

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

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J.P. MORGAN SECURITIES INC., J.P.
MORGAN CLEARING CORP., and THE BEAR
STEARNS COMPANIES LLC,

Plaintiffs,

-against-

VIGILANT INSURANCE COMPANY, THE
TRAVELERS INDEMNITY COMPANY,
FEDERAL INSURANCE COMPANY,
NATIONAL UNION FIRE INSURANCE
COMPANY OF PITTSBURGH, PA., LIBERTY
MUTUAL INSURANCE COMPANY,
CERTAIN UNDERWRITERS AT LLOYD'S,
LONDON, and AMERICAN ALTERNATIVE
INSURANCE CORPORATION,

Defendants.
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Index No. 600979109
Date Purchased: March 31, 2009

Plaintiffs designate New York
County as the place of trial

The basis of venue is Plaintiffs'
address: 245 Park Avenue, New
York, New York 10167

SUPPLEMENTAL SUMMONS

Plaintiffs are located in the County
of New York

FILED

JUN - 1 2009

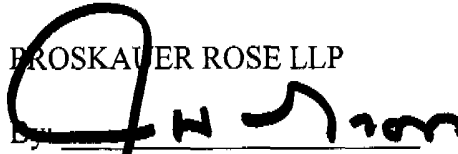
NEW YORK
COUNTY CLERK'S OFFICE

To the Above Named Defendants:

YOU ARE HEREBY SUMMONED to answer the amended complaint in this action and to serve a copy of your answer, or, if the amended complaint is not served with this supplemental summons, to serve a notice of appearance, on the Plaintiffs' Attorneys within 20 days after the service of this supplemental summons, exclusive of the day of service (or within 30 days after the service is complete if this supplemental summons is not personally delivered to you within the State of New York); and in case of your failure to appear or answer, judgment will be taken against you by default for the relief demanded in the amended complaint.

Dated: New York, New York
June 1, 2009

BROSKAUER ROSE LLP



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J.P. Morgan Securities Inc. and
J.P. Morgan Clearing Corp.

Defendants' Addresses:

Vigilant Insurance Company
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Travelers Indemnity Company
1 Tower Square
Hartford, Connecticut 06183

Federal Insurance Company
15 Mountain View Road
Warren, New Jersey 07059

National Union Fire Insurance Company of Pittsburgh, Pa.
70 Pine Street
New York, New York 10270

Liberty Mutual Insurance Company
175 Berkeley Street
Boston, Massachusetts 02116

Certain Underwriters at Lloyd's, London
c/o Mendes & Mount, LLP
450 Seventh Avenue
New York, New York 10019

American Alternative Insurance Corporation

555 College Road East
Princeton, New Jersey 08540

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

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J.P. MORGAN SECURITIES INC., J.P.
MORGAN CLEARING CORP., and THE BEAR
STEARNS COMPANIES LLC,

Index No. 600979/09

Plaintiffs,

-against-

VIGILANT INSURANCE COMPANY, THE
TRAVELERS INDEMNITY COMPANY,
FEDERAL INSURANCE COMPANY,
NATIONAL UNION FIRE INSURANCE
COMPANY OF PITTSBURGH, PA., LIBERTY
MUTUAL INSURANCE COMPANY,
CERTAIN UNDERWRITERS AT LLOYD'S,
LONDON, and AMERICAN ALTERNATIVE
INSURANCE CORPORATION,

Defendants.

AMENDED COMPLAINT

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NEW YORK
COUNTY CLERK'S OFFICE

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Plaintiffs J.P. Morgan Securities Inc., J.P. Morgan Clearing Corp. , and The Bear Stearns
Companies LLC, by their undersigned attorneys, upon knowledge as to themselves and their own
acts, and otherwise upon information and belief, for their Amended Complaint allege as follows:

Introduction

1. In this insurance coverage action, J.P. Morgan Securities Inc., formerly known as
Bear, Stearns & Co. Inc. ("BS&Co."), J.P. Morgan Clearing Corp., formerly known as Bear,
Stearns Securities Corporation ("BSSCorp."), and The Bear Stearns Companies LLC, formerly
known as The Bear Stearns Companies Inc. ("TBSC"), seek a declaratory judgment and money
damages from Vigilant Insurance Company ("Vigilant"), The Travelers Indemnity Company

("Gulf"), Federal Insurance Company ("Federal"), National Union Fire Insurance Company of Pittsburgh, Pa. ("National Union"), Liberty Mutual Insurance Company ("Liberty Mutual"), Certain Underwriters at Lloyd's, London ("Lloyds"), and American Alternative Insurance Corporation ("AAIC") (collectively "Defendant Insurers") for amounts paid and/or to be paid to defend and settle the Mutual Fund Claims described in this amended complaint.

2. The insurance program at issue in this action, the "Bear Stearns 00-03 Program," provided Professional Liability Insurance coverage to TBSC and its subsidiaries, directors, officers and employees. At the time of the inception of the Bear Stearns 00-03 Program on May 5, 2000, for the coverage layers up to \$100 million, and on March 21, 2000 for the insurers that provided coverage of \$100 million in excess of the first \$100 million in coverage, and throughout the period of the coverage provided under the Bear Stearns 00-03 Program, BS&Co. was a wholly owned subsidiary of TBSC. BSSCorp. was, in turn, a wholly owned subsidiary of BS&Co. TBSC, BS&Co. and BSSCorp. were Insureds under the Bear Stearns 00-03 Program.

3. TBSC was a public company, with tens of thousands of public shareholders and 11,000 employees. BS&Co. was a registered broker-dealer and a leading global investment banking, securities, and asset management firm. BSSCorp. was a registered broker-dealer engaged in the business of processing and clearing trades on behalf of hundreds of correspondents and thousands of professional and retail investors. BS&Co. also cleared and processed trades for its customers through BSSCorp.

4. In 2008, TBSC, through its merger with a subsidiary of JPMorgan Chase & Co., became a subsidiary of JPMorgan Chase & Co. TBSC subsequently was converted to a Delaware limited liability company and its name changed to The Bear Stearns Companies LLC.

After the 2008 merger of TBSC, BS&Co. became a direct subsidiary of JPMorgan Chase & Co., with BSSCorp. remaining as a subsidiary of BS&Co. BS&Co.'s name was changed to J.P. Morgan Securities Inc. and BSSCorp.'s name was changed to J.P. Morgan Clearing Corp. For ease of reference, the plaintiffs in this action, all of which were part of the Bear Stearns group of companies prior to the 2008 merger transactions with JPMorgan Chase & Co., are collectively referred to in this amended complaint as "Bear Stearns."

5. Prior to the mergers, BS&Co. and BSSCorp. were the subject of investigations conducted by the Securities and Exchange Commission ("SEC"), the New York Stock Exchange ("NYSE"), and other regulatory authorities, into possible violations of law and regulations in connection with their alleged facilitation, as a broker-dealer and securities clearing firm, of late trading and deceptive market timing by certain of their customers in connection with the buying and selling of shares in various mutual funds.

6. "Late trading" is the practice of placing orders to buy, redeem, or exchange mutual fund shares after the time as of which mutual funds calculate their net asset value. "Deceptive market timing" includes: i) frequent buying and selling of shares of the same mutual fund; and ii) buying or selling mutual fund shares to exploit inefficiencies in mutual fund pricing.

7. During its investigation, the SEC asserted that Bear Stearns' facilitation of its customers' late trading and deceptive market timing mutual fund transactions had damaged other investors in those funds by causing dilution of the value in the affected mutual funds.

8. At no time during the course of the SEC investigations or the SEC's settlement discussions with Bear Stearns did anyone from the SEC ever assert that the SEC's investigation had uncovered evidence that in fact Bear Stearns itself had received any ill-gotten gain as a result

of its customers' alleged late trading or deceptive market timing practices. The SEC never disputed Bear Stearns' showing that the total revenue it received from the alleged late trading market timing transactions of its customers was no more than \$16.9 million. Instead, during the negotiations of the settlement of the SEC investigation, the SEC staff informed Bear Stearns that the settlement payment was designed to provide compensation to mutual fund investors for the damages caused by the late trading and deceptive market timing practices of Bear Stearns' customers.

9. Pursuant to a Bear Stearns offer of settlement, without any admission by Bear Stearns of the SEC's findings, on March 16, 2006, the SEC issued an order resolving the SEC investigation in the administrative proceeding it commenced against BS&Co. and BSSCorp. captioned: *In the Matter of Bear, Stearns & Co., and Bear, Stearns Securities Corp.*, (Administrative Proceeding File No. 3-12238) (the "Administrative Order").

10. The Administrative Order did not allege that Bear Stearns received any revenue, much less any gain, that it would not otherwise have received but for its facilitation of market timing and late trading by its customers, or that Bear Stearns failed to provide services for any fees it received from its customers.

