

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

Case No: FSD 0134/11

BETWEEN:

PRIMEO FUND (IN OFFICIAL LIQUIDATION)

Plaintiff

and-

PIONEER ALTERNATIVE INVESTMENT MANAGEMENT LIMITED

Defendant

WRIT OF SUMMONS

TO: Pioneer Alternative Investment Management Limited



THIS WRIT OF SUMMONS has been issued against you by the above-named Plaintiff in respect of the claim set out on the next page.

Within days after the service of this Writ on you, counting the day of service, you must either satisfy the claim or return to the Court Office, P.O. Box 495G, George Town, Grand Cayman, the accompanying Acknowledgment of Service stating therein whether you intend to contest these proceedings.

If you fail to satisfy the claim or to return the Acknowledgment within the time stated, or if you return the Acknowledgment without stating therein an intention to contest the proceedings, the Plaintiff may proceed with the action and judgment may be entered against you forthwith without further notice.

Issued this day of July 2011.

NOTE - This Writ may not be served later than 4 calendar months (or, if leave is required to effect service out of the jurisdiction, 6 months) beginning with the date of issue unless renewed by order of the Court.

IMPORTANT

Directions for Acknowledgment of Service are given with the accompanying form.

This Writ was issued by Mourant Ozannes, Attorneys at Law for the Plaintiff, whose address for service is 2nd Floor, Harbour Centre, 42 North Church Street, George Town, PO Box 1348, Grand Cayman KY1-1108 (ref: 2042504/FOXNI/MdF/3502843/2)

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Plaintiff

-and-

PIONEER ALTERNATIVE INVESTMENT MANAGEMENT LIMITED

Defendant

STATEMENT OF CLAIM

A. The Parties

1. The Plaintiff was incorporated on 18 November 1993 under the law of the Cayman Islands as an exempt company and commenced operations on 1 January 1994. The Plaintiff is an open-ended investment fund and, prior to de-listing on 3 March 2009, its shares were listed for trading on the Luxembourg Stock Exchange.
2. According to the Offering Memorandum (as defined below), the Plaintiff was *“an open-ended investment fund designed for non-U.S. investors desiring to invest a portion of their assets in a fund emphasizing preservation of capital through diversification of investments”*.
3. The Defendant (**“Pioneer”**) is a company incorporated under the laws of the Republic of Ireland and is a wholly owned subsidiary of Pioneer Global Asset Management S.p.A., which is itself a subsidiary of Unicredito Italiano S.p.A. (**“Unicredit”**). Pioneer carries on business as an investment adviser and asset manager. Unicredit is one of the world’s leading financial institutions.

(2) *1996 Agreements*

7. The Plaintiff was originally structured as a single fund. However, in March 1996 the Plaintiff was restructured to consist of two sub-funds: the Primeo Global Fund and the Primeo Select Fund (denominated in US dollars).
8. On 19 December 1996 the Plaintiff entered into a further custodian agreement with HSBC Securities for the provision of custodian services ("**the Custodian Agreement**"), superseding the custody agreement dated 21 December 1993. HSBC Securities further entered into a Sub-Custody Agreement with Bernard L Madoff Investment Securities LLC ("**BLMIS**") in or about September 2004 in relation to various customers of HSBC Securities including Primeo.
9. The Plaintiff also entered into an agreement for the provision of administration services:
 - (1) The Plaintiff entered into an administration agreement dated 19 December 1996 with Bank of Bermuda (Cayman) Limited ("**BoB Cayman**") as Administrator for the provision of administration services ("**the Administration Agreement**");
 - (2) Under the Administration Agreement, BoB Cayman was, inter alia, responsible for calculating the Plaintiff's Net Asset Value;
 - (3) BoB Cayman in turn entered into a sub-administration agreement with HSBC Securities.

(3) *Changes between 2001 and 2004*

10. In April 2001 the Primeo Global Fund was closed and a Primeo Select Fund (denominated in Euros) opened. The Primeo Select Fund (€) invested in the Primeo Select Fund (US\$) which in turn invested with BLMIS. Accordingly,

by April 2001 virtually all of the assets of the Plaintiff were being invested with BLMIS.

11. The Primeco Select Fund (US\$) and Primeco Select Fund (€) subsequently merged into a single fund with US\$ and € share classes (“the Select Fund”).

12. In November 2003 the Primeco Executive Fund was opened (“the Executive Fund”). The Executive Fund invested in

(1) the Select Fund;

(2) Alpha Prime Fund Limited (“Alpha”), an open-ended investment fund organised under the laws of Bermuda; and

(3) certain cash funds.

13. In 2004 the Executive Fund switched its investment in the Select Fund to an investment in the Herald USA Segregated Portfolio One fund (“the Herald Fund”) operated by Herald Fund SPC (“Herald”). Herald is a segregated portfolio company incorporated in the Cayman Islands on 24 March 2004 under the Mutual Funds Law (2003).

(4) *Changes in 2007*

14. In April 2007, various changes were made to the operation of the Plaintiff, as a result of the merger of Hypo- und Vereins Bank (with which Bank Austria had merged in 2000) with Unicredit. The minutes of the meeting of the Directors of the Plaintiff held on 25 April 2007 record:

“The Chairman reported that as part of the successful merger of HVB, Bank Austria and the Unicredit Group (“the Merger”) the asset management arms of each bank were being consolidated under the Pioneer brand name.”

