SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

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STATE OF NEW YORK,

Plaintiff,

-against-

COLUMBIA MANAGEMENT ADVISORS, INC., and COLUMBIA FUNDS DISTRIBUTOR, INC.,

Defendants.

---X

COMPLAINT

INDEX NUMBER

Plaintiff, by Eliot Spitzer, Attorney General of the State of New York, on behalf of the State of New York, complaining of the above-named Defendants, alleges upon information and belief, that:

INTRODUCTION

1. Pursuant to the provisions of the Martin Act (Article 23-A of the General Business Law), Eliot Spitzer, Attorney General of the State of New York, commenced an investigation of the mutual fund industry in July 2003. As part of that investigation the Attorney General has uncovered evidence that two subsidiaries of FleetBoston Financial Corporation ("FleetBoston"), Defendant Columbia Management Advisors, Inc., ("Columbia Advisors"), the investment advisor to over 140 mutual funds, and Defendant Columbia Funds Distributor, Inc. ("Columbia Distributor"), the entity responsible for sales, marketing, and distribution of the

Columbia family of mutual funds ("Columbia Funds")[1], engaged in a fraudulent scheme in violation of Article 23-A of the General Business Law and other statutes.

2. Columbia Advisors and its officers committed fraud and violated their fiduciary duties by allowing Columbia Funds to be timed and by concealing these timing arrangements from the investors, the investing public, and the independent trustees of the Columbia Funds. Columbia Distributor facilitated Columbia Advisors' fraud by negotiating the secret timing arrangements.

3. By reason of Defendants' fraudulent conduct, the State of New York seeks a judgment and order, inter alia, directing that Defendants cease and desist from further violating New York's securities law, that all fees collected and profits obtained from the illegal activity be disgorged, that restitution and damages be awarded, and that costs and penalties be assessed and paid to the State of New York.

PRELIMINARY STATEMENT

4. From 1998 through October 2003, Columbia Advisors, its predecessor entities, and Columbia Distributor allowed certain preferred clients to engage in short-term or excessive trading and never disclosed this fact to other investors. Columbia Distributor secretly entered into arrangements with at least nine clients and pursuant to these arrangements and otherwise, allowed them to engage in frequent short-term trading in at least 17 different

[1] The Columbia Funds are a group of funds currently owned by FleetBoston. This group includes several funds (*e.g.*, the Acorn, Newport, and Stein Roe fund groups) that had belonged to Liberty Financial Investments until late 2001, when Liberty was acquired by FleetBoston. By September 2003, the names of the various fund groups FleetBoston owned had been changed so that all were uniformly referred to by the name Columbia.

Columbia Funds, including a fund targeting investments for children, in amounts totaling over $2.5 billion. These arrangements served to enhance the advisory fees earned by Columbia Advisors and the compensation paid to Columbia Distributor.

5. The Defendants entered into and/or approved these arrangements despite knowing or having had reason to know that these clients were engaged in "market timing" and despite knowing or having had reason to know that frequent short-term buying and selling of mutual funds shares could have a harmful effect on the funds involved and on the funds' long-term investors. Indeed, by Columbia Advisors' own estimate, timing activity reduced the annual return on one Columbia fund by more than four percent: instead of receiving a return of seven percent in an up year, longer-term investors in the targeted fund made only three percent.

6. In connection with certain of the arrangements, Columbia Distributor and Columbia Advisors accepted so-called "sticky assets" – investments that were to remain static in return for allowing clients to actively trade in the funds. In some cases, Columbia Distributor and Columbia Advisors caused certain Columbia Funds to allow frequent trading in those particular funds (to the fund's potential detriment) as a means of getting investors to place long-term assets in other Columbia Funds (to the benefit of Columbia Advisors, Columbia Distributor, and possibly the funds receiving the long-term assets).

7. Throughout the relevant period, the Defendants never disclosed to the long-term investors of the Columbia Funds or to the independent trustees of the Columbia Funds the special arrangements they made with short-term or excessive traders and the potential harm these arrangements posed to the relevant Columbia Funds. The Defendants also did not disclose the resulting conflicts of interest these arrangements created between Columbia Advisors and its

clients. Furthermore, Columbia Advisors failed to disclose the conflicts of interest created by the disparate treatment between long-term investors and special clients in the same fund, which was a result of these arrangements (*i.e.,* while clients with special arrangements were allowed to engage in frequent trading, those without such arrangements were not). These non-disclosures constituted material omissions of fact.

8. Many of the arrangements and the trades made pursuant to them were directly contrary to representations that Columbia Advisors made to investors that certain funds did not permit market timing or other short-term or excessive trading because of their harmful effect on the funds. In other cases, these arrangements and trades were contrary to Columbia Advisors' representations that certain funds would allow no more than three or four exchanges per fund per year. Columbia Advisors and Columbia Distributor knew or should have known that these prospectuses contained materially misleading statements and omissions of material facts.

9. Columbia Advisors had a fiduciary duty to act at all times in the best interests of investors in the Columbia Funds. As a result, Columbia Advisors had an affirmative obligation to act in the utmost good faith, and to provide full and fair disclosure of all material facts, including conflicts of interest, to investors and the independent trustees of the Columbia Funds. It further had an affirmative obligation to apply reasonable care to avoid misleading investors.

10. By placing its own interest in generating fees from the timing arrangements above the interests of long-term investors and by failing to disclose these arrangements and the conflict of interests that the arrangements created, Columbia Advisors,

aided and abetted by Columbia Distributor, breached its fiduciary obligation to investors in the funds in which short-term or excessive trading took place.

