

**UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF PENNSYLVANIA**

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THE R.W. GRAND LODGE OF FREE &  
ACCEPTED MASONS OF PENNSYLVANIA,

Plaintiff,

v.

CIVIL ACTION NO.

MERIDIAN CAPITAL PARTNERS, INC.,  
MERIDIAN DIVERSIFIED FUND, LTD.,  
MERIDIAN DIVERSIFIED FUND  
MANAGEMENT LLC, WILLIAM H.  
LAWRENCE and ERNST & YOUNG LLP,

JURY TRIAL DEMANDED

Defendants.

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**VERIFIED COMPLAINT**

Plaintiff, The R.W. Grand Lodge of Free & Accepted Masons of Pennsylvania, by its undersigned attorneys, alleges the following upon information and belief, except for those allegations as to itself, which are alleged upon personal knowledge. Plaintiff's information and belief is based on the investigation of its attorneys, including a review of public and non-public documents, a review of Securities and Exchange Commission ("SEC") documents and complaint, and reports published in the financial press and other media. Plaintiff believes that substantial additional evidentiary support exists for the allegations set forth herein as will be revealed after a reasonable opportunity for discovery.

### **SUMMARY OF ACTION**

1. This action relates to one of the largest Ponzi schemes in history. Orchestrated by Bernard L. Madoff (“Madoff”) and his investment firm Bernard L. Madoff Investment Securities, LLC (“BMIS”), the fraudulent scheme went undetected except by those who conducted due diligence into the man, his investment firm, the operations, and its supposed methods and results. For those who conducted such due diligence, they knew not to invest with Madoff directly or through any one of the feeder funds that directed money to him.

2. For those who did not perform the appropriate level of due diligence, over \$50 billion have been lost. This is an action for fraud, gross negligence, breach of fiduciary duty and unjust enrichment against Meridian Capital Partners, Inc., the operator of a “fund of hedge funds” and related entities that repeatedly touted to Plaintiff, verbally and in writing, its due diligence efforts in connection with its investments with one of Madoff’s feeder funds. Those representations were completely false. The Meridian defendants performed no such due diligence before or after Plaintiff’s money was invested with Madoff. But before Plaintiff discovered the falsity of those claims after the Madoff scandal came to light in December 2008, it had already invested \$13 million of its money in the fund of hedge funds, and paid management and performance fees for the operator’s supposed due diligence services. Unbeknownst to Plaintiff, the Meridian defendants had directed a significant and increasing portion of its money to the Madoff feeder fund - - all of which has since been written off as a loss. Before being written off as a loss and at all times relevant hereto, the Meridian defendants included the fictitious value and performance histories of the Madoff feeder fund in its quarterly reports to the Plaintiff.

3. Fund of hedge funds exist to carry out due diligence for investors who do not have the time or resources to do it themselves. For that, the operators charge and are paid management and performance fees. At the very least, the Meridian defendants grossly neglected their professional and fiduciary duties to manage the capital invested by Plaintiff by permitting money to be invested with a Madoff-related feeder fund without conducting proper due diligence or otherwise exercising due care in managing investments and concealing from Plaintiff the fact that it was not actively overseeing and safeguarding Plaintiff's investments as promised. In the meantime, it continued to collect fees for doing little more than blindly handing over its clients' funds to Madoff without telling its clients. As with many other unfortunate stories relating to the billions of dollars lost in the Madoff scandal, the Meridian defendants were more interested in collecting fees from the Plaintiff and using the unprecedentedly high fictitious returns claimed by the Madoff feeder fund over the years for their own pecuniary and reputational benefits while leaving the Plaintiff and other investors unprotected and blind to the fact that they were being defrauded.

4. There were many red flags within reach of the Meridian defendants to the fact that a fraud was taking place. The Meridian defendants should have uncovered these red flags through the exercise of proper due diligence and avoided any investment in with Madoff. Notwithstanding all the red flags, the Meridian defendants continued to invest millions of dollars in Madoff-related funds. Rather than conduct due diligence, the Meridian defendants spent their time assuring Plaintiff and other investors that they were protecting their assets. In a letter to Plaintiff and other investors before the Madoff fraud was uncovered, Meridian's Chief Executive and Investment Officer wrote: "We . . . strongly believe that financial markets are challenging and treacherous and good risk management comes from having a disciplined approach to only

investing in what you really understand, not by chasing short term profits recklessly.” Four months later -- and only seven months before the Madoff fraud was publicly disclosed, the same person told Plaintiff and the other investors that they were reviewing all of the fund of hedge fund’s positions “carefully” adding that they had “drilled down hard and demanded additional transparency so we can verify both security risk and counterparty risks while watching everyone like a hawk.” These statements were one of many false statements about the fund of funds’ due diligence efforts.

5. Defendant E&Y provided professional auditing services to the particular fund of hedge funds which the Meridian defendants convinced Plaintiff to invest in. During the relevant time period, E&Y reported twice to Plaintiff and the other shareholders that the fund of hedge fund’s financial statements presented fairly the actual financial condition of the fund. E&Y, which was very familiar with Madoff’s fraudulent investment strategy and structure failed to disclose that the investment in the Madoff feeder fund was questionable at the least, that the strategy it employed could not be explained or that the investment actually represented a loss. E&Y failed to conduct due diligence as the Meridian fund’s auditor, and it otherwise failed to conduct audits in accordance with Generally Accepted Auditing Standards.

6. Had Plaintiff known the truth from any of the defendants, it would never have invested money with the Meridian defendants or would have withdrawn its money after disclosure of the truth. Instead and as a direct result of defendants’ conduct, Plaintiff was forced to redeem its entire interest in the fund of hedge funds at a loss.

#### **JURISDICTION AND VENUE**

7. The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of the Securities Exchange Act, 15 U.S.C. §§ 78j(b) and 78t(a), and Rule 10b-5, 17 C.F.R.

§240.10b-5, promulgated thereunder by the SEC, as well as under the laws of the Commonwealth of Pennsylvania. This Court has jurisdiction in this action pursuant to 28 U.S.C. §1337, Section 27 of the Securities Exchange Act, 15 U.S.C. §78aa, and pursuant to the supplemental jurisdiction of this Court.

8. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §§1331 and 1337, Section 22 of the Securities Act, 15 U.S.C. §77u and Section 27 of the Securities Exchange Act, 15 U.S.C. §78aa.

9. This Court also has jurisdiction in this action independent of any federal question pursuant to 28 U.S.C. §1332(a)(1) as the parties are citizens of different states and the amount in controversy exceeds the statutory minimum.

10. Venue is proper in this District pursuant to Section 27 of the Securities Exchange Act, 15 U.S.C. §78aa, Section 22(a) of the Securities Act, 15 U.S.C. §77v, and 28 U.S.C. §1391(b)(2), as a substantial part of the events or omissions giving rise to the claims alleged herein occurred in this District, each of the defendants are authorized to do business in this District, and each of the defendants have substantial contacts with this District.

### **PARTIES**

11. Plaintiff, The R.W. Grand Lodge of Free & Accepted Masons of Pennsylvania, is a non-profit organization that maintains its headquarters at One Broad Street, Philadelphia, Pennsylvania 19107. It is part of the oldest and largest fraternity in the world. Substantially all of its assets are used for charitable purposes throughout the Commonwealth of Pennsylvania. Through its Consolidated Fund of the R.W. Grand Lodge of F. & A.M. of Pennsylvania, Plaintiff purchased shares of defendant Meridian Fund that were wrongfully invested as described herein and has suffered damages as a result.

12. Defendant Meridian Capital Partners, Inc. (“Meridian Capital”) is an alternative investment manager that offers funds-of-hedge funds to institutional and high net worth investors and has its principal offices at 767 Fifth Avenue, New York, New York 10153. Meridian Capital is registered with the SEC as an investment adviser. Meridian Capital conducts business regularly in this District. Meridian Capital purportedly has over \$3 billion in assets under management.

13. Defendant William H. Lawrence (“Lawrence”) is the Chief Executive Officer and Chief Investment Officer of Meridian Capital. According to Meridian Capital’s marketing materials, Lawrence is the chairman of the firm’s Executive Committee and Portfolio Management Group, and “oversees all aspects of [Meridian Capital’s] investment management function, and provides strategic leadership to the firm.”

14. Non-Defendant Mark A. Hurrell (“Hurrell”) is a Director of Meridian Capital and, according to Meridian Capital’s marketing materials, “is responsible for overseeing all aspects of client service to the firm’s institutional investment community.” Hurrell has an MBA degree and is a Chartered Financial Analyst charter holder.

15. Defendant Meridian Diversified Fund, Ltd. (“Meridian Fund”) is a Cayman Island investment fund registered under the Cayman Islands’ Mutual Fund Law. Formed on July 1, 2001, it is one of six “Diversified Strategy Funds” of Meridian Capital.

16. Defendant Meridian Diversified Fund Management LLC (“Meridian Management”), a Delaware limited liability company, is a management investment firm with its principal place of business at Corporate Woods Boulevard, Flr 4<sup>th</sup>, Albany, New York 12211. Meridian Management was at all relevant times the investment manager for and provided investment management services to the Meridian Fund. Meridian Management is registered with

the SEC as an investment adviser. Meridian Capital is the managing member of Meridian Management.

17. Meridian Capital, Meridian Fund, Meridian Diversified and Lawrence are collectively referred to as the “Meridian Defendants”.

18. It was common for each of the Meridian Defendants to ignore corporate formalities and structure in its communications with Plaintiff. For example, Meridian Capital made representations to the Plaintiff in a presentation clearly given by Meridian Capital concerning the duties, function and capabilities of Meridian Management and Lawrence, as well as the composition and financial performance of the Meridian Fund. Lawrence also regularly communicated with Plaintiff concerning the financial condition and performance of the Meridian Fund on Meridian Fund letterhead, but signed by Lawrence explicitly on behalf of Meridian Management. Many of those same reports made material representation to Plaintiff concerning Meridian Capital’s business operations, function and success – many of which were false and misleading as set forth below. Thus, it is difficult at this stage in the proceedings to distinguish, to the extent it is possible, which of the Meridian Defendants made certain representations and in what capacity. Notwithstanding, each of the Meridian Defendants worked in concert with the objective of deceiving Plaintiff into purchasing shares of the Meridian Fund and maintaining those investments for the purposes of garnering fees and other pecuniary benefits.

19. It is appropriate to treat the Meridian Defendants as a group for pleading purposes and to presume that the false, misleading and incomplete information conveyed to Plaintiff as alleged herein are the collective actions of the narrowly defined group of defendants identified above. Lawrence, by virtue of his high-level positions with Meridian Capital, Meridian Management and the Meridian Fund, directly participated in the management of those entities,

was directly involved in the day-to-day operations of the those entities at the highest levels and was privy to confidential proprietary information concerning those entities and their businesses, operations, growth, financial statements, and financial condition, as alleged herein. The Meridian Defendants were involved in drafting, producing, reviewing and/or disseminating the false and misleading statements and information alleged herein, were aware, or recklessly disregarded, that the false and misleading statements were being issued and approved or ratified these statements, in violation of the federal securities laws and common law.

