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

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THE PEOPLE OF THE STATE OF NEW YORK by ANDREW M. CUOMO, Attorney General of the State of New York,	:	**SUMMONS**
Plaintiff,	:	Index No.
- against -	:	
CHARLES SCHWAB & CO., INC.,	:	**Plaintiff Designates New York County as the Place of Trial**
Defendant.	:	

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TO THE ABOVE-NAMED DEFENDANT:

YOUARE HEREBY SUMMONED to answer in this action and serve a copy of your answer, or if the complaint is not served with the summons to serve a notice of appearance, on the Plaintiff's attorney within twenty (20) days after the service of the summons, exclusive of the day of service. If the summons is not personally served upon you, or if the summons is served upon you outside of the State of New York, then your answer or notice of appearance must be served within thirty (30) days. In case of your failure to appear or answer, judgment will be taken against you by default, for the relief demanded in the complaint.

Dated: August 17, 2009
New York, New York

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By: ______________________
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Counsel for Plaintiff

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

THE PEOPLE OF THE STATE OF NEW YORK by ANDREW M. CUOMO, Attorney General of the State of New York,	:	Index No.
Plaintiff,	:	
- against -	:	**COMPLAINT**
CHARLES SCHWAB & CO., INC.,	:	
Defendant.	:	

Plaintiff, the People of the State of New York, by Andrew M. Cuomo, Attorney General of the State of New York ("Attorney General"), alleges upon information and belief the following against defendant Charles Schwab & Co., Inc. ("Schwab" or "Defendant"):

TABLE OF CONTENTS

SUMMARY

1. Schwab engaged in fraudulent and deceptive conduct in the sale of hundreds of millions of dollars of auction rate securities to the investing public. Schwab misrepresented auction rate securities to hundreds of its customers as safe, liquid investments that were suitable for their short-term, cash management purposes. In fact, auction rate securities were complex financial instruments with significant, inherent and increasing liquidity risks. Schwab persistently failed to disclose or made misrepresentations that concealed the risk that customers would not be able to sell their auction rate securities and could thus lose liquidity should auctions fail.

2. Audio recordings produced by Schwab confirm that Schwab brokers repeatedly misled investors about the risks of investing in these securities, describing auction rates securities as liquid investments from which investors could always withdraw their money. One Schwab broker told a customer: "I think [auction rate securities are] great alternatives to cash, frankly." Another described preferred auction rate securities to a customer as a "short-term institutional holding instrument" that was particularly suitable for managing the customer's cash balances:

> If you need to have that access to them at any time, that's a good place for those to be. You know if you think you might need to get into that money, that's probably as good a place if not better than anywhere to leave them.

Still another broker assured a customer that she just needed to "call me … and then the next month I'll stop the auction and all the cash [you invested in auction rate securities] will come back to your account." Yet another broker represented that the hardest part of investing in an auction rate security "is getting into it. That would be the tough part. I mean, getting out is something as easy as just selling it." When one customer asked if he could get out of his auction rate securities every 7 days a Schwab broker assured him without equivocation: "That's right."

3. For years, Schwab held itself out to its customers as a trustworthy financial advisor and lower-cost alternative to the full service broker-dealers with whom it purported to compete for business. On its website, Schwab boasted about its "sophisticated" and "remarkable insight," and invited customers to "[l]everage our extensive fixed-income research" and "[t]ake advantage of our expertise" by "[c]all[ing] on our seasoned bond traders, who have an average of 15 years of industry experience." Rather than delivering expertise, however, Schwab instead misled its customers and sold them a product it did not fully understand and could not properly explain.

4. In contrast to its advertisements promising expertise, Schwab failed to adequately educate its brokers about auction rate securities or train them in the sale of auction rate securities. Consequently, Schwab brokers typically either did not understand auction rate securities or did not have the knowledge necessary to provide accurate disclosures. One broker admitted that Schwab customers "probably did not know that here is a product [auction rate securities] you might not be able to sell" because he and other Schwab representatives did not know enough about the securities to warn their customers. Another Schwab broker who sold auction rate securities to Schwab's customers acknowledged: "I don't know what measuring scale you would want to use to assess my knowledge about auction rate securities … but on whatever measuring scale my knowledge was pretty low."

5. Schwab also failed to ensure that its sales force was properly equipped with knowledge about the features and liquidity risks of auction rate securities that was already known within the firm. For instance, Schwab executives knew about the possibility that auctions could

fail and that the consequences of such failure would be a loss of liquidity until auctions cleared again, if they ever did. Schwab also knew that the major underwriter broker-dealers in the auction rate securities market were supporting the market with proprietary bids in order to keep auctions from failing, and could refrain from doing so at any time. Yet Schwab never undertook to properly inform its brokers about these features of auction rate securities and the risks they represented.

6. In addition, Schwab knew, or was reckless or negligent in not knowing, about rising problems in the auction rate securities market beginning in August 2007. During this period, Schwab executives received information identifying liquidity risks with auction rate securities and increasing pressures in the auction rate securities market that compounded those risks. This information came to rest not only with members of Schwab's fixed income trading operation, which was responsible for managing the auction rate securities business, but also with senior business executives in the fixed income and investment management divisions of Schwab.

7. Schwab received daily reports from the major underwriter broker-dealers, which indicated that the inventories of those underwriter broker-dealers were increasing dramatically during the critical period between the final months of 2007 and the failure of the auction rate securities market. Schwab also knew about auction failures in the auction rate securities market as early as August 2007. Some of these failures involved municipal auction rate securities, which were one the two main types of auction rate securities Schwab sold to its customers. These auction failures attracted the attention of senior Schwab managers.

8. Because of Schwab's misleading sales practices, many Schwab customers invested in auction rate securities based upon false assurances of liquidity, and without having

been provided the fundamental information they would have needed in order to properly assess the risks of investing in auction rate securities and make informed investment decisions.

9. Schwab's false statements about auction rate securities, and its failure to disclose the risks associated with them, has had an often-severe, detrimental impact on thousands of Schwab customers nationwide. Since the widespread failures of the auction rate securities market in mid-February 2008, Schwab customers, many of whom planned to use what they believed was cash safely stored as it would have been at a reputable bank for expenses such as home purchases and improvements, tax payments, tuition costs, nursing home payments, and living expenses, among others, instead have been unable to sell their auction rate securities, and were thus unable to access money they invested in securities that were either promised to be highly liquid or that they were not told faced liquidity risks.

