

JAN 04 2011

CLERK OF THE COURT  
BY: DEBORAH STEPPE  
Deputy Clerk

1 FARLEY J. NEUMAN (SBN 100021)  
TOM PROUNTZOS (SBN 209409)  
2 TERRENCE J. BRASCH (SBN 262069)  
JENKINS GOODMAN NEUMAN & HAMILTON LLP  
3 417 Montgomery Street, 10<sup>th</sup> Floor  
San Francisco, California 94104  
4 Telephone: (415) 705-0400  
Facsimile: (415) 705-0411  
5 Email: [fneuman@jgn.com](mailto:fneuman@jgn.com); [tprountzos@jgn.com](mailto:tprountzos@jgn.com); [tbrasch@jgn.com](mailto:tbrasch@jgn.com)

6 Attorneys for Plaintiffs

7  
8 **IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA**  
9 **IN AND FOR THE COUNTY OF SAN FRANCISCO**  
10 **(UNLIMITED JURISDICTION)**

10 SAN MATEO UNION HIGH SCHOOL  
11 DISTRICT; MENLO PARK CITY  
12 ELEMENTARY SCHOOL DISTRICT; SAN  
13 MATEO COUNTY SUPERINTENDENT OF  
14 SCHOOLS; BELMONT-REDWOOD SHORES  
15 ELEMENTARY SCHOOL DISTRICT;  
16 CABRILLO UNIFIED SCHOOL DISTRICT;  
17 BURLINGAME ELEMENTARY SCHOOL  
18 DISTRICT; JEFFERSON ELEMENTARY  
19 SCHOOL DISTRICT; RAVENSWOOD CITY  
ELEMENTARY SCHOOL DISTRICT; SAN  
BRUNO PARK ELEMENTARY SCHOOL  
DISTRICT; SAN CARLOS ELEMENTARY  
SCHOOL DISTRICT; LAS LOMITAS  
ELEMENTARY SCHOOL DISTRICT;  
PORTOLA VALLEY ELEMENTARY  
SCHOOL DISTRICT; WOODSIDE  
ELEMENTARY SCHOOL DISTRICT,

Plaintiffs

21 vs.

22 COUNTY OF SAN MATEO, LEE  
23 BUFFINGTON, and DOES 1 through 50,

Defendants.

CASE NO. **CGC-11-506958**

**COMPLAINT FOR DAMAGES**

Jenkins Goodman  
Neuman & Hamilton  
417 Montgomery St.  
10<sup>th</sup> Floor  
San Francisco, CA  
94104  
(415) 705-0400

1 I. PARTIES

2 1. Plaintiffs, by and through their attorneys, allege the following upon information  
3 and belief, except as to the paragraphs pertaining to their own actions, which are alleged  
4 upon personal knowledge.

5 2. Plaintiffs are as follows: San Mateo Union High School District; Menlo Park  
6 City Elementary School District; San Mateo County Superintendent of Schools; Belmont-  
7 Redwood Shores Elementary School District; Cabrillo Unified School District;  
8 Burlingame Elementary School District; Jefferson Elementary School District;  
9 Ravenswood City Elementary School District; San Bruno Park Elementary School District;  
10 San Carlos Elementary School District; Las Lomas Elementary School District; Portola  
11 Valley Elementary School District; Woodside Elementary School District (collectively  
12 "Plaintiffs"). All of the Plaintiffs, except the San Mateo County Superintendent of  
13 Schools, are school districts in the County of San Mateo.

14 3. The County of San Mateo is a county in the State of California.

15 4. Defendant Lee Buffington (the "Treasurer" or "Buffington") was at all times  
16 relevant hereto the Treasurer of the County of San Mateo and a resident of the State of  
17 California.

18 5. Plaintiffs are ignorant of the true names and capacities of defendants sued herein  
19 as DOES 1-50, inclusive, and therefore sue these defendants by such fictitious names.  
20 Plaintiffs will amend this complaint to allege their true names and capacities when  
21 ascertained. Plaintiffs allege that each of these fictitiously named defendants is  
22 responsible in some manner for the occurrences alleged, and that Plaintiffs' damages as  
23 herein alleged were proximately caused by these defendants.

