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ENDORSED
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San Francisco County Superior Court

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GORDON PARK-LI, Clerk

BY: PARAM NATT
Deputy Clerk

CASE MANAGEMENT CONFERENCE SET

SEP 25 2009 - 9:00 AM

DEPARTMENT 212

10 SUPERIOR COURT OF THE STATE OF CALIFORNIA

11 COUNTY OF SAN FRANCISCO

CGC-09-487641

14 THE PEOPLE OF THE STATE OF
15 CALIFORNIA,

16 Plaintiff,

17 v.

18 WELLS FARGO INVESTMENTS, LLC;
19 WELLS FARGO BROKERAGE
20 SERVICES, LLC; WELLS FARGO
INSTITUTIONAL SECURITIES, LLC;
DOES 1-100

21 Defendants

COMPLAINT FOR CIVIL PENALTIES,
ANCILLARY RELIEF AND
PRELIMINARY AND PERMANENT
INJUNCTION BASED ON VIOLATIONS
OF THE CALIFORNIA CORPORATE
SECURITIES LAW OF 1968

(Cal.Corp.Code §§ 25401 & 25216)

Verified Answer Required Pursuant To
California Code Of Civil Procedure Section
446

Exempt From Filing Fees Pursuant To
Government Code Section 6103

23 Plaintiff, the People of the State of California ("plaintiff" or the "People"), by and through
24 Edmund G. Brown Jr., Attorney General of the State of California, alleges as follows:

25 PLAINTIFF AND JURISDICTION

26 1. Edmund G. Brown Jr. is the duly elected Attorney General of the State of California
27 and is the chief law officer of the State. The Attorney General is authorized by Government Code
28 sections 12658 and 12660 to bring actions in the name of the People of the State of California in

1 the superior court to enforce the Corporate Securities Law of 1968 ("CSL").

2 **DEFENDANTS**

3 2. Wells Fargo Investments, LLC ("WFI") is, and at all times mentioned herein was, a
4 limited liability company, organized and existing under the laws of the State of Delaware. WFI
5 is a licensed securities broker-dealer and investment adviser, with its principal place of business
6 in San Francisco, California. WFI is a wholly owned subsidiary of Wells Fargo Investment
7 Group, Inc., whose ultimate parent is Wells Fargo & Company, a publicly traded financial and
8 bank holding company.

9 3. Wells Fargo Brokerage Services, LLC ("WFBS") is, and at all time mentioned herein
10 was, a limited liability company organized and existing under the laws of the State of Delaware.
11 WFBS is a licensed securities broker-dealer with its principal place of business in Minneapolis,
12 Minnesota. WFBS is a wholly owned subsidiary of Wells Fargo Investment Group, Inc., whose
13 ultimate parent is Wells Fargo & Company.

14 4. Wells Fargo Institutional Securities, LLC ("WFIS") is, and at all time mentioned
15 herein was, a limited liability company organized and existing under the laws of the State of
16 Delaware. WFBS is a licensed securities broker-dealer with its principal place of business in
17 Minneapolis, Minnesota. WFBS is a wholly owned subsidiary of Wells Fargo Investment Group,
18 Inc., whose ultimate parent is Wells Fargo & Company.

19 5. Whenever reference is made in this complaint to any act or transaction of a defendant
20 such allegation shall be deemed to mean that said defendant and, if a business, its owners,
21 officers, directors, agents, employees, or representatives, did or authorized such acts while
22 engaged in the management, direction, or control of the affairs of the defendant and while acting
23 within the scope and course of their duties.

24 6. Whenever reference is made in this complaint to any act of defendants, such
25 allegation shall be deemed to mean the act of each defendant acting individually and jointly with
26 the other defendants named in that cause of action.

27 7. At all times mentioned herein, each defendant knew that the other defendants were
28 engaging in or planned to engage in the violations of law alleged in this complaint. Each

1 defendant nevertheless intended to and did encourage, facilitate, or assist in the commission of
2 the unlawful acts, and thereby aided and abetted the other defendants in the unlawful conduct.

3 8. The violations of law which are the subject of this action occurred throughout the
4 State of California, including but not limited to, the County of San Francisco.

5 9. The true names and capacities, whether individual, corporate, or otherwise, of
6 defendants sued herein under the fictitious names of DOES 1 through 100, inclusive, are
7 unknown to plaintiff who therefore sues these defendants by using fictitious names. Plaintiff will
8 amend this complaint to show the true names of each when the name has been ascertained.

