UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	
v.	:	NO. 09 Civ. 4346 (PGG)
RESERVE MANAGEMENT COMPANY, INC., RESRV PARTNERS, INC., BRUCE BENT SR. and BRUCE BENT II,	:	ECF CASE
Defendants,	:	
and	:	
THE RESERVE PRIMARY FUND,	:	
Relief Defendant.	:	

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S MEMORANDUM OF LAW IN SUPPORT OF ITS PROPOSED ORDER TO SHOW CAUSE AND APPLICATION FOR INJUNCTIVE AND OTHER RELIEF AND APPROVAL OF THE COMMISSION'S PROPOSED PLAN OF DISTRIBUTION

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Plaintiff the United States Securities and Exchange Commission ("Commission") respectfully submits this memorandum of law in support of its proposed Order to Show Cause and application pursuant to Section 25(c) of the Investment Company Act of 1940 and Section 21(d)(5) of the Exchange Act of 1934 for injunctive and other relief and approval of the Commission's Proposed Plan of Distribution ("Application").

INTRODUCTION

By its Application, the Commission seeks to bring about a distribution of the Primary Fund that results in fair and equitable treatment of all of the Fund's shareholders. The Commission therefore asks that the Court issue the following orders to institute a process by which that goal can be efficiently achieved with notice to all affected persons.

The Commission respectfully requests that this Court enter an order (i) permanently enjoining Relief Defendant The Reserve Primary Fund ("Primary Fund"), pursuant to Section 25(c) of the Investment Company Act of 1940 ("Investment Company Act"), from consummating its announced plan of distribution of Primary Fund assets, and compelling, pursuant to Section 21(d)(5) of the Securities Exchange Act of 1934 ("Exchange Act"), the Primary Fund to distribute all Primary Fund assets *pro rata* for all shares for which shareholders have not been fully paid; (ii) enjoining, pursuant to the All-Writs Act, all current and future related actions by shareholders against the Primary Fund assets and compelling all interested parties[1] to resolve claims in this Court; and (iii)

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[1] For the purposes of this Memorandum of Law, any reference to "claimants," "claims," and/or "interested parties" shall not include state securities regulators. A stipulation or other written form of understanding will be entered into between state securities regulators and the Commission by which state securities regulators have agreed not to seek relief which would contradict the Commission's proposed final fair and equitable *pro rata* distribution plan of Primary Fund assets.

appointing a monitor to oversee the liquidation of the Primary Fund and distribution of its assets.

So that the Court's assessment of the Commission's Plan of Distribution can be informed by the participation of all potential objecting parties, the Commission also seeks preliminary relief necessary to ensure that all interested parties are heard. Thus, the Commission requests by Order to Show Cause that the Court enter an order (i) directing the Commission and the Primary Fund to publish notice to all potential objectors of the final relief it seeks herein; (ii) compelling all individuals and entities with any claims upon the Primary Fund assets (the "*Res*") who object to the final relief proposed by the Commission to register their objections with the Court; and (iii) enjoining the Primary Fund, pending a hearing on the Commission's application for final relief, from distributing any part of the *Res*, other than *pro rata* distributions to investors, for any costs other than ordinary and necessary expenses.

OVERVIEW

This action concerns the demise of the Primary Fund, a money market fund that announced it had "broken the buck" – i.e., had its per-share net asset value ("NAV") fall below $0.995, the lowest number that can permissibly rounded to $1.00 – on September 16, 2008. The Fund breaking the buck was precipitated by Lehman Brothers Holdings, Inc.'s announcement, on September 14, that it planned to file for bankruptcy protection. The Primary Fund held $785 million in Lehman securities at that time, valued at par, which constituted approximately 1.2% of the Fund's total assets. As word of Lehman Brothers' bankruptcy spread, investors – who had access to a list of Primary Fund investments, including its substantial stake in Lehman Brothers – sought to redeem

Primary Fund shares *en masse*, submitting redemption requests which totaled approximately 43 billion shares by the end of the day on September 16 of the approximately 62.5 billion shares with which the Primary Fund began the day on September 15. More than seven months later, the Primary Fund has yet to fully fund redemptions for all but the first approximately 10 billion shares redeemed during the early morning hours on September 15, 2008.

Thus far, Primary Fund assets have been paid out on a *pro rata* basis to those shareholders who were not fully paid for shares they beneficially owned on or after September 15, 2008 ("Unpaid Shareholders"). The Unpaid Shareholders have received approximately 89 cents on the dollar. If all remaining Primary Fund assets were distributed on a *pro rata* basis to all Unpaid Shareholders, investors would recover approximately 98.4 cents per share.

The delay in funding redemptions in the Primary Fund as assets mature is primarily a consequence of a dispute over how to divide assets remaining in the Primary Fund. Approximately 29 cases involving claims on the *Res* already have been filed, almost all of which have been consolidated for pre-trial purposes before this Court as the multi-district litigation titled *Re: The Reserve Fund Securities and Derivative Litigation, 09 MD 2011*. Some were brought by, or on behalf of, investors who delayed seeking redemptions until the Primary Fund announced that it had fallen below the $1 NAV. Others have been brought against the Fund by those who redeemed before the announcement, but whose redemptions were never funded. As discussed below, the Commission believes that any distinction between these shareholders in distributing the Fund's assets would be unfair and inequitable, in light of the undeniable impact

Defendants' misconduct had on the calculations of the Fund's NAV at any time after 10 a.m. on September 15, and on investors' perceptions of the stability of the Fund, and their resulting redemption decisions.