15. In particular:

- (1) On 25 April 2007, the directors of the Plaintiff decided to terminate the appointment of BAWFM as investment adviser and to replace it with Pioneer. The same day the Plaintiff entered into an Advisory Agreement with Pioneer (“**the Advisory Agreement**”) under which Pioneer agreed to provide investment advisory services to the Plaintiff;
- (2) On 25 April 2007, the founder shares in the Plaintiff (being 100 founder shares of US\$1.00 par value each) were transferred to Pioneer pursuant to a Share Sale and Purchase Agreement between L B Holding Gesellschaft m.b.H. and Pioneer;
- (3) The existing directors of the Plaintiff resigned and new directors were appointed being:
 - (a) Ursula Radel-Leszczynski (an employee of Bank Austria);
 - (b) Alberto La Rocca (an employee of Pioneer);
 - (c) Declan Murray (an employee of Pioneer); and
 - (d) Michael Wheaton.

Ursula Radel-Leszczynski (also known as Ursula Fano) had been heavily involved in the running of the Plaintiff prior to April 2007 and had been a central figure at many Board meetings dating back to at least June 1997;

- (4) On 25 April 2007, the Directors approved updated investment objectives and policies for the Plaintiff. The Directors approved an updated Offering Memorandum, which was issued to investors dated

25 April 2007 (“the Offering Memorandum”). According to the Offering Memorandum, the investment objectives of both the Select Fund and the Executive Fund were to achieve the goal of long term capital growth;

- (5) On 25 April 2007, the Plaintiff also adopted an amended and restated Memorandum and Articles of Association.

16. At the same time the directors of the Plaintiff decided that investments held by the Select Fund in a managed account with BLMIS would be moved to an investment in Herald which in turn invested with BLMIS. The minutes of the meeting of the directors of the Plaintiff on 25 April 2007 (1.30 pm) record that:

“[Pioneer] as Investment Adviser to the Fund had decided to restructure the portfolio by switching the investment currently held by the Primeo Select Fund in a managed account with [BLMIS] to an investment with [Herald] which in turn invests with Madoff”.

17. On 25 April 2007 Pioneer Global Funds Distributor Limited (“PGFDL”) also entered into a global distribution agreement with the Plaintiff (“the Global Distribution Agreement”) under which PGFDL agreed to use all reasonable endeavours to procure investors to subscribe for shares in the Fund in exchange for the reimbursement of its costs plus 10%. Under the terms of the Global Distribution Agreement, PGFDL was also entitled to sub-contract the provision of distribution services in which case it was entitled to its costs of monitoring the performance of sub-contracted distributors plus 10%.
18. By a further agreement dated 31 December 2007, Bank Austria agreed to provide consultancy services to Pioneer in respect of, inter alia, the Fund (“the Consultancy Services Agreement”). The Consultancy Services Agreement was stated to be effective from 25 April 2007.

19. BAWFM went into Members' Voluntary Liquidation on 11 December 2007 and was dissolved on 22 February 2008.

C. The Offering Memorandum

20. Following the restructuring of the Plaintiff in April 2007, the directors approved the updated Offering Memorandum. In relation to the role of Pioneer, the Offering Memorandum stated (page 7):

"The Adviser is responsible for advising the Fund on the selection and monitoring of the Managers and investment partnerships and the companies, among which assets will be allocated, and those other administrative matters as agreed upon with the Fund."

21. In relation to investment objective and policies, in relation to the Select Fund, the Offering Memorandum stated (page 8):

Investment Objective

The Select Fund aims to achieve the goal of long term capital growth. For Select Fund shareholders, the Fund intends to achieve the objective of a long-term capital growth by investing primarily with underlying Managers.

Investment Approach

Although the Adviser has the discretion to select different Managers, at present, substantially all of the Select Fund's assets are managed by one Manager, who utilizes a "split-strike conversion strategy" approach with respect to investment and management of its assets. The Manager, in consultation with its investment advisers, will select, on a continuous basis, one Sub-Manager.

The Adviser will consider, in supervising the selection of the Manager, its experience and market performance, trading strategy and techniques, areas of expertise and judgment.

...

The Adviser will continually monitor, directly or indirectly, the performance of the Manager in which such assets are invested and advise the Fund's Directors as to appropriate changes in, or reallocation of assets. The Manager is responsible for all the investment decisions, including asset allocations. Such monitoring will be direct, by the Adviser, or indirect, through the assistance of third parties, and include, as appropriate, personal visits and periodic review of performance in comparison to other investment managers in such market."

The reference to "the Manager" was to Herald and the reference to "the Sub-Manager" was to BLMIS.

22. In relation to the Executive Fund, the Offering Memorandum stated (page 9):

Investment Objective

The Executive Fund aims to achieve the goal of long term capital growth. For Executive Fund shareholders, the Fund intends to achieve the objective of a long-term capital growth by investing primarily with underlying Managers.

Investment Approach

Although the Adviser has the discretion to select different Managers, at present, substantially all of the Executive Fund's assets are managed by three Managers, who utilize a "split-strike conversion strategy" approach with respect to investment and management of its assets. The Managers, in consultation with its investment advisers, will select, on a continuous basis, one Sub-Manager."

The Offering Memorandum then contained similar passages to those set out above in relation to the Select Fund. The reference to the "Managers" included Herald and Alpha. The reference to "the Sub-Manager" was to BLMIS.

23. The Offering Memorandum further stated (page 10):

“Performance

The Adviser believes that its investment activities attempt to moderate risk through diversification and careful selection of Managers ...”

24. Finally, in relation to the Advisory Agreement, the Offering Memorandum stated (page 11):

“Pursuant to the Advisory Agreement, the Adviser will provide investment advice and management decisions and supervise the selection and monitoring of Managers for the Fund and the allocation of assets covering such, all in accordance with the Fund’s investment objectives and policies and under the direction and control of the Fund’s board of Directors.”

D. The Advisory Agreement

25. The Recitals to the Advisory Agreement recorded that:

“(B) The Company has been incorporated for the purposes of investing its assets through advisers selected by the Company in investment funds and partnerships and directly in securities and other instruments of issues throughout the [work] [sic].