20. The Meridian Defendants each had a duty to disseminate prompt, accurate and truthful information with respect to the Meridian Fund's financial condition and performance, growth, operations, financial statements, business, markets, management and earnings, and to correct any previously issued statements that had become materially misleading or untrue so that the value of the Meridian Fund and its shares would be based upon truthful and accurate information. The Meridian Defendants' misrepresentations and omissions during the relevant time period violated these specific requirements and obligations.

21. The Meridian Defendants participated in the drafting, preparation, and/or approval of the various public and investor reports and other communications complained of herein and were aware of, recklessly, and/or negligently disregarded, the misstatements contained therein and omissions therefrom, and were aware of their materially false and misleading nature. Because of his executive and managerial positions with the Meridian defendant entities, Lawrence had access to the adverse undisclosed information about the Meridian Fund's financial condition and performance and Meridian Capital and Meridian Management's business practices as particularized herein and knew (or recklessly or negligently

disregarded) that these adverse facts rendered the positive representations made by or about the Meridian Fund and the other Meridian defendant entities materially false and misleading.

22. Lawrence, because of his positions of control and authority as officer and/or director of the Meridian defendant entities, was able to and did control the content of the various public statements and investor reports pertaining to the Meridian defendant entities and the Meridian Fund during the relevant time period. Lawrence was provided with copies of the documents alleged herein to be misleading prior to or shortly after their issuance and/or had the ability and/or opportunity to prevent their issuance or cause them to be corrected.

23. Each of the Meridian Defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on Plaintiff by disseminating materially false and misleading statements and/or concealing material adverse facts. The scheme caused Plaintiff to purchase \$13 million worth of shares in the Meridian Fund.

24. Defendant Ernst & Young LLP (“E&Y”) is a global professional services firm that provides assurance and advisory business services, tax services, and consulting. E&Y maintains its headquarters at 5 Times Square, New York, New York, 10036. E&Y also maintains an office and conducts business regularly in this District. E&Y was at all relevant times the auditor for the Meridian Fund and issued annual audited financial reports to the Meridian Fund and its investors such as Plaintiff during the relevant time period.

### **SUBSTANTIVE ALLEGATIONS**

#### **A Historic, Massive Ponzi Scheme Is Revealed**

25. On December 11, 2008, Madoff, the founder of BMIS, a broker-dealer and investment advisory firm headquartered in New York City, was arrested and charged with

criminal securities fraud in the United States District Court for the Southern District of New York. Madoff was a former chairman of the NASDAQ stock exchange and a high-profile figure on Wall Street. BMIS engaged primarily in three distinct operations: (1) investment advisor services; (2) market making services; and (3) proprietary trading. Madoff conducted his advisory service business apart from the company's other services from a separate floor in his office building.

26. The federal government's criminal complaint filed against Madoff and BMIS alleges that on December 10, 2008, the day before his arrest, he told two senior employees that his investment advisory business was "basically, a giant Ponzi scheme", that he had "absolutely nothing" and that "it's all just one big lie." Madoff himself estimated the losses of his fraud to be at least \$50 billion.

27. According to regulatory filings, BMIS had more than \$17 billion in assets under management as of January 2008. It now appears that virtually all of those assets are missing. The Ponzi scheme essentially blew up as BMIS clients were increasingly seeking redemptions from the fund and Madoff had insufficient liquidity to meet the growing redemption obligations. Indeed, Madoff disclosed to the two senior employees on December 10, 2008 that BMIS was insolvent and had been so for several years. This disclosure reportedly came at the time Madoff was seeking to distribute whatever funds remaining at BMIS, estimated to be \$200-\$300 million, to certain employees, friends and family.

28. In the criminal complaint, the federal government said Madoff "had for years been paying returns to certain investors out of the principal received from other, different, investors." The Madoff fraud is one of the largest Ponzi schemes in history.

29. On March 12, 2009, three months after the federal government arrested him and after a federal court appointed a trustee to preside over the liquidation of Madoff's business, Madoff plead guilty to 11 securities-related fraud counts admitting that he operated a \$65 billion Ponzi scheme while lying to investors for years. Madoff has since remained jailed. As part of his plea allocution, Madoff stated the following:

The essence of my scheme was that I represented to clients and prospective clients who wished to open investment advisory and individual trading accounts with me that I would invest their money in shares of common stock, options and other securities of large well-known corporations, and upon request, would return to them their profits and principal. Those representations were false because **for many years up and until I was arrested on December 11, 2008, I never invested those funds in the securities**, as I had promised. Instead, those funds were deposited in a bank account at Chase Manhattan Bank.

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To the best of my recollection, my fraud began in the early 1990s. . . . While I never promised a specific rate of return to any client, I felt compelled to satisfy my clients' expectations, at any cost. I therefore claimed that **I employed an investment strategy I had developed, called a "split strike conversion strategy," to falsely give the appearance to clients that I had achieved the results I believed they expected. . . . In fact, I never made the investments I promised clients**, who believed they were invested with me in the split strike conversion strategy.

(emphasis added).

30. Madoff and BMIS obtained investor capital from various sources. While certain high net worth individuals and institutions invested directly with Madoff, other individuals and institutions invested with Madoff through feeder funds – a fund that conducts almost all of its investing in and through another fund. Many of these feeder funds were created by outside advisory firms that marketed the Madoff funds to investors.

31. Tremont Group Holdings, Inc. ("Tremont") is an investment manager offering funds of hedge funds products. Among the funds offered by Tremont during the relevant time

period were the Rye Select Broad Market Portfolio, Ltd. (the “Rye Fund”) and Rye Select Broad Market XL Portfolio Limited (the “Rye XL Fund”) (the Rye Fund and Rye XL Fund are collectively referred to as the “Rye Select Funds”). The day-to-day and the investment management of the Rye Select Funds were conducted by its general partner, Tremont Partners, Inc.

32. The Rye Fund was organized in May 1994. The Rye XL Fund was organized in July 2006. Plaintiff first invested in the Meridian Fund in July 2006. During all times relevant hereto, the Meridian Fund placed money in both of the Rye Select Funds.

33. The Rye Select Funds funneled substantially all of the money placed in it to BMIS. However, neither the Rye Select Funds nor the Meridian Defendants disclosed that fact to the Plaintiff. Instead, the Rye Select Funds and Meridian Defendants simply and repeatedly described themselves as investing with a manager that employs an investment strategy identified as a “split-strike conversion” strategy.

34. Tremont described the Rye Select Funds as allocating “substantially all of its assets to one manager who utilizes a non-traditional investment strategy often described as a ‘split-strike conversion.’” In a 64-page document the Rye Select Funds sent to its potential investors it revealed with respect to the Rye Select Funds: “Valuation provided by the counterparty affiliate will not be subject to independent review.” The name of the “counterparty affiliate” was not disclosed.

### **The Meridian Defendants’ Business and Fees**

35. Meridian Capital is a heavily self-promoted investment firm. Its website repeatedly touts the firm’s success, capabilities and processes. Recently, Meridian Capital’s

website claimed that its **“funds-of-hedge funds are designed and managed to navigate the difficult investment environment with a constant purpose: protecting clients’ capital from evident dangers and from those dangers still unseen.”** (emphasis added).

36. Meridian Capital further claimed in its website that its “investment process is to engage the world’s most talented investment managers in a proprietary risk management framework that combines various hedge fund strategies, thus providing investors with superior risk-adjusted returns.” Meridian Capital added:

Meridian seeks to provide investors with the highest quality absolute return, diversified, and hedged equity strategy products in the fund-of-hedge fund asset class. **Portfolios are constructed using a time tested, disciplined methodology focused first on risk management.** We then continually work to identify strategies within our framework and to develop relationships with the world’s most talented investment managers. Meridian has a demonstrated track record of superior performance in maintaining a highly disciplined and effective investment allocation decision process.

(emphasis added).

37. The “end result” claimed Meridian Capital in its website was “portfolios with demonstrated ability to protect capital from loss in adverse market conditions and to produce superior risk-adjusted returns.”

38. Lawrence is the chairman of Meridian Capital and leads its Portfolio Management Group (which is comprised of Lawrence and Meridian Capital’s president, John L. Sica). The Portfolio Management Group is reportedly the last step in the due diligence and portfolio management processes for the Meridian Fund. Lawrence is personally responsible for overseeing Meridian Capital’s investment management.

39. Hurrell’s duties at Meridian Capital include getting investors for the Meridian Defendants. Meridian Capital’s sales pitch typically includes a verbal presentation with written

materials such as a printed PowerPoint presentation. For years before Plaintiff agreed to listen to Meridian Capital's sales pitch, Hurrell had been meeting with institutional investors throughout the country perfecting a sales pitch that would make investors more likely to invest with the Meridian Defendants.

40. The Meridian Defendants' clients had to pay for the investment-related services they performed. Management and performance fees were collected by Meridian Management and Meridian Capital for the services purportedly rendered in connection with Plaintiff's investments in the Meridian Fund. Meridian Fund investors were required to pay a 1% management fee (% of assets), with a 10% performance fee (% of profits over high-water mark). In the aggregate, those fees represented substantial income to the Meridian Defendants.

41. Performance fees are intended to be an incentive for the investment manager to produce the largest returns possible. Performance fees are a means to provide a share of positive returns to the investment manager. Performance fees are extremely lucrative for managers who perform well and give managers an incentive to take excessive risk rather than targeting high long-term returns or more secure returns. In a fund of hedge funds, management and performance fees charged are generally charged at the fund of hedge fund as well as the sub-fund level. Therefore the aggregate fees charged to investors will be higher if they invest in a fund of hedge funds rather than directly in hedge funds.

**Plaintiff Is Deceived About A Fundamental Issue: Due Diligence**

42. In May 2006, Plaintiff, for the first time in its long history, deciding to consider investing in alternative investment strategies, agreed to consider Meridian Capital as one of its alternative investment managers. Plaintiff invited a representative of Meridian Capital to attend

a meeting of certain trustees and other persons associated with the Plaintiff and its Consolidated Fund. Plaintiff had not prior to May 2006 pursued any alternative investment strategies, including hedge funds or funds of hedge funds.

43. Fund of hedge funds are a common entry point for institutional investors to invest in alternative investments such as hedge funds because they provide diversity within that investment class and supposedly perform due diligence in connection with each underlying hedge fund investment. These are important factors to conservative institutional investors such as Plaintiff. Superior qualitative judgment and quantitative analysis separate hedge fund investment managers. Fund of hedge funds managers, such as Meridian Capital and Meridian Management, are expected to perform in depth due diligence on the underlying hedge fund investments.

44. On May 15, 2006, Hurrell, in his capacity as a director of Meridian Capital, made an in-person presentation to Plaintiff (the "Initial Presentation"). The Initial Presentation took place at Plaintiff's headquarters in Philadelphia, Pennsylvania and was attended by, among others, several members of the investment sub-committee of the trustees of the Plaintiff, and officers of the Plaintiff such as its Grand Secretary, Mark Haines, and its Treasurer Jeffrey Coy.

45. Due diligence was one of the most important aspects of the investment process for Plaintiff's contemplated fund of hedge fund investments. Plaintiff explicitly informed Meridian Capital at and prior to the Initial Presentation directly and through third parties that due diligence of its underlying hedge fund investments was critically important to it and that any allocation of money to Meridian Capital or any other Meridian entity was conditioned on their conducting thorough due diligence relating to their underlying investments.