PARTIES

11. This action by the Attorney General on behalf of the people of the State of New York is brought in the name of the State of New York pursuant to Civil Practice Law and Rule §1301.

12. Defendants Columbia Advisors and Columbia Distributor are indirect subsidiaries of FleetBoston, the nation's seventh largest financial holding company.

13. Columbia Advisors, which has offices in Boston, has been a registered investment adviser with the Securities and Exchange Commission since 1969 . In connection with its purchase of Liberty Financial Group ("Liberty") in November 2001, FleetBoston acquired various Liberty fund groups and investment advisers. The Liberty investment advisers included Liberty Advisory Services Corp., Colonial Management Associates, Inc., Stein Roe and Farnham Inc., Newport Pacific Management, Inc., Newport Fund Management, Inc., and Columbia Funds Management Company. In April 2003, these entities were merged with FleetBoston Investment Advisors Inc. into Columbia Advisors. Columbia Advisors is presently the sponsor of the approximately 140 mutual funds that comprise the Columbia Funds and remains responsible for all representations made in the prospectuses for those funds.

14. Columbia Distributor, a Massachusetts corporation with offices in Boston, is a wholly-owned subsidiary of Columbia Management and indirect subsidiary of FleetBoston. Columbia Distributor has been a broker-dealer registered with the Commission since 1992. It acts as the principal underwriter and distributor for the Columbia Funds and, in this role,

disseminates the prospectuses for the Columbia Funds. Prior to the acquisition of Liberty in November, 2001, it went by the name of Liberty Funds Distributor, Inc.

STATUTORY SCHEME

15. Article 23-A of the General Business Law ("GBL"), of the State of New York, commonly referred as the "Martin Act," in general prohibits fraud in the offer and sale of securities within and from the State of New York.

16. As indicated, the Martin Act proscribes fraudulent practices in connection with the sale of securities. Among the Martin Act provisions relevant to this action are the following:

(a) GBL § 352(1), which prohibits fraud and fraudulent practices and provides, inter alia, that a violation of any section of Article 23-A of the GBL is a fraudulent practice and authorizes the Attorney General to investigate such practices;

(b) GBL § 352-c, which prohibits any person, partnership, or corporation from making any false representations, engaging in deception or fraud, or concealing any material facts that the person knew, should have known, or made no reasonable effort to ascertain the truth;

(c) GBL § 353, which authorizes the Attorney General to seek a permanent injunction enjoining any individual or entity who has taken part in, or has been concerned with, fraudulent practices from directly or indirectly engaging in the issue, sale, or offer of securities within or from the State of New York, and for restitution.

17. GBL § 349, which makes unlawful any deceptive acts or practices in the conduct of any business, trade or commerce. The Attorney General is explicitly authorized to

bring an action on behalf of the State of New York under this section to enjoin such acts and obtain damages.

18. Pursuant to GBL § 350-d, civil penalties may be assessed against any individual or entity that violates GBL § 349.

19. In addition, Executive Law § 63(12) authorizes the Attorney General to seek an injunction barring repeated fraudulent and/or illegal conduct in the carrying on, conducting or transaction of business, and to seek restitution and damages.

BACKGROUND ON TIMING IN THE MUTUAL FUND INDUSTRY

A. Fund Timing

20. Mutual funds are meant to be long-term investments. They are designed for buy-and-hold investors, and are therefore the favored instruments for Americans' retirement and college savings accounts. Nevertheless, quick-turnaround traders look for opportunities to siphon value out of mutual funds. One such scheme is mutual fund timing -- trading in and out of certain types of mutual funds to exploit inefficiencies in the way the funds set their prices or Net Asset Values ("NAVs").

21. Generally, mutual funds are valued once a day, usually at 4:00 p.m. EST, when the New York market closes. The NAV reflects the closing price of the securities that comprise a given fund's portfolio, plus the value of any cash that the fund manager maintains for the fund. A mutual fund stands ready to buy or sell its shares (the mutual fund industry calls sales by investors "redemptions" or "exchanges") at the NAV with the public all day-- but unlike a stock, the price of a mutual fund does not change during the course of the day. Rather, a mutual fund always fills orders it receives at the next available NAV. Accordingly, orders placed

at any time during the trading day up to the 4:00 p.m. EST, get that day's NAV, but an order placed at 4:01 p.m. or thereafter receives the next day's NAV. This is the rule of "forward pricing," which became law in 1968.

22. Mutual fund timing is the rapid trading of a fund's shares to exploit arbitrage in the fund's NAV. It works because some funds use stale prices to calculate the value of securities held in their portfolios. A typical example is a U.S. mutual fund that holds Japanese shares. Because of the time zone difference, the Japanese market may close at 1:00 a.m. New York time. If the U.S. mutual fund manager uses the closing prices of the Japanese shares in his or her fund to arrive at an NAV at 4:00 p.m. in New York, he or she is relying on market information that is fifteen hours old. If there have been positive market moves during the New York trading day that will cause the Japanese market to rise when it later opens, the stale Japanese prices will not reflect such value, and the fund's NAV will be artificially low. Put another way, the NAV does not reflect the true current market value of the stocks the fund holds. On such a day, a trader who buys the Japanese fund at the stale price is virtually assured of a profit that can be realized the next day by selling after the increased fund value is reflected in its price. This and similar strategies are known as "time zone arbitrage."