(C) The Company is authorised to utilize in connection with its investment activities, the services of investment advisers and managers and the Adviser is prepared to provide such services.”

26. Under Clause 1.1 of the Advisory Agreement, Pioneer was appointed as adviser in respect of the assets of the Plaintiff on the terms and conditions set out in the Agreement.

27. Under Clause 1.2, Pioneer agreed to observe and comply with the Plaintiff's Memorandum and Articles of Association and with the applicable provisions of the Offering Memorandum relating to the participating shares. Clause 1.2 further provided that Pioneer was at all times to exercise its powers and duties under the Advisory Agreement subject at all times to the control of and review by the directors of the Plaintiff.

28. Clause 2.1 further provided:

"Subject to clause 1.2, the Adviser shall manage the investment and re-investment of the cash, securities, investments and other property comprising the assets of the Company within the investment objectives, strategies and restrictions referred to in the Prospectus and this Agreement ..."

29. Clause 2.2 provided:

"Subject to clause 1.2 and to the following provisions of this clause 2, the Adviser shall undertake the day-to-day investment management of the Company within the investment objective, strategy and restrictions referred to in the Prospectus and in this Agreement. The investment management activities of the Adviser shall at all times be subject to the control of and review by the Directors ..."

30. Clause 2.3 provided:

"Subject to compliance with the provisions of clause 2.1, the Adviser will have complete discretion on behalf of and as agent for the Company to buy, sell, retain, exchange or otherwise deal in investments and other assets ... take all day to day decisions and otherwise act as appropriate in relation to the management of the assets of the Company."

31. Clause 2.4 then set out particulars of the investment services to be provided by Pioneer which included (without prejudice to the generality of clause 2.3):

“(ii) seeking out and evaluating investment opportunities for investment by the Company;

(iii) analysing the performance of the investments and assets of the Company and the economic investment trends, market movements and all other matters likely, or which might reasonably be considered likely, to affect the investment objective or strategy of the Company;

...

(x) providing advice to the directors of the Company in relation to the calculation of the Fund’s net asset value, upon request;

...

(xiii) being responsible for supervising the administration of the procedure for the holding of assets and securities of the Company by the Custodian (with power for the Custodian to delegate to a sub-custodian);

(xiv) monitoring the performance of the manager(s) appointed by the Company;”

32. The Advisory Agreement also made provision for Pioneer to delegate its functions and duties. In particular, Clause 5.2 of the Advisory Agreement provided:

“The Adviser shall be entitled to delegate its functions, powers, discretions, privileges and duties hereunder or any of them to any person, firm or corporation approved in writing in advance by the Directors and any such delegation may be on such terms and conditions as the Adviser thinks fit, but

so that the Adviser shall remain liable hereunder for any act or omission of any such person, firm or corporation as if such act or omission were its own."

33. Accordingly, although Pioneer as the Adviser was permitted to delegate its functions and duties, Pioneer would remain liable for any acts or omissions of any such person as if they were Pioneer's own acts and omissions.
34. Clause 7 of the Advisory Agreement provided for Pioneer to receive remuneration consisting, in relation to the Select Fund, of (a) an annual fee of 2% of the monthly-end net asset value and (b) an annual fee of 20% of the annual growth of the Select Fund in excess of 10%. In the case of the Executive Fund, the relevant rates were 1.5% and 5% respectively.
35. Depending on the amounts invested with the Plaintiff, and the growth achieved, the fees payable to Pioneer would therefore be very substantial. The total management and performance fees paid to Pioneer during the period in which it was the investment adviser to the Plaintiff were US\$18,490,911.52.
36. Pursuant to Clause 8, the fees paid to Pioneer under Clause 7 were to be used, inter alia, to pay the fees, charges and expenses of any person to whom Pioneer had delegated its functions and duties under Clause 5.
37. Clause 11 of the Advisory Agreement provided:

"11. Indemnity

11.1 The Adviser agrees to use its best efforts and judgment and due care in performing its duties and obligations hereunder PROVIDED THAT it shall not, in the absence of gross negligence or wilful default on its part or on the part of its servants and agents, be liable for any loss or damage which the Company may sustain or suffer as a result or in the course of the discharge by the Adviser of its duties hereunder.

11.2 The Company agrees to indemnify the Adviser from and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursement of any kind or nature whatsoever (other than those resulting from gross negligence or wilful default on its part, or on the part of its servants or agents, in performing its obligations or duties hereunder) which may be imposed on, incurred by or asserted against the Adviser in performing its obligations or duties hereunder."

38. In relation to these exculpation and indemnity provisions, the minutes of the meeting of the directors of the Plaintiff held on 25 April 2007 recorded that:

"... it was noted that under the terms of the Advisory Agreement, [Pioneer] would be indemnified by the Fund for losses, other than those that result from [Pioneer's] gross negligence or wilful default ..."

A similar statement is made on page 11 of the Offering Memorandum.

39. The Advisory Agreement is governed by the law of the Cayman Islands and all disputes which arise out of or in connection with the Agreement are subject to an exclusive jurisdiction clause in favour of the Courts of the Cayman Islands (Clause 16).