24 6. Buffington and DOES 1 through 25 were the agents and employees of the  
25 County and, in doing the things hereinafter alleged, were acting within the course and

1 scope of such agency and employment. The County of San Mateo, Buffington and DOES  
2 1-25 shall hereinafter be collectively referred to as the “County.”

3 7. DOES 26 through 50 served as outside advisers, consultants, or securities  
4 brokers for the County, or served in similar capacities such that they owed a duty of care to  
5 the County and Plaintiffs. DOES 26-50 shall hereinafter be collectively referred to as the  
6 “Doe Advisers.”

## 7 II. INTRODUCTION

8 8. The County managed the San Mateo Pooled Investment Fund (the “Pool”) on  
9 behalf of Plaintiffs and other local agencies and lost approximately \$155 million of the  
10 Pool participants’ money by investing in Lehman Brothers Holdings Inc. (“Lehman”),  
11 which collapsed and declared bankruptcy in September 2008. Plaintiffs’ share of these  
12 losses was approximately \$20 million.<sup>1</sup> The money lost by the County included Plaintiffs’  
13 funds for instruction and operations, funds from taxpayer-approved bonds, and other funds  
14 critical to educating San Mateo County’s children.

15 9. The County, which charged Pool participants over \$3 million per year to  
16 manage their funds, failed in multiple respects to manage the Pool prudently and  
17 competently. For example, the County violated fundamental concepts of investment  
18 diversification by investing inordinate percentages of its funds in Lehman, and inordinate  
19 percentages of its funds in the financial sector. The County then compounded these  
20 mistakes by failing to sell the Pool’s Lehman securities when it became aware of the  
21 deterioration in Lehman’s credit rating and its plunging stock price. Instead, the County  
22 engaged in a high-stakes gamble that the government or some other entity would rescue  
23 Lehman. Furthermore, the County violated its own policies and California law, by  
24 purchasing two Lehman bonds with more than five years remaining to maturity. And the

25 \_\_\_\_\_  
26 <sup>1</sup> The County continues to hold its investments in Lehman, which is now in bankruptcy. The losses may be reduced if  
and when the County sells its holdings in Lehman or receives a distribution from Lehman’s bankruptcy estate.

1 County again violated its own policies by purchasing eight floating rate Lehman notes with  
2 maturities far in excess of the 270-day maximum set forth in the County's policies.

3 10. These violations of prudent practices, the County's policies, and California law  
4 caused Plaintiffs to incur losses of approximately \$20 million.

### 5 III. SUMMARY OF FACTS

6 11. The Pool was established to allow the County and local agencies within the  
7 County, including Plaintiffs, to aggregate their funds to facilitate safe and efficient  
8 investments. The Pool was at all times controlled, managed and operated by the County.  
9 Plaintiffs and other local agencies participating in the Pool paid the County millions of  
10 dollars in fees each year for these services.

11 12. On September 15, 2008, Lehman Brothers filed for bankruptcy relief and the  
12 market value of Lehman's stock and debt securities plummeted to pennies on the dollar.  
13 At the time of the bankruptcy, the Pool held nine notes issued by Lehman (the "Lehman  
14 Notes"), for which the Pool had paid approximately \$155 million. The Lehman Notes,  
15 described on the Treasurer's Monthly Investment Reports as eight "Floaters" and one  
16 "Corporate Bond," had maturities ranging from about 18 to 61 months from the dates they  
17 were purchased for the Pool.

#### 18 A. Government Code Violations

19 13. The County was required to comply with California law, including various  
20 provisions of the California Government Code governing the financial affairs of cities,  
21 counties and other agencies. The County violated requirements of the Government Code,  
22 including but not limited to those described below.