11. The Administrative Order is not a judgment or final adjudication that Bear Stearns received ill-gotten gains.

12. Bear Stearns has never admitted that the amount it paid to settle with the SEC was, in fact, ill-gotten gains. As a part of its settlement with Bear Stearns, the SEC did not preclude Bear Stearns from bringing this coverage action, or from submitting evidence that the \$160 million payment was, as a matter of fact, not ill-gotten gains.

13. The SEC recited in the Administrative Order that Bear Stearns facilitated deceptive market timing and late trading by its customers and that its “conduct benefited [its] customers and customers of correspondent firms by enabling those customers to generate hundreds of millions of dollars in profits from these trading tactics at the expense of mutual fund shareholders.” (¶ 5.) In making those findings (which Bear Stearns did not admit), the SEC never made any claim that Bear Stearns, as distinguished from its customers, profited in any way from the challenged practices.

14. To resolve the claims made by the SEC, and to provide funds to be used to compensate mutual funds and investors allegedly damaged as a result of the deceptive market timing and late trading the SEC found Bear Stearns to have facilitated, in the Administrative Order, Bear Stearns agreed to pay \$250 million, of which \$160 million was labeled “disgorgement,” and \$90 million was a penalty.

15. Pursuant to the Administrative Order, the \$250 million Bear Stearns payment was placed in a Fair Fund, pursuant to Section 308(a) of the Sarbane-Oxley Act of 2002, to be distributed (in a manner to be established pursuant to a plan of distribution) to compensate investors harmed in the mutual funds that the fund administrator determined had been damaged by the dilution in the value of their shares as a result of the late trading and deceptive market timing practices that the SEC found Bear Stearns to have facilitated.

16. On February 4, 2009, the SEC approved the Plan of Distribution for the payments Bear Stearns had made pursuant to the Administrative Order. Under the Plan of Distribution, the \$250 million is to compensate investors allegedly harmed by the conduct set forth in the Administrative Order through its distribution to the asset base of those mutual funds that may

have been affected by the late trading and deceptive market timing practices of Bear Stearns' customers under a formula designed to compensate the investors in the affected mutual funds for their alleged damages resulting from the dilution in the value of mutual fund shares caused by these activities.

17. TBSC, BS&Co. and BSSCorp. were also named as defendants in thirteen civil class actions commenced on behalf of mutual fund investors allegedly damaged by Bear Stearns' conduct (the "Mutual Fund Civil Actions"). The SEC investigation, and related regulatory investigations, and the Mutual Fund Civil Actions are referred to collectively in this amended complaint as the "Mutual Fund Claims." Bear Stearns has entered into a settlement agreement with the lead plaintiffs in the Mutual Fund Civil Actions which, if approved by the court after notice to the class, calls for a Bear Stearns payment of \$14 million. But for the reduction in the class plaintiffs' claimed damages resulting from the planned distribution of the Bear Stearns "disgorgement" payment of \$160 million pursuant to the Administrative Order and the Plan of Distribution, Bear Stearns' exposure in the Mutual Fund Civil Actions, and the payment required to settle those actions, would have been much greater.

18. The Defendant Insurers have refused to indemnify Bear Stearns for its settlement with the SEC. They contend that, because the \$160 million payment was labeled disgorgement in the Administrative Order, it is not a Loss under Bear Stearns' insurance policies and therefore Bear Stearns may not present evidence in this case that the payment in fact constitutes compensatory damages.

19. If the Defendant Insurers are allowed to evade their duty to indemnify Bear Stearns for the losses it incurred to resolve the SEC investigation, they will obtain an improper

windfall. The amount Bear Stearns paid as "disgorgement" to resolve the SEC investigation offset the damages claimed by investors in the mutual funds and thereby decreased the amount required to settle the Mutual Fund Civil Actions, and thus reduced the amount of Bear Stearns' Loss under the Bear Stearns 00-03 Program resulting from the settlement of the Mutual Fund Civil Actions.

20. The entire "disgorgement" payment Bear Stearns made pursuant to the Administrative Order constituted, in fact, compensatory damages and therefore constitutes a Loss under the Defendant Insurers' insurance contracts.

21. The Defendant Insurers' contention that Bear Stearns should be estopped from presenting evidence at trial that the \$160 million it paid to settle with the SEC was a Loss, has been unanimously rejected by the Appellate Division, First Department.

22. In *Vigilant v. Bear Stearns*, 34 A.D.3d 300 (1st Dept. 2006), *rev'd on other grounds*, 10 N.Y. 170 (2008), Bear Stearns entered into a consent judgment with the SEC to pay an amount which was labeled disgorgement. In a subsequent coverage action, the insurers contended that because the settlement was labeled disgorgement, Bear Stearns had received ill-gotten gains and could not recover the payment. The First Department rejected the insurers' contention, looked behind the disgorgement label in the SEC consent judgment, reviewed evidence presented to it by Bear Stearns that showed "the settlement amount was based on market share instead of being tied to the amount of commissions or fees it received," and found that there was a question of fact for trial. The Court of Appeals did not disturb the First Department's holding on this point.

23. The use of the term "disgorgement" in the Administrative Order should not be given collateral estoppel or legally preclusive effect with the consequence of excluding from consideration evidence and facts which Bear Stearns will present to show that, in reality, its payment to resolve the SEC investigation in fact constituted compensatory damages and thus constitutes a covered Loss under the Bear Stearns 00-03 Program.

24. Bear Stearns alleges in this amended complaint, and will present evidence at trial that, at most, the gross revenue Bear Stearns earned from all alleged late trading and deceptive market timing practices engaged in by its customers during the period referred to in the Administrative Order was only \$16.9 million, and that Bear Stearns made virtually no profit from the conduct at issue in the SEC investigation.

25. Based upon its settlement with the SEC, Bear Stearns seeks \$150 million from the Defendant Insurers (the \$160 million non-penalty portion of the SEC settlement less a \$10 million retention), plus defense costs in the approximate amount of \$40 million, plus pre-judgment interest, under the terms of the Bear Stearns 00-03 Program, for the Defendant Insurers' breaches of their insurance contracts by their refusal to indemnify Bear Stearns for those covered Losses. Bear Stearns also seeks a declaratory judgment that the Bear Stearns settlement payment to be made in the Mutual Fund Civil Actions comes within the coverage provided under the Bear Stearns 00-03 Program and that, upon the Bear Stearns payment of the \$14 million settlement amount, the Defendant Insurers are obligated, under their insurance contracts issued in connection with the Bear Stearns 00-03 Program, to indemnify Bear Stearns for that settlement payment as covered Loss.

Parties

Plaintiffs

26. J.P. Morgan Securities Inc., formerly known as Bear, Stearns & Co. Inc., is a Delaware corporation and an indirect wholly owned subsidiary of JPMorgan Chase & Co. with its principal place of business in New York, New York.

27. J. P. Morgan Clearing Corporation, formerly known as Bear, Stearns Securities Corporation, is a Delaware corporation and a wholly owned subsidiary of J.P. Morgan Securities Inc. with its principal place of business in New York, New York.

28. The Bear Stearns Companies LLC, formerly known as The Bear Stearns Companies, Inc., is a Delaware limited liability company with its principal place of business in New York, New York.

Defendants

29. Upon information and belief, Vigilant Insurance Company is a New York corporation with its principal place of business in Warren, New Jersey.

30. Upon information and belief, Gulf Insurance Company was a Connecticut Corporation with its principal place of business in New York, New York. Upon information and belief, in 2005 Gulf Insurance Company was merged into The Travelers Indemnity Company, a Connecticut corporation headquartered in Connecticut, with The Travelers Indemnity Company succeeding to the liabilities of Gulf Insurance Company. For ease of reference, The Travelers

Indemnity Company, as successor to Gulf Insurance Company, and the pre-merger entity Gulf Insurance Company, are referred to in this Complaint as "Gulf."

31. Upon information and belief, Federal Insurance Company is an Indiana corporation with its principal place of business in Warren, New Jersey.

32. Upon information and belief, National Union Fire Insurance Company of Pittsburgh, Pa., is a Pennsylvania corporation with its principal place of business in New York, New York.

33. Upon information and belief, Liberty Mutual Insurance Company is a Massachusetts corporation, with its principal place of business in Boston, Massachusetts.

34. Defendants Certain Underwriters at Lloyds, London ("Lloyd's") are the Lloyd's Syndicates that provided insurance coverage to Bear Stearns under the Bear Stearns 00-03 Program. Upon information and belief, the Lloyd's Syndicates that participated in the Bear Stearns 00-03 Program included: Syndicates 435, 456, 861, 1007, 1209, 1212, 1411, and 2488.