9 Other Related Person

10 10. Wells Fargo Bank, N.A. ("Wells Fargo Bank"), established January 1, 1870, is a
11 national bank with a principal place of business in Sioux Falls, South Dakota. Wells Fargo Bank
12 is a subsidiary of Wells Fargo & Company.

13 **AUCTION-RATE SECURITIES**

14 11. Plaintiff brings this action in response to the unlawful offer and sale of auction-rate
15 securities to the California investing public. Auction-rate securities are typically municipal
16 bonds, corporate bonds or preferred stocks with long-term maturities, but where the interest rates
17 or dividend yields are periodically re-set, through an auction process known as a Dutch auction,
18 providing the issuer of these instruments long-term capital at a short-term rate.

19 **Background of Auction-Rate Securities**

20 12. Auction-rate securities were introduced in 1984 and experienced dramatic growth. By
21 February 2008, there were approximately \$330 billion of auction-rate securities outstanding
22 nationwide.

23 13. Auction-rate securities were initially only offered to sophisticated institutional
24 investors, and a minimum investment of \$250,000 was required.

25 14. Since at least 2006, issuers and underwriters lowered the minimum investment to
26 \$25,000 and began marketing these investments to unsophisticated, retail investors including
27 individuals, charities, and small businesses.

28 15. As auction-rate securities grew in popularity, new products were introduced. For

1 instance, the traditional auction-rate securities issuer was a municipality seeking to finance long
2 range projects through municipal bonds. Such products traditionally carried a “penalty rate” such
3 that if an auction failed, the rate would jump to a higher rate, giving the investor some cushion for
4 taking the risk of a long-term investment. The issuer could then pay the higher rate, or refinance.
5 As the market expanded, companies began to offer preferred stock in an auction-rate product.
6 Typically, these products offered a much lower – if any – penalty rate, and sometimes had no
7 maturity date. The defendants sold both kinds of auction-rate securities; referring to those
8 auction-rate securities based on municipal debt as Auction Rate Debt Securities (“ARDS”) and
9 referring to those auction-rate securities based on preferred stock as Auction Rate Preferred
10 Shares (“ARPS”).

11 16. The defendants had several different roles in these transactions, including
12 underwriter, auction agent, auction managing dealer and/or auction co-managing dealer, and
13 broker.

14 17. Auction-rate securities seemed to offer a solution for two disparate groups: issuers of
15 long-term debt who wanted a short-term rate; and investors who wanted a safe, liquid short-term
16 investment that paid a better rate (if only slightly) than a money market fund or similar bank
17 product. In reality, these products generated profits from multiple sources for the financial firms
18 that sold them, some of which acted as underwriter for the issuer, broker to the investors, auction
19 agent, and also bought and sold these investments for their own accounts.

20 18. The following recent events have affected the auction-rate securities market:

21 a. Since March 2005, the “Big 4” accounting firms and the Financial Accounting
22 Standards Board (“FASB”) adopted the position that auction-rate securities should not be
23 characterized as “cash equivalents.”

24 b. Staff members of the SEC’s Division of Corporation Finance explained on
25 March 4, 2005 that “because the auction rate securities have long-term maturity dates and there is
26 no guarantee the holder will be able to liquidate its holdings, these securities do not meet the
27 definition of cash equivalents in paragraphs 8 and 9 of FASB Statement No. 95 *Statement of Cash*
28 *Flows*.”

1 c. On or around May 31, 2006, the United States Securities and Exchange
2 Commission ("SEC") settled its investigation of approximately 15 broker-dealer firms for
3 securities law violations in the auction-rate securities market dating back to 2003. This settlement
4 mainly dealt with issues in the auction process itself, finding these firms favored some clients
5 over others, and propped up the auctions on occasion to prevent failures or to set more favorable
6 rates. The SEC found the firms' conduct violated section 17(a)(2) of the Securities Act of 1933,
7 which prohibits material misstatements and omissions in any offer or sale of securities.

8 d. In 2007 particularly in and after August, some auctions began to fail throughout
9 the country.

10 e. An employee of Wells Fargo Bank's Trust Department prepared a document for
11 trust officers entitled "Fixed Income Update: Failed Auction Risk in the Auction Rate Preferred
12 Market," in November 2007. The document recommended against the purchase of auction-rate
13 securities because of the risk of auction failures. The document was transmitted to defendants,
14 and was also provided to a few of defendants' sales agents. Defendants' sales agents discussed
15 the document with their counterparts at Wells Fargo Banks' Trust Department. Despite this
16 recommendation, defendants continued to sell auction-rate securities to its investors.