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

24. A third type of arbitrage is available to the timers who engage in "late trading"-- buying or selling shares after 4:00 p.m. EST on a given day while receiving that day's NAV. Late trading allows timers to capitalize illegally on post-market close events. In essence, all NAVs are "stale" after 4:00 p.m. EST, so the ability to trade late creates arbitrage opportunities in any kind of mutual fund.

B. The effect of fund timing on the long-term shareholder

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

26. Fund timing is not entirely risk free, however. The timer has to keep his or her money in the target fund for at least a day, so he or she may enjoy additional gains or incur losses, depending on the market. But such gains and losses are distinct from the timer's arbitrage profit, which capitalizes on price inefficiencies.

27. Besides the pure wealth transfer of arbitrage (called "dilution"), timers also harm long-term investors in their target funds in a number of other ways. First, they impose their transaction costs, such as commissions, on the long-term investors. Second, trades necessitated by timer redemptions can lead to realization of taxable capital gains or losses at an undesirable time, increasing the tax bill for long-term investors. Third, the timer's trades may

result in the portfolio managers having to buy stock as it is going up in price or sell it into a falling market.

28. Fund managers often seek to minimize the disruptive impact of timers by keeping cash on hand to pay out the timers' profits without having to sell stock. This "strategy" does not eliminate the transfer of wealth out of the mutual fund caused by timing; it only reduces the administrative cost of those transfers and allows the long-term investors' money to be skimmed in a streamlined way. This "strategy" can also reduce the overall performance of the fund by requiring the fund manager to keep a certain amount of the fund's assets in cash at all times, thus depriving the investors of the advantages of being fully invested in a rising market. Some fund managers even enter into special investments as an attempt to "hedge" against timing activity (instead of just refusing to allow it), thus deviating altogether from the ostensible investment strategy of their funds, and incurring further transaction costs.

C. Tools to Combat Fund Timing

29. Mutual fund managers are aware of the damaging effect that fund timers have on their funds. And while the effects on individual investors may be small once they are spread out over all the investors in a fund, their aggregate impact amounts to billions of dollars a year. While it is virtually impossible for fund managers to identify every timing trade, large movements in and out of funds are easy to spot. And mutual fund managers have tools to fight back against timers.

30. Fund managers have the power simply to reject timers' trades. Many funds have also instituted short-term trading fees ("early redemption fees") that effectively wipe out the arbitrage that timers exploit. Generally, these fees go directly into the affected fund to

reimburse it for the costs of short-term trading. In addition, fund managers have the right to update NAVs at the end of the day in New York when there have been market moves that might render the NAV stale. This is called giving the fund a "fair value." It eliminates the timer's arbitrage. As fiduciaries for their investors, mutual fund managers are obliged to do their best to use these weapons to protect their customers from the dilution that timing causes.

D. Incentives for Allowing Fund Timing

31. Typically a single management company sets up a number of mutual funds to form a family of mutual funds or a fund complex that carry its name. Thus, Columbia Advisors is the investment manager for the Columbia Family of funds. While each mutual fund is ostensibly its own company, as a practical matter the management company runs each fund. The portfolio managers who make the investment decisions for the funds and the executives to whom they report all receive their paychecks from the management company, not from the mutual funds themselves. Still, the management company owes fiduciary duties to each fund and each investor.

32. The management company makes its profit from fees it charges the funds for financial advice and other services. These fees are typically a percentage of the assets in the fund, so the more assets in the family of funds, the more money the manager makes. The timer understands this perfectly, and offers the manager more assets for the funds in exchange for the right to time. Often the manager and the timer simply agree that the timing assets will remain in the manager's family of funds at all times, so that they will always be either in the manager's target fund or parked in a money market fund run by the manager.

33. As an additional inducement for allowing the timing, management companies often receive "sticky assets." These are typically long-term investments by the timers in one of the fund manager's other financial vehicles (often a bond fund or a hedge fund run by the manager) that assure a steady flow of management fees to the manager.

FACTS

A. Columbia's Misleading Disclosure

34. During the period from at least 1998 and continuing through summer 2003, Columbia Distributor managers entered into at least nine arrangements with investment advisers, hedge funds, brokers and individual investors allowing them to engage in frequent trading in particular mutual funds. All but one of these investors made multiple "round trips" (each round trip consisting of a purchase and subsequent sale) per month and some made hundreds of round trips, in amounts totaling over $2.5 billion. Further, much of this trading was directly contrary to the prospectus disclosure for the funds in which it occurred.

35. From 1998 through 2000, the prospectuses for various of the Columbia Funds contained disclosures stating that shareholders would be limited in the number of exchanges they could make during a given period. For example, the prospectuses for the Acorn Fund Group represented that investors would generally be permitted to make only up to four round trip exchanges per year, defining a round trip as an exchange out of one fund into another fund and then back again.

36. Further, starting in May 1999, certain Columbia Funds belonging to the Acorn Fund Group began representing in their respective prospectuses that "[t]he Acorn funds do not permit market-timing and have adopted policies to discourage this practice."

37. In the fall of 2000, a number of the Columbia Funds belonging to Liberty (e.g. the Acorn Fund Group) began including in their respective prospectuses the following disclosure expressly stating that short-term or excessive trading was prohibited (the "Strict Prohibition"):

> The Fund does not permit short-term or excessive trading in its shares. Excessive purchases, redemptions or exchanges of Fund shares disrupt portfolio management and increase Fund expenses. In order to promote the best interests of the Fund, the Fund reserves the right to reject any purchase order or exchange request particularly from market timers or investors who, in the advisor's opinion, have a pattern of short-term or excessive trading or whose trading has been or may be disruptive to the Fund. The funds into which you would like to exchange may also reject your request.