35. Upon information and belief, American Alternative Insurance Corporation is a Delaware Corporation with its principal place of business in Princeton, New Jersey.

Jurisdiction And Venue

36. This Court has jurisdiction over the Defendant Insurers pursuant to CPLR Sections 301 and/or 302 as follows: Defendant Insurers are regularly doing business within the State of New York.

37. Venue in this county is proper under CPLR 503(a) as at least one of the parties is a resident of New York County.

The Bear Stearns 00-03 Insurance Program

38. Bear Stearns purchased Professional Liability Insurance from the Defendant Insurers on a claims-made basis for the period May 5, 2000 to May 5, 2003 for the first \$100 million in coverage, and for the period March 21, 2000 to May 5, 2003 for the \$100 million in coverage excess of the first \$100 million in coverage.

39. The seven Defendant Insurers each participated in the first \$200 million of coverage under the Bear Stearns 00-03 Program. Defendant Vigilant, the lead insurer for the Bear Stearns 00-03 Program, having bound coverage prior to the Bear Stearns 00-03 Program's inception, issued a policy for the primary layer during the coverage term (the "Vigilant Primary Policy").

40. In binding coverage, and in their excess follow form insurance policies, each of the Defendant Insurers agreed to follow the terms of the Vigilant Primary Policy.

41. The insurers participating in the first \$200 million of coverage in the Bear Stearns 00-03 Program provided coverage (in excess of a \$10 million retention) as follows:

| <u>Layer/Insurance Co.</u> | <u>Coverage Limits</u> |
|---|---|
| Vigilant | \$10 million excess of a \$10 million retention |
| Gulf | \$15 million excess of \$10 million |
| Federal | \$15 million excess of \$25 million |
| Gulf | \$10 million excess of \$40 million |
| Federal, Liberty Mutual, National Union, Gulf | \$50 million excess of \$50 million |
| National Union | \$25 million excess of \$100 million |
| Liberty Mutual | \$25 million excess of \$125 million |
| Lloyd's & AAIC | \$50 million excess of \$150 million |

42. The level of participation of the insurers on the \$50 million excess of \$50 million layer is as follows: Federal – \$15 million; Liberty Mutual – \$15 million; National Union – \$10

million; Gulf – \$10 million. Originally, certain Lloyd's syndicates participated in the \$50 million excess of \$50 million layer, but those syndicates were replaced by Liberty Mutual effective August 11, 2000.

43. The level of participation of the insurers on the \$50 million excess of \$150 million layer is as follows: Lloyd's — \$40 million; AAIC — \$10 million. AAIC joined the Bear Stearns 00-03 Program effective March 9, 2001, replacing two of the Lloyd's syndicates on that layer.

44. For the three layers providing coverage for \$100 million excess of \$100 million, the policy period commenced on March 21, 2000, not May 5, 2000.

45. The Bear Stearns 00-03 Program provided professional liability coverage to Bear Stearns for all Loss, in excess of a \$10 million retention, which Bear Stearns became legally obligated to pay "as a result of any Claim or Claims first made against the Insured and reported in writing to the Insurer during the Policy Period for any Wrongful Act of the Insured."

46. Bear Stearns timely exercised its option to purchase an Extended Discovery Period Endorsement, under which it was granted a 365 day Discovery Period to expire at 12:01 A.M. local time on May 5, 2004. Pursuant to the Extended Discovery Period Endorsement, the Defendant Insurers agreed to provide coverage for Loss as a result of Claims made from May 5, 2003 through May 5, 2004, "with respect to any Wrongful Act committed or alleged to have been committed" before the May 5, 2003 expiration date of the Bear Stearns 00-03 Program.

47. Under the Bear Stearns 00-03 Program, "Claim" is defined as: "(1) a civil proceeding commenced by the service of a complaint or similar pleading, (2) any investigation

into possible violations of law or regulation initiated by any governmental body or self regulatory organization (SRO), or any proceeding commenced by the filing of a notice of charges, or formal investigative order or similar document, or (3) a written demand; against an Insured for any Wrongful Act, including any appeal therefrom.”

48. Under the Bear Stearns 00-03 Program, “Wrongful Act” is defined as “any actual or alleged act, error, omission, misstatement, misleading statement, neglect or breach of duty by the Insured(s) in providing services as a Securities/Broker Dealer and/or Investment Advisor and/or Administrator.”

49. Under the Bear Stearns 00-03 Program, the term “Loss” is defined as: “(1) compensatory damages, multiplied damages, punitive damages where insurable by law, judgments, settlements, costs, charges and expenses or other sums the Insured shall legally become obligated to pay as damages from any Claim or Claim(s); (2) costs, charges and expenses or other damages incurred in connection with any investigation by any governmental body or self-regulatory organization (SRO)”

50. The payments Bear Stearns has made, or expects to make, to settle the Mutual Fund Claims constitute a single loss under the Bear Stearns 00-03 Program, which provides that “Claim(s) involving the same Wrongful Act or interrelated Wrongful Acts of one or more of the Insured(s) shall be considered a single Loss and only one Retention shall be applied to each single Loss; provided however, that the earliest Claim(s) arising out of each Wrongful Act or interrelated Wrongful Acts is first made during the Policy Period.”

51. Under the Bear Stearns 00-03 Program, the term “Policy Period” is defined as “the period set forth in Item 2 of the Declarations to either the expiration or termination date in

accordance with this policy. If the Extended Discovery Period is exercised, it shall be part of the Policy Period and not an additional policy period.” Because Bear Stearns exercised the Extended Discovery Period, the Policy Period expired on May 5, 2004.

52. The Mutual Fund Claims that gave rise to the Bear Stearns’ Losses for which it seeks indemnification under the Bear Stearns 00-03 Program all involve alleged Wrongful Acts by Bear Stearns in providing services as a Securities Broker Dealer alleged to have been committed before May 5, 2003, and were made and noticed to the Defendant Insurers prior to the May 5, 2004 expiration of the Extended Discovery Period.

53. The Insureds have (i) paid all premiums due, and (ii) satisfied all obligations and conditions precedent to recovery under the Bear Stearns 00-03 Program.

The Mutual Fund Regulatory Investigations

54. Commencing in September 2003, and over the succeeding months, Claims, as that term is defined under the Bear Stearns 00-03 Program, were made against Bear Stearns in connection with alleged wrongful acts by Bear Stearns allegedly to facilitate late trading and deceptive market timing by its customers. Those Claims took three forms: 1) investigations commenced by agencies of the federal and state governments, including the SEC, the U.S. Attorney’s Office, and the New York Attorney General’s Office; 2) investigations commenced by self-regulatory organizations (“SRO”), including the New York Stock Exchange (“NYSE”) and the National Association of Securities Dealers (“NASD”); and 3) civil class actions commenced by investors in mutual funds seeking to recover damages for the alleged dilution in share values as a result of Bear Stearns’ allegedly wrongful acts.

55. All of these Claims focused on Bear Stearns' alleged violations of the Federal and State Securities Laws, as well as related rules and regulations of the SROs, as a result of its alleged facilitation of late trading and deceptive market timing practices by its customers and thus involved the same Wrongful Acts, or interrelated Wrongful Acts, under the Bear Stearns 00-03 Program. The regulatory investigations and related proceedings commenced by government agencies and SROs are referred to in this amended complaint as the "Mutual Fund Regulatory Investigations."

56. Bear Stearns first received written notice of the SEC's investigation into its practices with respect to deceptive market timing and late trading allegedly engaged in by its customers in connection with mutual fund transactions when it received a letter dated September 4, 2003 from the SEC. The SEC informed Bear Stearns that, pursuant to Sections 17(a) and 17(b) of the Securities and Exchange Act of 1934, it was "examining practices by broker-dealers with respect to the handling of customer orders to purchase or redeem mutual fund shares," and demanded that Bear Stearns produce documents concerning its acts and policies.

57. The September 4, 2003 SEC letter attached SEC Form 1661, which recited that the SEC's principal purpose in soliciting the information was to gather facts in order to determine whether any person has violated, is violating, or is about to violate the federal securities laws.

58. The SEC's September 4, 2003 letter followed the well-publicized September 3, 2003 lawsuit the New York Attorney General's Office had commenced against Bear Stearns' customer Canary Capital Partners LLC, and related entities, charging that hedge fund with

improper late trading and deceptive market timing practices in connection with the trading of the shares of various mutual funds.

59. On September 10, 2003, The SEC entered a Formal Order of Investigation In the Matter of Certain Mutual Fund Trading Practices (NY – 7220) directing an investigation into late trading and market timing in the trading of shares in mutual funds.

60. By letter dated September 16, 2003, the NASD informed Bear Stearns that, in connection with its examination of BS&Co., it demanded the production of documents and information related to late trading and market timing practices. The request recited that it was being made pursuant to NASD Procedural Rule 8210 “which requires a member firm . . . to provide information involved in an investigation. . . .”