10. By this action under Executive Law §§ 63(1) and 63(12) of the State of New York, Article 22-A of the General Business Law of the State of New York ("GBL"), § 349 *et seq*., Article 23-A of the GBL, § 352 *et seq*. (also known as the "Martin Act"), the Attorney General seeks redress for all of Schwab's defrauded customers by petitioning the court for an order requiring: (a) that Schwab buy back auction rate securities from defrauded customers at par, (b) disgorgement of ill-gotten gains, (c) restitution and other damages, (d) civil penalties, (e) changes to Schwab's sales practices and advertising claims, (f) injunctions from further violations of GBL § 349, the Martin Act and Executive Law § 63(12), and (g) such other relief as the Court finds just and proper.

PARTIES

11. This action is brought by the People of the State of New York by the Attorney General upon his authority under the Executive Law, the Martin Act, and the General Business Law of the State of New York.

12. Defendant Schwab, a wholly owned subsidiary of The Charles Schwab Corporation, is a California corporation licensed to do business in the State of New York. Schwab is a registered securities broker-dealer, and offers brokerage, financial planning and investment products and services to individual investors throughout the United States. It employs financial consultants in 306 domestic branch offices in 45 states, including the State of New York.

JURISDICTION

13. The State of New York has an interest in the economic health and well-being of those who reside or transact business within its borders. In addition, the State has an interest in ensuring that the marketplace for the trading of securities and other financial products functions fairly with respect to all who participate or consider participating in it. The State of New York, moreover, has an interest in upholding the rule of law generally. Schwab's conduct has injured these interests.

14. The State sues in its sovereign capacity, pursuant to Executive Law §§ 63(1) and 63(12), General Business Law § 349 *et seq*., and the Martin Act, General Business Law § 352 *et seq*. of the State of New York. The State sues to redress injury to the State and to its general economy and citizenry-at-large. The State seeks disgorgement, restitution, damages, penalties, and costs and equitable relief with respect to Schwab's fraudulent and otherwise unlawful conduct.

15. The market for auction rate securities has been centered in New York since its inception in the late 1980s. This gives the State a particular and unique interest in protecting the interests of persons investing in auction rate securities.

16. As a result of Schwab's conduct, numerous New York residents, as well as the interests of the State of New York as an honest marketplace for securities transactions, were harmed.

FACTUAL ALLEGATIONS

I. <u>Background</u>

A. Auction Rate Securities

17. Auction rate securities are long-term bonds issued by municipalities, corporations and student loan companies, or perpetual equity instruments issued by closed end mutual funds, which pay variable interest rates that reset periodically through a bidding process known as a Dutch auction. The auctions also serve as the mechanism by which auction rate securities are bought and sold.

18. At a Dutch auction, bidders generally state the number of auction rate securities they wish to purchase and the minimum interest rate they are willing to accept. Bids are ranked, from lowest to highest, according to the minimum interest rate specified by each bidder. The lowest interest rate required to sell all of the auction rate securities available at auction, known as the "clearing rate," becomes the rate payable to all holders of that particular security until the next auction. Depending upon the structure of the auction rate security specified in the offering documents, auctions are typically held every 7, 28 or 35 days.

19. When there are an insufficient number of buyers participating in an auction to purchase all of the securities being offered for sale, the auction "fails" and typically no orders to buy or sell are fulfilled. As auction rate securities can only be bought or sold when auctions clear, the most immediate and obvious consequence of an auction failure is that current holders of that issue of auction rate securities are unable to sell their holdings, and suffer a loss of liquidity. If auctions fail repeatedly, investors are left with no option but to hold the securities to maturity – potentially as long as thirty years, or in the case of auction rate preferred securities, perpetually – with no ability to access their money.

20. During the period when auctions are not clearing, investors are paid a default rate of interest, called a "fail rate", which is specified in the origination documents.

21. Until February 2008, underwriter broker-dealers generally supported the auction rate securities market by systematically purchasing auction rate securities into their own inventories in order to make up for shortfalls in natural demand that would have, in the absence of such support, caused the auctions for those securities to fail. These proprietary bids placed by the underwriter broker-dealers for their own accounts were known as "support bids."

22. The underwriter broker-dealers were under no legal obligation to place such support bids, and could refrain from doing so at any time in their sole discretion. Schwab knew about the practice of supporting auctions and that auctions could fail if the firms stopped supporting them. Despite this knowledge, Schwab repeatedly failed to disclose this liquidity risk to its customers.

23. In the middle of February 2008, broker-dealers stopped submitting support bids and the market for auction rate securities failed wholesale. The auctions for the vast majority of auction rate securities issues failed, and have continued to do so since. Investors who had

purchased auction rate securities from Schwab suddenly discovered that their investments were not as liquid as they had been led to believe by Schwab.

B. Schwab's Involvement in the Auction Rate Securities Market

24. Schwab distributed numerous issues of auction rate securities underwritten and/or managed by several major, New York-based underwriter broker-dealers, including Goldman Sachs, JPMorgan Chase, Citigroup, UBS, Morgan Stanley, and Bear Stearns, which it deceptively sold to investors in the State of New York and throughout the United States.

25. Schwab also made misrepresentations to customers relating to auction rate securities from branch offices located within the State of New York.

26. Auction rate securities can only be bought or sold in a successful auction through the underwriter broker-dealers that brought each particular auction rate issue to market. Upon information and belief, all of the auction rate securities issues sold by Schwab to its customers were underwritten and/or managed either entirely or primarily by New York-based financial institutions.

27. To transact its auction rate securities business, Schwab transmitted the buy, sell and hold orders of its customers to the auction rate trading desks of these financial institutions. All of these trading desks, including those of Goldman Sachs, JPMorgan Chase, Citigroup, UBS, Deutsche Bank, Morgan Stanley, Bear Stearns, and Oppenheimer, were located in New York City.

28. Schwab was generally paid an agreed-upon fee by these firms for successfully selling their auction rate securities to its customers. The fee ranged from 7.5 to 25 basis points depending upon the nature of the auction rate security and the relationship with the financial institution.

29. The substantial majority of the auctions for the auction rate securities Schwab sold were held in the State of New York by auction agents located here. Schwab made fraudulent statements or omitted to state material facts to its customers relating to these auctions, in particular in connection with the risks that the auctions could fail.

II. <u>Schwab Repeatedly and Persistently Fraudulently Sold Auction Rate Securities</u>

30. Schwab falsely represented auction rate securities as safe, liquid, short-term investments that were suitable for investors to use for their cash management purposes. Schwab also misrepresented or failed to disclose liquidity risks associated with auction rate securities. These misrepresentations and omissions are mutually corroborated by the admissions of individual members of Schwab's own sales force, the audio recordings of conversations between members of Schwab's fixed income sales force and Schwab's customers, and by Schwab's customers.