In the face of competing claims on the assets of the Fund, the Primary Fund Board of Trustees has announced publicly a plan of liquidation that would delay the distribution of at least $3.5 billion in Primary Fund assets (the "Special Reserve") to investors until claims on the *Res* are resolved. Many of the costs of the protracted litigation will be borne by the Fund. Further, these numerous outstanding suits create the possibility of conflicting judgments against the limited Fund assets. Conflicting judgments would mean that some shareholders could obtain a greater proportional distribution than others and would result in a non-*pro rata* distribution of the assets to shareholders of the same class. The Commission believes such a distribution would not be fair or equitable.

Thus, the Commission comes before this Court pursuant to Section 25(c) of the Investment Company Act, which expressly confers upon the Commission the authority "to proceed upon behalf of security holders" to prevent a registered investment company from implementing a plan of distribution, like that at issue here, that is not "fair and equitable to all security holders." After notice to shareholders and the Court's consideration of any objections to the Commission's proposed final relief, the Commission respectfully submits that this Court should order the distribution of Primary Fund assets *pro rata* to investors in a manner consistent with the terms of the Commission's proposed relief. In order to effectuate this relief, the Commission respectfully submits that the Court should enjoin any remaining claims against the *Res* so that the assets of the Fund can be distributed *pro rata* as they mature.

PARTIES

Relief Defendant the Primary Fund is a series of the Reserve Fund, a Massachusetts business trust registered with the Commission under the 1940 Act as an open-end investment company. The relief the Commission seeks in its Application relates to the Primary Fund.

Defendant RMCI is the investment adviser to various Reserve trusts and the funds constituting each trust, including the Primary Fund. RMCI, which carries out its business under the name "The Reserve," is a privately held corporation owned and controlled by Bruce Bent Sr. and his sons, including Bruce Bent II, with its headquarters and principal place of business in New York, New York.

Defendant Bruce Bent Sr. is Chairman of RMCI, and Chairman, President, Treasurer and Trustee of the Primary Fund. Bent Sr. has been employed by the Reserve family of companies since the creation of The Reserve in approximately 1971. Bent Sr. resides in Manhasset, New York.

Defendant Bruce Bent II is Vice Chairman and President of RMCI. Bent II is Co-Chief Executive Officer, Senior Vice President and Assistant Treasurer of the Primary Fund. Bent II has been employed by the Reserve family of companies since 1991. Bent II resides in Manhasset, New York.

Defendant Resrv Partners, Inc. is a broker-dealer registered with the Commission and a member of FINRA. Resrv Partners is the distributor for funds advised

by RMCI. Bruce Bent Sr. and his sons, including Bruce Bent II, collectively own and control Resrv Partners. Resrv Partners has its headquarters and principal place of business in New York, New York.

STATEMENT OF FACTS

I. Background

Approximately 29 lawsuits have been filed by investors claiming a right to assets remaining in the Primary Fund. Essentially, most investors claim entitlement to $1.00 per share in the Primary Fund regardless of the precise time they submitted their redemption requests. As there exists a limited pool of money to satisfy redemption requests – among other factors, the loss of all or part of the $785 million in Lehman Holdings reflects a diminution in net assets available to distribute to shareholders – the payment of $1.00 per share to any investor necessarily reduces the funds available to satisfy claims for remaining investors. Critically, and as investors' competing claims reflect, the process by which the Primary Fund computed its NAV on September 15 and 16 was so infected by a lack of accurate information (and Defendants' spread of materially false information) that there is no reasonable way to determine what hourly NAVs a properly informed Board would have struck. Any effort to distinguish among the claims of Unpaid Shareholders would require embracing arbitrary distinctions that would result in an unfair and inequitable distribution of Fund assets to shareholders.

The Commission, therefore, seeks an order compelling the distribution of Primary Fund assets *pro rata* to Unpaid Shareholders, which would avoid forcing any particular group of redeemers to bear the brunt of all Primary Fund losses and achieve the most fair

and equitable result of having all such investors share the assets remaining in the *Res*. The funds remaining in the Primary Fund include certain assets yet to mature, as well as a "Special Reserve" of at least $3.5 billion that the Primary Fund board has withheld indefinitely from distribution to investors. (See Ex. 1 to the May 4, 2009 Declaration of Michael J. Osnato, Jr., attached hereto, at 1.)[2] As explained by the Primary Fund Board, the Special Reserve exists to address: "(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." (Id.) If assets remaining in the Primary Fund are distributed on a *pro rata* basis to all Unpaid Shareholders, the Commission believes that those investors would recover approximately 98.4 cents per share.[3]

II. Defendants' Deception of the Trustees and Investors

A. Defendants' Misrepresentations of Material Facts to the Primary Fund Board Prevented the Trustees from Making Informed Decisions About the Primary Fund's Net Asset Value on September 15 and 16, 2008.