61. On September 26, 2003, Bear Stearns received a Subpoena Duces Tecum from the New York State Attorney General, stating that the “Attorney General deems the documents requested by this subpoena to be relevant and material to an investigation and inquiry undertaken in the public interest and into certain trading in mutual fund shares and mutual fund fees.” The subpoena required, *inter alia*, that Bear Stearns “List all hedge funds or other investors for which you have acted as a broker-dealer or clearing service for mutual fund shares bought, sold, exchanged or redeemed utilizing Late Trading or Timing Capacity.”

62. The SEC sent Bear Stearns additional document demands on September 11, 2003, September 30, 2003, October 3, 2003, October 10, 2003, October 17, 2003, November 3, 2003, November 6, 2003, November 20, 2003, December 4, 2003, and February 20, 2004. Pursuant to its formal Order authorizing the investigation, on November 21, 2003, December 4, 2003, April 6, 2004, May 3, 2004, May 10, 2004, June 3, 2004, March 3, 2005, and September 1, 2004,

December 14, 2004, April 27, 2005, and November 2, 2005, the SEC sent Bear Stearns subpoenas for documents and/or testimony. From the outset, the document demands, subpoenas, and oral requests from the SEC staff focused on whether Bear Stearns had violated the federal securities laws by facilitating their customers' late-trading and deceptive market timing.

63. On October 24, 2003, Bear Stearns received a grand jury subpoena duces tecum from the United States Attorneys Office for the Southern District of New York. The subpoena commanded Bear Stearns to produce documents relating to late trading and market timing in connection with the grand jury's consideration of alleged violations of law.

64. As a result of these investigations, Bear Stearns commenced its own internal review which resulted, initially, in the suspension of four employees. When Bear Stearns reported these suspensions to the NYSE, the NYSE informed Bear Stearns, by letter dated November 11, 2003, that the NYSE "has opened a formal investigation into these matters." In its letter, the NYSE also requested that Bear Stearns produce documents pertaining to the suspension of the four Bear Stearns employees.

**Notice to the Defendant Insurers
of the Mutual Fund Regulatory Investigations**

65. By letter dated October 16, 2003, Marsh & McLennan ("Marsh"), Bear Stearns' insurance broker, provided notice to all insurers on the Bear Stearns 00-03 Program, including the Defendant Insurers, that Claims had been made against Bear Stearns in connection with the regulatory proceedings commenced by the SEC, NASD and New York Attorney General.

66. By letter dated November 4, 2003, Marsh forwarded to all insurers on the Bear Stearns 00-03 Program, including the Defendant Insurers, the additional document demands Bear Stearns had received as of November 4, 2003, in connection with the SEC investigation.

67. By letter dated December 8, 2003, Marsh provided notice to all insurers on the Bear Stearns 00-03 Program, including the Defendant Insurers, of the additional Claims made against Bear Stearns in connection with the grand jury subpoena served on Bear Stearns by the United States Attorneys Office and the formal investigation commenced by the NYSE.

68. Thereafter, Bear Stearns kept the Defendant Insurers informed of developments in, and the status of, the Mutual Fund Regulatory Investigations.

The Mutual Fund Civil Actions

69. In the Fall of 2003, a class action was commenced against Bear Stearns in the United States District Court for the Southern District of New York captioned: *Pflugrath v. The Bear Stearns Companies, Inc. et al.*, Civ. Action No. 1:03 CIV 8864 (PKC) ("*Pflugrath*"). The *Pflugrath* action was commenced as a putative class action on behalf of investors in the Janus and Putnam family of mutual funds. The complaint alleged that Bear Stearns had, in violation of the Federal Securities Laws, damaged investors in those funds through its alleged facilitation of its customers' improper late trading and deceptive market timing practices.

70. In the Fall of 2003, a Private Attorney General complaint was filed in the Superior Court of California against a number of mutual funds, hedge funds and others seeking damages for the harm allegedly caused to investors in the named mutual funds resulting from late trading and deceptive market timing practices captioned: *Sayegh v. Janus Capital, et al.*,

Case No. BC 30 4655 (“*Sayegh*”). By Notice of Substitution of Parties dated December 17, 2003, plaintiff identified TBSC as one of the “Doe” defendants named in the original complaint.

71. By letter dated December 8, 2003, Marsh provided notice to all insurers on the Bear Stearns 00-03 Program, including the Defendant Insurers, of the claims made against Bear Stearns in the *Pflugrath* action.

72. By letter dated April 23, 2004, Marsh provided notice to all insurers on the Bear Stearns 00-03 Program, including the Defendant Insurers, of the claims made against Bear Stearns in the *Sayegh* action.

73. On January 26, 2004, plaintiff in the *Pflugrath* class action filed an amended complaint alleging that Bear Stearns facilitated late trading and deceptive market timing by: a) allowing mutual fund traders to have access to the Mutual Fund Routing System, which allegedly enabled its customers to enter late trades; b) cancelling orders after the close of the market, which allegedly enabled its customers to take advantage of post-market close events that affected the market; and c) opening multiple accounts for its market timing customers, which allegedly minimized the likelihood that their market timing practices would be discovered by the mutual funds.

74. By letter dated April 29, 2004, Marsh provided all insurers, including Defendant Insurers, a copy of the amended complaint in *Pflugrath*.

75. Bear Stearns ultimately was named as a defendant in thirteen class actions (the “Mutual Fund Civil Actions”) in connection with its alleged facilitation of improper late trading and deceptive market timing practices by its customers. The class plaintiffs in the thirteen class

actions asserted claims under the federal securities laws against Bear Stearns to recover the losses suffered by investors in several mutual funds that allegedly resulted from Bear Stearns' alleged facilitation of late trading and deceptive market timing practices by its customers. The class plaintiffs in those thirteen actions brought those claims on behalf of investors in several families of mutual funds, including: the Janus, AIM/Invesco, Strong, Columbia, MFS, One Group, Franklin Templeton, Pilgrim Baxter, Alger and Alliance families of mutual funds.

76. The Mutual Fund Civil Actions were transferred, pursuant to the federal rules governing multi-district litigation, to the United States District Court for the District of Maryland and grouped under the caption: *In Re Mutual Funds Investment Litigation*.

77. Bear Stearns also was named in two derivative actions brought in the name of two of the mutual funds, both of which were also part of the *In Re Mutual Funds Investment Litigation*. In an opinion dated August 25, 2005, the court dismissed all derivative claims against Bear Stearns.

78. Bear Stearns provided notice to all insurers on the Bear Stearns 00-03 Program, including the Defendant Insurers, of the claims made against Bear Stearns in each of the Mutual Fund Civil Actions.

Defense of the Mutual Fund Claims

79. In the notice letters sent on Bear Stearns' behalf by Marsh to the insurers on the Bear Stearns 00-03 Program, Bear Stearns informed its insurers that it had retained the law firm of Cleary Gottlieb Steen & Hamilton LLP ("Cleary Gottlieb") to defend the Mutual Fund Claims, and requested the consent of its insurers to the retention of Cleary Gottlieb.

80. The work of Bear Stearns' counsel, Cleary Gottlieb, and the other law firms, local counsel, and vendors that worked in conjunction with Cleary Gottlieb, was extensive and necessary considering the nature of the Mutual Fund Claims. All claims, actions, and investigations handled by Cleary Gottlieb, and the other law firms and local counsel representing Bear Stearns in the Mutual Fund Claims, emanate from a central factual allegation that Bear Stearns facilitated improper mutual fund "deceptive market timing" and "late trading" practices in its capacity as a broker-dealer and as a clearing broker for certain investors and correspondent brokers. All such defense costs come within the definition of Loss under the Bear Stearns 00-03 Program. Because the Mutual Fund Claims involve interrelated Wrongful Acts, the defense costs incurred in connection with those claims constitute a single Loss, subject to a single retention, under the Bear Stearns 00-03 Program.

81. On January 24, 2005, Bear Stearns informed the Defendant Insurers that Bear Stearns' covered defense costs for the Mutual Fund Claims had surpassed the self-insured retention of \$10,000,000 provided for under the Bear Stearns 00-03 Program.

82. Bear Stearns thereafter submitted copies of the legal bills, and supporting detail, for the defense costs that exceeded the \$10 million retention for reimbursement by its insurers. Vigilant, the primary insurer responsible for the first \$10 million in covered Loss in excess of the retention, repeatedly refused to reimburse Bear Stearns for its costs incurred in the defense of the Mutual Fund Claims.