A. Schwab Brokers Admit That They Did Not Understand, and Repeatedly and Persistently Misrepresented, Features and Liquidity Risks of Auction Rate Securities

31. Schwab brokers, including both rank and file employees and management, admit that they represented auction rate securities variously as safe, low risk, highly liquid investments, or cash management alternatives, or similar to money market funds. They also admit that they did not inform customers about the possibility that auctions could fail, or the liquidity and other consequences should auctions fail.

32. Following are the admissions of several members of Schwab's fixed income sales force of their misrepresentations relating to auction rate securities.

(1) Schwab Employee A

33. Schwab Employee A is a regional fixed income sales manager and Director of Schwab's Northeast Regional Bond Desk. He supervises about ten fixed income specialists, who provide sales coverage for Schwab customers through the Northeastern United States, including those located within the State of New York.

34. Employee A acknowledged that Schwab sold auction rate securities as suitable for short-term, cash management purposes. He also admitted that he did not know how liquidity was provided in the auction rate securities market or that there was any liquidity risks associated with auction rate securities.

35. Employee A testified that it was his own understanding and, as far as he knew, that of the fixed income department in general that a customer would be able to sell out of his or her auction rate securities at every auction.

36. Employee A admitted that he and his colleagues believed that auction rate securities were appropriate for cash management purposes alongside other classes of securities such as money market funds, treasury bills, government agency discount notes, individual name highly rated corporate bonds, individual highly rated municipal bonds, tax-exempt variable rate demand notes, and commercial paper. Employee A often made this association for customers, comparing the yields on auction rate securities with the prevailing tax-free money market yields or short-term municipal bonds.

37. Since 2002, Schwab Employee A sold auction rate securities to as many as 50 customers as safe, cash management alternatives. He did not recall addressing liquidity risks.

(2) Schwab Employee B

38. Schwab Employee B is a senior regional fixed income specialist on Schwab's Northeast Regional Bond Desk. He provides sales coverage for fixed income securities to customers serviced by certain Schwab branch offices, including several branch offices located within the State of New York.

39. Employee B testified that he presented auction rate securities to his customers as safe, liquid investments, and never discussed auction failures, or what would happen if auctions failed.

40. Employee B was aware that underwriter broker-dealers were providing liquidity support to the auction rate securities market by stepping in to take positions from sellers whose bids could not be matched with those of buyers, and that this practice was a standard feature of the auction rate product going back to the inception of the market. While he knew about the practice of liquidity support, however, Employee B testified that he never disclosed it to his customers. "The only thing I would say is that you could sell it on the auction dates. … I did not [tell them anything about the liquidity support being provided by the underwriters]".

41. Asked whether he thought his clients had an adequate understanding of the risks inherent in auction rate securities before they made their purchases, Employee B replied: "No. … They probably didn't know that here is a product you might not be able to sell. It wasn't conveyed by myself or the financial consultant because we didn't know either."

(3) Schwab Employee C

42. Schwab Employee C is a fixed income specialist on Schwab's Northeast Regional Bond Desk. He provides sales coverage for fixed income securities to customers serviced by

certain Schwab branch offices, including several branch offices located within the State of New York.

43. Employee C testified that he had heard about auction rate securities infrequently before late 2007. He could not recall when he first sold them, and confessed that he did not have a good understanding of them: "I don't know what measuring scale you would want to use to assess my knowledge about auction rate securities prior to the fails that started to take place in or around February 2008 but on whatever measuring scale my knowledge was pretty low".

44. Indeed, Employee C testified his level of knowledge at the time was so low that he did not know enough about auction rate securities to know how they compared with other securities, or whether they were suitable or not for cash management purposes. He testified that prior to the failures, he knew nothing about the liquidity of auction rate securities.

(4) Schwab Employee D

45. Schwab Employee D is a fixed income specialist on Schwab's Northeast Regional Bond Desk. He provides sales coverage for fixed income securities to customers serviced by certain Schwab branch offices, including offices located within the State of New York.

46. Employee D understood auction rate securities to be money market alternatives. Based upon discussions with his supervisors and with Schwab's traders, Employee D understood that other Schwab employees held the same view of auction rate securities. He was not familiar with the concept of auction failure and did not think there was any liquidity risk associated with auction rate securities. He believed that any customer who sold out of his position would have his money the next business day after the auction because, until the failures, this is what experience had taught.

47. Employee D sold auction rate securities to as many as 40 customers, presenting them as liquid and safe, money market alternatives. He also told customers that if they wanted to sell their securities they could count on having their funds one business day after the next auction.

(5) <u>Schwab Employee E</u>

48. Schwab Employee E is a regional fixed income sales manager and Director of Schwab's Southwest Regional Bond Desk. He supervises about eight fixed income sales specialists located in Phoenix, Arizona, who provide fixed income sales coverage for customers in the Southwestern United States. Employee E responsibilities include providing training and guidance to the fixed income sales specialists reporting to him.

49. Employee E regarded auction rate securities as appropriate for clients who wanted a short-term investment yielding a higher rate of return than alternatives such as money markets and other short term securities. He believed they were alternatives to money market funds, commercial paper, certificates of deposit, short-term government bonds, and other safe, AAA-rated, short-term investments, and thus a proper investment vehicle in which to invest cash balances, and sold them as such to Schwab customers. Employee E did not think that there were any risks associated with auction rate securities other than credit risk.

50. Employee E sold auction rate securities to as many as 50 customers to whom he presented them as safe, liquid alternatives for cash management purposes, comparable to money markets and other classes of short-term, fixed income assets.

51. On the basis of conversations with members of the trading desk, and other mangers, colleagues and subordinates, Employee E confirmed that his colleagues also all thought of auction rate securities as appropriate for cash management purposes.

(6) The Conduct of the Schwab Brokers Referred to Above Is Representative of the Conduct of Other Members of Schwab's Fixed Income Sales Force

52. Upon information and belief, other Schwab brokers generally misrepresented the liquidity of, and risks associated with, auction rate securities in substantially the same manner as Schwab brokers referred to in the sections above did. Of the eight customer-facing Schwab employees questioned by the Attorney General's office, four admitted that they sold auction rate securities variously as money market or cash management alternatives, and that they did not know about, did not fully understand, or did not discuss with customers the liquidity issues and risks associated with auction rate securities. One admitted that he knew nearly nothing at all about auction rate securities, even though he sold auction rate securities to Schwab customers. One testified both that he did and that he did not tell customers about the risks of auction failure. And only two testified that they raised with customers, at least some of the time, the possibility and consequences of auction failures.