E. Duties owed by Pioneer to the Plaintiff

40. It follows from the terms of the Advisory Agreement pleaded above (including the relevant provisions of the Offering Memorandum as incorporated by clause 1.2 of the Advisory Agreement), that Pioneer owed contractual duties to the Plaintiff:

- (1) to manage the investment and re-investment of the Plaintiff's assets;

- (2) to select the manager(s) with whom the Plaintiff's assets were invested or allocated, alternatively to advise on and supervise the selection of the manager(s) by the Plaintiff;
 - (3) to seek out and evaluate investment opportunities for investment by the Plaintiff;
 - (4) to analyse the performance of the investments and assets of the Plaintiff;
 - (5) to provide advice to the directors of the Plaintiff in relation to the calculation of the Plaintiff's net asset value ("NAV");
 - (6) to supervise the administration of the procedure for the holding of assets and securities of the Plaintiff by the custodian;
 - (7) to monitor the performance of the manager(s).
41. It was an implied term of the Advisory Agreement that Pioneer was to exercise reasonable care and skill in discharging its duties.
 42. The degree of care and skill required for these purposes was that of an investment adviser of ordinary competence and experience in the context of (a) the very substantial sums being invested, (b) the very substantial fees being charged and received by Pioneer for its services, and (c) the position of Pioneer as a member of a leading international banking group.
 43. During the period whilst Pioneer was investment adviser to the Plaintiff, the Plaintiff received very substantial sums for investment. During this period, the Plaintiff had net subscriptions of US\$243,447,400.25 which were then placed for investment through Alpha and Herald from subscriptions of US\$433,060,790.49 and redemptions of US\$189,613,390.25.

F. The Madoff Fraud

44. The investment advisory business operated by BLMIS was in fact a massive fraud. The business engaged in no material investment activity and generated no material investment returns. Rather, BLMIS operated a “Ponzi” scheme under which returns and redemptions to existing investors were paid from new funds paid in by new and existing investors.
45. Madoff informed investors that he operated a “split-strike conversion” investment strategy. Under this strategy, BLMIS purported to invest funds in a basket of S&P 100 Index stocks, with purchases and sales carefully timed to maximise value. In addition, the stock positions were purportedly hedged with put and call options. Whilst investors’ funds were out of the market, they were purportedly invested in Treasury bills or funds holding Treasury bills.
46. In fact, the “split-strike conversion” investment strategy was entirely fictitious.
47. In December 2008 when the requests by investors for redemptions exceeded the amount of new funds being deposited the “Ponzi” scheme collapsed.
48. On 11 December 2008 Madoff was arrested by authorities in the United States of America and charged with securities fraud. On 12 December 2008 the Directors of the Plaintiff passed a resolution, inter alia, to suspend calculation of the Net Asset Value.
49. On 23 January 2009 Pioneer as the shareholder of the Plaintiff passed a resolution for the Fund to be wound up voluntarily and James Cleaver and Richard Fogerty were appointed as joint voluntary liquidators. On 8 April 2009 the Grand Court of the Cayman Islands made an order for the winding up to continue under the supervision of the Court with Mr Cleaver and Mr Fogerty appointed as the Joint Official Liquidators (“JOLs”).

50. At the date the Plaintiff was placed into liquidation, all, or substantially all, of the assets of the Plaintiff were invested in Herald and in Alpha. Herald and Alpha had, in turn, invested all or substantially all of their assets in BLMIS.
51. On 12 March 2009 Madoff pleaded guilty in the United States to 11 felony counts in connection with the fraud perpetrated in respect of BLMIS. Madoff admitted that he had "*operated a Ponzi scheme through the investment advisory side of [BLMIS]*".
52. On 29 June 2009 Madoff was sentenced to 150 years imprisonment as a result of his conviction for fraud.
53. On 11 August 2009 another former BLMIS employee, Frank Di Pascali, pleaded guilty in the United States to participating in and conspiring to perpetuate the "*Ponzi*" scheme. Mr Di Pascali admitted that the fictitious scheme had begun at least as early as the 1980s.

G. Breaches of Duty by Pioneer

(1) Direct breaches of duty by Pioneer

54. Pioneer breached the duties which it owed the Plaintiff, as set out in paragraphs 40 to 42 above, in the following respects:
 - (1) the lack of due diligence undertaken in relation to BLMIS;
 - (2) the lack of monitoring of the performance of BLMIS;
 - (3) the lack of diversification of investments;

- (4) the lack of supervision of the administration of the procedure for the holding of assets and securities of the Plaintiff by the custodian;
- (5) the lack of proper analysis of the performance of the investments and assets of the Plaintiff and the failure to give adequate advice to the directors of the Plaintiff in relation to the calculation of the Plaintiff's NAV.

(a) *Lack of due diligence*

55. Pioneer was under a duty to select the manager or managers with whom the Plaintiff's assets were invested or allocated or, alternatively, to advise on and supervise the selection of the manager(s) by the Plaintiff.
56. In the present case, the selected managers were Herald and Alpha and the selected sub-manager was BLMIS. Pioneer either selected such managers and sub-managers or, alternatively, advised the Plaintiff and supervised the Plaintiff's selection of such manager and sub-managers.
57. In order to discharge its duty pleaded in paragraph 55 above, it was necessary for Pioneer to undertake due diligence in relation to the appointed sub-manager. Pioneer failed to undertake any or any adequate due diligence in relation to BLMIS. In particular:
 - (1) No work was undertaken by Pioneer by way of due diligence in respect of BLMIS.
 - (2) This was in the context of there being a number of unusual features of BLMIS's business (as set out in paragraph 63 below) which should have put Pioneer on inquiry and which heightened the need for due diligence of BLMIS to be undertaken.

(3) In addition, the fact that the Plaintiff's assets were not diversified and were very substantially invested with BLMIS heightened the need for due diligence to be undertaken.

58. Pioneer did not understand BLMIS's business and left its investigation to others. The minutes of the Board meeting held on 25 April 2007 recorded, in relation to the decision to switch funds from the Select Fund's managed account with BLMIS to an investment in Herald:

"Herald is in a unique position to perform more comprehensive, insightful and complete ongoing review and due diligence on Madoff, given the long and special relationship between Sonja Kohn of Bank Medici AG and Bernie Madoff."