83. Bear Stearns periodically provided its insurers updated schedules showing the costs incurred in defense of the Mutual Fund Claims listing the amounts incurred for the services provided by each law firm and vendor. The total covered defense costs incurred in the

investigation and defense of the Mutual Fund Claims exceeds \$40 million. All such defense costs were reasonable and are covered Losses under the Bear Stearns 00-03 Program, subject to a single \$10 million retention applicable to the entirety of Bear Stearns' Loss in connection with the Mutual Fund Claims. Despite Bear Stearns' demands for reimbursement of those defense costs as covered Loss under the Bear Stearns 00-03 Program, the Defendant Insurers have refused to pay such defense costs.

**The Refusal of Vigilant, Federal and Gulf to Recognize
Settlement Payments Denominated "Disgorgement"
as Covered Loss Under the Bear Stearns 00-03 Program**

84. Prior to the commencement of the Mutual Fund Regulatory Investigations, Bear Stearns had provided Vigilant and the other insurers on the Bear Stearns 00-03 Program notice of a different series of regulatory investigations involving alleged conflicts of interest in connection with Bear Stearns' research analysts reports (the "Research Analysts Regulatory Proceedings").

85. In 2003 Bear Stearns settled the Research Analysts Regulatory Proceedings by entering into a consent judgment in an action commenced by the SEC. Vigilant, and the other insurers on the Bear Stearns 00-03 Program whose limits were implicated by that settlement, denied coverage for the settlement on several grounds, including the claim that Bear Stearns' payments to the SEC labeled as disgorgement do not constitute Loss insurable under a liability insurance policy.

86. On July 9, 2003, Vigilant, Federal, and Gulf, the three insurers whose limits were implicated by the non-penalty amount Bear Stearns paid to settle the Research Analysts Regulatory Proceedings, commenced a declaratory judgment action against Bear Stearns seeking a declaration that the Bear Stearns settlement payment in the Research Analysts Regulatory

Proceedings did not constitute covered Loss under the Bear Stearns 00-03 Program. In their complaint, Vigilant, Federal, and Gulf asserted “[d]isgorgement payments do not constitute loss payable under a liability insurance policy.” In its answer, Bear Stearns denied that the payments it made to settle the Research Analysts Regulatory Proceedings constituted uninsurable disgorgement payments. Bear Stearns also counterclaimed asserting, among other things, that Vigilant, Federal, and Gulf had breached their contracts by refusing to indemnify Bear Stearns for the non-penalty portion of its settlement payments in the Research Analysts Regulatory Proceedings.

87. Vigilant, Federal, and Gulf subsequently moved for summary judgment in their declaratory judgment action concerning the Research Analysts Regulatory Proceedings on several grounds, including the claim that the Bear Stearns settlement payments were in fact the disgorgement of improper gains and therefore did not constitute a Loss under the Bear Stearns 00-03 Program. Bear Stearns disputed this factual contention.

88. Vigilant, Federal, and Gulf, thus made clear well before Bear Stearns sought to resolve the Mutual Fund Regulatory Investigations through a settlement with the SEC that called for Bear Stearns’ payment of an amount denominated disgorgement, that, irrespective of whether any improper profit had in fact been returned, those insurers would not provide coverage under the Bear Stearns 00-03 Program for any payments denominated “disgorgement.”

**Vigilant’s and Federal’s Coverage Denials
for the Mutual Fund Regulatory Investigations**

89. By a series of letters dated March 24, 2004, each addressing the related regulatory investigations Bear Stearns had noticed under the Bear Stearns 00-03 Program, Vigilant and Federal, through their counsel, in breach of their contractual obligations, improperly denied

coverage for the Mutual Fund Regulatory Investigations. In support of this coverage denial, Vigilant and Federal asserted that, because the document requests and related letters and subpoenas from the regulatory authorities did not expressly identify Bear Stearns as a target of the investigation, no Claim, as that term is defined in the Bear Stearns 00-03 Program, had been made.

90. After the expiration of the Extended Discovery Period, by letter dated March 17, 2005, Vigilant and Federal, through their counsel, persisted in their incorrect interpretation of the terms of the Bear Stearns 00-03 Program and again denied coverage on the ground that no Claim had been made within the Policy Period.

91. The terms of the Bear Stearns 00-03 Program do not require that Bear Stearns be the target in a regulatory proceeding for a Claim to have been made within the meaning of the Bear Stearns 00-03 Program. All that is required is that the regulators have commenced an investigation into possible violations of law or regulation.

92. Prior to the May 5, 2004 expiration of the Extended Discovery Period, the SEC and other regulatory agencies had commenced investigations of possible violations of law or regulation by Bear Stearns pursuant to a formal Order authorizing the investigation. From the outset, the investigations focused on Bear Stearns' acts and policies and resulted in charges against Bear Stearns of federal securities law violations.

93. The Mutual Fund Regulatory Investigations constitute a Claim made within the Policy Period because those investigations involve interrelated Wrongful Acts with those alleged in the Mutual Fund Civil Actions. The Claims in the Mutual Fund Civil Actions were made and noticed to the insurers on the Bear Stearns 00-03 Program within the Policy Period, as extended

by the Extended Discovery Period, thus bringing within coverage all other Claims involving interrelated Wrongful Acts, such as the Mutual Fund Regulatory Investigations.

94. By letter dated October 18, 2005, Vigilant and Federal, through their counsel, again denied coverage for the Mutual Fund Regulatory Investigations, this time on the ground, among others, that there is no coverage under the Bear Stearns 00-03 Program because payments denominated "disgorgement" do not constitute a Loss.

95. These improper denials of coverage by Vigilant and Federal, and any other Defendant Insurer that adopted Vigilant's and Federal's coverage denials, including, but not limited to Gulf and Lloyd's, relieved Bear Stearns of any obligation to seek consent from the insurers on the Bear Stearns 00-03 Program of any settlements of the Mutual Fund Claims.

Settlement Negotiations in the SEC Mutual Fund Investigation

96. In response to the SEC's document requests and subpoenas in connection with its investigation of Bear Stearns' alleged facilitation of its customers' late trading and deceptive market timing practices, Bear Stearns produced over 200,000 pages of documents, and large volumes of e-mail transmissions and electronic trading data, and provided audiotapes of its employees' conversations with its customers who were alleged to have engaged in such practices. The SEC and other regulators also conducted depositions or interviews of approximately thirty-five current and former Bear Stearns employees.

97. On February 23, 2004, Cleary Gottlieb attorneys Lewis Liman and Breon Peace, representing Bear Stearns, spoke with SEC staff lawyers Caren Pennington, Bill McGovern, and Alison Conn. McGovern stated that, as part of its investigation, the SEC needed information

concerning the fees Bear Stearns earned from its customers' late trading and deceptive market timing practices for potential disgorgement. McGovern stated that Bear Stearns should devise a formula to calculate the amount it had earned and then explain the methodology to the SEC staff.

98. On June 8, 2004, Liman and Peace received a telephone call from McGovern and Conn. The SEC lawyers said that they planned to recommend to the Commission that federal securities law charges be brought against BS&Co. and BSS Corp., and described some of the evidence on which they would rely. They did not assert that Bear Stearns had received any gains from the alleged violations.

99. By letter dated June 10, 2004 to Lewis Liman, McGovern confirmed that the SEC staff was considering recommending that the SEC bring a civil injunctive action and/or an administrative cease-and-desist proceeding against Bear Stearns for alleged violations of the federal securities laws. The SEC offered Bear Stearns the opportunity to respond to the proposed charges in what is known as a "Wells" submission.

100. On June 23, 2004, a conference call was held between SEC staff members McGovern and Conn and the Bear Stearns legal team. McGovern stated that the call was being held to review the evidence upon which the SEC staff would be relying in making their recommendation to bring charges against Bear Stearns. After reviewing some of that evidence, McGovern said that the SEC would be willing to discuss a resolution of the investigation *if* the SEC had an understanding of the amount of fees the market-timing business generated for Bear Stearns, *and* the amount of profits Bear Stearns' customers enjoyed.

101. On July 30, 2004, a conference call was held between Cleary Gottlieb lawyers and SEC staff members Conn and Daria Bachenheimer. Bachenheimer stated that the SEC

wanted Bear Stearns to produce profit and loss information for its customers engaged in late trading and deceptive market timing transactions. This request was repeated on an August 11, 2004 conference call held between SEC staff members and Cleary Gottlieb lawyers.

102. On November 3, 2004, the SEC staff sent a letter to Bear Stearns setting forth the proposed charges. On November 4, 2004, SEC staff members Andrew Calamari, Bachenheimer and Conn participated in a conference call with Bear Stearns lawyers to discuss the proposed charges.