B. Audio Recordings Confirm That Schwab Brokers Repeatedly Made Misrepresentations to Schwab's Customers about Auction Rate Securities

53. During its investigation, the Attorney General's Office requested that Schwab produce audio recordings of conversations between members of its fixed income sales force and its customers. To date, Schwab has made only a partial production of recordings that are subject to the Attorney General's request, and has also informed the Attorney General that it could not locate some recordings subject to production.

54. The audio recordings Schwab has produced, however, confirm that Schwab made repeated misrepresentations to its customers in connection with its sale of auction rate securities. The frequency of instances of misinformation heard on these recordings suggests that Schwab's misrepresentations were systematic and a common feature of its nationwide sales practices.

55. In one recording, a Schwab broker represented to a customer who was a resident of Massapequa, New York that investors could get their money out of auction rate securities every week, and that buying into these securities is "the tough part … getting out is something as easy as just selling it:"

Customer: "You know, I'm not trying to make a ton of money. I just want to play it safe."

Broker: "Understood."

….

Broker: "[W]hen you go to get out of this, even though you're telling the rep sell it, it really means stop the auction, because you're getting out of that auction.

….

Broker: But, uhh, again, the hardest part of this auction is getting into it. … [T]hat would be the tough part. I mean, getting out is something as easy as just selling it."

Customer: "Just say stop and . . . ?"

Broker: "Well you'd use the term sell my position, sell it, and . . . in this product, it really means stopping the auction, because then they're pulling you out of it."

….

Customer: "And then it turns into cash?"

Broker: "Yeah, it'll go right to money market, again with the interest paid. Now, they have days on these auctions, so if you get into a Thursday, then your rotation is Thursday to Thursday as your weekly auction.

….

Broker: [T]hat means if you wanna sell even though ... you'll say . . . let's say you called up on Monday and said hey sell, you know, sell my position, they can put the order in on Monday but it won’t sell ‘til Thursday . . .

Customer: “Yeah that’s okay.”

Broker: “Okay, just so you understand that.”

….

Broker: “… And lemme just run some names by you, uhh, it might be a moot point, in other words it might doesn’t matter which fund you go into per se, but the names might have some meaning to you.

….

Broker: … If you want to wait for the specific name?”

Customer: “Nah. I can get out in a week.”

Broker: “Yeah. Absolutely you can.”

56. Another recording of a call with a customer from Seaford, New York reflects a similar promise, that an investor could get his money out of auction rate securities every week:

Customer: “I can get out every seven days?”

Broker: “That’s right.”

Customer: “I can just give you seven days . . . if I want to get out of these things, I say don’t renew and then put the money back in my account?”

Broker: “That’s correct.”

57. One customer, after telling her broker that she wanted to keep her money liquid was told why a particular type of auction rate security was a suitable investment in which to park cash:

Customer: “I think I want to keep the $114,000 liquid right now. We just sort of parked that there because we didn’t know quite what else we were gonna do with it.”

Broker: “Okay.”

Customer: “But, uhh, I didn’t’ know exactly what the difference is between the [periodic auction rate securities] and some of the other issues.”

Broker: “Okay, well, I’d be glad to explain that. What the [periodic auction rate securities] are is usually they’re used for kind of a short-term institutional holding instrument.”

….

Broker: “If you need to have that access to them at any time, that’s a good place for those to be. You know. If you think you might need to get into that money, that’s probably as good a place if not better than anywhere to leave them.”

58. One broker described auction rate securities to a customer from Remsenburg, New York as an alternative to a money market that paid a higher yield, while also telling the customer that he could get out of his investment every week:

Customer: “It was some kind of very short term muni-based piece of paper that you use as an alternative to [a] money market.”

….

Customer: “That is better than what I am getting?”

Broker: “Oh yeah, yeah. It is better than sitting in the money market at the moment.”

Customer: “So maybe you should start doing some of those.”

Broker: “It is a $100,000 minimum on ‘em, and we go in on a daily basis. … Once you are in, it rolls over every seven days. Let’s say you go in every Tuesday, and every Tuesday you can get back out of it.”

….

Broker: "You pick up about fifty, sixty basis points over what you would be getting, say, in a money market, and what you are giving up is next day liquidity."

….

Customer: "So … I can … adjust it by what, $100,000 amounts every week?"

Broker: "In terms of if you wanna get out?"

Customer: "Yeah."

Broker: "Yeah."

Customer: "I'll know a week . . . more than a week ahead of time if I wanna suddenly make a big investment."

59. Another customer who was a resident of New Hyde Park, New York was told that she only had to say "stop" and after the next auction "all the cash will come back to your account:"

Broker: "… And it'll roll over monthly unless you call me and say "Hey [Broker], don't roll it over anymore."

Customer: "Oh, I see. Okay."

Broker: "Okay. And your husband's aware of that, so if and when you guys decide you don't want to roll it over every month you have to actually call me and tell me 'Hey [Broker], stop this from happening.' And then the next month I'll stop the auction and all the cash will come back to your account."

Customer: "Oh, Okay, [Broker], thank you."

60. One Schwab broker told a customer that auction rate securities provided "weekly liquidity" and "[y]ou'll be able to liquidate them on a weekly basis, not a daily basis, so at most it'll take, ya know, five business days to get to the money."

61. Another Schwab broker contacted a customer with a large cash balance invested in a money market fund to suggest alternative investments. After being told that the customer

was keeping the funds liquid in order to fund a potential house purchase, the Schwab broker recommended auction rate securities as a suitable, liquid investment:

Customer:	"Well I need the liquidity because, umm, I may buy a house soon."
Broker:	"I see."
Customer:	"Umm, I sold my house and this is money that's just, uhh, there temporarily."
Broker:	"So why don't you go with something like we call, uhh, the PARS, periodic auction rate securities. Normally, they are paying about three-and-a-half percent in the municipal part, and five point one, five point two percent in the taxable part. And you can liquidate those once a week or once a month. Uhh, these are basically the derivatives of the bond mutual funds, but their prices are constant; they are not moving. So, when you buy something in a monthly issue, that, uhh, the issue will pay at least for one month that, uhh, month's auction rate, which is about three-and-a-half percent nowadays. And that's very safe."
Customer:	"Okay."
Broker:	"Again, first of all, I would not recommend you to invest $300,000 in any bond mutual fund."
Customer:	"Oh, you wouldn't? Okay."
Broker:	"And second, uhh, if you will buy a house, instead of looking for the highest yield, I would personally look at the highest security.
Customer:	"Okay."
Broker:	"And that would be my second thing. And probably, probably that periodic auction rate securities. That would work better than any, uhh, bond mutual funds for you. That's my humble opinion."
Customer:	"Okay. And it would be safer?"
Broker:	"It would be much, much safer, sure."