46. As it was known to Meridian Capital that Plaintiff had not previously invested with funds of hedge funds or hedge funds, Hurrell conducted a separate, preliminary presentation entitled “Hedge Fund Fundamentals” to aid Plaintiff in understanding the fund of hedge funds and hedge fund investment process.

47. During this presentation, Hurrell explained “What a Fund of Funds Manager Does” with the aid of written materials. Among other things Hurrell advised, in writing and verbally, that funds of hedge funds such as Meridian Capital “[p]erform[] due diligence reviews of prospective hedge fund investments” and “[m]onitors investments on an on-going basis.”

48. After conducting the Hedge Fund Fundamentals presentation, Hurrell launched into Meridian Capital’s sales pitch to the Plaintiff concerning the Meridian Defendants.

49. In this second phase of the Initial Presentation, Hurrell distributed to the attendees a 26-page color hand-out with text and multiple charts concerning Meridian Capital and its various funds of hedge funds, including the Meridian Fund (the “Initial Written Materials”).

50. At the Initial Presentation, Hurrell identified Meridian Capital’s six “Diversified Strategy Funds.” Among those six funds was the Meridian Fund.

51. Hurrell stated at the Initial Presentation that the Meridian Fund was created on July 1, 2001 and had approximately \$951.6m in assets as of April 1, 2006. The Meridian Fund, claimed Hurrell, had as of April 1, 2006, a one year return of 10%, 3 year return of 8.5%, 5 year return of 5.8% and 7 year return of 12.4%. These representations were supported by charts in the Initial Written Material. Hurrell did not disclose that the Meridian Fund was invested in the Rye Fund, the risk that such investment represented or that the Meridian Fund’s value and performance as represented to Plaintiff at the time of the Initial Presentation (and thereafter) were false and misleading as those figures included nonexistent values and performances.

52. Hurrell also reviewed Meridian Capital's investment process. The first two stages of its investment process were specifically discussed by Hurrell and were recounted in the Initial Written Materials as follows:

**Stage 1: Manager Identification** – *Screen* our internal and external network of managers for attractive quantitative and qualitative characteristics. Assign preliminary risk classes and strength ratings.

**State 2: Due Diligence** – *Analyze* managers to understand how they executive their strategy and evaluate business viability. Finalize risk classes and strength ratings.

53. Significantly, Hurrell also explained in detail the Meridian Defendants' due diligence procedures (Stage Two of the Meridian Defendants' investment process) to Plaintiff at the Initial Presentation. Hurrell stated that the Meridian Defendants perform the same due diligence for every investment as described in the Initial Written Materials and in more detail by him at the Initial Presentation.

54. Hurrell stated that the Meridian Defendants' due diligence process begins with a quantitative analysis. That analysis involves the Meridian Defendants performing qualitative analyses, peer group analyses and statistical comparisons. According to Hurrell, Meridian Capital's quantitative analysis also includes analyzing various factors, such as returns and risks, correlations and betas, and exposures and assets under management. These same elements were recounted in the Initial Written Materials under the heading "Due Diligence".

55. Hurrell then stated that the Meridian Defendants' perform a qualitative evaluation as part of its due diligence process. Hurrell specifically described the Meridian Defendants qualitative evaluation concerning its investments. That evaluation involved the Meridian Defendants conducting "multiple meetings", evaluating: "written reports and analyses", "business practices", "legal, accounting and finance" matters, "qualitative manager ratings: and

conducting “counterparty and reference checks.” These same elements were recounted in the Initial Written Materials under the heading “Due Diligence”.

56. Hurrell stated that as part of the due diligence process the Meridian Defendants then perform compliance and legal reviews before any investment is made. Hurrell specifically stated that this review includes “background investigations”, “fund document reviews” and “regulatory reviews”. These same elements were also recounted in the Initial Written Materials under the heading “Due Diligence”.

57. Hurrell stated that after the quantitative analysis, qualitative evaluation and compliance/legal review, the Meridian Defendants then create a list of qualified managers that have been thoroughly subjected to the Meridian Defendants’ due diligence procedures and determined to be worthy to place investments. That list of managers is then forwarded to the Portfolio Management Group for further consideration. Lawrence is one of the two members of the Portfolio Management Group. These same elements were also recounted in the Initial Written Materials under the heading “Due Diligence”.

58. Hurrell stated at the Initial Presentation that the Meridian Defendants look for managers with a fundamentally driven investment process and sound business model and that the Meridian Defendants must be able to understand the investment process for a manager to make the Meridian Defendants’ list of managers.

59. Hurrell also stated that after a manager has been selected and money invested with a manager, the Meridian Defendants’ portfolio management involves on-going quantitative analyses, qualitative reviews, and portfolio risk evaluations. This process was also recounted in the Initial Written Materials under the heading “Portfolio Management”.

60. In exchange for the Meridian Defendants' services, including and especially its due diligence, Plaintiff was to pay a management fee to Meridian Management of 1 percent plus an additional performance fee representing 10 percent of net profits earned annually (subject to a high water mark).

**The Numerous Red Flags Underlying the Madoff Fraud**

61. At the time of the Initial Presentation, the Meridian Fund had been invested in the Rye Fund for several years. The Meridian Defendants and Hurrell knew at the time of the Initial Presentation that if Plaintiff were to purchase shares in the Meridian Fund, a portion of its capital would be allocated to that investment.

62. Unbeknownst to Plaintiff, however, at all times before, during and after Plaintiff purchased share in the Meridian Fund, there were many red flags that evidenced highly questionable activity on the part of Madoff and BMIS and the feeder funds that channeled money to them. The most basic due diligence would have uncovered multiple red flags precluding any sensible investment with the Rye Select Funds or any other Madoff-related entity. These red flags include, but are not limited to the following:

- BMIS had not purchased a security in the last 13 years.
- Madoff's reported investment returns were not credible. Madoff appeared to steadily and consistently outperform the market despite the fact that money managers rarely beat the market indexes by any substantial amount over time. Madoff's investment returns appeared to earn steady monthly increases of 1% or more even when the markets were volatile and performing poorly.
- The strategy marketed by the managers of Madoff's feeder funds as the strategy Madoff was employing ("Split-Strike Conversion") made little to no sense to many in the industry and could not be duplicated applying the same strategy.<sup>1</sup>

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<sup>1</sup> The split-strike strategy involves buying a basket of stocks, then writing call options against those stocks. The proceeds from writing the call option are then used to purchase a put option.

(The split-strike conversion is the same strategy description used by Rye Select Funds in their offering materials.)

- Madoff's consistently high returns resulted in suspicion among knowledgeable and trained investment personnel and complaints to the SEC. A number of hedge fund advisers that had examined Madoff's operations and returns had warned their clients not to invest with Madoff. These suspicions were raised within the investment industry.
- Madoff was not using a professional auditing firm commensurate with the \$17 billion that he claimed to have under management. While most of Madoff's feeder funds were audited by large auditing firms, Madoff's own firm was audited by an obscure auditing firm that had only three employees, one of which was a secretary and the other was an older gentleman who resided in Florida. The firm was unknown in the investment management industry and was not peer reviewed – therefore there were no independent checks of its quality controls. Further, the auditing firm was located in Rockland County, New York in a very small office and was not open every business day. (It is practically impossible for an auditing firm of that size to audit a firm the size of Madoff's.) Finally, in every year since 1993, the auditing firm declared in writing to the American Institute of Certified Public Accountants that it was conducting no audits.
- Madoff claimed to hold publicly traded investments in his own advisory firm without using a reliable custodian (namely a large, independent financial institution that distributes financial reports directly to investors). Instead, Madoff acted as his own custodian of assets.
- Madoff kept the records of his investment advisory business under his own control with little or no internal or third-party oversight of his activities.
- Madoff's company avoided filing disclosures of its holdings with the SEC by purportedly selling its holdings for cash at the end of each reporting period.
- Madoff mailed paper copies of his trading records to clients and did not allow clients to have electronic access to his trading platform. (This allowed Madoff to manufacture trade tickets and send those tickets to clients as purported evidence of trading activity).
- The large number of Madoff feeder funds was suspicious and did not seem to serve any purpose.

- The markets that Madoff and the feeder fund managers alleged were being traded revolved around S&P 100 options, but S&P 100 options were not liquid and did not have the volume purported to be executed by Madoff.
- Madoff investors were pressured not to reveal that they were invested with him. At the feeder funds, several of the private placement memoranda and marketing materials never mentioned Madoff or BMIS by name.
- Madoff refused to allow investors to perform due diligence.
- Key positions of control at BMIS were held by members of the Madoff family. Madoff's brother, Peter, was a senior managing director, head of trading and chief compliance officer for BMIS and the broker-dealer business. Madoff's nephew, Charles Wiener, served as the director of administration. Madoff's oldest son, Mark, was the director of listed trading. His youngest son, Andrew, was director of NASDAQ trading. Madoff's niece served as the in-house legal counsel and rules compliance attorney on the broker-dealer side of the business.
- Madoff represented in regulatory filings that BMIS only had between one and five employees who performed investment advisory functions, including research when, at the same time, it supposedly had \$17 billion of assets under management.
- BMIS' comptroller was located in Bermuda whereas the majority of hedge funds the size of Madoff's employ in-house comptrollers.

63. In some cases, simple risk management techniques readily available to the Meridian Defendants at a low cost could have shown that Madoff and the Rye Select Funds were claiming investment returns that were all but impossible.

64. One such risk management technique – the bias ratio – is mathematical analysis that identifies abnormalities in investment returns. Another technique involves a comparison of Madoff's risk profile to that of a peer group. Such analyses would have shown Madoff's risk profile to be inconsistent with his claimed investment style.

65. Other risk management analyses, many of which the Meridian Defendants claimed to perform prior to and throughout an investment, could be performed with ease and low

cost. Had the Meridian Defendant performed due diligence or even performed due diligence as they represented to Plaintiff verbally and in writing on multiple occasions, the Meridian Defendants would have uncovered many if not all of the red flags indicated above precluding any investment in a Madoff-related entity by the Meridian Fund.

66. Persons in the financial industry that performed competent due diligence on Madoff or analyzed Madoff or his investment strategy uncovered many of the red flags indicated above and in some cases reported their findings to federal regulators. Many red flags were uncovered through an analysis of technical aspects of options trading and how Madoff could not have been using a split-strike conversion strategy to achieve his positive returns. Several banks refused to do business with Madoff and at least one blacklisted Madoff in its asset management division and banned its brokering side from trading with BMIS. Several professional advisors and due diligence firms struck Madoff's feeder funds from their list of approved investments.

67. Immediately after the Madoff scandal was revealed, Jim Vos, the CEO of Aksia LLC, a hedge fund investment adviser that had performed due diligence on Madoff, disclosed that his firm had long held the position that its clients should not invest with Madoff-related entities adding "[T]here were a host of red flags, which taken together made us concerned about the safety of client assets should they [be] invested in these feeders. Consequently, every time we were asked by clients, we waved them away from the Madoff feeder funds." Aksia first warned its clients not to invest with BMIS in December 2006.

68. At least three articles had been written in the financial press questioning Madoff's investment strategy including an article that appeared in *Barron's* on May 7, 2001 entitled *Don't Ask, Don't Tell: Bernie Madoff is so secretive, he even asks his investors to keep mum*. In the article, *Barron's* noted: "Remarkably, some of the larger, billion-dollar Madoff-run funds have

never had a down year. When *Barron's* asked Madoff how he accomplishes this, he says, 'It's a proprietary strategy. I can't go into great detail.' Nor were the firms that market Madoff's fund forthcoming." The article further disclosed that certain Wall Street analysts were skeptical about how Madoff achieved double-digit returns using options alone and told *Barron's* they could not understand how Madoff "churns out such numbers" using his particular investment strategy.