103. On November 18, 2004, Bear Stearns advised the SEC that it had, at most, received revenue of only \$16,903,560 from the alleged late trading and deceptive market timing practices of its customers. Bear Stearns offered to settle the investigation through the payment of \$20 million, an amount Bear Stearns believed to be substantially in excess of any revenue it had earned in commissions for clearing the trades of its customers that engaged in any allegedly improper trading activity. In making that offer, Bear Stearns did not admit that any revenue it had received was in fact ill-gotten gains. The SEC rejected Bear Stearns' proposal.

104. The SEC staff informed Bear Stearns that they intended to recommend to the SEC that it bring a civil enforcement action against Bear Stearns seeking broad injunctive relief and monetary sanctions of \$720 million, including \$520 million in "disgorgement."

105. On March 30, 2005, Bear Stearns provided a detailed Wells submission disputing the proposed charges and monetary sanctions, and explained that, because it had, at most, received no more than \$16.9 million in gross revenues from commissions attributable to the alleged late trading and deceptive market timing practices of its customers, any disgorgement ordered by the SEC should, at the very least, be limited to that amount.

106. Bear Stearns' position then, and now, is that profit, and not revenue, is the appropriate measure of any ill-gotten gain. As Bear Stearns advised the SEC in the Wells Submission, it had made virtually no profit from the alleged late trading and deceptive market timing practices of its customers.

107. There is no evidence that the revenue Bear Stearns received for clearing the mutual fund shares transactions of its customers who were alleged to have engaged in improper late trading and deceptive market timing practices would not have been generated but for the alleged wrongful conduct.

108. On June 21, 2005, in a telephone call, SEC staff member Mark Schoenfeld informed Bear Stearns lawyers that the Commission had authorized an action against Bear Stearns. Schoenfeld said that \$300 million would be an acceptable figure to resolve the matter and that the SEC did not use any specific criteria in calculating the proposed payment. Instead, the SEC was ~~just~~ trying to get sufficient money to compensate for dilution.

109. At a June 22, 2005 meeting, for settlement purposes, Bear Stearns' provided to the SEC staff its calculation of the loss suffered by mutual fund shareholders as a result of its customers' purported late trading. As they informed the SEC staff, that calculation showed a \$140 million loss, based upon the most expansive list of potential late trades through Bear Stearns and then applying to those trades a "fair value" analysis to attempt to calculate the theoretical advantage gained by the Bear Stearns customers identified as allegedly engaging in late trading and deceptive market timing. At that meeting, Bear Stearns' lawyers reiterated their position that the gain achieved by its customers through late trading and deceptive market timing practice was not the appropriate basis for disgorgement, and that the actual gain Bear Stearns

received — measured on a gross basis without deducting expenses — as a result of those trades was only a small fraction of this amount, \$16.9 million at the most.

110. On June 28, 2005, Bear Stearns held a conference call with the insurers on the Bear Stearns 02-03 Program to review the status of the settlement negotiations with the SEC. Previously, in November 2004, Bear Stearns had advised its insurers of pending settlement negotiations with the SEC and of the SEC's rejection of Bear Stearns' initial proposals.

111. On June 30, 2005, in a telephone call, SEC staff member Schoenfeld offered an agreement in principle for \$250 million, with \$160 million in "disgorgement," based on a fair value analysis of the impact on the affected mutual funds, plus \$20 million in fees, and \$90 million in penalty. The fair value analysis had been based upon the alleged gains to Bear Stearns' customers from late trading, and concomitant dilution in the value of the mutual funds, not on any gains that Bear Stearns received as a result of the alleged violations.

112. As a result of the further negotiations with the SEC in the summer of 2005, the SEC staff informed Bear Stearns that it would agree to recommend a settlement to the SEC, the monetary portion of which called for payments by Bear Stearns of a \$160 million disgorgement payment and a \$90 million penalty payment.

113. In a conference call on September 29, 2005 Bear Stearns informed the insurers on the Bear Stearns 00-03 Program of the proposed SEC settlement, and sought their consent to consummate the proposed agreement.

114. To satisfy the insurers' requests for information concerning the underlying facts that led to the proposed settlement, after the insurers agreed to the terms of a confidentiality

agreement, Bear Stearns made available to its insurers the entire documentary record that had been produced to the SEC as part of its investigation.

115. In their October 18, 2005 letter responding to Bear Stearns' request that its insurers consent to the proposed SEC settlement, Vigilant and Federal, through their counsel, stated that disgorgement does not constitute a loss for which coverage can be obtained, thus reiterating the position that Vigilant and Federal had long asserted that, irrespective of the facts, SEC settlement payments denominated as "disgorgement" do not constitute a "Loss" and thus do not come within the terms of coverage of the Bear Stearns 00-03 Program.

116. On November 18, 2005, Bear Stearns held a conference call with its insurers on the Bear Stearns' 00-03 Program, during which Bear Stearns reviewed the proposed settlement terms, sought the insurers consent to the proposed settlement, and made clear that the settlement terms under discussion constituted an agreement in principle only.

117. On November 30, 2005, Bear Stearns' lawyers provided the SEC staff with information and data supportive of the \$140 million "fair value" figure which they had discussed at the June 22, 2005, meeting as the alleged loss suffered by mutual fund shareholders. The letter stated that this analysis should not form the appropriate basis for disgorgement because it did not represent the gain earned by Bear Stearns.

118. On December 2, 2005 Bear Stearns' lawyers met with members of the SEC staff to discuss a class action settlement mechanism which would provide a way to distribute the funds to be paid by Bear Stearns to investors who had incurred damages.

119. On December 6, 2005, Bear Stearns lawyers sent a letter to the SEC summarizing the proposal they made at the December 2, 2005 meeting. The letter reiterated their belief that the class action settlement mechanism would provide the best way to distribute the funds to be paid by Bear Stearns to investors who had incurred damages in a quick, fair, and efficient manner.

120. On December 15, 2005, Bear Stearns publicly announced that it had submitted to the SEC an offer of settlement that called for a \$250 million Bear Stearns payment to resolve the SEC investigation.

121. On December 16, 2005, Bear Stearns again reviewed the proposed SEC settlement terms with the insurers on the Bear Stearns 00-03 Program. Bear Stearns noted that the terms of the proposed agreement were not yet final and that, among other items, the manner in which the Bear Stearns settlement payments were to be distributed to injured investors was still to be negotiated. Bear Stearns also reviewed the charges to be settled, the factual basis asserted by the SEC for those charges, including the sections of the Federal Securities Laws cited by the SEC in support of the claimed violations. Bear Stearns informed its insurers on that call that \$160 million of the settlement amount, designated as disgorgement, would be used to compensate investors who had incurred damages and that the \$90 million balance of the settlement payment was a penalty. Bear Stearns again sought its insurers' consent to the proposed settlement.

122. On January 12, 2006, Bear Stearns' lawyers met again with representatives of the insurers on the Bear Stearns 00-03 Program to further review the proposed SEC settlement. At that meeting, Bear Stearns reviewed the proposed SEC order in detail and described its various

provisions. They also discussed that they understood the SEC to have based its \$160 million “disgorgement” figure on a “fair value” assessment which attempted to quantify the loss suffered to the mutual fund shareholders, and concomitant gain to the late traders and market timers, as a result of the late trading and deceptive market timing practices of Bear Stearns’ customers. The Bear Stearns lawyers reviewed the history of the settlement negotiations with the SEC, and the aspects of the settlement which remained to be negotiated.

123. On or about February 2, 2006, Bear Stearns made a formal Offer of Settlement to the SEC.

124. On March 14, 2006, Bear Stearns sent the SEC signature pages for its Offer of Settlement.

125. On March 16, 2006, the SEC accepted Bear Stearns Offer of Settlement and issued its Administrative Order.

126. By letter dated April 27, 2006, Vigilant and Federal confirmed that they would not consent to the SEC settlement because, among other reasons, “there is no coverage for amounts paid as fines or disgorgement.”

127. The other Defendant Insurers either adopted Vigilant’s and Federal’s coverage position or failed to respond to Bear Stearns’ repeated requests that they consent to the proposed SEC settlement. The Defendant Insurers’ withholding of consent to the Bear Stearns settlement of the Mutual Fund Regulatory Investigations was unreasonable.

The Administrative Order

128. On March 16, 2006, the SEC instituted an administrative proceeding (the “Administrative Proceeding”) against BS&Co. and BSSCorp. and entered the Administrative Order reflecting the SEC’s acceptance of Bear Stearns’ offer of settlement. Solely for the purpose of the Administrative Proceeding, and any other proceedings brought by or on behalf of the SEC, or to which the SEC was a party, and without admitting or denying the findings therein, except to the SEC’s jurisdiction over them and the subject matter of the Administrative Proceeding, Bear Stearns consented to the entry of the Administrative Order.

129. The Administrative Order did not provide that Bear Stearns could not present evidence or take legal positions that were contrary to the recitations in the Administrative Order.