To the extent that Pioneer was simply relying for due diligence on Herald and/or Alpha and/or on the relationship between Mrs Kohn and Madoff, then Pioneer failed to discharge its duties in this regard.

59. In the premises, there was a complete abrogation of responsibility by Pioneer in relation its duty to undertake due diligence in respect of BLMIS.

(b) *Lack of monitoring and supervision*

60. In addition to undertaking initial due diligence work, Pioneer was under a duty to monitor the performance of the managers.

61. In the present case, the managers were Herald and Alpha and the sub-manager was BLMIS. On the true construction of the Advisory Agreement, Pioneer's duty was to monitor the performance of Herald and Alpha and also to monitor the performance of BLMIS unless it was properly satisfied that such performance was being adequately monitored by Herald and Alpha respectively.

62. Further, on the true construction of the Advisory Agreement, the duty to monitor the performance of the managers included a requirement on Pioneer to supervise the managers (Herald and Alpha) and also to supervise the sub-manager (BLMIS) unless Pioneer was properly satisfied that such supervision was being adequately undertaken by Herald and Alpha respectively.
63. There were a number of unusual features of BLMIS's business which should have put Pioneer on inquiry and which heightened the need for monitoring and supervision of BLMIS to be undertaken. These features include the following:
- (1) *Secrecy.* Madoff avoided questions about his business and the operations of BLMIS were opaque and secretive. Further, the operations were family run with family members in key positions, including the position of Chief Compliance Officer held by Madoff's brother, Peter. There were no internal checks and controls within BLMIS.
 - (2) *No real-time reporting.* Contrary to custom in the hedge fund industry, BLMIS did not provide investors with electronic real-time online reporting but only paper statements. These statements did not record the exact time or price of each trade, but only average prices for transactions purportedly executed that day.
 - (3) *Self-clearing of trades.* BLMIS did not trade through an independent broker but self-cleared trades itself. It also functioned as both investment manager and as custodian of the assets. These matters materially heightened the risk of fraud, and should have put Pioneer on inquiry.
 - (4) *Unknown auditors.* BLMIS's auditors were a very small, unknown accounting firm, Friebling & Horowitz, which had only three

employees (a retired partner living in Florida, a secretary and one active certified public accountant). The firm was plainly wholly unsuitable to audit a firm of BLMIS's purported size and sophistication.

- (5) *Refusal to identify counterparties.* Madoff refused to identify any of BLMIS's options trading counterparties.
- (6) *Impossible level and consistency of returns.* The returns generated by BLMIS were "too good to be true" and moreover were at a level of impossible consistency. The Plaintiff purportedly received annual rates of return on investments with BLMIS from 1997 to 2006 ranging from 10% to 19% with a negative return in only four months from March 1996 to May 2006. By contrast, the S&P 500 index had a negative return in 48 months.
- (7) *Trade discrepancies.* There were discrepancies with BLMIS's recorded trades in relation to:
 - (a) trades that were purportedly settled on weekends or holidays;
and
 - (b) trades that were purportedly executed outside the range of prices for the relevant security on the day in question.
- (8) *Volume of purported options trades.* A massive number of equities and options would have had to have been traded in order to implement the purported "split-strike conversion" strategy operated by BLMIS. The volumes of equities and options purportedly traded by BLMIS from time to time exceeded the entire daily reported volume of such options and equities traded on the world's exchanges. Moreover, there were no observable price or liquidity disruptions caused in the

markets which such volumes of trading would necessarily have caused.

- (9) *Inconsistent trading.* Madoff's "split-strike" strategy purportedly involved purchasing S&P 100 equities whilst at the same time hedging that investment by executing put and call options. However, the account statements frequently showed options trades which did not hedge the purchase of equities. Further, where options were purportedly hedging equity exposures, the options were not changed in light of purchases and sales of the equity positions.
 - (10) *Generous fee structure.* BLMIS's fee structure was exceptionally and unusually generous and therefore suspicious. Typically, an investment manager such as BLMIS would at the material times have charged an annual fee based on 2% of assets managed and 20% of returns. BLMIS did not charge such fees, despite purportedly achieving a greater level of return than other investment managers. BLMIS charged only US\$0.04 per share on stock transactions and US\$1.00 per option contract.
 - (11) *Negative cash balances.* The Plaintiff from time to time purportedly had negative cash balances with BLMIS, but BLMIS did not charge any margin interest for these extensions of credit.
64. Pioneer knew or should have known of each of these matters by reason of its position as Investment Adviser.
65. In the present case:
- (1) There was no basis on which Pioneer was or could have been properly satisfied that the performance of BLMIS was being adequately monitored and supervised by Herald and/or Alpha;

(2) No work was undertaken by Pioneer itself in relation to the monitoring and supervision of BLMIS.

66. In the premises, there was a complete abrogation of responsibility by Pioneer in relation to its duty to monitor and supervise BLMIS.

(c) *Lack of diversification*

67. In order to discharge its duties and responsibilities, a reasonable investment adviser would invest the assets of a fund in a diversified manner. The purpose of such diversification is, in part, to avoid the risks of a particular class of asset or a particular manager or sub-manager underperforming the market. In addition, diversification helps to minimise the effects of fraud or regulatory non-compliance by a particular manager or sub-manager.

68. In the present case, the Summary in the Offering Memorandum stated (pages 6-7):

“The Primeo Fund is an open-ended investment fund designed for non-US investors desiring to invest a portion of their assets in a fund emphasizing preservation of capital through diversification of investments.”

And:

“The selection of Managers shall be dependent upon several criteria, including experience and performance. Such selection is designed to diversify risk and to reduce volatility ...”

(emphasis added)

69. The Offering Memorandum did also state that substantially all of the Select Fund’s assets were managed by one Manager and one Sub-Manager (page 8) and that substantially all of the Executive Fund’s assets were managed by

three Managers and one Sub-Manager (page 9). However, the lack of diversification was not identified as a risk factor for investors in the Offering Memorandum.