Rule 22c-1(b)(1) under the Investment Company Act requires money market funds to compute their net asset values "no less frequently than once daily, Monday through Friday, at the specific time or times during the day that the board of directors of

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[2] Exhibits cited herein are to the May 4, 2009 Declaration of Michael J. Osnato, attached hereto.

[3] The difference between that 98.4 cents and $1 is attributable to (i) Lehman-related losses; (ii) the payment of $1 per share for approximately 10 billion shares redeemed on September 15, which left 10 billion fewer shares to share any Lehman-related losses; and (iii) certain costs and expenses paid out of Primary Fund assets to date.

the investment company sets." 17 C.F.R. § 270.22c-1(b)(1). Unlike most other money market funds that compute a per-share NAV on a daily basis, the Primary Fund had committed to computing its per-share NAV on an hourly basis.[4] (See Ex. 2, at Prospectus Supplement dated November 30, 2007.) During an 8:00 a.m. Board meeting on September 15, the Trustees were advised that, under the Investment Company Act, the Board was required to "fair value" the Lehman Holdings as soon as it determined that valuing the Lehman Holdings under the "amortized cost method" no longer "fairly reflect[ed] the market-based net asset value per share." (Ex. 3 at 1.) Once the Board determined to fair value the Fund's Lehman Holdings, therefore, hourly NAV strikes necessarily relied upon the "fair value" assigned by the Board to the Lehman Holdings.

The Trustees, who were advised concerning their obligations throughout September 15 and 16 by Fund counsel, counsel to the Independent Trustees and the Fund's auditor, were aware of their responsibility to determine a "fair value" of Lehman Holdings on September 15. (Id.) As set forth below, however, the Board's ability to discharge those obligations was profoundly compromised by the dearth of accurate information provided to it by RMCI. This lack of reliable information was primarily the product of Bent Sr.'s and Bent II's efforts to provide the Independent Trustees with misinformation most likely to forestall any action that would cause the Primary Fund to break the buck and, in turn, irreparably damage the Reserve brand.[5]

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[4] On November 30, 2007, the Primary Fund Board amended its prospectus to require that the Fund's NAV be computed at "8:30 a.m., 9:00 a.m., thereafter hourly up to and including 5:00 p.m. Eastern Time ... ." (Ex. 2 at Nov. 30, 2007 Prospectus Supp.)

[5] Efforts to prevent the Primary Fund from disclosing that it had broken the buck should not be confused with measures taken to protect Primary Fund investors. As set forth herein and in the Commission's complaint, Defendants' misrepresentations did not

On September 15 and 16, one or more Defendants:

- provided incomplete and inaccurate information to the Board concerning the market's valuation of Lehman securities;
- reported false redemption totals to the Board on September 15 that obscured the extent of the ongoing run on the Primary Fund;
- failed to inform the Board at any time on September 15 that the Primary Fund's custodian bank had ceased funding redemption requests at or around 10:10 a.m., or that RMCI was struggling to find sources of liquidity to fund outstanding redemption requests;
- misrepresented RMCI's ability and intent to provide credit support to protect the Primary Fund's $1.00 NAV in the event it became impaired;
- failed to inform the Board that its mark-down of Lehman Holdings to 80% of par caused two Reserve funds that also held Lehman securities to break the buck; and

Thus Defendants either hid from, or misrepresented to, the Board material facts that prevented the Trustees from striking informed, meaningful hourly NAVs on September 15 and 16.

1. Defendants did not provide the Board with accurate and timely information about the market's valuation of Lehman securities.

On the morning of September 15, 2008, Bent Sr., in his own words, had just arrived in Italy and "had no electronic access to market information, documents or emails." (Ex. 7 at 15, 22.) Nevertheless, when the Trustees decided during their 8:00 a.m. meeting on September 15 that they needed more information before they could determine a "fair value" for the Primary Fund's Lehman Holdings, Bent Sr. volunteered "to supervise the collection of Lehman market information to 'see what happens in the

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change the actual value of the Fund's Lehman Holdings, but rather prevented the Board from arriving at informed decisions about the Lehman Holdings' value and the impact of the Lehman bankruptcy on the Primary Fund.

marketplace.'" (Id. at 26.) This role permitted Bent Sr. to selectively report to the Board, at its 9:30 a.m. meeting on September 15, the market information Bent Sr. learned from RMCI's chief investment officer ("CIO"). At that meeting, Bent Sr. initially recommended to the Board that Lehman Holdings should be valued at par, notwithstanding his knowledge, gained moments before from the CIO, that (i) there was no active market for Lehman securities; (ii) indicative pricing was at "30 to 40 cents on the dollar," and (iii) preliminary valuations of what might be recovered after bankruptcy proceedings (an extraordinarily long horizon for a money market fund seeking liquidity) were 60 to 80 cents on the dollar. (See Ex. 26.) When pressed, Bent Sr. acknowledged that he would not purchase Lehman securities at par and agreed to support what he called an "ultra-conservative" valuation of the Lehman Holdings at 80% of par. (Id.) The Trustees settled on 80% of par as a "fair value" for Lehman securities at the 9:30 a.m. meeting, but as one Trustee explained, based on the information available to the Board at that time, choosing a number was akin to "throwing a dart on the wall." (Ex. 27 at 14:11-15:37.)[6]