62. Advising a customer looking to ride out instability in the stock market in a money fund alternative, still another Schwab broker assured him that he helped "customers through short term investment quite a bit," and recommended auction rate securities as providing weekly liquidity:

Customer: "I've go a lot of cash, and, uhh, between all my various accounts, I have just over $5,000,000 in cash, and I'm trying to decide how I can get the highest yield I can in a money fund, umm, and that's what I'm calling to see what options you can to get me the highest yield I can."

Broker: "So, you are pretty much looking for a short term investment, like a money market or municipal bond. Is that correct?"

….

Customer: "Is this an area that you specialize in?"

Broker: "Well, we do a lot of short-term issues. Yeah, actually, we help customers through short-term investments quite a bit."

….

Broker: "Second option is, uhh, really a bit more involved, because this one is used by a lot of the money managers. It's not known to most individual customers, actually. It's what we call weekly auction reset rates. The name sound[s] really complicated. Essentially, it is a weekly issue. You only can cash out same day of week. For example, this Tuesday, you can only say on Tuesday. Interest is not fixed. Everyday they have an auction process to determine the rate. Sometimes it gets really high, sometime really low. … Once you get in, you don't have to do anything until you want to sell. Every week, they will reset the rate for you. So, it's, relatively speaking, pretty liquid. … So, that is the second option."

Customer: "So basically your money is tied up for one week?"

Broker: "That's right."

….

Customer: "I don't think that I'm gonna need the money. I'm really, what I'm doing is, I'm selling in the concern that the stock market may go down and I wanna take some of my money, you know, out of the equities, and then, if the market goes down, I can always buy back in later. … I like that weekly trend. Can I, uhh, so if I wanted to do that, I just tell you . . . "

Broker: "There are three numbers we need. We need to have your account number, the quantity you want, and third, since it is an auction, we have to set up a limit. … If you just wanted to get in, then I would say put the limit at the very low, so you would get in and get whatever rate the auction rate is. Then, you just sit, the money sits there every week until you want to sell."

Customer: "I guess, uhh, maybe I'll just go ahead and do that with you now."

63. The audio recordings contain other examples of such misrepresentations. When one customer asked if "it's easy to liquidate my money" invested in auction rate securities, a Schwab broker assured him "Oh yeah, I mean, you can. You're guaranteed to get out of it on the auction date." Another broker described auction rate securities as "they're looked at a lot like obviously a cash alternative," "short-term alternatives to support the account," and "a taxable, short-term alternative." Still another broker promised a customer that "You wanna call me if you need to get out. You give me any day during the week, and then your trade will go off the next trade date morning." One salesperson described auction rate securities as "so short-term that, you know, your money is, within a week you're gonna have it to do whatever you need," while another assured his client "We can always get out after a week, so it's not a big deal."

C. Schwab's Customers Were Sold Auction Rate Securities as Safe, Liquid Investments

64. Schwab's customers confirm the conduct admitted by Schwab's own brokers and disclosed by the audio recordings. A Schwab broker told Customer A, a resident of Lansing, New York, that auction rate securities could be sold through auctions that were held once a week, once every two weeks, or once a month, depending upon the reset interval of the particular issues the customer selected. The broker assured this customer that the auction rate securities market was a deep one, with plenty of buyers and sellers. Similarly, Customer B, a resident of Poughkeepsie, New York, was told he would be able to access his money every seven days, while Customer C, a resident of Scarsdale, New York, was told that auction rate securities were an alternative to certificates of deposits or money market accounts, and that he could retrieve his money on short notice.

65. Customer D, a resident of New York City, and his wife asked a Schwab broker to recommend a short-term investment to deposit the proceeds from the sale of their home while they looked to purchase a new house. Schwab recommended auction rate securities and told Customer D that, in contrast to certificates of deposit, which were liquid only once every 90 or 120 days, auction rate securities were liquid every week, and paid higher rates**.** Schwab recommended that Customer E, who needed to access his money to meet his and his parents' living expenses, invest in auction rate securities because they were liquid, tax exempt and would allow access to his money at any point.

66. Customer F, a resident of New York City, was told he could get into and out of auction rate securities at each weekly auction at par, without any fluctuation in price, so long as he put his order in by the appointed hour before the issue auctioned. After the market collapsed, one of Schwab's brokers told Customer F that it was a mistake for Schwab to sell sold auction

rate securities because Schwab did not understand enough about the risks of auction failure to properly inform its customers.

67. Customer G liquidated his equity holdings and began buying bonds. A Schwab broker called Customer G and recommended that he invest in auction rate securities in order to diversify his portfolio. The broker described auction rate securities as a bond like product, but more liquid and with a slightly higher interest. Customer G was told that the securities were traded daily like a stock, but backed by, and as safe as, bonds.

68. Customer H borrowed $400,000 to fund the renovation of her house and invested the loan proceeds in a Schwab money market fund. A Schwab broker called Customer H and suggested she invest this money in a new state government-issued, tax exempt investment that was like cash, with weekly liquidity. The broker suggested that this investment was better than a money market account because it would get a higher rate of interest. Customer H only learned she was invested in auction rate securities, and that her investment could become illiquid, in February 2008, after the auctions failed.

69. Schwab brokers variously misrepresented the liquidity risks to these and other customers, comparing auction rate securities to money market funds, or certificates of deposit, representing that customers would be able to access their investment every time an auction was held, or otherwise suggesting these securities as appropriate cash management investments. The representations made by Schwab's brokers conveyed to Schwab's customers a sense of confidence that their investments in auction rate securities would be safe and readily accessible to them in each auction cycle. These Schwab customers were not told about any liquidity risks associated with investing in auction rate securities, and they did not learn about these risks until the auctions failed.

70. In its records, Schwab characterized some auction rate securities trades as solicited and others and unsolicited. There is evidence that some calls may have been improperly characterized by Schwab brokers as unsolicited, when in fact they appeared to be solicited. In any case, however, this distinction appears to have been meaningless when it came to the representations and disclosures Schwab made. On audio tapes of customer calls produced to the Attorney General, Schwab brokers are heard making the very same kinds of misrepresentations and omissions to customers whose trades were classified as unsolicited as they were to customers whose trades were classified as solicited. Schwab owed all its customers the same obligation to properly understand and accurately represent the features of the products it sold and to provide them full disclosure of all material risks, regardless of their level of sophistication, or prior experience with auction rate securities, or whether a trade was classified as solicited or unsolicited. Once Schwab brokers chose to speak about auction rate securities, they had an obligation to speak completely and accurately.