130. The Administrative Order recited that, between 1999 and 2003, Bear Stearns facilitated late trading and deceptive market timing. It recited that at BS&Co., certain brokers in the Private Client Services Division facilitated mutual fund trading by knowingly processing late trades for certain market timing customers, predominately large hedge funds, and by helping market timing hedge funds evade detection by mutual funds that did not want market timing business.

131. The Order recited that BSSCorp., the clearing firm, cleared mutual fund share transactions for customers of its brokers, for prime brokerage customers (*i.e.*, hedge funds that cleared trades directly through BSSCorp.) and for customers of its correspondent firms (*i.e.*, introducing brokers that cleared customer trades through BSSCorp.).

132. The SEC ordered BS&Co. and BSSCorp. to pay “disgorgement” in the amount of \$160 million, and civil money penalties in the amount of \$90 million, and to retain an

Independent Distribution Consultant to develop a Distribution Plan for the distribution of the \$250 million in disgorgement and penalty.

133. Bear Stearns consented to the Administrative Order “without admitting or denying the findings herein.” The Administrative Order did not provide that Bear Stearns could not seek insurance coverage for the amount labeled disgorgement. The Administrative Order did not provide that Bear Stearns could not present evidence in an insurance coverage action that the amount it paid that was labeled “disgorgement” was not, in fact, the return of ill-gotten gains.

**The Gross Revenue Bear Stearns Received From
the Transactions at Issue in the Regulatory Proceedings**

134. The \$160 million payment labeled disgorgement was not, in fact, the return of ill-gotten gains received by Bear Stearns. In the Administrative Order, the SEC made no allegation that Bear Stearns had received any gain that it would not otherwise have received but for the alleged misconduct.

135. In the Administrative Order, the SEC did not find that Bear Stearns had improperly permitted late trading or deceptive market timing practices in Bear Stearns’ funds. Bear Stearns did not engage in market timing or late trading of any mutual fund shares for its own account, and the SEC did not allege to the contrary. Rather, Bear Stearns, through BSSCorp., processed trades executed by others that the SEC contended were either late trades or part of a deceptive market timing strategy. For the most part, these trades were executed for the customers of correspondents or for professional customers who had clearing relationships with BSSCorp. Bear Stearns had no financial interest in the success of the trades. It did not share in

the profits its correspondents and professional firms enjoyed from late trading or benefit in any substantive way from this activity.

136. Bear Stearns, at most, received gross revenues of \$16.9 million from the alleged late-trading and market timing by its customers, and virtually no profit, if any.

137. Bear Stearns did not seek to develop or attract late trading or deceptive market timing business from customers.

138. There is no evidence that the revenue Bear Stearns received for clearing the mutual fund shares transactions of its customers, who were alleged to have engaged in improper late trading and deceptive market timing practices, would not have been generated but for the alleged wrongful conduct.

The Distribution Plan

139. Bear Stearns selected Frances McGovern, a Professor of Law at Duke University, to serve as the Bear Stearns Fair Fund's Independent Distribution Consultant. Professor McGovern developed a proposed Plan of Distribution (the "Distribution Plan") in consultation with the SEC and Bear Stearns.

140. The Bear Stearns Fair Fund is comprised of the \$250 million paid by Bear Stearns, plus accumulated interest, less any federal, state, or local taxes on the interest. The Distribution Plan provides for the distribution of the Bear Stearns Fair Fund to certain mutual funds affected by the activity described in the Administrative Order during the period from January 4, 1999, through October 29, 2003.

141. As stated in the Distribution Plan, the Plan “is designed to allocate [Bear Stearns Fair Fund] monies among those harmed by the conduct described in the [Administrative] Order” during the period January 4, 1999 through October 29, 2003. (§ 18.) To accomplish this purpose, based upon an analysis of the proportionate dilution in value of the mutual funds affected by the conduct described in the Administrative Order, the Distribution Plan provides for the allocation of the Bear Stearns Fair Fund to the asset bases of those funds.

142. To the extent feasible and practicable, the Distribution Plan also calls for payments to be made directly to affected mutual fund shareholders.

143. On February 4, 2009, the SEC approved the Distribution Plan.

144. Bear Stearns’ payments in settlement of the SEC Mutual Fund Regulatory Investigation directly offset the damages claimed by investors in the Mutual Fund Civil Actions. The Bear Stearns settlement of those actions was reasonable.

145. In addressing summary judgment motions seeking dismissal of the investors’ claims with respect to the Janus and Putnam families of mutual funds, Judge Motz, one of the judges to whom the Mutual Fund Civil Actions have been assigned, ruled that the plaintiff investors in those funds had been fully compensated for any damages caused by alleged market timing in those funds as a consequence of the distributions of SEC settlement payments to compensate investors in those mutual funds.

146. Judge Motz’s ruling establishes the direct reduction as a result of its settlement of the SEC investigation of Bear Stearns’ potential liability for the damages allegedly caused to mutual fund investors.

Settlement of the Mutual Fund Civil Actions

147. Throughout the course of the Mutual Fund Civil Actions, Bear Stearns kept the insurers on the Bear Stearns 00-03 Program apprised of material developments and provided periodic updates concerning the status of those actions.

148. By letter dated November 29, 2006, Vigilant and Federal, through their counsel, confirmed that they were denying coverage for the Mutual Fund Civil Actions, with the exception of *Pflugrath*, and, on a provisional basis, the related lawsuits involving the Janus family of mutual funds. For all of the other Mutual Fund Civil Actions, Vigilant and Federal asserted that because, in their view, no Claim had been made prior to the expiration of the Extended Discovery Period on May 5, 2004, there was no coverage under the Bear Stearns 00-03 Program.

149. In denying coverage for the Mutual Fund Civil Actions other than those brought by investors in the Janus family of mutual funds, Vigilant and Federal breached their contracts because each of those matters involve interrelated Wrongful Acts with those alleged in *Pflugrath* and *Sayegh* and thus, together with *Pflugrath* and *Sayegh*, constitute a single Claim made during the Policy Period.

150. On September 12, 2007, representatives of Bear Stearns convened a conference call with representatives of the insurers on the Bear Stearns 00-03 Program during which Bear Stearns requested that its insurers consent to Bear Stearns' proposal to settle the Mutual Fund Civil Actions for a total payment of between \$14 million and \$14.5 million.

151. By letter dated September 14, 2007, Vigilant and Federal, through their counsel, refused to consent to the proposed settlement offer in the Mutual Fund Civil Actions. The other

Defendant Insurers joined in this refusal to consent to the proposed settlement offer. The Defendant Insurers' refusal to consent to Bear Stearns' proposed settlement offer of between \$14 million and \$14.5 million in the Mutual Fund Civil Actions was unreasonable.

152. After the September 12, 2007 conference call, Bear Stearns informed the insurers on the Bear Stearns 00-03 Program that it had reached a settlement in principle to resolve the Mutual Fund Civil Actions for \$14 million.

153. On February 27, 2009, after additional negotiations with class counsel in the Mutual Fund Civil Actions concerning the proposed settlement terms, Bear Stearns convened a conference call with representatives of the insurers on the Bear Stearns 00-03 Program. In that call, Bear Stearns informed its insurers that the negotiations over the proposed settlement of the Mutual Fund Civil Actions had been concluded and that Bear Stearns planned to proceed to consummate the proposed settlement. In that call, Bear Stearns reviewed the proposed settlement terms, which provides for a Bear Stearns payment of \$14 million, and reiterated the basis for Bear Stearns' determination that the proposed settlement constituted a reasonable resolution of the Mutual Fund Civil Actions. Bear Stearns again asked that its insurers consent to the proposed settlement.

154. By letter dated March 9, 2009, Vigilant and Federal, through their counsel, again refused to consent to the proposed settlement of the Mutual Fund Civil Actions. The other Defendant Insurers, other than Lloyd's, which failed to respond, joined in this refusal to consent to the proposed settlement. The Defendant Insurers' refusal to consent to the Bear Stearns settlement of the Mutual Fund Civil Actions was unreasonable.

155. By agreement dated March 20, 2009, Bear Stearns and the class plaintiffs agreed to settle the Mutual Fund Civil Actions for a Bear Stearns payment of \$14 million. That payment will not be made until the court approves the settlement.

First Claim
(Breach Of Contract)

156. Bear Stearns repeats and realleges paragraphs 1 through 155 of its amended complaint, as if fully set forth herein.

157. Bear Stearns and each of the Defendant Insurers have entered into binding, valid, and enforceable insurance contracts in connection with the Bear Stearns 00-03 Program.

158. The terms of the Defendant Insurers' insurance contracts are set forth in the Vigilant Primary Policy and, for the Defendant Insurers other than Vigilant, in each Defendant Insurers' excess follow form insurance policy which incorporates the terms of the Vigilant Primary Policy.