70. In the present case:

- (1) No reasonable investment adviser would have allowed the Plaintiff's assets to be invested such that they were ultimately managed exclusively or almost exclusively by a single entity (i.e. BLMIS);
- (2) This is particularly so given the lack of due diligence and supervision undertaken in relation to the sub-manager (i.e. BLMIS) with whom the assets were concentrated and the usual features about BLMIS's business which should have put Pioneer on inquiry.

71. In the premises, Pioneer breached its duties to the Plaintiff to invest the assets of the Plaintiff in a diversified manner.

(d) *Lack of supervision of Custodian*

72. Pioneer was under a duty to supervise the administration of the procedure for the holding of assets and securities of the Plaintiff by the custodian.

73. In the present case, at the material times the Plaintiff's assets consisted of its investments in Herald and Alpha. The assets of Herald and Alpha were in turn managed by BLMIS. HSBC Securities acted as Custodian for Herald and Alpha in this regard and BLMIS acted as Sub-Custodian. In economic terms, the value of the Plaintiff's assets was directly reflected in the value of Herald's and Alpha's own assets, and it was in relation to these assets (as opposed to the Plaintiff's shareholdings in Herald and Alpha) that there was a need to ensure safe custody.

74. In these circumstances, in order to discharge its duties it was necessary for Pioneer to supervise HSBC Securities and BLMIS as Custodian and Sub-Custodian respectively in relation to Herald and Alpha unless Pioneer was properly satisfied that such supervision was being properly undertaken by Herald and Alpha respectively.

75. In the present case:

- (1) There was no basis on which Pioneer was or could have been properly satisfied that the supervision of HSBC Securities as Custodian for Herald and Alpha and BLMIS as Sub-Custodian was being adequately undertaken by Herald and/or Alpha;
- (2) No work was undertaken by Pioneer itself in relation to the supervision of HSBC Securities as Custodian for Herald and Alpha or of BLMIS as Sub-Custodian.

76. In the premises, there was a complete abrogation of responsibility by Pioneer in relation to its duty to supervise the administration of the procedure for the holding of assets and securities of the Plaintiff.

(e) *Lack of proper analysis and advice*

77. Pioneer was under a duty to undertake proper analysis of the performance of the investments and assets of the Plaintiff and under a duty to give adequate advice to the directors of the Plaintiff in relation to the calculation of the Plaintiff's NAV.

78. In circumstances where the Plaintiff's assets consisted of investments in Herald and Alpha whose assets were in turn managed by BLMIS and held by BLMIS as Sub-Custodian it was incumbent on Pioneer, as part of its duties to undertake analysis and to provide advice in relation to the NAV, either to take steps itself or to ensure that steps were taken to confirm the

existence and safe custody of the assets held by BLMIS. The existence and safe custody of such assets was fundamental to analysis of the investments and assets of the Plaintiff and to the calculation of the Plaintiff's NAV.

79. In the present case, Pioneer failed to take steps itself or to ensure that any or any adequate steps were taken to confirm the existence and safe custody of the assets held by BLMIS.

(2) *Vicarious liability for acts and omissions of BLMIS*

80. As pleaded above, Clause 5.2 of the Advisory Agreement permitted Pioneer to delegate its functions and duties under the Advisory Agreement, including in relation to the investment of the Plaintiff's assets, to any other person. However, Clause 5.2 also expressly provided that in such circumstances Pioneer "*shall remain liable hereunder for any act or omission of any such person, firm or corporation as if such act or omission were its own*".

81. In other words, Clause 5.2 provided for a form of agency relationship between Pioneer and any persons to whom Pioneer's functions and duties were delegated, under which Pioneer remains liable to the Plaintiff for the acts and omissions of such persons.

82. Under Clauses 2.1, 2.3 and 2.4 of the Advisory Agreement Pioneer as Adviser was specifically obliged to provide investment services to the Plaintiff. Under Clause 5.2 Pioneer was entitled to delegate the provision of these services. It follows that, absent such a delegation, then the obligation of Pioneer under the Advisory Agreement to provide the services itself would remain and Pioneer would have been in breach of the Advisory Agreement by not providing such services itself.

83. In the present case, Pioneer delegated its functions and duties under the Advisory Agreement pursuant to Clause 5.2 of the Advisory Agreement. Such functions and duties were delegated to BLMIS. Alternatively, Pioneer

delegated its functions and duties to Alpha and Herald who in turn delegated these functions and duties to BLMIS.

84. In either case, pursuant to the terms of Clause 5.2 of the Advisory Agreement, Pioneer is liable to the Plaintiff for the acts and omissions of BLMIS as sub-manager. This is because either:

- (1) for the purposes of Clause 5.2 of the Advisory Agreement, Pioneer is to be regarded as having delegated its functions and duties to BLMIS;
- (2) alternatively, on the true construction of Clause 5.2, where functions and duties are delegated and then sub-delegated, Pioneer remains liable to the Plaintiff under the Advisory Agreement for the acts and omissions of the sub-delegate.

85. In the present case, the relevant acts and omissions of BLMIS are the acts of BLMIS in misappropriating the investments of the Plaintiff managed by BLMIS.

(4) *Exculpation and indemnity provisions*

86. The Advisory Agreement contains provisions (in Clause 11) exculpating Pioneer from liability arising from the performance of its duties and obligations absent gross negligence or wilful default and providing Pioneer with an indemnity in respect of such liability.

87. As to this:

- (1) In the present case, the direct breaches of duty by Pioneer (see paragraphs 54 to 79 above) amount to gross negligence and/or wilful default on the part of Pioneer.