38. By the spring of 2001, the rest of the Columbia Funds belonging to Liberty (*e.g.*, the Newport and Stein Roe fund groups) began including the Strict Prohibition in their prospectuses. Columbia Advisors retained this disclosure language upon FleetBoston's acquisition of the funds from Liberty, and in early 2002, adopted the same disclosure for most of the funds that had belonged to FleetBoston prior to the acquisition. In the Spring of 2003, Columbia Advisors amended the Strict Prohibition language in certain of the prospectuses to make clear that other funds distributed by Columbia Distributor similarly reserved the right to reject trade requests from market timers or investors with a pattern of short-term or excessive trading.

B. Ilytat's Arrangement and Trading

39. From April 2000 through October 2002, Ilytat, L.P., a San Francisco hedge fund, and its affiliates ("Ilytat") made almost 350 round trips in seven international Columbia Funds. A substantial number of these trades were made pursuant to an arrangement

with Columbia Distributor and approved by Columbia Advisors, which allowed Ilytat to engage in frequent and short-term trading in the Newport Tiger Fund (the "Newport Tiger Fund"), an Asian equity fund.

40. Through 2000 and early 2001, the prospectus for the Newport Tiger Fund noted that "[s]hort-term 'market timers' who engage in frequent purchases and redemptions can disrupt the Fund's investment program and create additional transaction costs that are borne by all shareholders." Starting in May 2001, the prospectus included the Strict Prohibition representation.

41. Notwithstanding the language in the prospectus, Columbia Distributor, with the approval of the Newport Tiger Fund's portfolio manager, allowed Ilytat, which it and Columbia Services identified as a market timer, to enter into a "sticky-assets" arrangement. Under this arrangement, Ilytat was to place $20 million in the Newport Tiger Fund, with two-thirds of that amount to remain static and one-third to be actively traded. According to calculations about the Newport Tiger Fund, Ilytat placed over $133 million in the fund in 2000 and redeemed $104 million. Further, during the first five months of 2001, Ilytat's purchases or exchanges accounted for $72 million out of the $204 million in total purchases made by all investors in the Newport Tiger Fund. During the same five-month period, Ilytat made redemptions totaling $60 million.

42. The portfolio manager for the Newport Tiger Fund repeatedly wrote to the president of Columbia Distributor expressing concern about Ilytat's trading activity and the harm that this trading activity could have on the fund and its investors. By the same token, by June

2000, Columbia Advisors' president became concerned that Ilytat appeared to be making weekly trades of $7 million in and out of the Newport Tiger Fund.

43. Notwithstanding these concerns, Ilytat was allowed to continue trading in the Newport Tiger Fund until September 2002. During the 30 months from April 2000 to September 2002 during which it actively traded in the Newport Tiger Fund, Ilytat made almost 90 round trips in amounts of up to $13 million apiece. This activity included over 30 round trips during the period from May 2001 through September 2002, when the fund's prospectus contained the Strict Prohibition representation.

44. Ilytat also traded extensively in the Acorn International Fund during the period from September 1998 through October 2003. During the period from September 1998 through September 2000, the prospectus for the fund stated that investors would be permitted to make only up to four round trips per year. Further, as of May 1999, the prospectus for the fund stated that market timing would not be permitted in the fund. In addition, by the end of September 2000, Columbia Advisors began including the Strict Prohibition representation in the fund's prospectus.

45. Despite these representations, from September 1998 through October 2003, Ilytat made 73 round trips in the fund, including 27 round trips in 1999 and 18 round trips in 2000. From July 2000 to December 2001, the period during which it most actively traded the Acorn International Fund, Ilytat made at least 40 round trips in the fund in amounts of up to $15 million. This activity included 27 round trips made after Columbia Advisors had begun to include the Strict Prohibition representation in the fund's prospectus.

46. Ilytat also traded extensively in the Acorn International Select Fund during the period from July 2000 through June 2001. Throughout this period, the prospectus for the Acorn International Select Fund included Columbia Advisors' Strict Prohibition representation. Contrary to this representation, from July 2000 to June 2001, Ilytat made about at least 20 round trips in the Acorn International Select Fund in amounts of up to $3 million.

47. In addition, from September 1999 through October 2000, Ilytat also made more than 40 round trips (over 10 in 1999 and over 30 in 2000) in amounts of $100,000 or more in the Acorn International Select, which went by the name Acorn Foreign Forty Fund at the time. This trading activity was contrary to Columbia Advisors' representation in the prospectus for the fund that traders would be restricted to four trades per year and further, that market timing would not be permitted.

48. From August 2000 through October 2000, Ilytat also actively traded in the Stein Roe International Fund. During this period, Columbia Advisors represented in the prospectus for the Stein Roe International Fund that traders would generally be limited to four telephone exchange round trips per year. Notwithstanding the disclosure, Ilytat made over 80 round trips of up to $1.4 million during this three-month period.

49. From April 2000 to September 2000, Ilytat also actively traded in the Newport International Equity Fund, making approximately 19 round trips during this five-month period in amounts of up to $2 million. During the eight-month period from February 2002 to October 2002, Ilytat made at least 10 round trips of up to $16 million in the Columbia International Equity Fund (formerly the Galaxy Equity Growth Fund) .

50. Neither Columbia Advisors nor Columbia Distributor disclosed to the investors and independent trustees of the Columbia Funds the arrangement with Ilytat or Ilytat's trading in the Columbia Funds.

