



U.S. Department of Justice

United States Attorney  
Southern District of New York

---

*The Silvio J. Mollo Building  
One Saint Andrew's Plaza  
New York, New York 10007*

October 27, 1994

Scott W. Muller, Esq.  
Davis Polk & Wardwell  
1300 I Street, N.W.  
Washington, D.C. 20005

Carey R. Dunne, Esq.  
Davis Polk & Wardwell  
450 Lexington Avenue  
New York, New York 10017

Re: Prudential Securities Incorporated

Dear Messrs. Muller and Dunne:

The Office of the United States Attorney for the Southern District of New York ("this Office") has received your letter on behalf of Prudential Securities Incorporated ("PSI") in connection with your request for a deferral of prosecution of PSI, a copy of which is attached hereto, but not a part of the terms hereof.

In recognition of PSI's willingness to cooperate with the this Office, the United States Postal Inspection Service, the United States Securities and Exchange Commission and any other law enforcement agency designated by this Office (hereinafter collectively referred to as "the governmental authorities"), the United States, on the understandings specified below, agrees that, except for criminal and civil tax violations (as to which this Office cannot and does not make any agreement), PSI, its direct and indirect subsidiaries, its parent Prudential Securities Group ("PSG"), and The Prudential Insurance Company of America ("The Prudential") and entities under common control will not be prosecuted by the United States for any crimes related to the sale of interests in the Prudential-Bache Energy Income Funds from 1983 to April 1990. This Agreement does not provide any protection to any individual or any entity other than as set forth above.

The understandings are that PSI shall truthfully disclose all information with respect to the activities of PSI, and its respective officers and employees concerning all matters about which the governmental authorities inquire of them, and shall cooperate fully with the governmental authorities. This obligation of truthful disclosure includes an obligation upon PSI to provide

to the governmental authorities, upon request, any document, record or other tangible evidence relating to matters about which the governmental authorities inquire of them. This obligation of truthful disclosure further includes an obligation to provide to the governmental authorities unlimited access to PSI's facilities, documents and employees.

Upon the request of this Office, with respect to any issue relevant to any criminal investigations, PSI shall designate knowledgeable employees, officers, agents, or attorneys to provide information and/or materials on PSI's behalf to the governmental authorities. It is further understood that PSI must at all times give complete, truthful, and accurate information. It is further understood that PSI must not commit any crimes whatsoever.

It is further understood that, with respect to any information, testimony, document, record, or other tangible evidence provided to the governmental authorities, or a grand jury, PSI consents to any and all disclosures of such materials as this Office, in its sole discretion, deems appropriate. With respect to any such materials that constitute "matters occurring before the grand jury" within the meaning of Federal Rule of Criminal Procedure 6(e), PSI further consents to (1) any order sought by this Office permitting such disclosure and (2) this Office's ex parte and/or in camera application for such orders.

It is further understood that PSI agrees to provide information and materials relating to legal advice provided prior to April 30, 1990 in connection with the offering and sale of the Prudential-Bache Energy Income Funds and factual information and materials provided to or gathered by counsel prior to October 21, 1993 in connection with the offering and sale of the Energy Income Funds. Such information and materials will not include or reflect communications between or among counsel relating to actual or potential litigation; analysis or advice concerning potential liability in, the handling of, or negotiations relating to, actual or potential litigation; or information or materials with respect to which a third party has a claim of attorney client privilege. By providing the foregoing materials or information, PSI does not intend to waive as to third parties any attorney client or other applicable privilege that may cover the materials or information.

It is further understood that PSI and PSG shall:

(a) on or before the filing of this Agreement, cause the sum of \$330 million to be added to the Fund established in the October 21, 1993 settlement with the Securities and Exchange Commission (the "SEC Agreement") and execute the attached stipulation providing a reversion to the United States Postal Inspection Service;

(b) comply with all the terms and conditions of the SEC

Agreement and retain a mutually acceptable outside counsel within 30 days of the filing of this Agreement to review PSI's policies and procedures in order to ensure that PSI has adopted all the compliance-related directives set forth in the SEC Agreement.