69. Prior to the *Barron's* article, a May 2001 article titled "Madoff Tops Charts; Skeptics Ask How" and published in a monthly industry publication called *MAR/Hedge*, seriously questioned Madoff's track record, operations and secretive investment methods. The article identified many red flags in connection with Madoff:

[E]xperts ask why no one has been able to duplicate similar returns using the [split-strike conversion] strategy and why other firms on Wall Street have not become aware of the fund and its strategy and traded against it, as has happened so often in other cases; why Madoff Securities is willing to earn commissions off the trades but not set up a separate asset management division to offer hedge funds directly to investors and keep all the incentive fees for itself, or conversely, why it does not borrow money from creditors, who are generally willing to provide leverage to a fully hedged portfolio of up to seven to one against capital at an interest rate of Libor-plus, and manage the funds on a proprietary basis.

70. In addition, one individual, Harry Markopoulos, lodged multiple complaints with the SEC concerning Madoff noting his suspicions that Madoff was engaging in a massive fraud and that the fraud was being accomplished through feeder funds such as the Rye Select Funds. Markopoulos first complained to the Boston office of the SEC in May 1999 and then again with the SEC in November 2005.

71. In his November 2005 written complaint to the SEC, Markopoulos described himself as having "experience managing split-strike conversion products both using index options and using individual stock options, both with and without index puts." Markopoulos based his complaints by engaging in simple due diligence: "My observations were collected first-

hand by listening to fund of fund investors talk about their investments in a hedge fund run by [BMIS], a SEC registered firm. I have also spoken to the heads of various Wall Street equity derivative trading desks and every single one of the senior managers I spoke with told me that Bernie Madoff was a fraud.” Markopoulos suggested that many fund of funds themselves “are naïve men and women with a notable lack of derivatives expertise and possessing little or no quantitative finance ability.” There were others, like Markopoulos, who were available and able to explain that investment strategy to fund of funds or auditors.

72. In his November 2005 letter to the SEC, Markopoulos identified 29 separate red flags leading to the conclusion that Madoff was running a Ponzi scheme. Markopoulos tellingly noted:

[Madoff] allows third party Fund of Funds (FOF’s) to private label hedge funds that provide his firm, Madoff Securities, with equity tranche funding. In return for equity tranche funding, [Madoff] runs a trading strategy, **as agent**, whose returns flow to the third party FOF hedge funds and their investors who put up equity capital to fund [Madoff’s] broker-dealer and ECN operations. [Madoff] tells investors it earns its fees by charging commissions on all of the trades done in their accounts. **Red Flag #1:** *Why would a US broker-dealer organize and fund itself in such an unusual manner? Doesn’t this seem to be an unseemly way of operating under the regulator’s radar screens? Why aren’t the commissions charged fully disclosed to investors? Can a SEC Registered Investment Advisor charge **both** commissions and charge a principle fee for trades? **MOST IMPORTANTLY**, why would [Madoff] settle for charging only undisclosed commissions when he could earn standard hedge fund fee of 1% management fee + 20% of the profits?*

(emphasis in original)

73. Markopoulos added: “The third parties organize the hedge funds and obtain investors but 100% of the money raised is actually managed by [BMIS] in a purported hedge fund strategy. The investors that pony up the money don’t know that [Madoff] is managing their money. That Madoff is managing the money is purposefully kept secret from the investors.”

Markopoulos then specifically names several such hedge funds including Tremont - - the manager of the Rye Select Funds. “The third party hedge funds and fund of funds that market this hedge fund strategy that invests in [Madoff] don’t name and aren’t allowed to name Bernie Madoff as the actual manager in their performance summaries or marketing literature. . . . [Y]ou won’t see [Madoff’s] name anywhere on the document, yet [Madoff] is the actual hedge fund manager with discretionary trading authority over all funds, as agent.”

74. Markopoulos cited an email he received in June 2005 (a year before Plaintiff invested in the Meridian Fund) that referenced a “savvy European investor” who studied the hedge fund of fund market who stated that the Royal Bank of Canada and Societe Generale “removed Madoff from approved lists of individual managers used by investors to build their own tailored” fund of funds. Markopoulos added that “[a]n official from a Top 5 money center bank’s [fund of funds] told me that his firm wouldn’t touch Bernie Madoff with a ten foot pole and that there’s no way he’s for real.”

75. Markopoulos’ Red Flag #27, as are the other 28 red flags, is telling: “Several equity derivatives professionals will all tell you that the split-strike conversion strategy that [Madoff] runs is an outright fraud and cannot possibly achieve 12% average annual returns with only 7 down months during a 14 ½ year time period.”

76. Markopoulos concluded: “I am pretty confident that [Madoff] is a Ponzi scheme. . . . The elaborateness of [Madoff’s] fund-raising, his need for secrecy, his high 61% average cost of funds, and reliance on a derivatives investment scheme that few investors (or regulators) would be capable of comprehending lead to a weight of the evidence conclusion that this is a Ponzi Scheme.”

77. Markopoulos also concluded in his November 2005 submission to the SEC:

Bernie Madoff is running the world's largest unregistered hedge fund. He's organized this business as "hedge fund of funds private labeling their own hedge funds which Bernie Madoff secretly runs for them using a split-strike conversion strategy getting paid only trading commissions which are not disclosed." If this isn't a regulatory dodge, I don't know what is. This is back-door marketing and financing scheme that is opaque and rife with hidden fees (he charges only commissions on the trades). If this product isn't marketed correctly, what is the chance that it is managed correctly? In my financial industry experience, I've found that wherever there's one cockroach in plain sight, many more are lurking behind the corner out of plain view.

**Plaintiff Is Duped Into Making A \$10 Million Initial Investment in the Meridian Fund**

78. None of the red flags identified above or otherwise concerning Madoff was known to or knowable by Plaintiff. None of the Meridian Defendants disclosed any of the red flags or expressed any concern with the Meridian Fund's investment in the Rye Select Funds. Plaintiff also did not know that the Meridian Fund's investments in the Rye Select Fund were being fed directly to Madoff or who Madoff was. It was for reasons such as this that Plaintiff opted to invest with and pay fees to Meridian Capital and Meridian Management by purchasing shares of the Meridian Fund. The Meridian Defendants were reasonably expected to perform due diligence as a matter of practice and as it repeatedly represented to Plaintiff.

79. On or about July 1, 2006 and as a direct result of the Meridian Defendants' representations concerning the Meridian Defendants and their supposed due diligence procedures, Plaintiff purchased \$10 million worth of Class A shares in the Meridian Fund.

80. At the time Plaintiff invested in the Meridian Fund, it was also known to the Meridian Defendants that the Meridian Fund was being selected, in part, because it represented and agreed its investments would be directional and balanced with other investment strategies

Plaintiff was knowingly engaging in with respect to its new alternative investments. Plaintiff's investments in the Meridian Fund were not to be used for investments based on a trading strategy.

81. Pursuant to an investment management agreement between the Meridian Fund and Meridian Management, Meridian Management is responsible for the investment allocation of the Meridian Fund's capital and is paid management and performance fees.

82. In connection with Plaintiff's investment in the Meridian Fund, Plaintiff was provided with an Amended and Restated Information Memorandum ("ARIM"), an Amended and Restated Supplemental Disclosure Statement to Information Memorandum and Subscription Materials for U.S. Investors Subscribing for Class A or Class B Shares ("ARSD"), and signed a subscription agreement.

83. The terms of the ARIM, ARSD and subscription agreement are silent about any of the Meridian Defendants' due diligence process, policies, procedures or obligations.

84. Likewise, none of the misrepresentations alleged herein are contrary to any representation made in the ARIM, ARSD or subscription agreement.

**The Meridian Defendants' Repeated Misrepresentations  
Concerning Due Diligence and the Rye Select Funds**

85. Subsequent to Plaintiff's purchase of shares in the Meridian Fund in July 2006, the Meridian Defendants regularly reported to Plaintiff concerning the status and performance of the Meridian Fund, the market in general and actions taken by the Meridian Defendants, among other matters.

86. Every report sent by the Meridian Defendants to Plaintiff contained false and misleading statements as set forth below.

The 3Q 2006 Report

87. In a October 18, 2006 report from Lawrence on behalf of Meridian Management but on Meridian Fund letterhead addressed to Meridian Fund investors and sent to Plaintiff, the Meridian Fund reported its results for the third quarter 2006 (the “3Q 2006 Report”).

88. In addressing apparent concerns from other Meridian investors that other fund-of-funds managers are getting better returns than the Meridian Fund, Lawrence stated in the 3Q 2006 Report:

**We are long term investors and do not chase “hot returns.”** Many fund-of-funds have morphed into asset gatherers and take in billions and tens of billions convincing investors they can do proper due diligence and invest wisely. They habitually make major errors like Amaranth. Our mission at Meridian is to provide superior long term returns by sticking to a disciplined approach. If we find a superior investment manager who we are convinced (based on our vigorous analysis) will make us 15 to 20% per annum over the next ten years and that manager loses a little money in the short run, we will be patient. **More importantly, we are extremely diligent in not being seduced by current “star performers” with no risk controls just because they are achieving outsized short term results.**

(emphasis added).

89. The Meridian Defendants disclosed in the 3Q 2006 Report that “[a] portion of [its] investment in Rye Select Broad Market Portfolio Ltd. was transferred to the newly launched Rye Select Broad Market XL Portfolio Limited. The funds are managed by the same Investment Manager” that Meridian has invested with since 1994.”

90. According to the 3Q 2006 Report, the Rye Fund earned 2.6 percent for the quarter and 8.1 percent year to date. The 3Q 2006 Report added with respect to the Rye Fund:

The manager was fully invested in its split strike conversion strategy by mid-July and has substantially maintained its equity positioning throughout the quarter. Returns for the quarter were attributable to appreciation in the value of equity

positions and associated dividend income and interest earnings. Gains were partially offset by losses sustained from options positions and trades. Portfolio positioning is approximately 100% long and 100% short.

91. The 2Q 2007 Report also included a fact sheet concerning the reportedly newly launched Rye XL Fund. In it, the Meridian Defendants describe the fund as having been launched on September 1, 2006 and a fund “that seeks to provide investors with long term capital growth and a return linked to a three times levered exposure to the economic performance of the Rye Select Broad Market Portfolio Limited.” The Meridian Defendants’ description continued:

The XL Fund intends to achieve this return by entering into a total return swap transaction with one or more designated counterparties on a leveraged basis. If, at any time, it becomes advantageous to achieve the foregoing investment objective by utilizing another type of investment transaction, the Investment Manager of the XL Fund, in its sole discretion, may discontinue the use of the swap in whole or in part.