C. Ritchie Arrangement and Trading

51. From January 2000 through September 2003, Ritchie Capital Management, Inc. ("Ritchie"), a hedge fund manager, traded frequently in the Newport Tiger Fund and the Columbia Growth Stock Fund (formerly the Stein Roe Advisor Growth Stock Fund) ("Growth Stock Fund"), making over 270 round trips.

52. Ritchie made most of its trades in the Newport Tiger Fund. During the period from January 2000 through April 2001, notwithstanding the language in the fund's prospectus regarding the potential harm caused by short-term market timers, Ritchie made 153 round trips. In addition, from May 2001 through September 2002, Ritchie made 105 trades in the Newport Tiger Fund even though the prospectus included the Strict Prohibition representation during this period.

53. In 2001, Columbia Distributor discussed an arrangement with Ritchie under which it would be allowed to make up to 12 round trips per year in the Newport Tiger Fund. In addition, at the end of 2001, Columbia Distributor's Senior Vice President met with Ritchie's principals and discussed the possibility of a "sticky-asset" arrangement. More specifically, they discussed the possibility of Ritchie placing "long-term" assets in a fixed income fund "to offset their activity in Tiger." The Senior Vice President's subordinate summarized the proposal as follows: "we would need to see some money from them...if they were going to

continue to use Tiger." At the time, Ritchie's $52 million position in the Newport Tiger Fund accounted for nearly 10% of its $525 million in assets.

54. In early 2002, Ritchie began negotiating with Columbia Distributor an arrangement to actively trade the Growth Stock Fund, a large cap fund, which by then included the Strict Prohibition disclosure in its prospectus. Ritchie's initial proposal was to place up to $200 million in the fund (which at that time had a total asset value of approximately $776 million), with the ability to trade up to half of that amount every day. Columbia Distributor countered with a proposal to keep 90% of the investment in place for 90 days, with no limit on trades of the remaining 10%. Columbia Advisors' portfolio manager for the fund was aware of these negotiations and provided his input. Shortly thereafter, Ritchie began trading in the Growth Stock fund, making five round trips in two months in amounts of up to $7 million.

55. In early 2003, Ritchie entered into a "sticky-asset" arrangement with Columbia Distributor under which it agreed to place $20 million in the Growth Stock Fund, trade up to $2 million at a time with no limits on the number of trades per month, and place another $10 million in the Columbia Short Term Bond Fund as a "static" (non-trading) asset. Columbia Distributor's CEO and the portfolio manager for the Growth Stock Fund both approved the arrangement. Overall, pursuant to its arrangements with Columbia Distributor and contrary to Columbia Advisors' Strict Prohibition representation in the fund's prospectus, Ritchie made approximately 18 round trips in the Growth Stock Fund from June 2002 through September 2003.

56. Neither Columbia Advisors nor Columbia Distributor disclosed to the investors and independent trustees of the Columbia Funds the arrangement with Ritchie or Ritchie's trading in the Columbia Funds.

D. <u>Canary's Arrangements and Trading</u>

57. During late 2002 and early 2003, entities controlled by Canary Capital Corp. ("Canary") negotiated trading arrangements with Columbia Distributor through two intermediaries. In early 2003, Epic Advisors, on behalf of Canary, entered into an arrangement with Columbia Distributor, approved by its National Sales Manager, under which Canary entities agreed to make investments in three funds (*i.e.,* the Columbia Growth & Income Fund, the Columbia Select Value Fund, and the Columbia [then Stein Roe] Growth Stock Fund [the "Growth Stock Fund"], a large cap fund), totaling $37 million. Despite the fact that Columbia Advisors had included the Strict Prohibition disclosure in the prospectus for each of these three funds, the arrangement permitted Canary entities to make three round trips per month in each fund.

58. In late 2002 or early 2003, Canary also entered into an arrangement with Columbia Distributor pursuant to which he placed $5 million in the Columbia High Yield Fund (the "High Yield Fund"), a high-yield bond fund. Despite the fact that Columbia Advisors had included the Strict Prohibition disclosure in the prospectus for the High Yield Fund, Canary was permitted to make one round trip each month in the fund. The portfolio manager for the High Yield Fund approved the arrangement. During the period from November 2002 through July 2003, Canary made seven round trips in an average amount of $2.5 million.

59. Neither Columbia Advisors nor Columbia Distributor disclosed to the investors and independent trustees of the Columbia Funds the arrangement with Canary or Canary's trading in the Columbia Funds.

E. Calugar's Arrangement and Trading

60. In or around April 1999, Daniel Calugar ("Calugar") reached an arrangement with Columbia Distributor allowing him to place up to $50 million in the Columbia Young Investor Fund ("Young Investor Fund"), a fund targeting investments by children, and the Growth Stock Fund, with permission to make one round trip per month using his entire position. The portfolio manager for the Growth Stock Fund, as well as Columbia Distributor's Managing Director of National Accounts and Senior Vice President approved the arrangement.

61. The 1998 Young Investor Fund owner's manual states on its front cover that it is "[t]he investment that's also an education." Pictures of children and children's handwriting are found throughout the manual. In the manual, the President of Stein Roe indicates that the Young Investor Fund was developed to alleviate the fears that the financial markets can bring to a first-time investor. Investors who purchased shares in the Young Investor Fund would periodically receive educational materials "that will help [them] make informed investment decisions". These materials did not mention Columbia's timing arrangement.

