

STATE OF NEW MEXICO
SANTA FE COUNTY
FIRST JUDICIAL DISTRICT

ms

MAY 20 2009

Santa Fe, Rio Arriba &
Los Alamos Counties
PO Box 2238
Santa Fe, NM 87504-2288

No. D-101-CV-2009-01604

**THE NEW MEXICO STATE TREASURER'S
OFFICE and the NEW MEXICO FINANCE AUTHORITY,**

Plaintiffs,

v.

**THE RESERVE FUND, THE PRIMARY FUND,
RESERVE MANAGEMENT COMPANY, INC.,
THE RESERVE, and RESERV PARTNERS, INC.,**

Defendants.

COMPLAINT FOR DAMAGES AND INJUNCTIVE RELIEF

The New Mexico State Treasurer's Office ("the STO") and the New Mexico Finance Authority ("NMFA") file this Complaint and would show the Court as follows:

PARTIES

1. Plaintiff STO is an official arm of the State of New Mexico responsible for the management of banking services for the state government and the investment of short-term funds. Its principal office is located at 2019 Galisteo Street, Building K, Santa Fe, New Mexico, 87504-0608.

2. Plaintiff NMFA is statutorily-created government instrumentality that exists "for the performance of essential functions." *See* NMSA 1978, § 6-21-4(A). Its powers are delineated in NMSA 1978, § 6-21-5. Its principal office is located at 207 Shelby Street, Santa Fe, New Mexico, 87501.

3. Defendant The Reserve Fund is a money management vehicle organized under the laws of New York. Its principal place of business is 1250 Broadway, New York, New York, 10001-3071.

4. Defendant The Primary Fund is a money market fund operated by the Reserve. Its principal place of business is 1250 Broadway, New York, New York, 10001-3071.

5. Defendant Reserve Management Company, Inc. is the Reserve Fund's principal investment advisor. Its principal place of business is 1250 Broadway, New York, New York, 10001-3071.

6. Defendant The Reserve is the parent company of Defendant Reserve Management Company, Inc. Its principal place of business is 1250 Broadway, New York, New York, 10001-3071.

7. Defendant Reserv Partners, Inc. is a distributor of the Reserve Fund and an affiliate of Defendant Reserve Management Company, Inc. Its principal place of business is 1250 Broadway, New York, New York, 10001-3071. Defendants are hereinafter collectively referred to as "Defendants" or "the Reserve."

JURISDICTION

8. This Court has subject matter jurisdiction over this matter pursuant to Article VI, § 13 of the New Mexico Constitution.

9. This Court has personal jurisdiction over Defendants because Defendants have conducted business with Plaintiffs in the State of New Mexico and have thus availed themselves of this forum.

VENUE

10. Venue is proper in this County because it is Plaintiffs' principal place of business and the venue in which the transactions giving rise to this Complaint occurred.

BACKGROUND FACTS

11. In 2006, the STO opened three separate investment accounts with the Reserve. Each account was invested exclusively in the Primary Fund. The STO opened the first account on behalf of New MexiGROW LGIP on or about July 14, 2006, the second account on behalf of the General Fund on or about September 29, 2006, and a third account consisting of bonds investment proceeds pools on or about August 31, 2007. The STO completed its account applications in New Mexico and then transmitted those applications to Defendants. As of September 15, 2008, the STO had, in its three accounts, approximately \$1.14 billion invested in the Primary Fund. Much of that money was invested on behalf of New Mexico counties and municipalities who depended on the fund to provide consistent, safe returns on their investments.

12. NMFA opened three separate investment accounts with the Reserve in 2007 and 2008. All three accounts were invested exclusively in the Primary Fund. NMFA opened one account on behalf of the New Mexico Department of Transportation on or about October 31, 2007, a second account on behalf of the New Mexico Department of Transportation on or about November 21, 2007, and a third account on its own behalf on or about January 8, 2008. NMFA completed its account applications in New Mexico and then transmitted those applications to Defendants. As of September 15, 2008, NMFA had, in its three accounts, approximately \$126.7 million invested in the Primary Fund.

13. The September 28, 2007 prospectus for the Primary Fund read, in a section entitled "How to sell shares" as follows:

You may redeem your shares on each day that the Funds' NAV [Net Asset Value] is calculated. Shares will be redeemed at the next NAV determined after a proper redemption request, by telephone or in writing, is received by a Fund or by an authorized financial intermediary. Proceeds from a redemption request will be transmitted to a shareholder no later than the next business day after the receipt of the redemption request in good order.

14. Approximately 1.5% of the \$65 billion worth of assets in the Primary Fund was invested in Lehman Brothers Holdings, Inc. ("Lehman"). On September 15, 2008, Lehman filed for Chapter 11 bankruptcy protection. The same day, the \$785 million of the Primary Fund invested in Lehman was valued at zero dollars.

15. Following the Lehman bankruptcy, the fund broke the dollar and was valued at \$0.97 per share. Many investors in the Primary Fund attempted to withdraw their holdings. The run on the fund caused liquidity problems which ultimately led to the freezing of the fund.