92. The page-long, single-spaced fact sheet, intended to build confidence in the fund and making it appear as if the Meridian Defendants conducted thorough due diligence of the fund also stated with respect to the new Rye fund:

The current Portfolio Manager seeks to grow capital by using a non-traditional options trading strategy known as a “split strike synthetic conversion” strategy. The establishment of a typical portfolio position entails: (i) purchasing twenty to twenty-five large capitalization S&P 100 Index (“OEX”) stocks, (ii) selling out of the money OEX call options, and (iii) purchasing out of the money OEX put options. The logic of the strategy is that once a long stock position has been established, selling a call option against the long position will increase the standstill rate of return (price of stock remains unchanged), while allowing upward movement to the short call strike price. The purchase of a put option, funded with proceeds from the call is an integral part of the strategy. The Fund is normally fully hedge using options that represent an amount equal to the aggregate value of the underlying stock positions. Since option valuation is in part driven by interest rates, returns may improve in a higher rate environment. The Fund’s Portfolio Managers are not limited in the type of securities and instruments they may invest including equities, options, swaps, debt, derivative instruments, illiquid securities and others, and may use leverage.

93. The 3Q 2006 Report also included a chart showing Historic Manager Returns. For the Rye Select Funds, the Meridian Fund showed positive returns from 2002 through October 2006.

The 4Q and YE 2006 Report

94. In a year-end report from Lawrence on behalf of Meridian Management, but on Meridian Fund letterhead addressed to Meridian Fund investors and sent to Plaintiff, the Meridian Fund reported its results for the fourth quarter and year ending 2006 (the “4Q 2006 Report”).

95. The 4Q 2006 Report stated that the Meridian Fund returned 4.9% in the fourth quarter 2007 and was up 10.1% for 2006. Lawrence added that the Meridian Fund “has generated positive returns in sixteen of the last seventeen quarters, and in 42 of 50 quarters since July 1, 1994.” Lawrence also stated in the 4Q 2006 Report that, “While pleased and encouraged by recent results, we remain dedicated to the tremendous amount of hard work and discipline needed to ensure that returns are achieved without taking undue risk.”

96. The 4Q 2006 Report stated that 7.2 percent of the Meridian Fund was invested in “Relative Value” – specifically the Rye Select Funds. According to the 4Q 2006 Report, the Rye Fund earned 2.1 percent for the quarter and 10.4 percent year to date. The report also stated that the Rye XL Fund earned 3 percent since the fund was hired by the Meridian Defendants on October 1, 2006. The 4Q 2006 Report described the Rye Fund as employing a “split strike conversion strategy” and the Rye XL Fund as utilizing the same investment manager and similar investment strategies as the Rye Fund.

The 1Q 2007 Report

97. In a April 19, 2007 report from Lawrence on behalf of Meridian Management, but on Meridian Fund letterhead addressed to Meridian Fund investors and sent to Plaintiff, the Meridian Fund reported its results for the second quarter 2007 (the “1Q 2007 Report”).

98. According to the 1Q 2007 Report, the Rye Fund earned 2 percent for the quarter. The report also stated that the Rye XL Fund earned 2.5 percent for the quarter. The 1Q 2007 Report described the Rye Select Funds as employing a “split strike conversion strategy” and that “January returns were essentially flat, a modest loss was realized in February as equity markets experienced a sharp, short term decline, and solid gains were generated in March (attributable to appreciation in equity positions, associated dividend income, and gains in option positions).”

The 2Q 2007 Report

99. In a July 20, 2007 report from Lawrence on behalf of Meridian Management but on Meridian Fund letterhead addressed to Meridian Fund investors and sent to Plaintiff, the Meridian Fund reported its results for the second quarter 2007 (the “2Q 2007 Report”).

100. The 2Q 2007 Report stated that 6.3 percent of the Meridian Fund was invested in “Relative Value” – specifically the Rye Select Funds. According to the 2Q 2007 Report, the Rye Fund earned 2.7 percent for the quarter and 4.8 percent year to date. The report also stated that the Rye XL Fund earned 4.2 percent for the quarter and 7.1 percent year to date.

101. The 2Q 2007 Report described the Rye Select Funds as employing a “split strike conversion strategy”

102. The 2Q 2007 Report also included a chart showing Historic Manager Returns. For the Rye Select Funds, the Meridian Fund shows positive returns from 2003 through July 2007.

The September 14, 2007 In-Person Presentation and Report

103. On September 14, 2007, Anthony R. Cottone (“Cottone”), a director of Meridian Capital, made an in-person presentation concerning the Plaintiff’s investments in the Meridian Fund at a meeting of the trustees of the Plaintiff held in Elizabethtown, Pennsylvania. Present at the meeting and presentation were various trustees and officers of the Plaintiff as well as other individuals.

104. Cottone discussed the nature of Meridian Capital’s business operations, process and relationships with Meridian Management and the Meridian Fund. Cottone assured Plaintiff that the Meridian Defendants engaged in thorough due diligence and further explained how Meridian Capital operates and the processes used to determine which assets would provide consistent positive returns with low volatility. Cottone represented to Plaintiff that Meridian Capital had earned \$1.6 million on behalf of the Plaintiff since it first purchased shares in the Meridian Fund on July 1, 2006.

105. Associated with Cottone’s presentation was a written Performance Report provided to the Plaintiff dated June 30, 1997 (the “Performance Report”). The Performance Report was provided under Cottone’s name as a director of Meridian Capital. The Performance Report, which dealt in part with the reported performance of the Meridian Fund, contained 13 pages. At the outset, Cottone stated that the Meridian Fund’s objectives were to “preserve capital and provide superior risk-adjusted returns.”

106. The Summary of Capital Account Balances respecting Plaintiff for the period ending June 30, 2007 showed an ending capital balance of \$11,615,839 (a gain of \$1,615,839 from July 1, 2006). Cottone also represented to Plaintiff that the Meridian Fund earned 16.2% cumulatively since July 1, 2006.

107. Cottone also reviewed the portion of the Performance Report that outlined Meridian Capital's investment process. This written portion of the Performance Report was identical to the same portion of the Initial Written Materials discussed at the Initial Presentation.

108. The Performance Report identified and described the five stages of Meridian Capital's investment process, the first two of which were represented as follows:

**Stage 1: Manager Identification** – *Screen* our internal and external network of managers for attractive quantitative and qualitative characteristics. Assign preliminary risk classes and strength ratings.

**State 2: Due Diligence** – *Analyze* managers to understand how they executive their strategy and evaluate business viability. Finalize risk classes and strength ratings.

109. Cottone reviewed both of these stages verbally as well, highlighting the Meridian Defendants' due diligence efforts. Cottone stated that the Meridian Defendants assess each manager's risk/return potential as part of any investment. Cottone also represented, both in writing and verbally, that the Meridian Fund's portfolio is regularly monitored.

110. Cottone also reviewed the Meridian Fund's performance history as reflected in the Performance Report. Cottone stated that the Meridian Fund's performance for 2006 was 10.1% and 8.5% for the first half of 2007. Cottone also claimed the Meridian Fund had annualized returns of 16.2% after one year, 11% for three years and 8.7% for five years. Indeed, Cottone referred to Rye as a "sleep well" investment.

The December 2007 Update

111. In a December 11, 2007 letter from Lawrence on behalf of Meridian Management but on Meridian Fund letterhead addressed to Meridian Fund investors and sent to Plaintiff, the Meridian Fund reported it had received certain industry accomplishments and recognition. In addition to those reports, Lawrence recounted the Meridian Fund's performance cumulative returns from January 1, 1998 (187.1%) and July 1, 1994 (417.1%) and year to date for 2007 (11.6%). Lawrence added, "Our focus remains on preserving capital in volatile or down markets, and investing with managers and strategies that have transparent performance drivers and are time-tested."

The 12/31/2007 Statements of Account

112. On December 31, 2007, the Meridian Fund through its administrator reported Plaintiff as having 75,557.0011 shares in the Meridian Fund with a value of \$11,985,025.30. The Meridian Fund also noted Plaintiff's purchase of an additional \$3 million worth of Class A shares on December 1, 2007.

The 4Q and YE2007 Report

113. In a year-end report from Lawrence on behalf of Meridian Management, but on Meridian Fund letterhead and sent to Plaintiff, the Meridian Fund reported its results for the fourth quarter and year ending 2007 (the "4Q 2007 Report").

114. The 4Q 2007 Report stated that the Meridian Fund returned 2.5% in the fourth quarter 2007 and was up 11.9% for 2007. Lawrence added that the Meridian Fund "has

generated positive returns during 20 of the last 21 quarters, and in 46 of 54 quarters since July 1, 1994.”

115. Suggesting the Meridian Defendants continue to engage in thorough due diligence, Lawrence wrote in the 4Q 2007 Report:

The world’s largest financial institutions (who tout their tremendous risk management and risk models which proclaim their losses would be minimal during stress periods) lost billions of dollars of their capital . . . . We do not mean to disparage these institutions, they are full of extremely intelligent people. **We do, however, strongly believe that financial markets are challenging and treacherous and good risk management comes from having a disciplined approach to only investing in what you really understand, not by chasing short term profits recklessly.**

(emphasis added).

116. In the 4Q 2007 Report, the Meridian Fund reported assets of \$1.1 billion as of January 1, 2008 and concluded by stating: **“We will grind away (as we have for 14 years) and position the fund to provide exceptional returns while protecting capital.”** (emphasis added).

117. The Manager Commentary accompanying the 4Q 2007 Report stated that the Meridian Fund earned 2.3% for the fourth quarter 2007 and 11.2% for the year. The Manager Commentary further claimed with respect to the Rye XL Fund:

This fund’s split strike conversion strategy was employed at various times during the quarter, consistent with market trends. Returns for the quarter were mixed on a monthly basis and the majority of the fund’s performance during the quarter was attributable to the trading of equity index options in conjunction with the execution of its strategy. Portfolio positioning is approximately 300% long and 300% short.

The 1Q 2008 Report

118. In an April 21, 2008 report from Lawrence on behalf of Meridian Management, but on Meridian Fund letterhead addressed to Plaintiff, the Meridian Fund reported its results for the first quarter 2008 (the “1Q 2008 Report”).

119. The 1Q 2008 Report stated that the Meridian Fund returned -2.8% in the first quarter 2008. The report added that the Meridian Defendants:

have been communicating with [their] investment managers on a very frequent basis this year. While some results have been disappointing, **we have reviewed all of our positions carefully.** Where the thesis and fundamentals are intact we will keep and add to our positions. Where that is not the case or there is a disconnect between a manager’s objectives and their portfolio, we have not and will not hesitate to exit a position. **We have drilled down hard and demanded additional transparency so we can verify both security risk and counterparty risks while watching everyone like a hawk.**

(emphasis added).

120. The Manager Commentary attached to the 1Q 2008 Report stated with respect to the Rye XL Fund that it earned 1.1% for the quarter. The Manager Commentary added:

The manager entered the fund’s split strike conversion strategy at the end of January and remained invested through mid-March. Returns for the quarter were mixed on a monthly basis, and the majority of the fund’s performance during the quarter was attributable to appreciation in equity positions and the trading of equity index options in conjunction with the execution of its strategy. Portfolio positioning is approximately 300% long and 300% short.

The 3/31/2008 Statements of Account

121. On March 31, 2008, the Meridian Fund through its administrator reported Plaintiff as having 94,497.3897 shares in the Meridian Fund with a value of \$14,570,250.13.

The 2Q 2008 Report

122. In a July 24, 2008 report from Lawrence on behalf of Meridian Management, but on Meridian Fund letterhead addressed to Plaintiff, the Meridian Fund reported its results for the second quarter 2008 (the “2Q 2008 Report”).