It is further understood that PSI, PSG and The Prudential shall:

(a) within 30 days of the filing of this Agreement, obtain a mutually acceptable new outside director to sit on the Board of Directors of PSG and the Compliance Committee of PSI. The new director will also serve as an independent "ombudsman" whom PSI employees can call anonymously with complaints about ethics and compliance. PSI shall report any allegations or instances of criminal conduct and material improprieties to the new director. The new director will submit compliance progress reports which shall identify all such allegations or instances of criminal conduct and material improprieties to this Office, the Board of PSG and the audit committee of The Prudential every three months for the duration of this agreement.

(b) not directly or indirectly transfer ownership or assets of PSI in such a way that would frustrate the purposes of this Agreement.

It is further understood that PSG and The Prudential will take all appropriate steps in their capacities as parent corporations to further PSI's compliance with this Agreement, provided however, that nothing herein shall be construed to impose any financial obligations on The Prudential in connection with the SEC Agreement.

Should PSI commit any crimes, or should this Office, in its sole discretion, determine that PSI has given false, incomplete, or misleading information, or should PSI otherwise violate any provision of this Agreement, or should PSG or The Prudential fail to meet their obligations under this agreement, PSI shall, in this Office's sole discretion, thereafter be subject to prosecution for any federal criminal violation of which this Office has knowledge, including, but not limited to obstruction of justice. Any such prosecutions may be premised upon any information provided by PSI. Moreover, any prosecutions relating to the Prudential-Bache Energy Income Funds that are not time-barred by the applicable statute of limitations on the date of the signing of this Agreement may be commenced against PSI in accordance with this Agreement, notwithstanding the expiration of the statute of limitations between the signing of this Agreement and the commencement of any such prosecutions. It is the intent of this Agreement to waive any and all defenses based on the statute of limitations with respect to any prosecutions relating to the Prudential-Bache Energy Income Funds which are not time-barred on the date this Agreement is signed.

Furthermore, it is agreed that in the event that this Office, in its sole discretion, determines that PSI has violated any provision of this Agreement, or should PSG or The Prudential fail to meet their obligations under this Agreement (i) all statements made by or on behalf of PSI to the governmental authorities, or any other testimony given by any agent of PSI before a grand jury or other tribunal, whether prior to or subsequent to this Agreement, or any leads from such statements or testimony, shall be admissible in evidence in any and all criminal proceedings hereafter brought against PSI and (ii) PSI shall not assert any claim under the United States Constitution, any statute, Rule 11(e)(6) of the Federal Rules of Criminal Procedure, Rule 410 of the Federal Rules of Evidence, or any other federal rule, that statements made by or on behalf of PSI prior to or subsequent to this Agreement, or any leads therefrom, should be suppressed. It is the intent of this Agreement to waive any and all rights in the foregoing respects.

The decision as to whether the conduct and/or statements of any individual will be imputed to PSI for the purpose of determining whether PSI has violated any provision of this Agreement shall be in the sole discretion of this Office.

It is further understood that this Agreement is binding on the United States, but cannot bind state or local prosecuting authorities, although this Office will bring the cooperation of PSI to the attention of other prosecuting offices or regulatory agencies, if requested by PSI's counsel.

With respect to this matter, this Agreement supersedes all prior, if any, understandings, promises, and/or conditions between this Office and PSI, PSG and the Prudential Insurance Company of America, except for the deferred prosecution agreement dated October 27, 1994 between PSI and this Office which is incorporated herein by reference. No additional promises, agreements, and conditions have been entered into other than those

set forth in this letter and the deferred prosecution agreement, and none will be entered into unless in writing and signed by all parties.