The Trustees relied upon RMCI to provide any material information bearing on the value of Lehman securities. In fact, the Trustees directed RMCI at the 9:30 a.m. Board meeting to reconvene the Board if any information became available that might assist the Board in determining the fair value for the Fund's Lehman Holdings. (Ex. 27 at 0:34-1:46.) But despite RMCI's senior management's frequent contacts with the investment community on September 15, including discussions of how the investment

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[6] For the Court's convenience, references to Exhibits at _:__ refer to the time, measured from the beginning of an audio file, at which a cited excerpt appears.

community was valuing Lehman securities (see, e.g., Ex. 33), RMCI only reconvened the Board once more on September 15, and that was for the purpose of advising the Trustees of RMCI's purported intention to provide credit support for the Primary Fund. (Ex. 3.) In fact, even though the Primary Fund was required to compute its NAV hourly on September 15 through 5:00 p.m., the Board held its last meeting of the day on September 15 at 1:00 p.m. and did not reconvene until 10:00 a.m. on September 16 (by which time the Primary Fund had already "struck" several hourly NAVs). (Id.) Notably, and as set forth in greater detail below, the Board did not believe the Primary Fund's NAV was in danger of going below $1.00 on the afternoon of September 15, as the Bents had led the Trustees to believe that RMCI would provide capital support for the Fund if the $1.00 per-share NAV was threatened. Thus, any NAV for the hours between Board meetings – when Trustees were relying on RMCI to bring to their attention any information material to the valuation of Lehman – was not the product of an informed judgment by the Board that the Primary Fund's NAV should remain unchanged.

2. Defendants hid from the Board the severity of the run on the Primary Fund and failed to inform the Board on September 15 that the Fund ceased funding redemption requests at approximately 10:10 a.m.

Aside from the value of the Primary Fund's Lehman Holdings on September 15 and 16, the two factors most likely to determine whether the Reserve would survive the run on its flagship fund were (i) the pace at which investors sought to redeem their Primary Fund shares, and (ii) the Fund's ability to quickly pay those investors $1.00 per share. Defendants misrepresented or hid facts from the Board concerning both of these factors to the Board.

On September 15, RMCI grossly understated redemption totals to the Board, providing figures that were off by billions of dollars. (Ex. 8 at 147-149.) As one Independent Trustee explained, this misrepresentation prevented the Board from fully understanding the problems the Primary Fund faced on September 15. (Ex. 9 at 61-65.)

RMCI also hid from the Board on September 15 the material facts that the Primary Fund's custodian bank, State Street, had stopped funding Primary Fund investors' redemptions by approximately 10:10 a.m., and that RMCI senior management had already discovered by 1:00 p.m. – i.e., before the Board's last meeting on September 15 – that they could not liquidate sufficient Fund holdings to keep pace with redemption requests. (Osnato Decl. at ¶ 34.) The Board was completely in the dark about these problems. (Ex. 9 at 68-70). Had the Board been aware of these facts, it might have suspended hourly pricing or written its Lehman Holdings down to zero. By not providing this critical information to the Trustees, RMCI deprived the Board of the opportunity to make that judgment.

3. The Board relied upon the Bents' false representations about protecting the Primary Fund's NAV.

On September 15, at the Board's 1:00 p.m. meeting, the Bents informed the Board that RMCI intended to provide credit support to protect the Primary Fund's $1.00 per share NAV. (Ex. 3; Ex. 20 at 13, RF-SEC 00252419; Ex. 21 at 2; Ex. 22 at 4.) This was an incredibly significant, though false, disclosure, as the Bents' statements signaled that Primary Fund investors would receive $1.00 per share regardless of whether the run on the Primary Fund continued, or whether the Board marked down Lehman Holdings further. (Ex. 9 at 55.) At the Board meeting, counsel for the Independent Trustees

pointedly asked Bent Sr. if RMCI had sufficient resources to support the Primary Fund's $1.00 per share NAV, and Bent Sr. assured the Board that it did. (Ex. 3; Ex. 11; Ex. 20 at 13, RF-SEC 00252419.)

Contrary to the Bents' representations to the Board, the Bents either would not or could not provide credit support sufficient to ensure the $1.00 per share NAV of the Primary Fund. The Trustees were not told that the Bents would not support the Fund until a 10:00 a.m. Board meeting on September 16 (by which time the Fund had already "struck" three NAVs that day), the same meeting at which they were provided, for the first time, with accurate redemption figures. (Ex. 11.) When the Independent Trustees learned of these previously undisclosed facts, they were, in their own words, "shocked." (Id.; Ex. 9 at 61-62.)