123. The 2Q 2008 Report stated that the Meridian Fund returned 2.5% in the second quarter 2008 and was down .4% year to date. The Manager Commentary attached to the 2Q 2008 Report stated with respect to the Rye XL Fund that it earned 3.9% for the quarter and was up 4.7% year to date. The Manager Commentary added:

The manager entered the fund’s split strike conversion strategy at the beginning of March and remained invested until late May 2008. From that point on through the balance of the quarter, the fund was strictly invested in cash and cash equivalents. Returns during the quarter were mixed and most widely attributable to gains in option positions, appreciation in equity positions, and associated dividend income. Portfolio positioning is approximately 300% long and 300% short.

The 6/30/2008 Statements of Account

124. On June 30, 2008, the Meridian Fund through its administrator reported Plaintiff as having 94,497.3897 shares in the Meridian Fund with a value of \$14,931,315.20.

The 3Q 2008 Report

125. In a October 16, 2008 report from Lawrence on behalf of Meridian Management, but on Meridian Fund letterhead addressed to Plaintiff, the Meridian Fund reported its results for the third quarter 2008 (the “3Q 2008 Report”).

126. The 3Q 2008 Report stated that the Meridian Fund returned -8.5% in the third quarter 2008 and was down 8.5% year to date. This was reportedly the worst result of Meridian Management's 57 quarters of managing Meridian funds. Lawrence highlighted the fact that the Rye XL Fund led the Meridian Fund in the quarter with a 6% gain and led year to date with an 11% gain.

127. Lawrence stated in the 3Q 2008 Report that **the Meridian Defendants “will [] continue to closely monitor [their] investment managers’ custody and counterparty exposures in a rapidly changing environment.”** (emphasis added). Lawrence concluded that as of October 1, 2008, the Meridian Fund had assets of \$793 million.

128. The Manager Commentary attached to the 3Q 2008 Report stated with respect to the Rye XL Fund that it earned 6% for the quarter and was up 11% year to date. The Manager Commentary added:

The manager entered the fund's split strike conversion strategy in mid-July and remained invested until mid-September. At that point, the manager moved into cash and cash equivalents. Returns for the quarter were consistent on a monthly basis and primarily attributable to interest earned on cash securities, gains in equity positions, and associated dividend income. Portfolio positioning is approximately 300% long and 300% short.

The 9/30/2008 Statements of Account

129. On September 30, 2008, the Meridian Fund through its administrator reported Plaintiff as having 94,497.3897 shares in the Meridian Fund with a value of \$13,716,617.41.

**Why The Meridian Defendants' Statements Above Were False and Misleading**

130. Every report sent to Plaintiff by the Meridian Defendants and each representation specified in paragraphs ¶¶ 85 through 129 above were materially false and misleading because each report and representation failed to, among other things,:

- (a) disclose that BMIS had not purchased a security in at least 13 years;
- (b) fully explain the split-strike conversion strategy;
- (c) disclose that the split-strike conversion strategy made little sense to many in the financial industry;
- (d) disclose that the Meridian Defendants did not understand the split-strike conversion strategy;
- (e) disclose that a number of persons in the financial industry and media questioned the veracity of Madoff's investment products including the Rye Select Funds;
- (f) disclose that the split-strike conversion strategy could not have resulted in the returns represented for the Rye Select Funds;
- (g) disclose that the consistently high returns by Madoff and his investment products were suspicious;
- (h) disclose that the money invested in the Rye Select Funds were being funneled entirely to Madoff;
- (i) disclose that the Meridian Fund's investments in the Rye Select Funds were valueless;
- (j) disclose that none of the Meridian Defendants performed due diligence before or when the Meridian Fund made investments, especially the Rye Select Funds;
- (k) disclose that none of the Meridian Defendants were performing due diligence on the Meridian Fund's investments, especially the Rye Select Funds, on on-going basis;
- (l) disclose the true performance history for the Meridian Fund and Rye Select Funds;

- (m) disclose the true value of the Meridian Fund and its holdings in the Rye Select Funds;
- (n) disclose that Meridian Management was taking excessive, unwarranted and unearned management and performance fees from the Meridian Fund;
- (o) disclose that the investment strategy employed by Madoff as fed by the Rye Select Funds was based on a trading strategy, not relative value;
- (p) disclose that Madoff's and the Rye Select Funds' reported investment returns were not credible;
- (q) disclose that the Meridian Fund's investments in the Rye Select Funds were significantly at risk;
- (r) disclose that Madoff did not use a credible or reliable custodian and acted as his own custodian of assets;
- (s) disclose that Madoff kept the records of his investment advisory business under his own control with little or no internal or third-party oversight of his activities;
- (t) disclose that Madoff acted in complete secrecy;
- (u) disclose that Madoff would not let any third party conduct due diligence of his internal activities;
- (v) disclose that Madoff intentionally avoided filing disclosures of his holdings with the SEC by selling his holdings for cash at the end of each reporting period;
- (w) disclose that Madoff mailed paper copies of his trading records to clients and did not allow clients to have electronic access to his trading platform;
- (x) disclose that the large number of Madoff feeder funds, including the Rye Select Funds, was suspicious and did not seem to serve any purpose;
- (y) disclose that the markets that Madoff and the feeder fund managers alleged were being traded were revolved around the S&P 100 options, but S&P options were not liquid and could not take the volume purported to be executed by Madoff;
- (z) disclose that Madoff was not using a professional auditing firm commensurate with the amount of money he reportedly had under management; and

- (aa) disclose that Madoff's auditing firm was a small firm with only three employees (one of which was a secretary) located in a very small office in Rockland County, New York.

131. The representations made to Plaintiff by the Meridian Defendants were also false and misleading because each statement concerning the Meridian Fund's short term and long term performance, assets and value were wrong since they included the Meridian Fund's investments in the Rye Select Funds which had no value and were not performing as stated.

132. The returns on investments from the funds invested with Madoff were misleading in that they failed to disclose that the investment capital paid into the Rye Select Funds represented investment losses.

133. The Meridian Defendants falsely stated that they and each of them did not "chase hot returns". To the contrary and as evidenced by the eventual write-off of the Rye Select Funds' investments by the Meridian Fund, the Meridian Defendants failed completely to perform due diligence or otherwise investigate the Meridian Fund's investment in the Rye Select Funds because they were generating fees from those investments and the investments purported to provide excellent investment returns even when the market was volatile or in decline.

134. The Meridian Defendants also falsely stated directly and implicitly that they and each of them were engaging in due diligence or otherwise analyzing and monitoring the Meridian Fund's investments.

135. The Meridian Defendants also falsely represented that the investments with the Rye Select Funds were based on "relative value" when they were based on trading activity. The Rye Select Funds' investment was also contrary to Plaintiff's mandate to the Meridian Defendants.

136. Each report was intended to and did deceive Plaintiff regarding the Meridian Defendants, and each of their, business, operations, management and the intrinsic value of the Rye Select Funds and the Meridian Fund.

137. Plaintiff bought an additional \$3 million worth of Class A shares in the Meridian Fund in December 2007 based on the misrepresentations made to it by the Meridian Defendants.

**The Meridian Defendants Confess All Invested With Madoff Through the Rye Funds Is Lost**

138. Subsequent to the disclosure of the massive Madoff fraud on December 11, 2008, Meridian Capital communicated at least twice with Plaintiff concerning the Meridian Fund's investments with Madoff through the Rye Select Funds. On December, 12, 2008, Lawrence in his capacity of CEO/CIO of Meridian Capital wrote a letter directed to Plaintiff [and other investors] that relayed stunning news:

We are writing to inform you that last night we received shocking news concerning Bernard Madoff of Bernard L. Madoff Investment Securities LLC ("Madoff Securities"). Yesterday, Mr. Madoff was arrested by the FBI and charged with securities fraud. Madoff Securities acts as investment manager of Rye Select Broad Market XL funds managed by Tremont Partners, and Meridian's diversified funds have investments in those funds. . . . We can tell you, however, that approximately 6% to 8% of the assets of our diversified funds are invested in the Broad Market Funds.

139. On December 18, 2008, Lawrence as CEO/CIO and Sica as President of Meridian Capital wrote another letter directed to Plaintiff [and other investors] that disclosed more information:

Since 2001, Meridian Diversified Fund, Ltd. ("MDF") has had an investment in Rye Select Broad Market XL Portfolio Limited or prior related funds (collectively, "Broad Market"). Tremont Partners, Inc. ("Tremont") is the investment manager of Broad Market. Tremont engaged Madoff Securities as the asset manager for the fund. As of November 30, 2008, MDF's investments in Broad Market represented approximately 6.0% of MDF's assets. Based upon

current limited information and discussions with MDF's accountants at Ernst & Young ("E&Y) and administrator, Olympia Capital (Cayman) Limited, we are contemplating at this time that MDF will write down to zero the MDF investments in Broad Market as of November 30.

140. The December 18, 2008 letter further disclosed that the Meridian Defendants' relationship with Tremont existed for many years, that Tremont was a respected operation, and, disclosed that Meridian Capital met not only with Tremont, but with Madoff "on multiple occasions at his offices to discuss his investment approach."

141. In a January 21, 2009 report from Lawrence on behalf of Meridian Management, but on Meridian Fund letterhead addressed to Plaintiff, the Meridian Fund reported its results for the fourth quarter and year end for 2008. In the letter, Meridian Management disclosed that the Meridian Fund had "taken the position of fully writing off [its] investment" in the Rye XL Fund. The Meridian Fund also estimated the value of Plaintiff's 94,497.39 shares in the Meridian Fund as of December 31, 2008 at \$11,488,322 - - a year to date loss of 23.4%.

**E&Y's Involvement in the Fraud**

142. During all relevant times hereto, E&Y was the so-called "independent auditor" for the Meridian Fund. Subsequent to Plaintiff's initial investment with the Meridian Fund, Plaintiff received two audited financial statements prepared by E&Y.

143. Plaintiff read and relied upon the statements in those financial statements. At the time the reports were prepared and disseminated, E&Y knew the audited financial statements would be provided to the Meridian Fund's investors, including Plaintiff.

144. In the capacity of independent auditor, E&Y was responsible for ensuring, for the investors of the Meridian Fund, including Plaintiff, the financial statements prepared by the Meridian Fund complied with Generally Accepted Accounting Principles ("GAAP"). E&Y has

an obligation to perform an audit in conformance with Generally Accepted Auditing Standards (“GAAS”).

145. The “independent auditor” serves an invaluable role. The accuracy and reliability of a company’s financial disclosures are necessary to ensure that investors are provided with such truthful information on which they can base investment decisions.

146. Many accounting principles control the Meridian Fund’s financial reporting and E&Y’s audit of same. Statement of Financial Accounting Concepts No. 2 provides that a company’s financial statements must be reliable, transparent, truthful and accurately reflect the financial performance of the company. By falsely representing its assets and value of investments to the extent that the Rye Select Funds investments were valueless during the relevant time period and at the time E&Y issued its reports, E&Y violated FASB Statement of Accounting Concepts No. 2.

147. Statement of Fieldwork No. 2 requires the auditor to “obtain a sufficient understanding of the entity [being audited], and its environment, including its internal control, to assess the risk of material misstatements of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures.” Standard of Fieldwork No. 3 requires the auditor to “obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.”