1           **1.     Violation of maximum maturity requirements**

2           14. The Government Code prohibited the County from purchasing corporate debt  
3 securities with a remaining maturity of more than five years. (Section 53601(k).)<sup>2</sup> Two of  
4 the nine Lehman Notes held by the Pool when Lehman went bankrupt were purchased in  
5 violation of the Government Code. On October 19, 2004, the Pool paid approximately \$10  
6 million to purchase a note issued by Lehman due more than five years later on November  
7 10, 2009. On January 16, 2008, the Pool paid approximately \$15 million to purchase a  
8 note issued by Lehman due more than five years later on January 24, 2013. These two  
9 Lehman Notes were held by the Pool at the time of the Lehman bankruptcy, resulting in  
10 losses to the Pool's participants of approximately \$25 million.

11           **2.     Violations of prudent investor standard**

12           15. The Government Code required the County to adhere to the prudent investor  
13 standard:

14           “[T]he county treasurer or the board of supervisors, as applicable, shall act  
15 with **care, skill, prudence, and diligence** under the circumstances then  
16 prevailing, specifically including, but not limited to, the general economic  
17 conditions and the anticipated needs of the county and other depositors, that  
18 a prudent person acting in a like capacity and familiarity with those matters  
19 would use in the conduct of funds of a like character and with like aims, to  
20 safeguard the principal and maintain the liquidity needs of the county and the  
21 other depositors.”

22           (Section 27000.3. Emphasis added. See also section 53600.3 [entitled, “Prudent investor  
23 standard; investments on behalf of local agencies”].)

24           16. This standard requires an understanding of the investment strategy and  
25 objectives for the Pool. Significantly, Government Code section 53600.5 provides that the  
26 primary investment objective is to safeguard principal:

<sup>2</sup> All section references are to the Government Code, unless otherwise noted.

1 “When investing, reinvesting, purchasing, acquiring, exchanging, selling, or  
2 managing public funds, the **primary objective of a trustee shall be to**  
3 **safeguard the principal of the funds under its control.** The secondary  
objective shall be to meet the liquidity needs of the depositor. The third  
objective shall be to achieve a return on the funds under its control.”

4 (Emphasis added.) Thus, the prudent investor standard required the County, first and  
5 foremost, to avoid losing Plaintiffs’ money.

6 17. The County made a series of mistakes, each of which constituted a violation of  
7 the prudent investor rule, including but not limited to those described below.

8 **a) Imprudent portion of pool was invested in Lehman**

9 18. The County invested an excessive portion of the Pool’s funds in Lehman,  
10 thereby failing to adhere to basic principles of diversification. Excluding amounts invested  
11 in or secured by U.S. Treasuries and its agencies, the Pool had more than 17% of its  
12 holdings invested in Lehman as of August 29, 2008, just two weeks prior to the Lehman  
13 bankruptcy. At the time of the Lehman bankruptcy, the Pool had approximately 6% of its  
14 total holdings invested in Lehman securities.

15 19. The portion of the Pool invested in Lehman would have been excessive and  
16 imprudent under the best of circumstances, but was particularly excessive and imprudent  
17 in light of the deteriorating condition of Lehman and the County’s knowledge of  
18 heightened risks for investments in Lehman. For example, minutes of an October 15, 2007  
19 meeting of the San Mateo Investment Advisory Committee reported that the County’s  
20 assistant treasurer “named Lehman Bros. as his least favorable of the financial floaters the  
21 pool owns.” He further said that “when the credit crisis spread began, spreads on all  
22 finance paper began to widen, [sic] Lehman Bros. was hit the worst because they were one  
23 of the first to be named in regards to subprime exposure.”

24 20. Subsequent to these acknowledgements by the County of the additional risk  
25 associated with Lehman, Bear Stearns collapsed in March 2008, requiring a federal bailout  
26 to avoid bankruptcy. In June 2008, Moody’s downgraded the outlook for Lehman from

1 stable to negative and placed Lehman on credit review. In a meeting on July 21, 2008, the  
2 County's assistant treasurer announced the credit rating downgrade by Moody's of  
3 Lehman from A1 to A2 and said he would continue to "closely monitor Lehman  
4 Brothers." Subsequently, Moody's announced it had placed Lehman on review for a  
5 possible further downgrade.