Very truly yours,

MARY JO WHITE  
United States Attorney

By: *Kenneth J. Vianale / Baruch Weiss*  
Kenneth J. Vianale  
Baruch Weiss  
Assistant U.S. Attorneys

APPROVED:

*[Signature]*  
Chief, Criminal Division

Prudential Securities  
Incorporated

By: *[Signature]*

10/27/94  
DATE

*[Signature]*

Scott W. Muller, Esq.  
Carey R. Dunne, Esq.  
Attorneys for PSI

10/27/94  
DATE

Prudential Securities Group

By: *[Signature]*  
Attorney for PSG

The Prudential Insurance Company  
of America

By: *[Signature]*  
Attorney for The Prudential

DAVIS POLK & WARDWELL

450 LEXINGTON AVENUE  
NEW YORK, N.Y. 10017

212-450-4000  
FAX: 212-450-4800

WRITER'S DIRECT NUMBER:

1300 I STREET, N.W.  
WASHINGTON, D.C. 20005

4, PLACE DE LA CONCORDE  
75008 PARIS

1 FREDERICK'S PLACE  
LONDON EC2R 8AB

2-1, MARUNOUCHI 1-CHOME  
CHIYODA-KU, TOKYO 100

MESSEURM  
60308 FRANKFURT AM MAIN

3A CHATER ROAD  
HONG KONG

October 13, 1994

Kenneth J. Vianale, Esq.  
Assistant United States Attorney  
Office of the United States Attorney  
for the Southern District of New York  
One Saint Andrew's Plaza  
New York, New York 10007

Baruch Weiss, Esq.  
Senior Trial Counsel  
Office of the United States Attorney  
for the Southern District of New York  
One Saint Andrew's Plaza  
New York, New York 10007

Dear Messrs. Vianale and Weiss:

We are writing on behalf of Prudential Securities Incorporated ("PSI") in connection with your office's investigation of the Prudential Bache Energy Income Fund limited partnerships that were marketed during the 1980s by the former Direct Investment Group of Prudential-Bache Securities, Inc. ("Pru-Bache"). The purpose of this letter is to set forth the principal reasons why we believe a criminal prosecution of PSI for the conduct of PruBache's former Direct Investment Group ("DIG") would not be warranted, and to request that your office avoid such a prosecution by entering into cooperation and deferral agreements.

Prudential Securities has changed dramatically since the 1980s. The Firm is under new management and it has instituted extensive new compliance procedures. It has apologized to past and current clients and has spent over \$1 billion to fund and administer the legitimate claims of partnership investors. It has actively worked with all

levels of the Government to resolve its past problems and get on with the business of serving its clients of today.

As we have discussed, the following are the central reasons, apart from the merits, why a criminal prosecution of PSI would be inappropriate and why cooperation and deferral agreements would be more appropriate:

1. The Limited Partnership Problems Occurred in the 1980s, and the Firm Has Dramatically Improved its Compliance Procedures Since Then

The various problems associated with the sale of limited partnership products by the Direct Investment Group were a phenomenon of the 1980s and were the direct result of PSI's explosive growth during that period -- a growth that was not matched by a concurrent expansion of PSI's Compliance Department. From 1983 to 1989, the number of PSI brokers grew from 3,846 to over 7,000, the number of branch offices grew from 240 to 378, and the number of customer accounts grew from 700,000 to 2.6 million. The Direct Investment Group, moreover, grew from a handful of employees in 1983 to 183 employees in 1989.

By the early 1990s, however, the expansion was substantially reversed. Between 1989 and 1993, the number of PSI brokers diminished from 7,012 to 5,500. The Direct Investment Group was disbanded and was no longer creating or marketing limited partnerships. (Its only remaining role was to administer those that remained.) Indeed, during this period the number of Direct Investment Group employees fell from 183 to 18.