148. Under SAS No. 82, Consideration of Fraud in a Financial Statement Audit, an auditor is also responsible for detecting irregularities that will give rise to fraudulent financial reporting. In order to comply with this auditing standard, E&Y should have considered that the Meridian Fund’s underlying investments were with investments that were at risk and involved in

a fraudulent scheme. GAAS also requires the auditor to assess the risk that statements are materially misstated and provides the auditor with specific factors to be considered in connection with the auditor's assessment. E&Y further violated GAAS by failing to use due professional care in the performance of its work, AU §230; failing to properly plan the audits, AU §311; failing to maintain an appropriate degree of skepticism during the audits, AU §316; and failing to obtain sufficient competent evidential matter to support the conclusions of the audit reports, AU §326.

149. E&Y simply turned a blind eye to the existence of several risk factors. At the time E&Y issued the audited financial reports described below, it was intimately familiar with Madoff. Indeed, E&Y audited several different feeder funds of Madoff including a \$2.5 billion fund from Herald Asset Management, Pioneer Alternative Investments, the Rye Select Funds, and others.

150. As a result of the fact that E&Y performed audits of several Madoff feeder funds over the course of many years before the Plaintiff invested in the Meridian Fund and subsequent to that time, E&Y was aware of or should have known about some or all of the red flags identified above and that the Meridian Fund's investment in the Rye Select Funds were not as represented. Indeed, the Meridian Fund's Rye Select Funds investments were valueless.

151. E&Y made multiple misrepresentations in its two audit reports issued during the relevant time period as described below.

#### 2006 Audited Financial Statement

152. On April 30, 2007, E&Y issued a report concerning the Meridian Fund's financial statements as of December 31, 2006. E&Y's report stated that its audit "includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements,

assessing the accounting principles used and significant estimates made by management, and evaluating our overall financial statement presentation.” E&Y added: “We believe that our audit provides a reasonable basis for our opinion.”

153. Following its audit, it issued a written opinion that the Meridian Fund’s financial statements “present fairly, in all material respects, the financial position of [the Meridian Fund] as of December 31, 2006.”

154. In its Statement of Assets and Liabilities as of December 31, 2006, E&Y included assets of \$942,045,545 reflecting the Meridian Fund’s “Investments in investment funds, at fair value”. The value of the investment in the Rye XL Fund was included in that amount and as an asset of the Meridian Fund.

155. Nowhere in E&Y’s report did it disclose the risks involved in the Rye XL Fund or that the actual value of the Meridian Fund’s investment was not what was represented, let alone valueless.

#### 2007 Audited Financial Statement

156. On May 18, 2008, E&Y issued a report concerning the Meridian Fund’s financial statements as of December 31, 2007. E&Y’s report stated that its audit “includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating our overall financial statement presentation.” E&Y added: “We believe that our audit provides a reasonable basis for our opinion.”

157. Following its audit, it issued a written opinion that the Meridian Fund’s financial statements “present fairly, in all material respects, the financial position of [the Meridian Fund] as of December 31, 2007.”

158. The Condensed Schedule of Investments as of December 31, 2007 for the [Meridian Fund] included in E&Y's audit reflects the Meridian Fund's investment in the Rye XL Fund with 53,290 shares invested reflecting a purported fair value of \$61.6 million. As noted by E&Y, that sole investment represented 5.9 percent of the Meridian Fund's net assets. The amount invested in the Rye XL Fund rendered that particular fund the third largest investment of the Meridian Fund for a single fund.

159. In its Statement of Assets and Liabilities as of December 31, 2007, E&Y included assets of \$941,171,652 reflecting the Meridian Fund's "Investments in investment funds, at fair value". The value of the investment in the Rye XL Fund was included in that amount and as an asset of the Meridian Fund.

160. In the Meridian Fund's financial statement for the year ending December 31, 2007, the Rye XL Fund represented a substantial percentage of the Meridian Funds total assets and was therefore material to the overall financial worth of the Meridian Fund.

161. Nowhere in E&Y's report did it disclose the risks involved in the Rye XL Fund or disclose that the actual value of the Meridian Fund's investment was not what was represented, let alone valueless.

162. Every report issued by E&Y concerning the Meridian Fund during the relevant time period and sent to Plaintiff by the Meridian Defendants, and each representation specified in paragraphs ¶¶ 152 through 161 above were materially false and misleading because each report and representation failed to, among other things,:

- (a) disclose that BMIS had not purchased a security in at least 13 years;
- (b) disclose that a number of persons in the financial industry and media questioned the veracity of Madoff's investment products including the Rye Select Funds;

- (c) disclose that the split-strike conversion strategy could not have resulted in the returns represented for the Rye Select Funds;
- (d) disclose that the consistently high returns by Madoff and his investment products were suspicious;
- (e) disclose that the money invested in the Rye Select Funds was being funneled entirely to Madoff;
- (f) disclose that the Meridian Fund's investments in the Rye Select Funds were valueless;
- (g) disclose the true performance history for the Meridian Fund and Rye Select Funds;
- (h) disclose the true value of the Meridian Fund and its holdings in the Rye Select Funds;
- (i) disclose that Meridian Management was taking excessive, unwarranted and unearned management and performance fees from the Meridian Fund;
- (j) disclose that Madoff's and the Rye Select Funds' reported investment returns were not credible;
- (k) disclose that the Meridian Fund's investments in the Rye Select Funds were significantly at risk;
- (l) disclose that Madoff did not use a credible or reliable custodian and acted as his own custodian of assets;
- (m) disclose that Madoff kept the records of his investment advisory business under his own control with little or no internal or third-party oversight of his activities;
- (n) disclose that Madoff acted in complete secrecy;
- (o) disclose that Madoff would not let any third party conduct due diligence of his internal activities;
- (p) disclose that Madoff intentionally avoided filing disclosures of his holdings with the SEC by selling his holdings for cash at the end of each reporting period;

(q) disclose that Madoff mailed paper copies of his trading records to clients and did not allow clients to have electronic access to his trading platform;

(r) disclose that the large number of Madoff feeder funds, including the Rye Select Funds, was suspicious and did not seem to serve any purpose;

(s) disclose that the markets that Madoff and the feeder fund managers alleged were being traded were revolved around the S&P 100 options, but S&P options were not liquid and could not take the volume purported to be executed by Madoff;

(t) disclose that Madoff was not using a professional auditing firm commensurate with the amount of money he reportedly had under management;

(u) disclose that Madoff's auditing firm was a small firm with only three employees (one of which was a secretary) located in a very small office in Rockland County, New York;

(v) disclose that E&Y failed to perform adequate and proper audit tests concerning the Meridian Fund's investment in the Rye Select Funds; and

(w) failed to disclose that E&Y did not perform a proper audit or an audit that conformed to GAAS.

163. E&Y falsely represented for the reasons stated above and herein that the Meridian Fund's financial statements presented fairly. E&Y also failed to disclose that the Meridian Fund's financials violated GAAP. Every figure in the Meridian Fund's financial statements for the years ending 2006 and 2007 that included or referenced investments in the Rye Select Funds was grossly misstated.

164. The returns on investments from the funds invested with Madoff were misleading in that they failed to disclose that the investment capital paid into the Rye Select Funds represented investment losses. The financial statements also included its investments in the Rye Select Funds as part of its assets when those investments had no value.

165. Each report was intended to and did deceive Plaintiff regarding the Meridian Defendants, and each of their, business, operations, management and the intrinsic value of the Rye Select Funds and the Meridian Fund.

166. As a result of E&Y's knowledge of the red flags respecting the Rye Select Funds, a clean audit opinion should never been given to the Meridian Fund.

167. Had the Meridian Defendants conducted reasonable and adequate due diligence as they repeatedly assured Plaintiff in person and in writing they would have detected the fraud based on the red flags and glaring inconsistencies identified by Markopolos. Further, had they and E&Y otherwise not committed the wrongful acts alleged herein and/or acted in conformance with the law and common practice, none of Plaintiffs investment capital would have been invested with any Madoff-related entity including Rye Select Funds.

### **CAUSES OF ACTION**

#### **COUNT I**

#### **Violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5 Promulgated Thereunder Against All Defendants**

168. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

169. During all relevant times, the Meridian Defendants and E&Y carried out a plan, scheme and course of conduct which was intended to and did: (i) deceive Plaintiff regarding the Meridian Defendants, and each of their, business, operations, management and the intrinsic value and performance of the Rye Select Funds and the Meridian Fund; and (ii) cause Plaintiff to invest in the Meridian Fund where it would otherwise not have had Plaintiff known the truth

about the Meridian Defendants' business practices. In furtherance of this unlawful scheme, plan and course of conduct, the defendants, and each of them, took the actions set forth herein.

170. The Meridian Defendants and E&Y: (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon Plaintiff in connection with its investments in the Meridian Fund in violation of Section 10(b) of the Exchange Act and Rule 10b-5. The Meridian Defendants are sued either as primary participants in the wrongful and illegal conduct charged herein or as controlling persons as alleged below.

171. The Meridian Defendants and E&Y, individually and in concert, directly and indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business and operations of the Meridian Defendants as specified herein.

172. The Meridian Defendants and E&Y engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of the Meridian Fund of its value and performance and continued substantial growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state material facts necessary in order to make the statements made about the Meridian Fund and its business operations in the light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of the stock of the Meridian Fund.

173. Lawrence's primary liability, and controlling person liability, arises from the following facts: (i) Lawrence was a high-level executive and chairman of the Meridian

Defendants during the relevant time period and had control thereof; (ii) Lawrence, by virtue of his responsibilities and activities as a senior officer and/or director of the Meridian entities was privy to and participated in the creation, development and reporting of the Meridian Fund's internal budgets, plans, projections and/or reports; (iii) Lawrence was advised of and had access to other members of Meridian Management, internal reports and other data and information about the Meridian Fund's finances, operations, and sales at all relevant times; (iv) Lawrence was the key member of the Meridian Fund's Portfolio Group and had ultimate responsibility for all day-to-day matters concerning the Meridian entities, and (v) Lawrence was aware of the Meridian Fund's dissemination of information to Plaintiff and its other investors which he knew or recklessly disregarded was materially false and misleading.

174. The defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were available to them. Such defendants' material misrepresentations and/or omissions were done knowingly or recklessly and for the purpose and effect of concealing the Meridian Defendants' operating condition from the Plaintiff as well as other Meridian Fund investors and supporting the artificially inflated price of its shares.

175. As demonstrated by defendants' overstatements and misstatements of the Meridian Fund's business, assets, operations and earnings throughout the relevant time period, defendants, if they did not have actual knowledge of the misrepresentations and omissions alleged, were reckless in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false or misleading.

176. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above and/or on the absence of material adverse information that was known to or recklessly disregarded by defendants but not disclosed by defendants during the relevant time period, Plaintiff invested in and with the Meridian Defendants during the relevant time period at artificially high prices and was damaged when the value of their shares and the value of the Meridian Fund's holdings in the Rye Select Funds declined upon disclosure of the truth about Madoff, the Rye Select Funds and defendants' false and misleading statements.

177. At the time of said misrepresentations and omissions, Plaintiff was ignorant of their falsity, and believed them to be true. Had Plaintiff known the truth regarding the Meridian Defendants' lack of due diligence and honesty, and the Rye Select Funds actual financial results and value, which were not disclosed by defendants, Plaintiff would not have purchased or otherwise acquired, or kept, shares in the Meridian Fund.