There is no telling precisely what the Trustees would have done had they learned on September 15 that RMCI would not, or could not, support the Primary Fund's NAV, but the fact indisputably would have been material to the Trustees' decision making process. (Ex. 9 at 54.) Indeed, upon finding out on September 16 that RMCI would not provide any credit support for the Primary Fund, the Board directed RMCI to quickly pursue all other options the Bents had identified as ways to save the Fund, then, within hours, marked down the Fund's Lehman Holdings to zero. (Ex. 15.)

Immediately after the 10:00 a.m. Board meeting on September 16, the Independent Trustees convened an Executive Session – i.e., a meeting of only Independent Trustees – to discuss the information just conveyed to them and to consider whether the Primary Fund was "still a going concern or ... were really in the beginnings of a liquidation of the fund." (Ex. 9 at 88-89.) At that point, as an Independent Trustee

has explained, the Board's decision to continue valuing Lehman Holdings at $.80 did not reflect a belief that Lehman paper was actually worth $.80 or could be sold for 80% of par. (Id. at 93-94.) Rather, the Trustee explained, the Board resolved to leave the stated value of the Fund's Lehman Holdings unchanged because nobody could credibly assign *any* specific value to the Lehman Holdings. (Id.) The Board considered marking the Lehman Holdings down to zero at 10:00 a.m., but agreed to forego any markdown temporarily in order to grant RMCI time to find a third party savior that might intervene to protect the Primary Fund's $1.00 NAV. (Id. at 88-92.) Had the Bents not hidden facts from the Board on September 15, the Trustees might have acted to mark down the Lehman Holdings to zero much sooner than it did, or taken other steps to protect Primary Fund shareholders.

4. Defendants failed to inform the Board that marking Lehman Holdings to 80% of par caused two Reserve funds to break the buck.

When the Board voted to mark the Primary Fund's Lehman Holdings down to 80% of par, they were also acting in their capacity as the Board of Trustees for the Reserve's Yield Plus Fund ("YP Fund"), a fund registered under the Investment Company Act, though not a money market fund under Rule 2a-7. (See Ex. 25.) The YP Fund, as well as the Reserve's International Liquidity Fund ("IL Fund"), an off-shore fund registered in the British Virgin Islands for which the Bents served as Trustees, both held Lehman securities on September 15, 2008. Both the YP and IL Funds, although not money market funds, were expressly managed in order to maintain a stable $1.00 per share NAV.

In fact, both funds' Lehman Holdings were substantial enough that a mark-down of Lehman securities to 80% of par dropped each fund's per-share NAV below $0.995. (Id.) As one Independent Trustee testified, the fact that the Board's mark-down of Lehman caused another Reserve fund to break the buck would have been a fact the Trustee expected RMCI to disclose to the Board. (Ex. 9 at 104.) But nobody told the Trustees at any point on September 15 that any Reserve funds broke the buck when Lehman was marked down to 80% of par. (Id.)

5. Defendants failed to inform the Board when the Primary Fund broke the buck.

Incredibly, on a day that Defendants were intensely focused on whether the Primary Fund would break the buck, RMCI apparently failed to notice – and, consequently, inform the Board – that the Fund, based on the Board's 80% valuation of Lehman Holdings, broke the buck by 11:00 a.m. on September 16. Initially, the Primary Fund announced that the Fund broke the buck "effective as of 4:00PM" on September 16, when the Board resolved to value the Fund's Lehman Holdings at zero. (Ex. 14.) But the Reserve has since announced that the accounting personnel responsible for monitoring the Fund's NAV made an "administrative error" and, consequently, failed to realize that redemptions in the Primary Fund were so severe that, even with the Fund's Lehman Holdings valued at 80, the Fund's per-share NAV was less then $0.995 by 11:00 a.m. on September 16. (Ex. 13.)

There is no telling precisely what the Board would have done at any particular hour if the Trustees possessed accurate information concerning some or all of these issues, but there should be no doubt that these facts were material to questions before the

Board on September 15 and 16, including whether to mark down the Lehman Holdings to zero or to suspend hourly pricing of redemptions to take advantage of additional time to gather information.

B. Investors and Ratings Agencies Were Repeatedly Misled on September 15 and 16, 2008

RMCI's dissemination of false information was not limited to communications with the Trustees. RMCI misled Primary Fund investors through direct communications and misled the ratings agencies, which were prepared to downgrade the Primary Fund absent assurances that the $1.00 per share NAV was protected, into believing that RMCI would provide the Fund with necessary credit support. (See Exs. 16, 19, 24, 31 and 33.) For example, with Bent II's authorization, RMCI salespeople informed investors on September 15 and early on September 16 that RMCI had decided to provide credit support for the Primary Fund to protect the Fund's $1.00 per share NAV. RMCI's message to investors, memorialized in a 1:19 p.m. email from Bent II on September 15, was as clear as it was false:

> We (Reserve Management Company Inc.) intend to protect the NAV on the Primary fund to whatever degree is required. We have spoken with the SEC and are waiting [for] their final approval which we expect to have in a few hours. You may communicate this to clients on an as needed basis.

(Ex. 17.) RMCI repeated its false representations about non-existent credit support in a press release widely disseminated to investors on September 15. (Ex. 16.) RMCI never provided – or intended to provide – any meaningful support for the Primary Fund, but the misrepresentations to investors successfully staunched the flow of redemptions in the Primary Fund. (Ex. 10; see also Ex. 36 at 6:51-8:46.)

