the prices Bear Stearns had falsely portrayed as market prices was increasing with every passing day. In August 2006, borrowing more money to artificially maintain the appearance of a true market represented a fraud clearly not advertised by Bear Stearns.

35. Respondents also concealed the real reasons for creating the Enhanced Fund. The Enhanced Fund was created for two, undisclosed reasons. First, given the increased difficulty of finding real unrelated buyers in arms-length transactions, Respondents expected that the High-Grade Fund's performance would deteriorate, especially now that Bear Stearns was closed off

from engaging in related-party transactions with itself. A clever, but no less unscrupulous, way to mask the problem was to arrange to borrow cash against the Fund's securities that allowed additional purchases and necessary liquidity. In other words, Respondents did not intend for the additional leverage to improve returns; rather, Respondents envisioned the use of leverage as a last-ditch way to maintain their fiction of real trading prices.

36. Second, the Enhanced Fund provided a potential source of cash liquidity. Respondents intended to fund the Enhanced Fund by convincing investors in the High-Grade Fund to roll-over their investments into the Enhanced Fund. Rather than transferring money from one account to another, the High-Grade Fund simply would transfer assets in-kind to the Enhanced Fund. Not only did this transfer illiquid assets from the High-Grade Fund, but the Enhanced Fund could now use those illiquid assets to borrow additional money. The Enhanced Fund had an agreement with Barclays that effectively provided hundreds of millions of dollars of cash based on the valuation or, in reality, the mis-valuation of assets in the Fund.

37. Convincing as many investors as possible to transfer from the High-Grade Fund to the Enhanced Fund was critical to the continuation of Respondents' fraudulent scheme. In the summer of 2006, with the other Respondents' knowledge and consent, Spector called and solicited Epstein to transfer FTC's investment from the High-Grade Fund to the Enhanced Fund by falsely representing to Epstein, among other things, that the Enhanced Fund's investments would be principally AAA- or AA-rated securities, involve spreads of about 3-4%, and generate expected returns of 15-20%. As he had in the beginning, Spector again represented to and assured Epstein that Spector personally was overseeing and monitoring the investments and risk in the Fund. But this time, Spector went even further in his fraudulent representations to Epstein. Spector claimed to Epstein that Spector was so sure of the safety of the Enhanced Fund that he

was investing his own money. This representation by Spector was pivotal in Epstein's decision to move his investment to the Enhanced Fund – it signaled Respondents' confidence in the Enhanced Fund and suggested an alignment of interests between the investors and the fund managers that would provide special motivation for Respondents to manage the Enhanced Fund well.

38. In fact, Spector's representations were false. Spector had not invested his own money. Moreover, the fact that Spector's compensation was tied directly to the Fund's reported paper profits was also not disclosed. Nor was the fact that appropriate safeguards were not in place. For example, Spector neglected to mention that Bear Stearns' compliance department had imposed a moratorium on all transactions between the Funds and Bear Stearns because of a complete failure by the Funds' managers to observe proper procedures.

39. As a direct result of Spector's and the other Respondents' false statements and representations to Epstein, on August 1, 2006, Epstein caused FTC to transfer its entire investment of \$20,155,344.25 in the High-Grade Fund to the Enhanced Fund.

40. In November 2006, Respondents again set their sights on FTC as a potential target. In addition to the High-Grade Fund and the Enhanced Fund, Bear Stearns ran another fund that was heavily invested in mortgage-backed securities. This hedge fund was the ABS Fund. Although the ABS Fund was managed by a different group of managers than the High-Grade Fund and the Enhanced Fund, it also fell under the direct authority and control of Spector, and claimed to utilize the same unique skill and knowledge about trading mortgage-backed securities (and risk management procedures) as the High-Grade Fund and the Enhanced Fund. As of November 2006, Epstein was familiar with the ABS Fund because COUQ (the private foundation that Epstein managed) had invested \$10 million in the ABS Fund back in 2004. In

November 2006, Spector solicited FTC to invest an additional \$10 million into the ABS Fund. FTC would never have made this investment had it known the truth about the High-Grade Fund and the Enhanced Fund or about Spector's misrepresentations regarding Spector's personal investment in the Enhanced Fund. FTC would have not increased its exposure either to Bear Stearns hedge fund operations or to the mortgage-backed securities market. (Not surprisingly, Epstein also would have caused COUQ to redeem its position in the ABS Fund.)

41. Upon information and belief, Claimants allege that as of November 2006, the ABS Funds were experiencing, but failed to disclose, similar problems to those experienced by the High-Grade Fund and Enhanced Fund, which were also not disclosed investors. Upon information and belief, Claimants further allege that the ABS Funds were manipulating and falsely reporting to investors the value of the securities held by those Funds in same fashion as the High-Grade Fund and the Enhanced Fund. The ABS Funds also invested in mortgage-backed securities that were valued largely using a mark-to-market methodology that was also manipulated by Bear Stearns.