16. In addition to the steps set forth in the prospectus for selling shares, Defendants issued a press release on September 16, 2008 indicating that as of 4:00 p.m. Eastern Standard Time on the same day, the Net Asset Value of the shares in the fund would be \$0.97. Defendants also stated that all redemption requests received before 3:00 p.m. Eastern Standard Time on September 16, 2008 would be "redeemed at a net asset value of \$1.00 per share."

17. At approximately 10:14 a.m. Eastern Standard Time on September 16, 2008 the STO submitted, in good order, a redemption request to the Reserve for approximately 50 million shares. Under the terms of the prospectus and the press release issued by Defendants, Defendants should have honored the redemption requests and paid to the STO within one day the money resulting from the redemption of the subject shares. Defendants did not, however, honor the STO's redemption request.

18. On December 3, 2008, the Reserve published its "Plan of Liquidation and Distribution of Assets," which announced a preliminary plan for the liquidation of the Primary

Fund. That plan indicated that fund participants could expect to recoup as much as \$0.92 on the dollar for their investments in the fund.

19. Beginning on October 31, 2008, the Reserve began winding down the Primary Fund and making distributions to the Fund participants. By February 26, 2009 the Reserve had distributed approximately 85% of the Fund, leaving approximately \$7.8 billion in the Primary Fund.

20. On February 26, 2009, the Reserve unexpectedly announced that it intended to set aside \$3.5 billion of the funds in the Primary Fund, called a "special reserve," to pay: "(a) anticipated costs and expenses of the Fund, including legal and accounting fees; (b) pending or threatened claims against the Fund, its officers and Trustees; and (c) claims, including but not limited to claims for indemnification that could be made against Fund assets."

21. In addition, the Reserve's February 26, 2009 announcement indicated that the Reserve was defending twenty-seven individual and class action cases connected to the Primary Fund's performance and that the special reserve would be used to pay for all legal fees connected to the defense of those actions as well as paying for any judgments against the Reserve, its trustees, or its shareholders. Defendants also suggested that a quick resolution to the pending litigation would increase the payout from the special reserve: "Obviously, the sooner the litigation is resolved, the sooner monies held in the special reserve can be released to shareholders and, potentially, the greater the payout."

22. Not every participant in the Primary Fund has brought a cause of action against Defendants based on the Primary Fund's performance. The creation of the special reserve has, however, nonetheless forced those participants who have not brought suit to pay for Defendants' legal fees and costs in defending claims brought by other participants. Consequently,

Defendants are unjustly discriminating between different classes of fund participants to the detriment of those participants who have not sued Defendants.

23. In the September 28, 2007 prospectus for the Primary Fund, Defendants describe the fees charged to each class of investor in the fund. Among the fees listed was "other expenses" defined as follows:

Other Expenses include interest charges, taxes, brokerage fees and commissions, extraordinary legal and accounting fees and other extraordinary expenses including expenses incurred in connection with litigation proceedings, other claims and the legal obligations of the Trust to indemnify its trustees, officers, employees, shareholders, distributors and other agents of the Trust, payments made pursuant to the Trust's Distribution Plan, the compensation of the chief compliance officer and related expenses, and the fees and expenses of the Trustees who are not "interested persons" of the Adviser as defined in the Investment Company Act of 1940 ("Independent Trustees"), including the fees of the independent counsel of the Independent Trustees. It is estimated that these fees and expenses will be less than 0.005% for each fund.

24. Despite this definition, the prospectus indicates that no "other expenses" were to be charged to any class of investor in the Primary Fund. Contrary to this representation, with the creation of the special reserve, participants in the Primary Fund, including Plaintiffs, were charged "other expenses" of 5% of the fund total. By February 26, 2009, the date on which Defendants stated their intention to create the special reserve, only \$7.8 billion remained in the Primary Fund. The \$3.5 billion special reserve thus represents payment by Plaintiffs of "other expenses" of approximately 45% - nearly 9,000 times greater than the amount Defendants disclosed in the prospectus.

25. Plaintiffs neither sought the return of their investments in September 2008 nor filed suit against Defendants seeking compensation for those Primary Fund losses at least partially attributable to the Lehman bankruptcy. Defendants have nonetheless set aside, on a pro rata basis, approximately 5% of Plaintiffs investment in the Primary Fund to pay for legal expenses and judgments for which Plaintiffs bear no responsibility.

COUNT ONE: CONVERSION

26. Plaintiffs re-allege Paragraphs 1 through 25 above.

27. Plaintiffs have a collective pro rata ownership interest in the \$3.5 billion Defendants have set aside from the Primary Fund for the purpose of paying their legal expenses.

28. That ownership interest is valued at approximately \$87.5 million.

29. Defendants have unlawfully exercised dominion and control over Plaintiffs' assets in defiance of Plaintiffs' rights to those assets. Moreover, Defendants have clearly stated their intention of using that money for their own benefit and in a manner injurious to Plaintiffs.