62. Instead, the prospectuses for the years 1998 through 2000 and the owner's manual indicate that "the Young Investor Fund is designed for long-term investors." These prospectuses include a disclosure limiting the number of exchanges per year: "you will be limited to four telephone exchange round-trips per year." In 2001 the Young Investor Fund adopted specific anti-market-timing language: "[t]he Fund does not permit short-term or excessive

trading. Excessive purchases, redemptions or exchanges of Fund shares disrupts portfolio management and increases Fund expenses."

63. In 2000, notwithstanding the supposed terms of the arrangement, Calugar, on average, made more than one round trip every trading day in various of the Columbia Funds. At the time, Columbia Advisors represented in the prospectuses for the Young Investor Fund and the Stein Roe International Fund that investors were generally limited to four telephone exchange round-trips per year. However, during 2000, Calugar made over 200 round trips in the Young Investor Fund, placing trades of up to $2.3 million at a time, and during the four month period from January 2000 through April 2000, he also made at least 13 round trips in the Stein Roe International Fund.

64. During the period from January 2000 through February 2001, Calugar also made nearly 70 round trips in the Growth Stock Fund, placing trades of up to $4 million at a time. Throughout 2000 and into January 2001, he also made approximately 20 round trips in the Newport International Equity Fund, in amounts of up to $6.6 million.

65. Neither Columbia Advisors nor Columbia Distributor disclosed to the investors and independent trustees of the Columbia Funds the arrangement with Calugar or Calugar's trading in the Columbia Funds.

F. Giacalone Arrangement and Trading

66. In late 2000, Columbia Distributor, with the approval of its President, entered into a "sticky-asset" arrangement with Sal Giacalone ("Giacalone"). Under the arrangement, which was approved by the head of the Newport Fund Group, Giacalone was

allowed to make four round trips per month of up to $15 million in the Newport Tiger fund. In return, Giacalone was required to place $5 million in "long term assets" in Acorn Funds.

67. Notwithstanding the supposed terms of his arrangement and the language in the prospectus discussing the potential harm caused by short-term market timers, Giacalone made a total of 43 round trips in the Newport Tiger Fund during six months of trading from November 2000 through April 2001. During the first two months of 2001 alone, Giacalone made at least 30 round trips in amounts of up to $4.7 million.

68. Neither Columbia Advisors nor Columbia Distributor disclosed to the investors and independent trustees of the Columbia Funds the arrangement with Giacalone or Giacalone's trading in the Columbia Funds.

G. D.R. Loeser Arrangement and Trading

69. In late 1998, Columbia Distributor entered into an arrangement with D. R. Loeser ("Loeser"), a registered investment adviser, allowing Loeser to make five round trips per month of up to $8 million in the Growth Stock Fund. Columbia Distributor's Senior Vice President, the president of the Stein Roe fund complex, to which the Growth Stock Fund belonged at that time, and the Growth Stock Fund portfolio manager all approved the arrangement.

70. During the first five months of 2000, Loeser made approximately 20 round trips in the Growth Stock Fund. In addition, despite the fact that the prospectus for the Young Investor Fund represented that investors were generally limited to four telephone exchange round trips per year, Loeser made 20 round trips in the Young Investor Fund during this same period in amounts of up to $16.6 million.

71. Neither Columbia Advisors nor Columbia Distributor disclosed to the investors and independent trustees of the Columbia Funds the arrangement with Loeser or Loeser's trading in the Columbia Funds.

H. <u>Signalert Arrangement and Trading</u>

72. Beginning in 1999, Signalert, a registered investment adviser, began trading in Columbia Funds under arrangements with Columbia Distributor. Initially, Signalert was allowed to invest $7.5 million in the Growth Stock Fund and $7.5 million in the Young Investor Fund, with the ability to make up to 10 round trips annually in each of these two funds. At the time, the prospectus for the Young Investor Fund stated that investors were limited to four telephone exchange round trips in and out of the fund per year. Under the arrangement, Signalert was also to place $5 million in each of six funds, trading just once a quarter.

73. Columbia Distributor senior management subsequently pushed to increase the size of Signalert's investments. In late 1999, as part of a "sticky-asset" arrangement, Signalert agreed to place an additional $10 million in the Growth Stock and Young Investor funds, and to invest and maintain other assets in a money market fund, thereby allowing Columbia Distributor to generate a management fee off those assets. In return, Columbia Distributor allowed Signalert to make up to 12 round trips per year in each fund. The portfolio manager for both the Growth Stock Fund and the Young Investor Fund approved this arrangement.

74. During the first 11 months of 2000, notwithstanding the supposed terms of the arrangement, Signalert made over 60 round trips in the two funds, one every one to two weeks. Overall, during the period 2000-2001, Signalert made more than 50 round trips in the

Growth Stock Fund and approximately 50 round trips in the Young Investor Fund. Moreover, as of February 2001, Columbia Advisors had represented by way of the Strict Prohibition disclosures in the prospectuses for these funds that short-term or excessive trading would not be permitted. Yet, from February 2001 through August 2001, Signalert made 20 round trips in the Young Investor Fund. It also made over 20 round trips in the Growth Stock Fund from February 2001 through December 2001.

75. Signalert also began trading in four additional funds: the Stein Roe Income Fund (a bond fund), the Acorn Fund (a small to mid cap fund), the Galaxy Equity Value Fund (a large cap fund), and the Galaxy Growth & Income Fund. Despite the fact that the Stein Roe Income Fund and the Acorn Fund both included the Strict Prohibition representation in its prospectuses, Signalert made eight round trips in the Stein Roe Income Fund, all in the month of November 2001, and at least 15 round trips in the Acorn Fund during the period from March 2001 through February 2003. In addition, notwithstanding the fact that the two Galaxy funds generally limited investors to three exchanges per year, Signalert made approximately 23 round trips in the Galaxy Equity Value Fund and more than 25 round trips in the Galaxy Growth & Income Fund in a period of less than a year, from February 2001 through January 2002.