At the same time, PSI's Compliance staff has steadily grown. In 1986 the Compliance Department had only 26 employees and a budget of \$1.1 million. By 1991 the Compliance Department had 60 full-time employees and a budget of \$4.7 million. Now, PSI has a Compliance staff of 95 and a Compliance Department budget of \$10.4 million. Given this vast increase in the number of people and the amount of resources that PSI has dedicated to compliance activities (as well as the extensive reforms that are discussed below), PSI's compliance procedures and its

business controls are now among the most sophisticated in the industry.

2. PSI Now Has Extensive, State of the Art Compliance Procedures

In early 1991, Hardwick Simmons replaced George Ball as the new CEO of PSI. Soon after becoming CEO, Simmons initiated a series of improvements and reforms to begin the process of creating an appropriate and unifying firm-wide culture. As a result of these reforms, there is now an independent and systematic review of the promotional materials that are provided to brokers; new product offerings are all reviewed and approved by disinterested parties; and broker training has been improved and compliance efforts have dramatically increased.

In a nutshell, the reforms included the following:

- PSI dramatically increased the size and resources of its Compliance Department. The Department now has an annual budget of \$10.4 million, and has 95 full-time employees.
- A Risk Management Group, comprised of senior executives who report to the CEO, was created to coordinate PSI's legal, compliance, and origination functions, and to ensure that all new products have been thoroughly reviewed before they are offered to customers.
- Business Review Committees were created in an effort to systematize the review of all of PSI's major transactions and business decisions. There are now eight Business Review Committees, organized by type of product or area of business. The committees meet regularly to consider and rule on the propriety of business transactions, and to resolve any policy decisions within their jurisdictions.
- A New Product Analysis Group was activated to evaluate any new product or service that PSI proposes to introduce. The group includes 20 members of senior management, representing all of

PSI's departments. As a result of their review, it is now impossible for any one department (such as the former Direct Investment Group) to originate, review, and sell a product without oversight by other departments.

- In order to improve the review of marketing and related materials, PSI created a Marketing Review Department and published a Marketing Review Guide for all branch managers and product area heads. The Marketing Review Department, which now consists of a director of marketing review and eight Marketing Review Coordinators, is designed to ensure that all marketing materials intended for public use receive a compliance review prior to distribution, and that internal-use-only materials are reviewed prior to, or shortly after, distribution.
- The Training Department was vastly expanded. PSI now spends more than \$70,000 to train each new financial advisor and the Training Department budget is now \$16.5 million. In June 1992, PSI completed a new training center for brokers in San Diego, at a cost of \$3.4 million. The firm also spent \$6.5 million renovating and expanding its New York training facility, where all of its training functions are centralized.
- PSI greatly enhanced its audit programs to detect and deter misconduct by brokers throughout the system, and new customer-related computer programs were installed which make it easier for compliance personnel to detect unauthorized trading activity.

Of course, no set of procedures can assure that compliance will be faultless. However, these changes, which were all voluntarily undertaken by PSI's new management, demonstrate PSI's commitment and good faith.

In October 1993, PSI entered into an unprecedented agreement with the SEC, the NASD and the 50 states, which resolved claims arising out of the Direct Investment Group's marketing of limited partnership products. As part of that settlement (the terms of which are more fully discussed in section 3, below), PSI agreed to undertake a series of

compliance reforms that were designed specifically to prevent a recurrence of the limited partnership problems. These new measures were developed jointly by PSI and the SEC. Coupled with additional steps which PSI has voluntarily undertaken, these new measures provide PSI with "state-of-the-art" compliance procedures.

The new measures include the following:

- A Compliance Committee has been established as a formal committee of the board of directors of PSI. The Compliance Committee has ultimate responsibility for all compliance functions at PSI, including adherence to the 1993 SEC agreement, thus guaranteeing accountability by the senior managers of the company.
- Regional Compliance Officers were appointed in each of the firm's eight regions. Each Regional Compliance Officer is responsible for monitoring the retail sales activity in his or her region for compliance with state and federal securities laws. The Regional Compliance Officers report, not to the Retail Department, but directly to the Deputy Director of Compliance in New York.
- The branch audits conducted by the Compliance Department and the Audit Department have been further refined and improved, to ensure that all deficiencies that are identified are promptly corrected.
- In addition to the various reviews described previously, virtually all marketing materials are now also reviewed by the Law Department.