III. Schwab Held Itself Out to Its Customers as a Trustworthy Financial Advisor They Could Rely Upon, Yet Recklessly Failed to Understand, and Properly Inform or Train Its Sales Force Concerning, Auction Rate Securities

71. Schwab held itself out to its customers as a trustworthy financial advisor. On its website, Schwab boasted: "[F]or 30 years, we've … creat[ed] a true Wall Street alternative for all investors … where you can get the guidance and support you need—whatever type of investor you are." Schwab promised "sophisticated" and "remarkable insight," all at "a great price."

72. In its zeal to compete with the big Wall Street firms, Schwab also wanted to participate in the fixed income market by offering auction rate securities. As Schwab's Vice President for Fixed Income Trading put it:

> [Schwab is] an asset gathering firm. If [our customers] couldn't buy [auction rate securities] through us, they were going to buy it through any other dealer that existed. The market is well-established in the dealer community. If they didn't buy it from us, they were going to buy it from somebody else, so it was important to make the product available.

73. Touting its expertise in fixed income investing, Schwab invited customers to "[r]esearch fixed-income securities and get investment ideas[,] … [l]everage our extensive fixed-income research" and "[t]ake advantage of our expertise" by "[c]all[ing] on our seasoned bond traders, who have an average of 15 years of industry experience" to "[g]et one-on-one guidance from a Schwab fixed-income specialist." And Schwab promised its customers: "you'll get investment guidance and portfolio planning that's right for you" and "benefit from our fact-based, company-wide approach—not the arbitrary opinions of one broker."

74. But, when it came to auction rate securities, Schwab failed to make good on these promises. In contrast to its advertising claims of fixed income expertise, Schwab did not ensure that its fixed income sales force had a proper understanding of auction rate securities or their risks before it sold hundreds of hundreds of millions of dollars worth of auction rate securities to hundreds of its customers. Nor did Schwab ensure that its sales force was adequately apprised about all the information that already resided within the firm about the features and risks of auction rate securities.

75. It was not possible for a Schwab customer to purchase auction rate securities in a self-directed manner. Schwab did not post substantive auction rate securities-related information on its customer website, nor did it make any written material available to customers relating to auction rate securities. Any person interested in purchasing auction rate securities from Schwab could do so only by speaking in person with a salesperson in Schwab's fixed income sales department. Thus, all representations to customers relating to auction rate securities came

directly from Schwab salespersons, who were registered representatives licensed to give investment advice to Schwab's customers. As brokers, these salespersons had an obligation to properly understand the securities they sold, and not mislead their customers about the features and risks inherent in those securities. And Schwab had an obligation to ensure that its brokers were properly trained, made adequate disclosures and did not mislead its customers.

76. Members of Schwab's auction rate securities trading operation admitted that they knew, at all relevant times during which Schwab sold auction rate securities to its customers before the widespread failure of the auction rate securities market, of the possibility that auctions could fail and the broker-dealers' practice of supporting auctions. For instance, the manager who oversaw fixed income trading desk at Schwab that was responsible for auction rate securities testified that "[t]he risk was always that the liquidity came from the auction process and that an auction could fail." His immediate supervisor, Schwab's Vice President of Fixed Income Trading, testified that he understood that auctions would fail if they were not supported. The trader directly responsible for auction rate securities testified that he thought the underwriter broker-dealers would put in support bids because "they don't want the auction[s] to fail, and they want [them] to clear so that the people are able to, you know, liquidate their money if they have to."

77. Yet Schwab made no effort to systematically share this knowledge with its fixed income sales force. Indeed, according to the testimony of its fixed income brokers and sales managers, Schwab provided no formal training relating to auction rate securities to any of its employees, including its fixed income sales and service specialists. Nor evidently did Schwab provide any formal, specific guidance or standards with respect to the substance of auction rate securities, the suitability of auction rate securities for one investment objective versus another,

the manner in which auction rate securities were to be presented to or discussed with customers, or to the risk disclosures that were to be made to customers relating to auction rate securities. And neither did Schwab guide its sales force managers on how to supervise their subordinates in connection with auction rate securities. What little instruction Schwab employees did receive in connection with auction rate securities was provided on-the-job in an ad hoc, manner without any specific guidance from Schwab about how that instruction was to be provided or what substance was to be conveyed.

78. Because Schwab maintained no internal standards governing auction rate securities, it was left substantially to the discretion of individual members of Schwab's fixed income sales force how and to what extent to inform themselves about auction rate securities, how to discuss the substance or suitability of auction rate securities with customers, and what kinds of disclosures to make, if any, including disclosures about risks. According to the Schwab fixed income brokers and sales managers who testified, the level of education Schwab's employees were expected to have, and did have, about auction rates securities, varied from office to office, sales person to sales person, and even manager to manager.

79. As a result, there was no consistency in how Schwab presented auction rate securities to customers or in what disclosures Schwab's fixed income sales and service personnel made to customers. Schwab fixed income sales managers testified that they and their subordinates considered auction rate securities along with money markets, certificates of deposit and other classes of short-term, fixed income assets, as suitable alternatives for cash management purposes. The managers testified that these views had developed within Schwab on the basis of accumulated knowledge passed from one employee to another, reflecting what amounted to a consensus within Schwab's regional fixed income sales and service groups. Schwab's fixed

income specialists simply adopted these views about the liquidity of auction rate securities and their comparability to other classes of fixed income securities without any independent basis to support them.

80. Many Schwab brokers simply adopted deceptive and misleading representations originating from the New York based trading desks of the major underwriting firms. These brokers transmitted information about auction rate securities to Schwab's customers without independently verifying the accuracy of that information.

81. While many members of Schwab's fixed income sales force echoed these views, other Schwab brokers who sold auction rate securities understood little if anything about the product and made little if any liquidity risk disclosures at all, or made representations about the liquidity of auction rate securities without sufficiently understanding the risks associated with them.

82. And because Schwab undertook no efforts to systematically evaluate the level of knowledge of its fixed income sales and service personnel about auction rate securities, many erroneous views that members of its sales force had come to hold about auction rate securities went unidentified and uncorrected.