159. Bear Stearns has complied with any applicable conditions for coverage of any Loss incurred in the Mutual Fund Regulatory Investigations and of the costs of defense of the Mutual Fund Claims under the Bear Stearns 00-03 Program, including but not limited to: (i) providing sufficient and timely notice; and (ii) advising the Defendant Insurers of any efforts to resolve the Mutual Fund Regulatory Investigations in advance of settlement.

160. Defendant Insurers, in breach of their contractual obligations under the Bear Stearns 00-03 Program, denied coverage for the Mutual Fund Regulatory Investigations, refused to reimburse Bear Stearns for its covered defense costs incurred in defense of the Mutual Fund

Claims, and unreasonably withheld their consent to the Bear Stearns settlement of the Mutual Fund Regulatory Investigations.

161. Bear Stearns has incurred covered Losses in connection with the Mutual Fund Regulatory Investigations and the defense of the Mutual Fund Claims. Under the Bear Stearns 00-03 Program, the Defendant Insurers are obligated to pay for all costs and expenses incurred in defense of the Mutual Fund Claims and, after deducting the \$10 million retention from the settlement amount, for the \$160 million, non-penalty portion of the SEC settlement as covered Loss under the Bear Stearns 00-03 Program.

162. The Defendant Insurers have breached their contractual obligations under the Bear Stearns 00-03 Program to indemnify Bear Stearns for its covered Losses as a result of the defense and final resolution through settlement of the Mutual Fund Regulatory Investigations and for its covered costs and expenses incurred in connection with the defense of the Mutual Fund Claims.

163. As a direct and proximate result of their breaches of contract, the Defendant Insurers are liable to Bear Stearns for : i) the covered Loss it incurred in settlement of the Mutual Fund Regulatory Investigations in the amount, after deduction of the \$10 million retention, of \$150 million; ii) the covered costs and expenses it incurred in defense of the Mutual Fund Claims, in the amount of approximately \$40 million; and iii) pre-judgment interest.

Second Claim
(Declaratory Judgment)

164. Bear Stearns repeats and realleges paragraphs 1 through 163, of its amended complaint, as if fully set forth herein.

165. Bear Stearns has complied with any applicable conditions for coverage of any Loss incurred in the Mutual Fund Civil Actions under the Bear Stearns 00-03 Program, including but not limited to: (i) providing sufficient and timely notice; and (ii) advising Defendant Insurers of any efforts to resolve the Mutual Fund Civil Actions in advance of settlement.

166. Bear Stearns has entered into an agreement to settle the Mutual Fund Civil Actions for a payment of \$14 million.

167. The Bear Stearns settlement agreement of the Mutual Fund Civil Actions is reasonable and the \$14 million settlement payment, when made, will constitute a covered Loss under the Bear Stearns 00-03 Program.

168. The Defendant Insurers have unreasonably withheld their consent to the Bear Stearns settlement of the Mutual Fund Civil Actions and have improperly denied coverage for the payment Bear Stearns is to make to settle the Mutual Fund Civil Actions.

169. Accordingly, an actual case or controversy exists among the parties with respect to the Defendant Insurers' obligations to indemnify Bear Stearns for the \$14 million payment to be made in settlement of the claims made against Bear Stearns in the Mutual Fund Civil Actions.

170. Bear Stearns is entitled to a judicial declaration that: i) the claims made against Bear Stearns in the Mutual Fund Civil Actions come within the coverage afforded under the Bear Stearns 00-03 Program; ii) the Defendant Insurers have unreasonably withheld their consent to the settlement agreement Bear Stearns entered into in the Mutual Fund Civil Actions; iii) the \$14 million Bear Stearns settlement payment, when made, in the Mutual Fund Civil Actions constitutes a covered Loss under the Bear Stearns 00-03 Program; iv) Bear Stearns has complied

with any applicable conditions for coverage of that Loss under the Bear Stearns 00-03 Program; and v) the Defendant Insurers are contractually obligated to indemnify Bear Stearns for that Loss.

Prayer For Relief

WHEREFORE, plaintiffs J.P. Morgan Securities, Inc., J.P. Morgan Clearing Corp. and The Bear Stearns Companies LLC, collectively "Bear Stearns," respectfully request that the Court enter judgment on the amended complaint as follows:

(1) On JPMC's First Claim for breach of contract, an award of money damages against each of the Defendant Insurers as follows:

a) an award of money damages against Vigilant Insurance Company in the amount of \$10 million, together with pre-judgment and post-judgment interest and costs;

b) an award of money damages against The Travelers Indemnity Company, as Successor to Gulf Insurance Company, in the amount of \$35 million, together with pre-judgment and post-judgment interest and costs;

c) an award of money damages against Federal Insurance Company in the amount of \$30 million, together with pre-judgment and post-judgment interest and costs;

d) an award of money damages against National Union Fire Insurance Company of Pittsburgh, Pa. in the amount of \$35 million, together with pre-judgment and post-judgment interest and costs;

e) an award of money damages against Liberty Mutual Insurance Company in the amount of \$40 million, together with pre-judgment and post-judgment interest and costs;

f) an award of money damages against defendants Certain Underwriters at Lloyd's, London in the amount of the portion of the \$40 million in coverage provided by Lloyd's as part

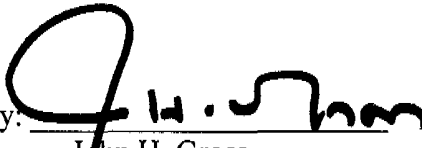
of a \$50 million coverage layer required to fully indemnify Bear Stearns for all covered Loss in excess of \$150 million, including defense costs and expenses, incurred in connection with the Mutual Fund Claims, together with pre-judgment and post-judgment interest and costs; and

g) an award of money damages against American Alternative Insurance Corporation in the amount of the portion of the \$10 million in coverage provided by AAIC as part of a \$50 million coverage layer required to fully indemnify Bear Stearns for all covered Loss in excess of \$150 million, including defense costs and expenses incurred in connection with the Mutual Fund Claims, together with pre-judgment and post-judgment interest and costs.

(2) On Bear Stearns' Second Claim for declaratory judgment: a declaration that the claims made in the Mutual Fund Civil Actions are covered under the Bear Stearns 00-03 Program and that the Defendant Insurers are obligated to indemnify Bear Stearns for all Loss incurred in connection with the Mutual Fund Civil Actions, including the \$14 million payment to be made in settlement of the Mutual Fund Civil Actions, and all costs and defenses incurred in defense of the Mutual Fund Civil Actions; and

(3) For such other and further relief as the Court deems just and proper.

Dated: New York, New York
June 1, 2009

By: 
John H. Gross
Francis D. Landrey
Bertrand C. Sellier
PROSKAUER ROSE LLP
1585 Broadway
New York, New York 10036
(212) 969-3000
Attorneys for Plaintiffs
J.P. Morgan Securities Inc. and
J.P. Morgan Clearing Corp.

Please take notice that the within is a true copy of
is duly entered and filed herein in the
office of the clerk of

New York
dated New York 20

Yours, etc.,

PROSKAUER ROSE LLP
NEW YORK
COUNTY CLERKS OFFICE

5 Broadway
New York, NY 10036-8299

600979

Attorneys for **D**

Please take notice that an order of
which the within is a true copy will be pre-
sented for settlement and signature herein

of

is Court at
the Borough of

City of New York,

the day of , 20

o'clock in the noon.

ated, New York, 20

Yours, etc.,

PROSKAUER ROSE LLP

Attorneys for

5 Broadway
New York, NY 10036-8299

Attorneys for

INDEX NUMBER 600979 200 9

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

**JP MORGAN SECURITIES INC., J.P. MORGAN
CLEARING CORP., and THE BEAR STEARNS
COMPANIES LLC,**

Plaintiffs,

-against-

**VIGILANT INSURANCE COMPANY, THE
TRAVELERS INDEMNITY COMPANY, FEDERAL
INSURANCE COMPANY, NATIONAL UNION
FIRE INSURANCE COMPANY OF PITTSBURGH,
PA., LIBERTY MUTUAL INSURANCE COMPANY,
CERTAIN UNDERWRITERS AT LLOYD'S,
LONDON, and AMERICAN ALTERNATIVE
INSURANCE CORPORATION,**

Defendants.

**SUPPLEMENTAL SUMMONS
AMENDED COMPLAINT**

PROSKAUER ROSE LLP

Attorneys for

Plaintiffs, *J.P. Morgan Securities
Inc. and J.P. Morgan Clearing Corp.*

1585 Broadway
New York, NY 10036-8299
Telephone 212.969.3000

All communications should be referred

to **John H. Gross**

Due service of a copy of the within
is hereby admitted.

Dated, New York

June 1, 2009

To

Attorneys for