On its own, PSI has gone beyond the requirements of the SEC Agreement. PSI has now established, in each of its regions, the new position of Regional Values Officer, whose job is to assist the regional personnel in meeting the new and complicated obligations that have been imposed by the expansion of the firm's compliance procedures during the past several years. PSI has also increased its training and scrutiny of branch managers and has stepped up the pressure on brokers to comply with every applicable rule. As a

result of these changes, PSI's compliance programs and its management structures have been radically reformed.

3. PSI is Funding the Legitimate Claims  
of the Partnership Investors

Under the terms of its settlement with the SEC, PSI agreed, not only to pay \$330 million into a fund for the benefit of investors, but to pay any and all additional valid claims in excess of the \$330 million. In connection with this agreement, moreover, PSI voluntarily submitted to an elaborate, court-approved claims-review process, pursuant to which all investors who purchased limited partnerships from PSI have the right to submit claims to an independent administrator for expedited review. The administrator is Irving Pollack, a former SEC Commissioner and Director of Enforcement. His office has stated that the settlement process has worked effectively.

Under the supervision of Mr. Pollack, PSI compiled a list of 340,000 limited partnership investors, and distributed to each investor a notice and claim form that spells out the investor's rights under the plan. Each investor has a one-year period in which to decide whether to submit a claim against the settlement fund. Once a claim is submitted, it is reviewed by a member of a team of analysts that PSI has hired to study the claims. The analysts evaluate each claim on the basis of criteria that have been agreed upon by the SEC and approved by the court, and, in response to each claim, either reject it or make a settlement offer. An investor who receives such an offer may accept it in whole or in part (in exchange for a release as to the particular partnership at issue), reject it in favor of expedited, binding arbitration administered by Mr. Pollack, or reject it in favor of civil litigation. PSI has agreed to pay all of the expenses of administering this settlement process; to date, PSI has paid over \$25 million in such expenses.

Another extraordinary aspect of the October 1993 settlement was PSI's decision to waive any and all statute of limitations defenses it could assert against investors who elect to make a claim against the settlement fund. This waiver enormously expanded PSI's potential liability, because a large percentage of the limited partnerships was

sold outside the statute of limitations period. Absent a waiver, many PSI customers would otherwise have had no claim against PSI. As a result of this process, it is already clear that PSI will pay out more in restitution and related amounts than any other firm in Wall Street history.

4. PSI has Accepted Responsibility for the Problems of Its Past and Has Paid More Than \$1 Billion in Compensation

Through the procedural changes it has made, and through the compensation it has paid, PSI has accepted responsibility for, and attempted to resolve, the limited partnership problems of the 1980s. To date, PSI has paid out over \$1 billion in settlements, fines and expenses in connection with limited-partnership-related claims, including \$330 million in its 1993 settlement with the SEC; \$41 million in fines to state and federal regulators; \$490 million in settlements of arbitrations and lawsuits; and \$185 million in expenses and legal fees. In the case of the Prudential Bache Energy Income Funds (the "Energy Income Funds"), which involved the sale of \$1.4 billion in product to over 100,000 investors from 1983 through April 1990, PSI made a class-action settlement for over \$90 million. These amounts in the aggregate far exceed the profits derived by PSI from the sale of direct investment products.