83. Only one week before the auction failures in February 2008, Schwab held a conference call with one of its major underwriter broker-dealers for the purposes of preparing its sales force to respond to the increasing number of inquiries that were coming from Schwab's customers about troubles in the auction rate securities market that were by then being widely reported. One broker was so misinformed that he asked: "I missed the first two minutes, but how could an auction fail?"

84. Indeed, even after the auction rate securities market failed, Schwab made no systematic effort to more fully disclose to its customers what it knew about auction rate securities before the market failure, or what it learned subsequently. Some Schwab fixed income sales and service personnel even told some customers who had inquired about their frozen auction rate securities holdings, without any apparent basis, that the auction rate securities market would soon recover. On at least one occasion, Schwab even failed to notify a customer who called in to purchase auction rate securities after the February 2008 auction failures that auctions had failed. When asked whether he discussed suitability or any other substance about auction rate securities, the Schwab broker who facilitated that trade testified: "what I recall vaguely from that conversation was a sense that the client that I was speaking to knew more about the product than I did." Asked whether he felt that he did not need to discuss anything more with this customer before putting in the order, the broker replied simply: "Correct."

85. Apart from falling far short of its obligations as a registered broker-dealer, Schwab's failure to properly train and inform its sales force was completely inconsistent with the image that Schwab portrayed in its marketing to the public and its customers.

IV. Schwab Management Knew, or Was Negligent and Reckless in Not Knowing, About Liquidity Risks and Developing Problems in the Auction Rate Securities Markets

86. Schwab knew more about auction rate securities, and the liquidity risks inherent in auction rate securities, than it shared either with its sales force or with its customers. Schwab also knew about rising problems in the auction rate securities market, which it likewise did not share with either its sales force or its customers.

87. Beginning in August 2007, Schwab became aware of a number of auction failures in the broader market for auction rate securities. On August 13, 2007, Schwab was first notified

that an issue of auction rate securities owned by one of its institutional clients failed because, "[d]ue to the market conditions[,] D[eutsche]B[ank] could not support the deal and the amount of supply they already have in auctions."

88. Later the same day, Schwab's Senior Vice President for Fixed Income Trading and Operations wrote the Executive Vice President for Investment Management Services, and two other executives that the failures in the market occurred because the underwriting firms decided not to support the auctions:

> Auctions in similar structures from Merrill and Lehman also failed today. **It sounds as though D[eutsche]B[ank]'s desk was told they can own no more of this type of structure themselves, and no other buyers are around (at least not enough)**. It is probably reasonable to assume that this will remain the case for several days, limiting or eliminating the liquidity.

(emphasis supplied.)

89. After learning of these failures, Schwab focused on protecting itself rather than on informing its customers about the problems in the auction rate securities market. Schwab's Executive Vice President for Investment Management Services wrote to Schwab's Senior Vice President for Fixed Income & Specialized Products, asking "[w]hat's our exposure in this development, if any?" The Senior Vice President for Fixed Income & Specialized Products responded that there was a "brand risk of course" if Schwab customers "can't get … access to their funds."

90. On September 5, 2007, Schwab became aware of yet another failure, this time of a municipal auction rate security that was being held in the portfolio of one of Schwab's proprietary funds. Unlike the structures involved in the August failures, this was a class of auction rate security that Schwab commonly sold to its retail customers. Schwab's Head of Municipal Research wrote to the Executive View President for Investment Management Services

about the failure and Bank of America's decision not to support this issue of auction rate security:

> This is the first failed muni auction that I am aware of (ever). Due to credit issues, we had already decided to sell through this auction. **The dealer (B[ank]ofA[merica]) did not step in to make a clearing bid which is typically what happens when there is not a full subscription**.

(emphasis supplied.)

91. Once more, Schwab focused on the public relations consequences of the failure. Schwab's Head of Municipal Research wrote to Schwab's Executive Vice President for Investment Management Services:

> We are listed as an owner of the security on Bloomberg, so once the auction failure becomes known on the Street we will be identified (along with USAA, and B[ank]ofA[merica] as the dealer) as holders. **This will definitely hit the Bond Buyer (maybe not until Friday) and it will likely hit the Journal as well.** B[ank]ofA[merica] has told us that they are not telling anyone today there has been a failed auction – but it will come out tomorrow when the actual settlement occurs.

(emphasis supplied.)

92. By mid-September, the manager who oversaw the fixed income trading desk responsible for auction rate securities acknowledged that there was "volatility and turmoil" in the auction rate securities market.

93. Schwab also had information that underscored the growing problems in the auction rate securities market. Schwab received from the underwriters of the auction rate securities that it sold, daily reports of the auction rate securities inventories of those firms during the critical period between September 2007 and the failure of the auction rate securities market in February 2008. This information was not generally available to the investing public.

94. These reports revealed that the inventories of auction rate securities these firms were holding and, in turn, offering to Schwab to sell to its customers, were steadily increasing. Increasing inventories meant that more of the support bids submitted by the underwriter broker-dealers were hitting in order to make the auctions clear, because natural demand for auction rate securities was flagging. The inventory reports as a whole formed an unmistakable pattern indicating that the auction rate securities market was under growing strain. Yet, upon information and belief, the individuals on the trading desk at Schwab responsible for auction rate securities performed no analysis of the inventory reports they were receiving, and apparently overlooked the significance of this trend of rising inventories, which should have been obvious. Indeed, Citigroup and UBS even provided cover sheets with their daily inventories totaling their aggregate inventories.

95. Between the auction failures Schwab learned about, and the information it received daily about the underwriting broker-dealers' growing inventories, Schwab had at its disposal all the evidence it needed in order to infer that all was not well in the auction rate securities market. The information Schwab possessed also put all the issues relating to auction rate securities that are at the center of Schwab's inadequate disclosures to its customers in play – auction failure, illiquidity resulting from auction failure, support of auctions by underwriter broker-dealers. Yet, in spite of all this, Schwab failed to connect the dots. Nor did Schwab make any changes to its sales practices or, apparently, undertake any effort or give any serious consideration to improving disclosures about the liquidity of auction rate securities to buyers or holders of those securities among its retail customers.

96. Throughout the fall and winter of 2007, the market for auction rate securities continued to erode. By the end of January 2008, an increasing number of Schwab's customers

were asking questions about the stability of the market. The Director of Schwab's Northeast Regional Bond Desk wrote to his boss, Schwab's Vice President for Fixed Income Sales and Service:

> Have you heard anything lately that may affect a client's ability to sell these securities, in their entirety, at an upcoming auction? Or, any other news regarding auction rate securities?
>
> **We're starting to get quite a few questions on these securities**.

(emphasis supplied.)