76. Neither Columbia Advisors nor Columbia Distributor disclosed to the investors and independent trustees of the Columbia Funds the arrangement with Signalert or Signalert's trading in the Columbia Funds.

I. Waldbaum's Arrangement and Trading

77. During late 2002, Columbia Distributor entered into a "sticky-asset" arrangement with investor Alan Waldbaum ("Waldbaum") under which he was allowed to make

10 round trips per year in the Columbia Tax-Exempt Fund ("Tax-Exempt Fund"), a municipal bond fund, if he moved less than $5 million each time and always kept $2 million in the fund. The arrangement was approved by the portfolio manager for the Tax-Exempt Fund.

78. At the time, the prospectus for the Tax-Exempt Fund included Columbia Advisors' Strict Prohibition representation. Notwithstanding Columbia Advisors' representation, Waldbaum made 10 round trips in the Tax-Exempt fund from November 2002 through October 2003.

79. Neither Columbia Advisors nor Columbia Distributor disclosed to the investors and independent trustees of the Columbia Funds the arrangement with Waldbaum or Waldbaum's trading in the Columbia Funds.

J. Tandem's Arrangement and Trading

80. By early 2000, Tandem Financial ("Tandem"), an investment adviser, entered into an arrangement with Columbia Distributor, which was approved by its Senior Vice President. The arrangement permitted Tandem to make an unlimited number of trades in one or more of the Columbia Funds. Overall, pursuant to this arrangement, during the period from February 2000 through September 2003, Tandem made more than 100 round trips in the Tax-Exempt Fund.

81. During 2000, Tandem made approximately eleven round trips in the Tax-Exempt Fund. Starting in April 2001, the prospectus for the Tax-Exempt Fund prospectus included the Strict Prohibition disclosure. Despite the disclosure, Tandem made 106 round trips during the period from April 2001 through September 2003.

82. Neither Columbia Advisors nor Columbia Distributor disclosed to the investors and independent trustees of the Columbia Funds the arrangement with Tandem or Tandem's trading in the Columbia Funds.

K. Damage to the Columbia Funds

83. During the period 1998 to 2003, many of the Columbia Funds' portfolio managers, some of the Columbia Distributor executives, and the senior executives responsible for Columbia Advisors' knew and disregarded the fact that short-term or excessive trading caused potential and actual harm to the Columbia Funds. For example:

a.) By the beginning of 2000, Columbia Distributor's Senior Vice President expressed concern about the potentially harmful effect that Calugar's frequent trading was having on the relevant Columbia Funds.

b.) In the spring of 2000, shortly after the peak of Calugar's trading in the Stein Roe International Fund, the fund's liaison with Columbia Distributor sent an e-mail to the heads of Columbia Advisors, Columbia Distributor, the transfer agent for the Columbia Funds, Columbia Fund Services, Inc. ("Columbia Services"), with a chart that he summarized as showing: "for the last 6 weeks...$142,018,026 has gone into the Fund and $134,935,372 has gone out...These figures exceed the total size of the Fund!" He continued, "My goal here is to increase awareness of the magnitude of this problem and to get everyone involved working on a solution on a timely basis."

c.) In August 2000, in an e-mail discussing Ilytat, the portfolio manager for the Newport Tiger Fund, complained about market timers to the head of Columbia Advisors and the President of Columbia Distributor, stating: "Their active trading has increased and it has become unbearable. There will be long term damage to the fund." He further noted, "Let's

understand that they [timers] really are not investors. They take advantage of the fund's delayed pricing mechanism which almost guarantees a risk free return ... I hope wholesalers understand that by flipper's [ie., a short-term trader's] investment they do damage to the fund's performance, tax status, and other shareholders (their clients)."

d.) In August 2000, the Tiger Fund's portfolio manager wrote to the President of Columbia Distributor and a senior executive for Columbia Advisors that Ilytat's trading activity would cause long-term damage to the fund.

e.) In March 2001, in another e-mail sent to the head of the Columbia Advisors and the President of Columbia Distributor, the Tiger Fund portfolio manager stated that "Newport ... and the fund's long-term shareholders are all negatively impacted by flippers." He suggested that action be taken against these type of traders. The portfolio managers spoke directly with the heads of Columbia Advisors, Columbia Distributors, and Columbia Services about market timing issues, including his concerns about the negative impact on this funds that frequent movements of large amounts of cash in and out of the fund could have, making it difficult to manage the funds. The portfolio manager also spoke with the CEO of their common parent, Columbia Management Group, about the concerns created by this short-term trading.

f.) In December 2001, the portfolio manager of the Acorn International Fund complained that "timer money has created large swings in cash balances that are unprecedented ... very disruptive ... I believe timers hurt long term shareholders." Four days later, she noted that "Today ... one percent of the [fund's total] cash went out the door, making a mockery of the notion of managing cash levels ... We should talk about what to do."

g.) In July 2002, the portfolio manager for the Tiger Variable Fund experienced a problem with excess cash redemptions. The President of Columbia Services wrote

to the President of Columbia Distributor informing him that the Fund was "still being plagued by market timers," and specifically that "The timers are impacting [the portfolio manager's] ability to manage this fund, and likewise, impacting shareholders."

h.) In September 2002, Columbia Services reported to Columbia Distributor's Manager Director that, "Despite the tools currently available to us, timers continue to disrupt fund performance and management as well as exaggerate sales figures.