PSI has made these settlement payments because it recognizes that there were problems in the marketing of the limited partnerships. In the case of the Energy Income Funds, which have been the subject of the Government's investigation, PSI acknowledges that misstatements were made by DIG, which disseminated "internal use only" promotional materials to instruct the brokers on some of the features of the Energy Income Funds. Certain of these materials, without additional explanation, directly compared the cash distributions paid by the funds to interest payments that could be obtained on certificates of deposit, money market instruments and bonds. In reality, however, as DIG knew, such unexplained comparisons were false and misleading, since oil and gas are depleting assets, and since Energy Income Fund investors would thus have to look to their cash distributions, not just for their profit, but for a return of their original investment capital as well. (By contrast, the interest payments on CD's, money markets and bonds

consist of interest or profit.) While Pru-Bache (in 1984 and thereafter) disclosed in the prospectuses for the Energy Income Funds (and in a glossy wrapper that contained the prospectus) that the cash distribution rates on the Energy Income Funds were not readily comparable to rates of return on fixed income investments, some internal promotional materials distributed to brokers after 1984 nevertheless made such comparisons without additional explanation.

While the funds provided certain limited tax advantages, some internal promotional materials, without additional explanation, characterized the cash distributions as, in part, "sheltered" and "tax advantaged yield" and as "tax free" income. As DIG knew, these characterizations, in particular contexts, overstated the tax advantages and created the false impression that the Energy Income Funds were like municipal bonds in the sense that a portion of their otherwise taxable income would be exempt from tax.

Finally, DIG sometimes made misstatements concerning the past and expected future performance of the funds. In the wake of the crash in oil and gas prices in 1986, some internal DIG promotional material suggested, without additional disclosure, that prior funds had a proven record of financial success. As DIG knew, however, this suggestion was misleading in the particular context and in the absence of additional information, because the 1986 crash in oil and gas prices had a significant adverse impact on the performance and prospects of certain prior partnerships. Similarly, DIG sometimes falsely stated that particular results could be anticipated with no or only slight increases in oil and gas prices. In some of these instances, DIG knew that it was making these statements without regard to whether they were true or false.

PSI regrets these misstatements and, as detailed above, is committed to ensuring that such misstatements will not be made again.

5. PSI has Cooperated Extensively  
in Governmental Investigations

In addition to devoting unprecedented sums to compensate injured customers, PSI has been actively cooperating with the SEC and with Government in this case.

During the SEC's investigation, PSI voluntarily provided information and evidence relating to the limited partnership issues. In the present investigation, PSI has retained independent counsel for all of the current and former PSI employees that the Government has sought to interview. Rather than encouraging these individuals to adopt a "company line," PSI instead made it clear that it would not enter into any joint-defense agreements, and that it was going to cooperate with the Government and let "the chips fall as they may." Indeed, without any prompting by the Government, PSI went so far as to insist that all of its current and former employees voluntarily provide information to the Government, on penalty of losing their employment or the advancement of their attorney's fees. PSI has also complied with every Government request for formal and informal assistance. PSI has volunteered information, offered assistance and cooperated to the fullest extent possible with the Government's investigation.

\* \* \*

For all of the reasons discussed above, PSI should not be the subject of a prosecution. First, given the amounts that PSI has already paid, and the well-publicized nature of the limited-partnership problems, no "punitive" or "deterrent" purpose would be served. Second, given PSI's already-unlimited commitment to pay compensation where appropriate, a prosecution would bring no benefit to the limited partnership purchasers. Third, given the extensive changes in PSI's management and compliance procedures, there is no "remedial" need for a prosecution here. Finally, a prosecution would be seriously unfair, given PSI's cooperation and its demonstrated good faith.

Having now taken every possible step to resolve the partnership problems of the past and fund legitimate claims from investors, PSI deserves a resolution of the Government's investigation which avoids, rather than imposes, further stigma and punishment.

In order to provide PSI with the opportunity to move forward and demonstrate that it is dedicated to succeed with the changes it has made, we ask that your office, on behalf of the United States, refrain from prosecuting PSI with respect to the matters you have been investigating and that the parties instead enter into a cooperation and

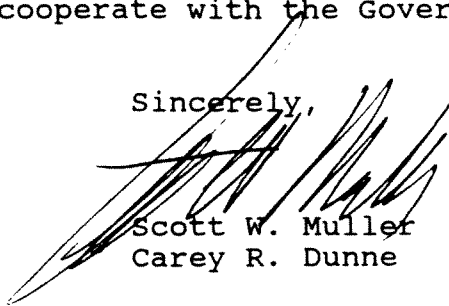
Kenneth J. Vianale, Esq.  
Baruch Weiss, Esq.