30. Plaintiffs seek immediate disbursement of their pro rata share of the remaining assets in the Primary Fund, including the \$3.5 billion special reserve, into an escrow account that can then be paid to Plaintiffs as the assets in the account are sold according to the maturation schedule set forth in Defendants' December 3, 2008 plan.

31. If Defendants spend all or a portion of Plaintiffs' pro rata share of the special reserve before this litigation is resolved, Plaintiffs seek compensation from Defendants in an amount equal to the amount of Plaintiffs' funds Defendants unlawfully spend.

32. Because Defendants willfully and intentionally converted Plaintiffs' assets, Plaintiffs seek punitive damages in an amount to be determined at trial.

33. Plaintiffs also seek attorneys' fees and costs.

COUNT TWO: BREACH OF CONTRACT BETWEEN BOTH PLAINTIFFS AND ALL DEFENDANTS

34. Plaintiffs re-allege Paragraphs 1 through 33 above.

35. The prospectus for the Primary Fund constitutes a binding contract between Plaintiffs and the Reserve.

36. In that contract, Defendants indicate that no fees will be charged to participants in the Primary Fund for "other expenses," which are defined in the prospectus to include "extraordinary legal fees."

37. In no event, according to the contract, are those fees to be grossly in excess of .005% of the fund total.

38. By setting aside \$3.5 billion of the Primary Fund to pay their legal fees and expenses, Defendants breached the contract.

39. As a consequence of this breach, Plaintiffs have been deprived of the fullest value of their assets in the fund. Plaintiffs are rightfully entitled to that value.

40. Plaintiffs seek damages to be determined at trial stemming from this breach.

41. Plaintiffs also seek attorneys' fees and costs.

**COUNT THREE: BREACH OF CONTRACT BETWEEN
THE STO AND ALL DEFENDANTS**

42. Plaintiffs re-allege Paragraphs 1 through 41 above.

43. The prospectus for the Primary Fund constitutes a binding contract between the STO and the Reserve.

44. In that contract, Defendants agreed to honor redemption requests made in good order and pay the proceeds resulting from the redemption within one day. The value of the redeemed shares was to be equal to the next Net Asset Value of the Primary Fund determined after a proper request. The Net Asset Value of the Primary Fund was determined every trading day at 5:00 p.m. Eastern time. Defendants further promised to honor any and all redemption requests sent to Defendants by 3:00 p.m. Eastern Standard Time on September 16, 2008.

45. Defendants breached the contract by failing to honor redemption requests placed by the STO on September 16, 2008 for 50 million shares.

46. As a consequence of this breach, the STO lost a portion of the value of the shares it properly attempted to redeem. On the day the STO made its redemption request, the Net Asset Value of the subject shares was \$1.00 per share. Defendants paid the STO \$0.97 per share.

47. The STO seeks damages to be determined at trial that are sufficient to give the STO the benefit of its bargain – the difference between the Net Asset Values of the shares as determined on September 15, 2008 and September 16, 2008.

48. Plaintiffs also seek attorneys' fees and costs.

COUNT FOUR: REQUEST FOR INJUNCTIVE RELIEF

49. Plaintiffs re-allege Paragraphs 1 through 48 above.

50. Defendants are currently involved in no fewer than twenty-seven lawsuits connected to the Primary Fund. While those claims have been consolidated into a single multidistrict litigation court, Defendants' fees and other costs are steadily mounting. Those fees and costs will, and likely already have, come from the special reserve to which Plaintiffs have a right of pro rata ownership.

51. Without injunctive relief from this Court, Plaintiffs face immediate and irreparable injury for which there is no adequate remedy at law.

52. Plaintiffs thus seek an order from this Court prohibiting Defendants from spending any of Plaintiffs' pro rata share of the special reserve and requiring Defendants to immediately disburse Plaintiffs' pro rata share of the special reserve into a segregated account that can then be paid to Plaintiffs as the assets in the account are sold according to the appropriate schedule.

CONCLUSION

Based on the foregoing, the New Mexico State Treasurer's Office and the New Mexico Finance Authority respectfully request that this Court: (1) order Defendants to immediately

disburse Plaintiffs' pro rata share of the Primary Fund into an escrow account that can then be paid to Plaintiffs as the assets in the account are sold according to the maturation schedule set forth in Defendants' December 3, 2008 plan; (2) order Defendants to pay the STO a sufficient sum to put the STO in the position it would have occupied had Defendants honored the STO's redemption request on September 16, 2008 as Defendants were contractually obligated to do; (3) enjoin Defendants from spending any of Plaintiffs' pro rata share of the Primary Fund; (4) award costs and a reasonable attorneys' fee to Plaintiffs; and (5) provide any other relief to which Plaintiffs may be justly entitled.

Respectfully submitted,

GARY K. KING
NEW MEXICO ATTORNEY GENERAL



Scott Fuqua
Assistant Attorney General
New Mexico Attorney General's Office
408 Galisteo Street
Santa Fe, NM 87504
(505)827-6000 – Telephone
(505)827-6036 – Facsimile

Attorney for Plaintiffs