6 21. Throughout this time, the price of Lehman's common stock was plunging,  
7 reflecting widespread recognition of its financial troubles. During the first eight months of  
8 2008, the price for Lehman's stock plunged almost 75% from approximately \$65 to \$16.  
9 And in the two weeks of September 2008 preceding the bankruptcy, Lehman's stock price  
10 plunged more than another 75% to \$3.65 three days before the bankruptcy. Nonetheless,  
11 the County continued its high-stakes gamble on the survival of Lehman by holding all nine  
12 of the Lehman Notes for which the Pool had paid \$155 million.

13 22. Alan Biller and Associates Investment Consultants ("Biller"), hired after the  
14 Lehman Bankruptcy by the County of San Mateo's Board of Supervisors, stated that by the  
15 summer of 2008, "it was then common knowledge that Lehman was in bad shape." (Biller  
16 Report, dated June 17, 2009, at p. 5.) Despite this common knowledge, according to  
17 Biller, the County decided to hold onto the Lehman Notes based on "a belief that it would  
18 be rescued." (*Id.*) However, continued investment in a failing company, on the premise  
19 that the company would be rescued, is completely inconsistent with a conservative  
20 portfolio for public funds.

21 23. According to Biller, the County "appears to confuse issues of where to invest  
22 and how much to invest," and the County's explanation for its decisions "does not justify  
23 the exposure level" to Lehman. (*Id.* at p. 6.) In fact, according to Biller, many  
24 institutional fixed income managers (especially after the WorldCom bankruptcy) limit their  
25 investments, in practice, to 1% to 2% per issuer. (*Id.*) In light of the County's investment  
26

1 objectives and its responsibility to safeguard public funds, it should have been more  
2 conservative than managers of institutional fixed income funds.

3 24. The County should have prohibited investments of more than 1% to 2% of the  
4 Pool in any single issuer. In a memo dated October 8, 2008 to the Finance and Operations  
5 Committee, the County Manager's Office recommended that the County never invest more  
6 than 2% of the Pool in debt securities of a single company. Moreover, the County should  
7 have only approached or reached such limits for investments in outstanding companies  
8 with sterling financial performance and credit risk, not investments in companies in  
9 financial distress like Lehman.

10 25. As further evidence that the County did not adhere to the prudent investor rule,  
11 no other county in the State of California had as much money invested in Lehman, either  
12 in absolute dollars or as a percentage of funds. In fact, few if any institutional funds—  
13 which are not charged with a primary objective of safeguarding principal—invested such a  
14 large percentage of funds in Lehman.

15 **b) Imprudent portion of pool was invested in the financial sector**

16 26. In the months preceding the Lehman bankruptcy, the County had more than  
17 50% of the Pool's value invested in securities of Lehman and other companies in the  
18 financial sector. Remarkably, as of June 30, 2008, the Pool had 43% of its assets invested  
19 in only five companies, all of which were in the financial sector.<sup>3</sup>

20 27. This concentration in the financial sector violated a fundamental principal of  
21 investing. With more than ten major sectors (such as financials, basic materials, consumer  
22 staples, energy, healthcare, industrial, technology, telecom, utilities, real estate,  
23

24  
25 <sup>3</sup> The County of San Mateo's Comprehensive Annual Financial Report (at p. 45) for the fiscal year ended June 30,  
26 2008 stated the Pool invested 11% in Lehman, 11% in Wells Fargo & Company, 9% in Deutsche Bank, 7% in Union  
Bank, and 5% in Morgan Stanley.

1 construction, and retail), investments should not be concentrated in a single sector,  
2 particularly in times of financial upheaval.

3 28. In fact, the County's assistant treasurer recognized that an entire sector could  
4 collapse, "reminding the committee of the days of the Resolution Trust Corporation, when  
5 the S&L industry collapsed." (Minutes, July 21, 2008 meeting of San Mateo County  
6 Investment Advisory Committee.)