97. Notwithstanding, the head of Schwab's fixed income trading operation maintained his optimism in spite of the facts:

> We'll try to get you an update. As you know, it is a fluid situation and for the most part stuff [ ] away from Auction CDOs, we've fared pretty well.

98. But his optimism was not uniformly shared. On January 31, 2008, one Schwab executive advised disclosing – at least to a customer who had $100 million invested at Schwab already and was looking to invest millions more – the possibility that auctions could fail, and that auction rate securities were neither absolutely liquid, nor equivalents of money market funds or short-term Treasury securities:

> I would suggest further diversification for a client looking to place this much money. **Nobody can tell us or the client with 100% certainty that an Auction can't fail**. Some have in the recent past. So **if the client needs absolute liquidity, we should be suggesting they stay in a money market fund or buy extremely short Treasury securities**.

(emphasis supplied.)

99. Evidently, however, no effort was made nor consideration given to expanding this circle of disclosure to include Schwab's retail customers.

100. It was only after the market-wide failures in February 2008 that Schwab was finally willing to concede that auction rate securities were not as liquid as had previously been represented. Schwab's Vice President for Fixed Income Sales and Service wrote to his sales and service management team, who supervised Schwab's fixed income sales force, to advise them of the new disclosures:

> It is imperative that we set proper expectations with both Clients and Field Partners regarding these securities. … For any new purchases of these securities, we need to discuss in our order read backs that **while auction schedules are generally each 7, 28, or 35 days, this fact does not equate to 100% certainty of being able to liquidate a position. If clients need absolute liquidity, a money market fund is likely a more appropriate investment vehicle**.

(emphasis supplied.) This mandate came too late for Schwab customers who had been told that they could convert their auction rate securities to cash at every auction.

101. But Schwab was only willing to concede this to new entrants into the auction rate securities market. Even at this time, upon information and belief, Schwab made no effort to actively convey the same message to the existing customers it had already misled into purchasing auction rate securities. No systematic effort was made to call customers. No instructions were conveyed to the sales force.

102. Instead, Schwab prepared a letter addressing the crisis, which it sent to customers who had purchased auction rate securities as liquid, cash management investments, and which it posted on its public website. The letter downplayed the significance of the auction failures, describing them as happening on very rare occasions – a startling characterization in the wake of a market-wide failure. The letter also played up the great yields paid by failed auction rate securities:

> On very rare occasions, failed auctions happen when sell orders exceed buy orders. This results in rates resetting at the maximum

> permitted level, which creates higher interest payments for issuers until the auction process stabilizes and rates return to normal levels. It is important to understand that the failed auctions are not the result of bond defaults; this outcome has been more of a problem of adequate auction liquidity, not underlying credit quality.

103. To the last, Schwab was apparently more concerned with risk to its own reputation than with the liquidity needs of the clients to whom it misleadingly sold auction rate securities. On February 20, 2008, a senior Schwab public relations executive outlined to senior management Schwab's response to the widespread auction failures and accompanying lack of liquidity as "to remain at the ready and attempt to manage smartly, endeavoring to **keep Schwab out of the spotlight (to the extent possible)**." (emphasis supplied.)

V. <u>The Reality – the Auction Rate Securities Schwab Sold Faced Serious Liquidity Risks</u>

104. Contrary to the representations made by Schwab's fixed income sales and service personnel, auction rate securities were in fact far different from cash or money market funds. As discussed above, auction rate securities sold at auction, and, if auctions failed then auction rate securities could not be sold. Schwab persistently failed to disclose, or made misrepresentations that concealed, the risk that customers could lose liquidity should auctions fail.

105. Beginning in late Summer 2007, the auction rate securities market came under increasing strain. During the subsequent months, the distress on the auction rate securities market intensified until the market finally failed wholesale in February 2008. When it did, many Schwab investors suddenly discovered that the securities they had been led to believe were highly liquid were in fact completely illiquid, as a result of which they could not access their money.

FIRST CAUSE OF ACTION

(Persistent Fraud or Illegality - Executive Law § 63(12))

106. The acts and practices alleged herein constitute conduct proscribed by § 63(12) of the Executive Law, in that Defendant engaged in repeated fraudulent or illegal acts or otherwise demonstrated persistent fraud or illegality in the carrying on, conducting or transaction of business.

SECOND CAUSE OF ACTION

(Securities Fraud - General Business Law § 352-c(1)(a))

107. The acts and practices of the Defendant alleged herein violated Article 23-A of the General Business Law, in that they involved the use or employment of a fraud, deception, concealment, suppression, or false pretense, where said uses or employments were engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation, or purchase within or from this state of any securities.

THIRD CAUSE OF ACTION

(Securities Fraud - General Business Law § 352-c(1)(c))

108. The acts and practices of the Defendant alleged herein violated Article 23-A of the General Business Law, in that Defendant made, or caused to be made, representations or statements which were false, where (i) they knew the truth, or (ii) with reasonable efforts could have known the truth, or (iii) made no reasonable effort to ascertain the truth, or (iv) did not have knowledge concerning the representations or statements made, where said representations or statements were engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation, or purchase within or from this state of any securities.

FOURTH CAUSE OF ACTION
(Consumer Fraud - General Business Law § 349)

109. The acts and practices of the Defendant alleged herein violate Article 22-A of the General Business Law in that defendants have engaged in deceptive acts and practices prohibited by section 349 of the General Business Law.

WHEREFORE, Plaintiff demands judgment against the Defendant as follows:

A. Enjoining and restraining Defendant, its affiliates, assignees, subsidiaries, successors and transferees, its officers, directors, partners, agents and employees, and all other persons acting or claiming to act on its behalf or in concert with it, from engaging in any conduct, conspiracy, contract, or agreement, and from adopting or following any practice, plan, program, scheme, artifice or device similar to, or having a purpose and effect similar to, the conduct complained of above, to the extent such conduct has any nexus with the New York marketplace.

B. Directing that Defendant, pursuant to Articles 22-A and 23-A of the General Business Law and Section 63(12) of the Executive Law and the common law of the State of New York, disgorge all gains and pay all restitution and damages caused, directly or indirectly, by the fraudulent and deceptive acts complained of herein;

C. Directing that Defendant pay penalties and costs, including attorneys' fees as provided by law;

D. An order requiring Defendant to buy back auction rate securities from defrauded customers at par;

E. Directing such other equitable relief as may be necessary to redress Defendant's violations of New York law; and

F. Granting such other and further relief as may be just and proper.

* * *

Dated: August 17, 2009
New York, New York

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