RMCI senior management also instructed salespeople to misrepresent to investors the nature of the problem the Primary Fund faced in funding redemptions, claiming the Fund's inability to fund redemptions was technical in nature, when the true problem was a lack of liquidity and State Street's refusal to further increase The Reserve's overdraft limits. (Ex. 37.)

Moody's and Standard and Poor's were also misled, which caused them to delay downgrading their ratings of the Fund. Both agencies were told by RMCI senior management of the same non-existent plans to support the Primary Fund's $1.00 NAV. (Exs. 19, 24, 31, 33.) Moody's was also told that the Primary Fund had addressed its liquidity problems and satisfied all outstanding redemption requests when, in fact, the Fund was unable to pay redeemers of billions of Primary Fund shares. (Ex. 31.)

Determining precisely how many investors delayed their redemption requests based on RMCI's misleading statements, and for how long, would likely be exceedingly difficult, requiring a finder of fact to parse scores of investors' claims that each would have, or might have, redeemed shares earlier but for Defendants' misrepresentations. Further complicating matters, if certain investors delayed redeeming shares on September 15 and 16 – and evidence supports this premise (Ex. 4) – then RMCI's misrepresentations may have delayed the time at which total redemption volume would have caused the Primary Fund to break the buck even with the Lehman Holdings valued at 80% of par. Whether the Primary Fund would have broken the buck one hour earlier on September 16 or at some point on September 15 would depend, in part, on the virtually unknowable fact of when all investors would have redeemed their shares if they had not been misled by Defendants. Combined with the aforementioned problems attendant to the Board's

decision making process on September 15 and 16, these questions highlight the impracticability of segregating Unpaid Shareholders into groups deserving of different amounts to satisfy redemption requests.

In light of these circumstances, the most fair and equitable plan of distribution of the Primary Fund's remaining assets would take into account the context in which any hourly NAV was "struck" and distribute assets *pro rata* to all Unpaid Shareholders. Simply put, at no time after State Street stopped funding Primary Fund redemption requests on September 15 did the Board have at its disposal information necessary to determine how best to discharge their duties to Primary Fund investors. Moreover, misleading information was communicated to investors, both directly and through misrepresentations to ratings agencies, that was certainly material to an analysis of whether or when to redeem Primary Fund shares.

ARGUMENT

In order to effectuate full relief that determines investors' and other claimants' rights to the Primary Fund's assets fairly and equitably, the Commission seeks both temporary and final relief. In its Application for final relief, the Commission seeks (i) a permanent injunction enjoining the Primary Fund from consummating its announced plan of distribution of Primary Fund assets, and compelling the Primary Fund to distribute all Primary Fund assets *pro rata* to all Unpaid Shareholders consistent with the Term Sheet annexed to the Commission's Proposed Scheduling Order; (ii) a permanent injunction, pursuant to the All-Writs Act, enjoining all current and future claims by shareholders

against the Primary Fund[7] and compelling all interested parties to resolve claims against the Primary Fund in this Court; and (iii) the appointment a monitor to oversee the liquidation and distribution of Primary Fund assets. This relief is essential to preserve the limited *Res* over which all claimants may assert certain rights, to prevent different courts from entering conflicting judgments concerning the distribution of that finite *Res*, and to avoid the attendant delay in distribution that will accompany any plan that requires that all claims be adjudicated before final distribution. Before the imposition of these injunctions, the Commission seeks temporary relief, specifically an Order to Show Cause, that would effectively bring all interested parties to one forum while this Court resolves the Commission's Application for final relief.

I. This Court Is Authorized to, and Should, Enjoin the Current Plan of Distribution and Compel a *Pro Rata* Distribution of Primary Fund Assets.

Section 25(c) of the Investment Company Act confers authority on a United States District Court to "enjoin the consummation of any plan of reorganization of [a] registered investment company ... if such court shall determine that any such plan is not fair and equitable to all security holders." The Commission's role in initiating actions to protect investors under Section 25(c) is made clear by the plain language of the statute, which sets forth the Court's injunctive authority in connection with "proceedings instituted by the Commission (which is authorized ... to proceed upon behalf of security holders of such registered company ... .)"

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[7] Claims against the Primary Fund include claims against Defendants, their officers, directors, trustees, representatives, agents or employees that are indemnifiable by the Fund.

The purpose of Section 25(c) was clarified in 1970, when Congress amended the statute to authorize injunctive relief to enjoin plans that are not "fair and equitable," rather than the more demanding standard previously set forth in the Investment Company Act, which required a "plan to be grossly unfair or to constitute gross misconduct or gross abuse of trust ... " to warrant injunctive relief. Pub.L. 91-547. The United States House of Representatives Committee on Interstate and Foreign Commerce's report to the full House of Representatives in support of certain changes to the Investment Company Act, including the change ultimately made to Section 25(c) ("Committee Report"), explained that the "amendment [to Section 25(c)] would eliminate a standard which unduly restricts courts from passing upon plans of reorganization of registered investment companies ... [and would] place the courts in a better position to carry out the congressional intent of protecting the security holders of the investment company when a plan [of] reorganization is filed." Pub.L. 91-547, at 32-33 [4142-43]. In short, the 1970 amendment to Section 25(c) expanded District Courts' authority to enjoin plans of reorganization by permitting such injunctive relief whenever a court finds a plan is not "fair and equitable" to all security holders. Id.