42. By early 2007, Bear Stearns was forced to engaged in outright and gross deception to conceal the problems at the Enhanced Fund. By this time, Respondents were keenly aware that the High Grade and Enhanced Funds were at significant risk of collapse. Rather than oversee an orderly wind-down of the Funds, Respondents chose to continue to defraud their investors in the vain and ultimately futile hope that circumstances would miraculously change, and thereby prevent Respondents' fraud from coming to light. Respondents' conduct is so egregious that the two managers of the High-Grade and Enhanced Funds—Coiffi and Tannin—are awaiting trial on federal securities fraud charges for the multitude of lies told to investors

during the Spring of 2007 in order to conceal problems at the Enhanced Fund. These allegations are well-known to Respondents, so Claimants will not repeat them all in detail here.

43. In mid-March 2007, as the first report of a negative return in the Enhanced Fund was disseminated to the investors, Epstein was concerned and promptly telephoned Spector to question the unusual loss and to redeem FTC's interest. Spector assured Epstein that he did not have anything to worry about and that the loss was due to "bad" marks, but such "bad" marks were not valid.

44. After a loss for March 2007 was announced in mid-April 2007, Epstein again promptly telephoned Spector and demanded to redeem FTC's interests. Spector convinced Epstein not to redeem FTC's interest by falsely stating that the situation was under total control, that the assets had merely taken a bad mark, and the situation would rectify itself, when the assets were properly priced.

45. In mid-May 2007, after an announced loss for April, Epstein promptly telephoned Spector yet again and informed Spector that FTC had decided to redeem its interests. Spector once again convinced Epstein not to redeem by falsely assuring Epstein that the Enhanced Fund owned assets whose valuations had now been conservatively re-confirmed and that Bear Stearns stood behind its valuations. In fact, Spector, following a pattern of deceit also practiced by Cioffi and Tannin, as the government's allegations detail, falsely told Epstein that Spector intended to purchase additional interests in the Enhanced Fund. Epstein decided at least to delay FTC's redemption based on his conversations with Spector.<sup>1</sup>

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<sup>1</sup> Spector's misconduct was aimed even at Bear Stearns itself. In the Spring of 2007, Spector caused Respondent Bear Stearns to invest an additional \$25 million in the Enhanced Fund. Spector did so without receiving the proper internal authorizations, and hid this fact from Bear Stearns' Board of Directors. However, far from being a legitimate investment, this infusion was simply a scheme by Spector to buy-time in a desperate effort to find a way to avoid the inevitable meltdown of the Fund.

46. On June 7, 2007, FTC received a letter from the Enhanced Fund substantially revising its performance downward and also announcing that no further redemptions would be permitted. Ultimately, both the High-Grade Fund and the Enhanced Fund lost 100% of their respective values, resulting in total investor loss of approximately \$1.4 billion.

47. On July 31, 2007, Bear Stearns suddenly suspended withdrawals from the ABS Funds. At the time, Bear Stearns claimed that the ABS Fund had experienced a wave of redemption requests provoked by the high-profile collapse of the High-Grade and Enhanced Funds. Bear Stearns said that it believed the ABS Fund was “well-positioned” and would ride out the current issues. On December 20, 2007, Bear Stearns announced that it had decided to wind-down the ABS Fund. While FTC has since received \$2,964,196 in distributions from the ABS Fund as part of its liquidation, the substantial remainder of FTC’s investment, which was \$10 million, is believed to be lost. COUQ’s investment also was lost, and that investment, even after accounting for the \$3 million redemption in early 2007, was worth in excess of \$11 million before the fund collapsed.

48. Had Respondents disclosed the true nature and manipulation of the prices of the Funds’ securities and not provided false performance figures and had Epstein known the truth about Spector’s misrepresentations regarding Spector’s own investment in and the true status of the Enhanced Fund, FTC would never have invested approximately \$20 million in the Enhanced Fund and \$10 million in the ABS Fund. At a minimum, FTC would have withdrawn its investments at the time that Epstein first demanded redemption from Spector. In addition, COUQ would have withdrawn its \$11 million investment in the ABS Fund. Therefore, FTC’s and COUQ’s base damages to date, with interest, exceed \$45 million.

**Causes of Action**

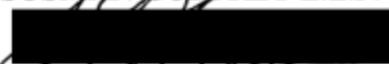
49. As a result, Respondents are liable to Claimants for fraudulent inducement, breach of fiduciary duty, constructive fraud, negligent misrepresentation and breach of contract. Bear Stearns and its subsidiaries are additionally liable for all of the above causes of action under the doctrine of *respondeat superior*.

**Conclusion**

50. As a result of Respondents' fraudulent and otherwise unlawful conduct, Claimants have been damaged in an amount not less than \$45 million plus interest and other damages, and are also entitled to rescissionary damages, plus interest, and punitive damages for Respondents' willful and egregious conduct, together with the attorneys' fees and costs of this proceeding.

Dated: New York, New York  
September \_\_, 2009

Respectfully submitted,

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**PROOF OF SERVICE**

This is to certify that a true and correct copy of the foregoing instrument has been served by email and first class mail, this 16th day of September, 2009, on:

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