17 f. On or around February 13, 2008, there were not enough purchasers for auction-
18 rate securities in the marketplace, resulting in a nationwide failure of such auctions, effectively
19 freezing such investments. As a result of these auction failures, auction-rate securities investors
20 are forced to continue holding their positions for an indefinite period of time.

21 Sales of Auction-Rate Securities by Defendants

22 19. WFI, WFBS, and WFIS each have business models that focus on serving customers
23 of Wells Fargo Bank. WFI focuses on private banking customers, while WFBS and WFIS focus
24 on commercial and institutional banking customers. Wells Fargo & Company engages in what it
25 terms "cross-selling," selling products across its business lines, such as selling securities to its
26 bank customers. Wells Fargo Bank, WFI, WFBS and WFIS engaged in cross-selling in
27 connection with auction-rate securities sales.

28 20. Defendants' sales agents offered and sold auction-rate securities in California to

1 commercial and retail investors, including individuals, small businesses, and non-profit
2 organizations. Defendants began selling ARPS to investors in 2001 and ARDS in 2006, and
3 continued to sell them at least through February 2008.

4 21. Defendants' sales agents typically represented to commercial and retail investors,
5 including individuals, small businesses and non-profit organizations, that auction-rate securities
6 were safe, liquid investments similar to money market funds, but with better interest or dividend
7 rates than bank accounts, money market funds, or certificates of deposit.

8 22. Defendants' sales agents typically did not disclose how the interest or dividend rates
9 of auction-rate securities were determined, how the auction process worked, the risk of auction
10 failure, or the consequence of auction failure, including the risk that investments in auction-rate
11 securities could become illiquid.

12 23. Defendants' sales agents typically were unaware of and did not disclose the specific
13 risks associated with the "single dealer" structure of auction-rate securities. Unlike other short-
14 term investments where investors can purchase and sell instruments through other markets or
15 dealers, auction-rate securities can only be purchased or sold in a successful auction run by the
16 auction dealer. There is no market other than that auction for that issue. If the dealer can no
17 longer support or run the auction, or resigns without appointing a successor dealer, there ceases to
18 be a market for that auction-rate security and it is then illiquid.

19 24. Defendants' sales agents typically were unaware and did not disclose that auctions
20 could fail, had failed, and the money invested in auction-rate securities could become frozen such
21 that it would be difficult or impossible for investors to access their funds for an indefinite period.

22 25. Defendants' sales agents typically were unaware of and did not disclose the events
23 listed in paragraph 18 above, including the interpretive opinion by PriceWaterhouseCoopers of
24 March 4, 2005, the SEC settlements with numerous auction-rate securities market makers in
25 2006, or the auction failures beginning in 2007, or the Wells Fargo Bank Trust Department
26 document entitled "Failed Auction Risk in the Auction Rate Preferred Market."

27 26. Defendants and their sales agents continued to market auction-rate securities as safe,
28 liquid, cash-like investments despite the fact that the Big 4 accounting firms and the FASB had

1 reexamined their rules so that auction-rate securities investments could no longer be booked as
2 cash, but rather should be booked as short-term investments.

3 27. Defendants' sales agents typically were unaware and did not disclose that investment
4 banks could, and often did, intervene in auctions by placing "support bids" to purchase auction-
5 rate securities for their own account when the auction otherwise would have failed due to lack of
6 sufficient demand, and that these investment banks were under no obligation to place such
7 support bids.

8 28. In and after August 2007, several auctions around the country failed when the
9 investment banks refused to place support bids.

10 29. When investment banks refused to support such auctions, beginning in 2007, the
11 auctions failed en masse, causing the auction-rate securities market to freeze in February 2008.
12 Defendants' sales agents typically were unaware of and did not disclose information about the
13 turmoil in the market leading up to market freeze in February 2008, including the fact that an
14 increasing number of investment banks were refusing to place support bids. Instead these
15 investment banks and their remarketing agents, including defendants, aggressively increased their
16 sales after the auction failures of August 2007, continuing to market them as safe, liquid cash-like
17 investments similar to money market funds.

18 30. In January 2008, Defendants learned of an auction failure for ARPS issued by
19 Nuveen, with Lehman Brothers acting as the auction managing dealer. Defendants discovered
20 that the auction failed because Lehman Brothers did not support the auction. Defendants did not
21 notify its investors of the auction failure and continued to sell ARPS.

22 31. Defendants typically did not provide adequate training about auction-rate securities to
23 its sales agents, nor did they typically require product training prior to accepting orders for
24 auction-rate securities.