As an initial matter, the Primary Fund's plan qualifies as a "plan of reorganization" subject to Section 25(c), which is defined under the Section 2(a)(33)(E) of the Investment Company Act as "a voluntary dissolution or liquidation of a company." 15 U.S.C. § 80a-2(a)(33)(E). Furthermore, the Primary Fund's plan would not be fair and equitable to all security holders. Critically, the myriad claims currently asserted against the *Res* substantially increase the likelihood of conflicting judgments affecting the same

finite pool of assets, resulting in arbitrary and inconsistent distinctions among shareholders.

The situation here – whereby at least $3.5 billion of Primary Fund assets would be subjected to numerous possibly conflicting judgments against the *Res* – warrants precisely the kind of relief contemplated under Section 25(c). This Court is plainly authorized not only to enjoin the Fund's announced plan of distribution but also to compel a *pro rata* distribution of the *Res* under Section 21(d)(5) of the Exchange Act, which, as amended by the Sarbanes-Oxley Act, provides: "In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors." 15 U.S.C. § 78u(d)(5); cf. SEC v. Lauer, 445 F. Supp.2d 1362, 1367 (S.D. Fla. 2006) (ordering asset freeze pursuant to Section 21(d)(5) because "[t]he Sarbanes-Oxley Act of 2002 amended Section 21(d) of the Exchange Act to also allow any federal court to grant 'any equitable relief that may be appropriate or necessary.'") The Sarbanes-Oxley Act was enacted to give courts greater authority to protect investors, often in proceedings initiated by the Commission. In the instant action, for the reasons set forth above, a *pro rata* plan of distribution is most appropriate in light of the circumstances surrounding the September 15 and 16 NAV calculations.[8] This, combined with the other relief requested herein, will enable the vast

[8] Although Exchange Act Section 21(d)(5) employs the disjunctive "or," authorizing equitable relief that may be appropriate *or* necessary for the benefit of investors, a *pro rata* plan of distribution here is not only most appropriate but is also necessary to prevent the withholding, and potential dissipation, of assets that most equitably should be distributed to the Unpaid Shareholders.

majority of the *Res* to be distributed *pro rata* as it matures, resulting in a recovery for all Unpaid Shareholders of approximately 98 cents per share.

Unpaid Shareholders might eventually receive additional funds equal to a *pro rata* share of any proceeds from the sale of Lehman Holdings, which are valued at zero for the purposes of these calculations but are likely to be sold at some higher value, even if far below par. Investors' recovery also might grow if a court were to determine that Defendants in some or all of the pending lawsuits against them owe money to the Primary Fund. While the relief the Commission seeks under the All-Writs Act (infra at III.A) would enjoin all claims that would ultimately lead to dissipation of the *Res*, including certain claims against various entities and individuals that would be entitled to indemnification from the Primary Fund, the Commission does not seek to enjoin claims for the kind of willful malfeasance that would subject Defendants to liability for which they would not be entitled to indemnification. Thus, certain claims against entities and individuals who played a role in deceiving the Trustees, investors and ratings agencies may add to the total money available to Unpaid Shareholders – namely, the claims for which Defendants could not obtain indemnification from the Fund.[9]

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[9] Under the Commission's proposed final relief, once those claims are enjoined, the only Fund assets that will not be available for distribution are potential litigation expenses needed to defend indemnified parties, such as the Trustees, from non-indemnifiable claims. If those claims are found to be meritorious, the potentially indemnified parties will need to fund those litigation costs. If the claims turn out to be non-meritorious, the costs of defending those claims will be borne by the Fund.

II. Ancillary Equitable Relief Is Warranted Under the Circumstances

A. The Court Should Enter an Order Under the All-Writs Act Enjoining Related Actions and Compelling Interested Parties to Resolve Claims in This Court.

In order to ensure that all claims to the *Res* are finally and fully adjudicated in this case, the Commission seeks an order under the All-Writs Act, 28 U.S.C. § 1651(a), enjoining all current and future related actions against the Primary Fund and compelling all interested parties – namely, the Primary Fund, Defendants, the Commission and investors – to resolve claims in this Court ("All-Writs Injunction"). Moreover, because certain of those claims are, or will likely be, for indemnification of Fund advisers and other individuals and entities affiliated with the Fund, the Commission's proposed plan would provide for the disposition of those claims as well. Upon entry of a final judgment, the Commission's proposal contemplates that all further claims against the *Res* would be released and bound by an anti-suit injunction.