- (2) Further, the acts of BLMIS itself amount to gross negligence and wilful default. BLMIS perpetrated a large scale and systematic fraud on investors.
- (3) The exculpation and indemnity provisions expressly do not apply to *“gross negligence or wilful default on [Pioneer’s] part or on the part of [Pioneer’s] servants and agents”* (emphasis added).

H. Loss and Damage

88. The above breaches of duty by Pioneer and by BLMIS for which Pioneer is vicariously liable have caused the Plaintiff very substantial loss and damage through the loss or reduction in value of the Plaintiff’s investments placed with BLMIS and/or Herald and Alpha.
89. If Pioneer had performed its duties then the Plaintiff would not have placed funds with Herald and Alpha for investment in circumstances where Herald and Alpha in turn placed their funds for investment with BLMIS, and the Plaintiff’s investments would not have been lost or reduced in value. If BLMIS had performed its duties then the Plaintiff’s investments would not have been lost or reduced in value.
90. During the period from 25 April 2007, the Plaintiff had net subscriptions of US\$243,447,400.25 which were then placed for investment through Alpha and Herald as follows:

Select Fund Class 1 USD	US\$288,806,295.87
Select Fund Class 1 Euro	(€14,949,101.35)
Select Class B USD	US\$594,980
Executive Euro	(€16,552,170.22)
Executive USD	(US\$652,482.59)

91. The net subscriptions were placed for investment through Alpha and Herald with BLMIS. In particular as at 17 February 2009 the investments of the Plaintiff in Alpha and Herald were as follows:

(1) In relation to Alpha:

	Security	No of Shares
Executive Euro	Alpha Prime Equity Hedged Fund CI A DS67826	11,915.43
Executive USD	Alpha Prime Equity Hedged Fund CI A EUR	107,973.49

(2) In relation to Herald:

	Security	No of Shares
Executive Euro	Herald USA Segregated Portfolio One (EUR) DS11096	11,332.26
Executive USD	Herald USA Segregated Portfolio One (USD) DS13675	1,222.01
Select USD	Herald USA Segregated Portfolio One (USD) DS13675	569,229.24

92. The Plaintiff is entitled to damages from Pioneer to compensate it for the loss or reduction in value of these investments which represent the proceeds of the net subscriptions set out above.

PARTICULARS OF LOSS AND DAMAGE

- (1) The best estimate of the Plaintiff's loss is that the entire amount of the Plaintiff's investments in Alpha and Herald have been lost. The Plaintiff is therefore entitled to damages from Pioneer in the sum of US\$243,447,400.25.
 - (2) The Plaintiff will give relevant credit for any sum which it receives by way of dividend or other recovery from BLMIS, Herald or Alpha. The Plaintiff has received US\$10,500,193.20 from the sale of shares in Herald.
 - (3) In addition, the Plaintiff is entitled to recover the amount of the fees taken and received by Pioneer in the sum of US\$18,490,911.52.
93. Further, if Pioneer had performed its duties then the Plaintiff would have, following Pioneer's appointment, withdrawn its existing investments managed by and held directly by BLMIS. Accordingly, the Plaintiff is further entitled to damages from Pioneer to compensate it for the loss or reduction in value of these investments.
94. The claims for damages in paragraphs 90 to 923 above give credit for the payments received by the Plaintiff (directly or indirectly) from BLMIS. BLMIS and the Trustee for the Liquidation of BLMIS appointed under the United States Securities Investor Protection Act have commenced proceedings against the Plaintiff for the recovery of these transfers. In the event such claims are successful, and the Plaintiff is held liable to repay these transfers, the Plaintiff reserves its right to amend the damages claims above to recover such further loss and damage from Pioneer.

I. **Restatement of NAV**

95. As pleaded above, the fees paid to Pioneer were calculated by reference to the monthly NAV of the Plaintiff together with its annual growth. The provisions of the Articles of Association of the Plaintiff provide for the determination of the NAV by the directors of the Plaintiff.

96. The Articles of Association provide:

(1) *"The Net Asset Value and the Net Asset Value of each class of Participating Share (and each separate series for which a Separate Fund shall have been established) shall be determined by the Directors as at the Valuation Point on each Valuation Day." (Article 41)*

(2) *"In calculating the Net Asset Value the Directors shall apply such generally accepted accounting principles as they may determine." (Article 43)*

(3) *"The assets of the Company shall be valued in accordance with such policies as the Directors may determine. Any valuations made pursuant to these Articles shall be binding on all persons." (Article 45)*

97. As pleaded above, BLMIS perpetrated a systematic and long-standing fraud through which the investments of the Plaintiff (directly and indirectly) placed by Pioneer for management with BLMIS were misappropriated.

98. The monthly NAV as determined by the Directors of the Plaintiff was based on fraudulent misinformation provided by BLMIS, and was materially incorrect. If correct and accurate information had been provided to the Directors, then the monthly NAV of the Plaintiff for the months following Pioneer's appointment would have been determined to be zero. In the premises, the monthly NAV, and the consequent fees payments made to Pioneer under the terms of the Advisory Agreement, were based on mistakes of fact.

99. The Plaintiff therefore claims restitution from Pioneer of the fees paid by the Plaintiff to Pioneer on the grounds that such fees were paid under a mistake of fact as to the true level of the monthly NAV. Further or alternatively, it was an implied term of the Advisory Agreement, required in order to give it business efficacy, that Pioneer would be liable to repay fees if and to the extent that they had been paid under a mistake of fact as to the true level of the monthly NAV.

J. Interest

100. The Plaintiff claims interest pursuant to Section 34 of the Judicature Law on such damages as may be awarded to it at such rate and for such period as the Court thinks fit.