25 32. Defendants typically did not prepare or provide informational materials about
26 auction-rate securities for its investors, and to the extent it did provide such material, typically
27 they were inadequate. Defendants typically did not obtain prospectuses, disclosure documents or
28 other informational materials on auction-rate securities. Defendants' sales agents typically did

1 not supply investors with prospectuses, disclosure documents or other informational materials,
2 nor did they tell investors such information was available.

3 33. When the auctions failed in February, 2008, defendants' investors nationwide held
4 more than \$2.9 billion in auction-rate securities, in approximately 5,687 accounts. In California,
5 approximately 2,400 investors held more than \$1.5 billion in auction-rate securities.

6 34. The majority of defendants' investors who held auction-rate securities at the time of
7 the auction failure are still unable to access their funds.

8 35. After the auction failures in February 2008, the majority of defendants' investors'
9 securities became frozen. Defendants exploited the situation by selling loan programs to its
10 auction-rate securities investors. One program, offered through defendants involved a margin
11 loan for 50% of the par value of the auction-rate securities. Wells Fargo Bank later offered a non-
12 recourse line of credit to defendants' investors for up to 90% of the par value of the auction-rate
13 security, which served as collateral. Several investors, needing the money they had invested in
14 auction-rate securities, took these loans.

15 **FIRST CAUSE OF ACTION**

16 **Securities Fraud**

17 (Corporations Code Section 25401)

18 36. Plaintiff refers to and realleges paragraphs 1 through 35, inclusive above, and
19 incorporates them by reference as though fully set forth therein.

20 37. Pursuant to Corporations Code section 25401, it is unlawful for any person to offer or
21 sell a security in this state by means of any written or oral communication which includes an
22 untrue statement of a material fact.

23 38. The auction-rate securities, including ARPS and ARDS, offered for sale and sold by
24 defendants, as alleged hereinabove, are "securities" as defined in Corporations Code section
25 25019.

26 39. Defendants' misrepresentations were made in connection with the offer and sale of
27 securities within the meaning of Corporations Code section 25017.

28 40. Defendants' misrepresentations took place within the State of California within the

1 meaning of Corporations Code section 25008.

2 41. In offering for sale and/or selling the auction-rate securities defendants
3 misrepresented that they were safe, liquid, and cash-like investments, similar to certificates of
4 deposit or money market funds. Defendants violated Corporations Code section 25401 because
5 these statements were untrue and misleading by virtue of the omission of material facts, including
6 without limitation, those set forth in paragraphs 22-30, above.

7 **SECOND CAUSE OF ACTION**

8 **Securities Fraud by a Broker-Dealer**

9 (Corporations Code Section 25216(a))

10 42. Plaintiff refers to and realleges paragraphs 1 through 41, inclusive above, and
11 incorporates them by reference as though fully set forth herein.

12 43. Pursuant to Corporations Code section 25216(a), no broker-dealer or agent shall
13 effect any transaction in, or induce or attempt to induce the purchase or sale of, any security in
14 this state by means of any manipulative, deceptive or other fraudulent scheme, device, or
15 contrivance.

16 44. In knowingly offering for sale and/or selling auction-rate securities by means of
17 untrue and misleading statements, namely that such investments were safe, liquid, and cash-like
18 investments, similar to certificates of deposit or money market funds, defendants violated
19 Corporations Code section 25216(a).

20 **THIRD CAUSE OF ACTION**

21 **Unsuitable Investments**

22 (Corporations Code Section 25216(c) and Cal. Code Regs., tit. 10, § 260.218.2)

23 45. Plaintiff refers to and realleges paragraphs 1 through 44, inclusive above, and
24 incorporates them by reference as though fully set forth herein.

25 46. Corporations Code section 25216 (c) provides, in relevant part, that no broker-dealer
26 or agent shall sell any security in California in contravention of any rule prescribed by the
27 California Corporations Commissioner ("Commissioner") for the protection of investors.

28 47. Cal. Code Regs., tit. 10, section 260.218.2, a rule prescribed the Commissioner.

1 required defendants and their agents to have reasonable grounds to believe that their auction-rate
2 securities recommendations were suitable based on facts disclosed by the customers after
3 reasonable inquiry as to their objectives, financial situation, and needs.