7 29. Contrary to this knowledge and fundamental investment principles, the County  
8 concentrated the Pool's investments, and therefore its risk, in the financial sector, which  
9 included Lehman. Such a concentration violated the prudent investor rule.

10 **B. Violations of The County's Investment Policies**

11 30. The County violated its own investment policies. For example, the 2008  
12 County Investment Policy required, *inter alia*, that:

- 13 ● Funds be invested in accordance with the "Prudent Investor Rule."
- 14 ● "Preservation of capital is of primary importance."
- 15 ● "The maximum maturity for any corporate securities purchased is five  
16 years."
- 17 ● "Commercial Paper/Floating rate notes" must have a "Maturity" of "270  
18 days or less."

19 31. For the same reasons as described in paragraphs 15 through 29 above  
20 (regarding the Counties violations of the prudent investor standard set forth by the  
21 Government Code), the County violated its own policies requiring it to invest in  
22 accordance with the prudent investor rule. Moreover, the violations are particularly  
23 pronounced in light of the County's policy to make "preservation of capital" its top  
24 priority.



- 1 • Plaintiffs would entrust the County with virtually all of their funds, including
- 2 their operating funds.
- 3 • The County would hold, safeguard and invest those funds on behalf of
- 4 Plaintiffs.
- 5 • Plaintiffs would pay the County a fee for its services equal to a specified
- 6 percentage of assets in the Pool.
- 7 • The County's primary objective in managing those funds would be to
- 8 safeguard the principal.
- 9 • The County would act with care, skill, prudence, and diligence under the
- 10 circumstances.
- 11 • The County would also comply with California law and the policies adopted
- 12 by the County.

13 37. Sometime after the bankruptcy of Lehman, Plaintiffs discovered that the  
14 County and the Treasurer had breached the terms of this agreement by, *inter alia*: failing  
15 to act with care, skill, prudence, and diligence under the circumstances; violating  
16 California law; and violating the County's policies.

17 38. The County's breaches of this contract caused Plaintiffs to suffer losses  
18 stemming from the Lehman bankruptcy of approximately \$20 million.

19 39. The Doe Advisers entered into a contract or contracts with the County, and  
20 Plaintiffs were third party beneficiaries of said contract(s). The Doe Advisers breached  
21 said contract(s), *inter alia*, by failing to render their services in a competent manner and  
22 failing to advise the County and the Treasurer of the inordinate risks of their investments.  
23 These breaches by the Doe Advisers were a substantial factor in bringing about the losses  
24 suffered by Plaintiffs.

1 WHEREFORE, Plaintiffs pray for judgment as set forth in the Prayer For Relief  
2 below.

3 **SECOND CAUSE OF ACTION**  
4 **(Negligence and Negligence Per Se)**

5 40. Plaintiffs hereby incorporate by reference paragraphs 1 through 34, above.

6 41. The County had a duty to act with due care, and in accordance with the care,  
7 skill, prudence and diligence of other competent and responsible managers of funds with  
8 similar goals and objectives.

9 42. The County acted negligently and in breach of its duty of care by, *inter alia*:

- 10 ● Failing to comply with provisions of the Government Code, including but  
11 not limited to sections 53601 and 27000.3.  
12 ● Violating the County's written investment policies.  
13 ● Failing properly to diversify the investments among issuers of securities.  
14 ● Failing properly to diversify the investments among sectors of the economy.  
15 ● Failing to sell the Lehman Notes after learning of deterioration in the  
16 finances, credit rating, and stock price of Lehman.  
17 ● Otherwise failing to act with care, skill, prudence and diligence in the  
18 management of the Pool.

19 43. The County's negligence was a substantial factor in bringing about the losses  
20 incurred by Plaintiffs.

21 44. Moreover, the County is liable to Plaintiffs under the doctrine of negligence  
22 *per se* because the County violated various Government Code provisions that were enacted  
23 to reduce the risk of loss of public funds, and such violations were a substantial factor in  
24 bringing about the losses suffered by Plaintiffs.