101. The Plaintiff claims compound, alternatively simple, interest in equity on such sum ordered to be paid by Pioneer to the Plaintiff by way of restitution at such rate and for such period as the Court thinks fit.

K. Jurisdiction

102. The claims of the Plaintiff against Pioneer arise under the terms of the Advisory Agreement. The Advisory Agreement contains an exclusive jurisdiction clause in favour of the Courts of the Cayman Islands. The proper jurisdiction for such claims is therefore the Grand Court.

AND THE PLAINTIFF CLAIMS:

(1) Damages as above.

- (2) Further or alternatively, US\$18,490,911.52.
- (3) Interest as above.
- (4) Such further or other relief as the Court thinks fit.
- (5) Costs.

Mourant Ozannes

Mourant Ozannes
Attorneys-at-law for the Plaintiff

DIRECTIONS FOR ACKNOWLEDGMENT OF SERVICE
OF WRIT OF SUMMONS

1. The accompanying form of *Acknowledgment of Service* should be completed by an Attorney acting on behalf of the Defendant or by the Defendant if acting in person.

After completion it must be delivered or sent by post to the Law Courts, P.O. Box 495G, George Town, Grand Cayman.

2. A Defendant who states in his Acknowledgment of Service that he intends to contest the proceedings *must also serve a defence* on the Attorney for the Plaintiff (or on the Plaintiff if acting in person).

If a Statement of Claim is indorsed on the Writ (i.e. the words "Statement of Claim" appear on the top of page 2), the Defence must be served within 14 days after the time for acknowledging service of the Writ, unless in the meantime a summons for judgment is served on the Defendant.

If the Statement of Claim is not indorsed on the Writ, the Defence need not be served until 14 days after a Statement of Claim has been served on the Defendant.

If the Defendant fails to serve his defence within the appropriate time, the Plaintiff may enter judgment against him without further notice.

3. A *Stay of Execution* against the Defendant's goods may be applied for where the Defendant is unable to pay the money for which any judgment is entered. If a Defendant to an action for a debt or liquidated demand (i.e. a fixed sum) who does not intend to contest the proceedings states, in answer to Question 3 in the Acknowledgment of Service, that he intends to apply for a stay, execution will be stayed for 14 days after his Acknowledgment, but he must, within that time, *issue a Summons* for a stay of execution, supported by an affidavit of his means. The affidavit should state any offer which the Defendant desires to make for payment of the money by instalments or otherwise.

See over for notes for guidance

NOTES FOR GUIDANCE

1. Each Defendant (if there are more than one) is required to complete an Acknowledgment of Service and return it to the Courts Office.
2. For the purpose of calculating the period of days for acknowledging service, a writ served on the Defendant personally is treated as having been served on the day it was delivered to him.
3. Where the Defendant is sued in a name different from his own, the form must be completed by him with the addition in paragraph 1 of the words "sued as (the name stated on the Writ of Summons)".
4. Where the Defendant is a FIRM and an attorney is not instructed, the form must be completed by a PARTNER by name, with the addition in paragraph 1 of the description "Partner in the firm of (.....)" after his name.
5. Where the Defendant is sued as an individual TRADING IN A NAME OTHER THAN HIS OWN, the form must be completed by him with the addition in paragraph 1 of the description "trading as (.....)" after his name.
6. Where the Defendant is a LIMITED COMPANY the form must be completed by an Attorney or by someone authorised to act on behalf of the Company, but the Company can take no further step in the proceedings without an Attorney acting on its behalf.
7. Where the Defendant is a MINOR or a MENTAL PATIENT, the form must be completed by an Attorney acting for a guardian ad litem.
8. A Defendant acting in person may obtain help in completing the form at the Courts Office.

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

Cause No:

BETWEEN:

PRIMEO FUND (IN OFFICIAL LIQUIDATION)

Plaintiff

-and-

PIONEER ALTERNATIVE INVESTMENT MANAGEMENT LIMITED

Defendant

ACKNOWLEDGMENT OF SERVICE
OF WRIT OF SUMMONS

If you intend to instruct an Attorney to act for you, give him this form IMMEDIATELY.

Important. Read the accompanying directions and notes for guidance carefully before completing this form. If any information required is omitted or given wrongly, **THIS FORM MAY HAVE TO BE RETURNED.**

Delay may result in judgment being entered against a Defendant whereby he may have to pay the costs of applying to set it aside.

-
1. State the full name of the Defendant by whom or on whose behalf the service of the Writ is being acknowledged.

-
2. State whether the Defendant intends to contest the proceedings (*tick appropriate box*)
- yes no

-
3. If the claim against the Defendant is for a debt or liquidated demand, AND he does not intend to contest the proceedings, state if the Defendant intends to apply for a stay of execution against any judgment entered by the Plaintiff (*tick box*)
- yes no
-

Service of the Writ is acknowledged accordingly

(Signed)

..... [Attorneys for the Defendant]

Address for service: (*See overleaf*)

NOTES ON ADDRESS FOR SERVICE

Attorney: where the Defendant is represented by an attorney, state the attorney's place of business in the Cayman Islands. A Defendant may not act by a foreign attorney.

Defendant in person: where the Defendant is acting in person, he must give his post office box number and the physical address of his residence or, if he does not reside in the Cayman Islands, he must give an address in Grand Cayman where communications for him should be sent. In the case of a limited company, "residence" means its registered or principal office.

Indorsement by plaintiff's Attorney (or by plaintiff if suing in person) of his name, address and reference, if any, in the box below.

Mourant Ozannes
Attorneys at Law
2nd Floor, Harbour Centre
42 North Church Street
George Town
PO Box 1348
Grand Cayman KY1-1108

ref: 2042504/FOXNI/MdFJ/3502843/2

Indorsement by defendant's Attorney (or by defendant if suing in person) of his name, address and reference, if any, in the box below.