In complex matters such as this, where there exist competing claims to a finite *res*, the Second Circuit has expressly approved of district courts invoking the All-Writs Act to "issue all writs necessary or appropriate in aid of their respective jurisdiction and agreeable to the usages and principles of law." In re Johns Manville Corp., 27 F.3d 48, 48 (2d Cir. 1994) (ruling that issuance of an injunction under the All-Writs Act was critical to lower court's ability to "improve the financial viability of the Trust and treat all beneficiaries fairly" in light of single "*res*" within the jurisdiction of the district court). Indeed, the Second Circuit has recognized that an injunction under the All-Writs Act is most appropriate "when federal courts have jurisdiction over a *res*" because the exercise of jurisdiction by other courts over the same *res* "necessarily impairs, and may defeat, the

jurisdiction of the federal court ... ." In re Baldwin-United Corp., 770 F.2d 328, 336-37 (2d Cir. 1985) (affirming order enjoining states from pursuing actions impacting rights of class in federal action). As the Baldwin-United Corp. Court explained: "An important feature of the All-Writs Act is its grant of authority to enjoin and bind non-parties to an action when needed to preserve the court's ability to reach or enforce its decision in a case over which it has proper jurisdiction." In re Baldwin-United Corp., 770 F.2d at 338 (citations omitted).

Here, there exists only one finite *res* – i.e., assets remaining in the Primary Fund – to distribute to any claimants. The Primary Fund Board of Trustees has authorized the distribution of approximately 89% of fund assets to investors on a *pro rata* basis, but fear of judgments and damages from both filed and threatened lawsuits – the very matters an All-Writs Injunction would address – has prevented the Board from returning to investors a significant portion of the assets remaining in the Primary Fund. An All-Writs Injunction would bring to this forum any and all claimants to Primary Fund assets, resolving some of the uncertainty at the heart of the Board's stated justification for the Special Reserve. And such relief would be particularly easy to effectuate here, where nearly all existing actions against the Defendants and related entities and individuals already have been consolidated in this Court under 28 U.S.C. § 1407 for the purpose of coordinating pretrial proceedings.

B. The Court Should Appoint a Monitor for the Primary Fund

Once the equitable jurisdiction of a District Court has properly been invoked, the Court may invoke the full range of its equitable powers to effectuate the statutory purpose, including ordering of non-injunctive relief in a variety of forms. See J.I. Case

Co. v. Borak, 377 U.S. 426, 433 (1964); SEC v. Materia, 745 F.2d 197, 200 (2d Cir. 1984). While courts historically have appointed receivers to take over the operations of a wayward defendant when necessary, courts have found, with increasing frequency, that the appointment of a "monitor" is appropriate where the court's primary purpose is to allow an objective third party to "oversee" a defendant's operations and to more generally protect investors' interests. See, e.g., SEC v. Trabulse, 526 F. Supp.2d 1008, 1019 (N.D. Cal. 2007) (appointing monitor where court found a "need for an objective party to oversee [defendant's] conduct as he continues to manage funds"); SEC v. Alanar, Inc., 2007 WL 2479318, at *1-2 (S.D. Ind. Aug. 28, 2007) (referring to prior order appointing a "[m]onitor with a mandate to protect the interests of ... investors" and subsequent order converting monitorship into receivership); SEC v. WorldCom, Inc., 2002 WL 1788032, at *1 (S.D.N.Y. Aug. 2, 2002) (appointing agreed-upon monitor).

Here, a monitor's mandate would be to oversee the liquidation of the Primary Fund's assets and facilitate the distribution of those assets to Unpaid Shareholders. The Commission respectfully submits that because the Primary Fund will be fully liquidated no later than October 2009, and investors to whom funds would be distributed have already been identified and have participated in previous distributions, a monitor could effectively, and at little cost to investors, oversee a distribution plan ordered by the Court.

III. The Court Should Grant the Commission's Proposed Order to Show Cause

The distribution of Primary Fund assets will impact many parties, including plaintiffs and defendants in existing litigation concerning the *Res*, and Primary Fund investors who might claim an interest in the *Res* but have not filed any lawsuit to date. The final relief the Commission seeks in its Application will prevent different courts from

entering conflicting judgments concerning the same finite *Res*. The Commission recognizes, however, that entry of a final order disposing of the *Res* should only be done after all potential objectors have an opportunity to review the Commission's Application and, if they so choose, be heard before this Court. Accordingly, the Commission submits its Proposed Order to Show Cause to facilitate an orderly process by which all interested parties may be notified of the Commission's Application and advance any arguments they might make in this forum.

Specifically, the Commission's Proposed Order to Show Cause would (i) compel the Commission and the Primary Fund to publish notice to all claimants to the *Res* of its Application; (ii) enter a scheduling order specifying the dates by which interested parties must identify any objections to the Commission's Application; and (iii) enjoin the distribution of the *Res* by the Primary Fund's Board of Trustees, other to cover necessary and ordinary expenses or to pay Unpaid Shareholders in a *pro rata* manner, while the Commission's Application is pending. Such an Order would not compromise any claimants' rights and, to the contrary, would help preserve the *Res* during the pendency of the Commission's Application, a result that will benefit all claimants.

CONCLUSION

For the foregoing reasons, the Commission respectfully requests that the Court issue the requested permanent injunction by consent and grant the requested ancillary relief.

Dated: New York, New York
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Respectfully submitted,

SECURITIES AND EXCHANGE COMMISSION

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