Despite the concerns raised about the harm caused on the Columbia Funds by short-term or excessive trading, Columbia Advisors and Columbia Distributor allowed this trading to continued through September 2003.

i) In November 2002, a Columbia portfolio manager attempted to quantify the impact of fund timing: "[F]yi, the impact of market timers can be understood by looking at the mutual funds vs. a representative account run by the same manager with an identical mandate. [T]he tiger fund is a good example since [I] run both of these accounts. The estimate of 400 bps of impact would be a fair approximation. You can see the smaller funds of [J]apan and [E]urope have been hurt much worse..." The smaller funds referred to in this message had their annual returns reduced by nine percent and five percent respectively.

L. Columbia's interference with the efforts to limit fund timing

84. Columbia Distributor recognized its obligation to act consistently with the Columbia Funds' disclosures prohibiting short-term or excessive trading, and professed to want to prevent short-term or excessive traders from investing in the Columbia Funds. Nonetheless, on multiple occasions, Columbia Distributors' executives and employees instructed Columbia Services to allow certain institutional clients with special arrangements to excessively or short-term trade. For example:

a.) In 2000, a Columbia Distributor sales executive halted efforts to stop Giacalone from making almost daily round-trips in the Newport Tiger Fund. Although the Giacalone accounts were subsequently shut down, Columbia Distributor's interference delayed the process and allowed a substantial number of additional trades to be done.

b.) In March 2001, Columbia Distributor's Senior Vice President intervened when a portfolio assistant to the Acorn International Fund had telephoned the broker responsible for the Ilytat account and asked him to stop Ilytat from violating the fund's short-term trading policy. The Columbia Distributor executive caused the Columbia Services manager responsible for market timing to telephone the portfolio assistant and tell her that it was "inappropriate" for her to take any direct steps to halt Ilytat's trading.

c.) By March 2001, with the participation of Columbia Distributors Ilytat was placed on a list of "Authorized Accounts for Frequent Trading," maintained by Columbia Services against which no action was to be taken, however frequent their trading.

d.) In December 2001, Columbia Distributor's Senior Vice President intervened when the portfolio manager for Acorn International Fund complained about how Ilytat's market timing adversely impacted her fund and tried to halt it. Ilytat was allowed to continue trading.

e.) In 2002, Columbia Distributor's Managing Director of National Accounts personally intervened to reverse a stop placed on Ilytat's trading by Columbia Services market timing surveillance personnel. Ilytat continued trading for almost three more months thereafter.

f.) In January 2003, a Columbia Distributor sales manager insisted that no restrictions be placed on trading by Waldbaum because of the trading arrangement with him.

g.) In early 2003, a sales manager at Columbia Distributor intervened when Columbia Services sough to block Tandem from making any more trades in the Tax-Exempt Fund. She wrote to the Columbia Services market surveillance manager, "They [Tandem Financial] are an advisor that we have a very close relationship with. We definitely do not want to restrict them," and further stated that "there are certain relationships like Tandem that are allowed to time based on prior discussions." As a result of this intervention, Tandem was allowed to continue trading in the Tax-Exempt Fund up through October 2003.

h.) In March 2003, a Columbia Distributor executive intervened to allow Signalert to continue trading in the Columbia High Yield Fund, despite a previous bar for excessive trading.

FIRST CAUSE OF ACTION

85. The acts and practices of the Defendants relating to timing violated GBL § 352-c(1)(a), in that they involved the use or employment of a fraud, deception, concealment, suppression, or false pretense, engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of securities or commodities.

SECOND CAUSE OF ACTION

86. The acts and practices of the Defendants relating to timing violated GBL § 352-c(1)(c), in that they involved the use or employment of a representation or statement which was false, where the person who made such representation or statement: (i) knew the truth; or (ii) with reasonable effort could have known the truth; or (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representation made, and where such acts or practices were engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of securities or commodities.

THIRD CAUSE OF ACTION

87. The acts and practices of the Defendants relating to timing violated GBL § 352-c(2), in that Defendants engaged in an artifice, agreement, device or scheme to obtain money, profit or property by a means prohibited by GBL § 352-c.

FOURTH CAUSE OF ACTION

88. The acts and practices of Defendants relating to timing were fraudulent and deceptive in violation of GBL § 349.

FIFTH CAUSE OF ACTION

89. The acts and practices of the Defendants relating to timing violated Executive Law § 63(12) of the, in that Defendants engaged in repeated fraudulent or illegal acts or otherwise demonstrated persistent fraud or illegality in the carrying on, conducting or transaction of a business.

90. Plaintiff State of New York on behalf of the People of the State of New York has been irreparably harmed and has no other remedy at law.

WHEREFORE, Plaintiff demands judgment against the Defendants as follows:

A. That Defendants be permanently restrained and enjoined from engaging in any fraudulent practices in violation of Article 23-A of the GBL § 349 and Executive Law § 63(12);

B. That Defendants and any of their agents or others acting on their behalf be restrained and enjoined permanently from permitting timing of its mutual funds.

C. That Defendants, pursuant to GBL § 353(3), GBL § 349 and Executive Law § 63(12), disgorge all profits obtained, including fees collected and pay all restitution and damages caused, directly or indirectly by the fraudulent acts complained of herein;

D. That Defendants pay penalties pursuant to GBL § 350-d;

E. That Defendants pay costs; and

F. That the Court award such other and further relief to Plaintiff as the Court may deem just and proper in the circumstances.

Dated: New York, New York
February 24, 2004

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