178. By virtue of the foregoing, defendants have violated Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

179. As a direct and proximate result of the defendants' wrongful conduct, Plaintiff suffered damages in connection with its investments in the Meridian Fund as alleged herein.

**COUNT II**  
**Violation of Section 20(a) of**  
**the Exchange Act Against the Meridian Defendants**

180. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

181. Lawrence acted as controlling persons of defendants Meridian Capital, Meridian Management and the Meridian Fund within the meaning of Section 20(a) of the Exchange Act as alleged herein.

182. By virtue of his high-level position, and ownership and contractual rights, participation in and/or awareness of defendants Meridian Capital, Meridian Management and Meridian Fund's operations and/or intimate knowledge of the false financial statements made by the Meridian Defendants to Plaintiff, Lawrence had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Meridian Defendants, including the content and dissemination of the various statements which Plaintiff asserts are false and misleading.

183. Lawrence was provided with or had unlimited access to copies of the Meridian entities' reports, press releases, public filings and other statements alleged by Plaintiff to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

184. In particular, Lawrence had direct and supervisory involvement in the day-to-day operations of the Meridian entities and, therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same.

185. As set forth above, each of the Meridian Defendants each violated Section 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their positions as a controlling person, Lawrence is liable pursuant to Section 20(a) of the Exchange Act.

186. As a direct and proximate result of the defendants' wrongful conduct, Plaintiff suffered damages in connection with its investments in the Meridian Fund as alleged herein.

**COUNT III**  
**Fraud in the Inducement**  
**Against Meridian Capital and Meridian Management**

187. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

188. The Meridian Defendants made misrepresentations of material facts concerning their performance of due diligence in connection with investments made by the Meridian Defendants.

189. The Meridian Defendants made those misrepresentations for the purpose of inducing Plaintiff to purchase shares in the Meridian Fund through the Meridian Defendants.

190. Plaintiff reasonably relied on the misrepresentations made by the Meridian Defendants to its detriment.

191. As a direct and proximate result of the Meridian Defendants' wrongful conduct, Plaintiff suffered damages in connection with its investments in the Meridian Fund as alleged herein.

**COUNT IV**  
**Misrepresentation**  
**Against All Defendants**

192. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

193. Defendants knowingly and willfully misrepresented and omitted material facts to Plaintiff that they intended Plaintiff to rely upon and be induced to act as set forth above.

194. Plaintiff in reasonable and justifiable reliance upon the misrepresentations made by the defendants and as a result of defendants' failure to disclose and fraudulently conceal material facts as set forth above invested a total of \$13 million in the Meridian Fund and maintained its investment in the Meridian Fund to its detriment.

195. At the time the misrepresentations and omissions were made by defendants as set forth herein, the defendants knew them to be false and intended to deceive Plaintiff by making such misrepresentations.

196. At the time of the misrepresentations and omissions set forth herein, each of the defendants intended that Plaintiff would act on the basis of the misrepresentations and omissions in determining whether to invest in the Meridian Fund and maintain its investments with them.

197. Had Plaintiff known of the material facts that the defendants wrongfully concealed and misrepresented, and the falsity of the defendants' representations, Plaintiff would not have invested in and with the Meridian Defendants.

198. Plaintiff, as a result of its investments in and with the Meridian Defendants, and by reason of defendants' wrongful concealments and misrepresentations, has sustained actual damages.

199. By reason of the foregoing, defendants are jointly and severally liable to Plaintiff.

200. Defendants' fraudulent acts were willful and wanton and Plaintiff is entitled to punitive damages.

**COUNT V**  
**Negligent Misrepresentation**  
**Against All Defendants**

201. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

202. Defendants owed to Plaintiff a duty to: (a) act with reasonable care in preparing and disseminating written material and making verbal statements and other representations reasonably relied upon by Plaintiff in deciding to invest and maintain its investments in the Meridian Fund; and (b) use reasonable diligence in determining the accuracy of and preparing the information contained in the written materials and made verbally to Plaintiff and other representations reasonably relied upon by Plaintiff, including that defendants would investigate the technical investment strategies employed by the Meridian Fund.

203. Defendant E&Y knew that its audited financial statements identified herein would be provided to Plaintiff and other investors and potential investors of the Meridian Fund and relied upon by them in making investment decisions concerning the Meridian Fund.

204. The defendants breached their duties to Plaintiff by failing to investigate, confirm, prepare and review with reasonable care the information contained in the written materials and verbal statements made by the defendants as alleged herein and other representations, including the annual financial statements.

205. None of the defendants' written materials or verbal representations ever disclosed that virtually all of the money invested in the Rye Select Funds was invested with Madoff, BMIC or other Madoff controlled entities.

206. Defendants should have known the falsity or failed to conduct a reasonable investigation of the truth.

207. Defendants had the concurrent intent to have Plaintiff act in detrimental reliance of its misrepresentations and omissions.

208. Plaintiff justifiably relied on the material misrepresentations and omissions set forth herein.

209. As a direct, foreseeable and proximate result of this negligence, Plaintiff has sustained actual damages.

210. By reason of the foregoing, defendants are jointly and severally liable to Plaintiff.

211. Defendants' fraudulent acts were willful and wanton and Plaintiff is entitled to punitive damages.

**COUNT VI**  
**Negligence**  
**Against Meridian Capital, Meridian Management and Lawrence**

212. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

213. Defendants Meridian Capital, Meridian Management and Lawrence owed to Plaintiff a duty to: (a) act with reasonable care in preparing and disseminating written material and making verbal statements and other representations reasonably relied upon by Plaintiff in deciding to invest and maintain its investments in the Meridian Fund; and (b) use reasonable diligence in determining the accuracy of and preparing the information contained in the written materials and made verbally to Plaintiff and other representations reasonably relied upon by Plaintiff.

214. Defendants Meridian Capital, Meridian Management and Lawrence breached their duties to Plaintiff by failing to investigate, confirm, prepare and review with reasonable care the information contained in the written materials and verbal statements made by the defendants as alleged herein and other representations, including the annual financial statements.

215. Defendants Meridian Capital, Meridian Management and Lawrence failed to exercise the ordinary skill and knowledge of like situated investment managers.

216. None of the defendants' written materials or verbal representations ever disclosed that virtually all of the money invested in the Rye Select Funds was invested with Madoff, BMIC or other Madoff controlled entities.

217. As a direct, foreseeable and proximate result of this negligence, Plaintiff has sustained actual damages.

218. By reason of the foregoing, Defendants Meridian Capital, Meridian Management and Lawrence are jointly and severally liable to Plaintiff.

**COUNT VII**  
**Unjust Enrichment**  
**Against Meridian Capital and Meridian Management**

219. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

220. As a result of the misconduct detailed herein, there have been substantial losses sustained by Plaintiff and defendants Meridian Capital and Meridian Management collected substantial fees and other pecuniary benefits at the expense of Plaintiff despite the fact that they were not performing their duties owed to Plaintiff and were making material misrepresentations.

221. Defendants Meridian Capital and Meridian Management have received and accepted such benefits under circumstances that they have been unjustly enriched and it would be inequitable for those defendants to retain the benefits conferred.

222. Equity and good conscience require that these defendants disgorge to the Plaintiff all such unjust enrichment in an amount to be determined at trial.

**COUNT VIII**

**Breach of Fiduciary Duty  
Against Meridian Capital, Meridian Management and Lawrence**

223. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

224. Defendants Meridian Capital, Meridian Management and Lawrence at all times relevant hereto owed Plaintiff fiduciary duties including those of care, loyalty and to act in good faith.

225. Defendants Meridian Capital, Meridian Management and Lawrence also voluntarily assumed a fiduciary duty by intentionally taking affirmative acts in furtherance of its falsely described due diligence practices and have imported a common law fiduciary duty upon them.

226. As a result of their conduct as described herein, defendants Meridian Capital, Meridian Management and Lawrence breached their fiduciary duties to Plaintiff by acting in bad faith, with gross negligence and in utter disregard for due care and reasonable and prudent investment standards and practices and in all other matters for which Plaintiff paid money to the Meridian Defendants.

227. As a proximate result of defendants Meridian Capital, Meridian Management and Lawrence's bad faith and breach of fiduciary duties, Plaintiff sustained actual damages.

228. By reason of the foregoing, defendants Meridian Capital, Meridian Management and Lawrence are liable to Plaintiff.

**COUNT IX**

**Aiding and Abetting Breach of Fiduciary Duty  
Against the Meridian Defendants**

229. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

230. The Meridian Defendants owed Plaintiff fiduciary duties as described immediately above and breached those fiduciary duties.

231. To the extent any of the Meridian Defendants did not owe Plaintiff a fiduciary duty, any and each of those Meridian Defendants (the “Aider and Abettor Defendants”) had knowledge of the breach of fiduciary duty alleged immediately above by the other Meridian Defendants.

232. The breach of fiduciary duty described immediately above occurred with the substantial assistance and encouragement by the Aider and Abettor Defendant in effecting that breach.

233. As a proximate result of the Aider and Abettor Defendants’ conduct, Plaintiff sustained actual damages.

234. By reason of the foregoing, the Aider and Abettor Defendants are liable to Plaintiff.

**COUNT X**

**Conspiracy  
Against the Meridian Defendants**

235. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

236. The Meridian Defendants worked in concert for the common purpose of making the misrepresentations and omissions to Plaintiff as set forth herein to cause it to invest and maintain its investment in the Meridian Fund.

237. In furtherance of the Meridian Defendants' conspiracy, each defendant made affirmative misrepresentations to and omitted material information from the Plaintiff. These misrepresentations were made verbally at in-person meetings and through regular financial reports sent to Plaintiff.

238. As a proximate result of the Meridian Defendants' conspiracy, Plaintiff sustained actual damages.

**COUNT XI**

**Violations of §§1-401 and 1-501 of the Pennsylvania Securities Act of 1972  
Against the Meridian Defendants**

239. Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein including, without limitations, Counts I and II above.

240. The Meridian Defendants employed a scheme to defraud Plaintiff in connection with the offer, sale and purchase of shares of the Meridian Fund.

241. As a proximate result of the Meridian Defendants' actions, Plaintiff sustained actual damages.

**PRAYER FOR RELIEF**

WHEREFORE, Plaintiff prays for relief and judgment in its favor as follows:

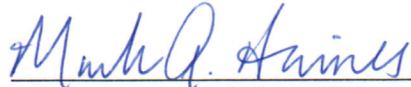
- A. Awarding compensatory damages in favor of Plaintiff against all defendants, jointly and severally, for all damages sustained as a result of defendants' wrongdoing, in an amount to be proven at trial, including both pre-judgment and post-judgment interest thereon to the extent permitted by law;



**VERIFICATION**

I, Mark A. Haines, hereby verify I am the Grand Secretary of The R.W. Grand Lodge of Free & Accepted Masons of Pennsylvania, that I am authorized to make this Verification on its behalf, and that I have reviewed the foregoing Verified Complaint. The Complaint is based on the investigation of counsel and, in reliance on that investigation, as well as my own knowledge and information, I verify pursuant to 28 U.S.C. §1746 that the factual information contained therein is true to the best of my knowledge, information and belief.

Dated: May 11, 2009

  
Mark A. Haines  
Mark A. Haines  
Grand Secretary