4 48. Despite these requirements, defendants' sales agents recommended and sold auction-
5 rate securities to many investors for whom auction-rate securities were unsuitable. Defendants'
6 sales agents falsely promoted auction-rate securities as safe, liquid, and cash-like investments,
7 similar to certificates of deposit or money market funds. Defendants' sales agents recommended
8 auction-rate securities to investors who needed and requested safe, liquid, cash-like investments
9 in order to have ready access to their funds to pay living or other immediate expenses. Auction-
10 rate securities for these investors were unsuitable because of the risk of auction failures and the
11 consequences of such a failed auction included that their funds would be frozen for an indefinite
12 period of time. Defendants' sales agents recommended auction-rate securities as cash-like
13 investments, even though auction-rate securities had long-term maturity dates, or in the case of
14 ARPS, no maturity dates, and without explaining the risks of auction failures. Defendants' sales
15 agents recommended auction-rate securities to investors without concern for the concentration of
16 auction-rate securities that investors would hold in their accounts. The auction-rate market failure
17 created hardships for defendants' investors in California and nationwide. Defendants and their
18 sales agents created these hardships by making unsuitable investment recommendations, in
19 violation of Corporations Code section 25216(c) and Cal. Code Regs., tit. 10, section 260.218.2.

20 **FOURTH CAUSE OF ACTION**

21 **Failure to Supervise**

22 (Corporations Code Section 25216(c) and Cal. Code Regs., tit. 10, § 260.218.4)

23 49. Plaintiff refers to and realleges paragraphs 1 through 48, inclusive above, and
24 incorporates said paragraphs by reference as though fully set forth herein.

25 50. Corporations Code section 25216 (c) provides, in relevant part, that no broker-dealer
26 or agent shall sell any security in California in contravention of any rule prescribed by the
27 Commissioner for the protection of investors.

28 51. Cal. Code Regs., tit. 10, section 260.218.4, a rule of the Commissioner, required that

1 defendants exercise diligent supervision over the securities activities of all their agents.

2 52. Defendants failed to provide adequate supervision to its sales agents in connection
3 with the offer and sale of auction-rate securities. Defendants' sales agents typically were not
4 aware of significant aspects of the auction-rate securities market. Defendants typically did not
5 prepare or provide resource materials on auction-rate securities for their sales agents to educate
6 themselves on the auction-rate securities market. Defendants typically did not prepare any
7 disclosures or written materials for their sales agents to provide to auction-rate securities
8 investors. Defendants typically did not ensure that the information sales agents did have available
9 on auction-rate securities was consistently delivered to investors. Defendants' typically did not
10 provide all the information they had about auction-rate securities to their sales agents.
11 Defendants typically did not provide or require proper training for their sales agents. Despite a
12 lack of training or information, defendants allowed their sales agents to offer and sell auction-rate
13 securities to its investors as safe, liquid, and cash-like investments, similar to certificates of
14 deposit or money market funds.

15 53. Defendants typically did not establish any written supervisory procedures for the
16 review of auction-rate securities transactions, nor did defendants train supervisory personnel on
17 how to review auction-rate securities for suitability.

18 54. By failing to provide adequate training and information on auction-rate securities,
19 defendants failed to adequately supervise their sales agents in connection with the sale of auction-
20 rate securities, in violation of Corporations Code section 25216(c) and Cal. Code Regs., tit. 10,
21 section 260.218.4. The failure to adequately train sales agents directly resulted in sales agents
22 making unsuitable investment recommendations and failing to disclose material information.

23 **Prayer**

24 WHEREFORE, plaintiff prays for judgment against defendants as follows:

25 1. For a permanent and preliminary injunction, enjoining defendants and their agents,
26 servants, and employees, and all persons acting under, in concert with, or for it, from directly or
27 indirectly or in any other manner engaging in the conduct as above alleged in violation of
28 Corporations Code sections 25401 and/or 25216;

2. For an order that defendants pay to plaintiff, a civil penalty in the maximum sum of \$25,000 for each violation of Corporations Code sections 25401 and/or 25216;

3. For an order disgorging all profits and compensation obtained by defendants as a result of its violations of Corporations Code sections 25401 and/or 25216;

4. For an order requiring defendants to make restitution to the purchasers of the auction-rate securities in the principal amount paid by each purchaser by means of the unlawful conduct alleged hereinabove, less the amount of any repayment of principal to any such purchaser by defendants, with interest from the date of purchase of the fund shares on the amount of any such principal amounts remaining unpaid;

5. For an order awarding damages to the purchasers of the auction-rate securities in an amount sufficient to compensate the purchasers for loss suffered as a result of defendants' violations of Corporations Code sections 25401 and/or 25216;

6. For plaintiff's cost of suit incurred herein; and

7. For such other and further relief as this Court deems just and proper.

Dated: April 23, 2009

Respectfully Submitted,

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