-10-

October 13, 1994

deferral arrangement pursuant to which PSI will commit to abide by certain conditions for a period of time, after which, if the conditions have been met, the Government will be constrained from pursuing prosecution and any potential charge arising from your investigation will be dropped. As we have discussed, PSI would, in connection with such agreement, continue to cooperate with the Government.

Sincerely,

A large, stylized handwritten signature in black ink, appearing to be a combination of the names Scott W. Muller and Carey R. Dunne, written over the typed names.

Scott W. Muller  
Carey R. Dunne

94-1-39

UNITED STATES ATTORNEY  
SOUTHERN DISTRICT OF NEW YORK

DEFERRED PROSECUTION

TO: Prudential Securities Incorporated

Magistrate Judge's  
Docket No. 94-

On October 27, 1994, a criminal complaint was filed with a United States Magistrate Judge in the Southern District of New York, in which you are accused of committing an offense against the United States, to wit, committing fraud in the sale of limited partnership interests in the Prudential Bache Energy Income Funds in violation of 15 U.S.C. §§ 78j(b), 78ff; 17 C.F.R. § 240.10b-5; 18 U.S.C. § 2. However, after a thorough investigation it has been determined that the interest of the United States and your own interest will best be served by deferring prosecution in this District. Prosecution will be deferred during the term of your satisfactory compliance with the terms of this agreement for the period of three years from the signing of this agreement. The terms and conditions constituting your satisfactory compliance are set forth in the Cooperation Agreement filed simultaneously herewith.

If upon completion of this period you have complied with all the rules, regulations and conditions and special conditions, if any, above mentioned, no further prosecution will be instituted by the United States for the above offense.

Dated: New York, New York  
October 27, 1994

MARY JO WHITE  
United States Attorney

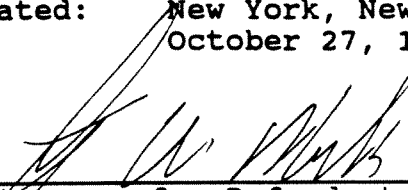
By:

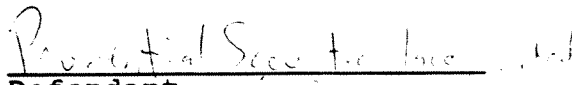
  
Kenneth J. Vianale  
Baruch Weiss

Assistant United States Attorneys

The undersigned hereby consents to the foregoing and expressly waives any and all rights to a speedy trial pursuant to the Sixth Amendment to the United States Constitution, Title 18, United States Code, Section 3161 (h) (2) and the Rules of the District Court of the Southern District of New York, or other pertinent provisions and consent to the adjournment of all pending proceedings in this case.

Dated: New York, New York  
October 27, 1994

  
\_\_\_\_\_  
Attorney for Defendant

  
\_\_\_\_\_  
Defendant

The foregoing waiver of the defendant's right to a speedy trial is approved pursuant to Rule 5 (b) of the Second Circuit Plan for Achieving Prompt Disposition of Criminal Cases and the Rules of the District Court for the Southern District of New York.

Dated: New York, New York  
October 27, 1994

  
\_\_\_\_\_  
United States Magistrate Judge

Leonard Bernikow  
United States Magistrate Judge  
S.D.N.Y.

Approved:

*Kenneth J. Vianale* *Baruch Weiss*  
KENNETH J. VIANALE  
BARUCH WEISS  
Assistant United States Attorneys

Before: HONORABLE LEONARD BERNIKOW  
United States Magistrate Judge  
Southern District of New York

-----X  
UNITED STATES OF AMERICA

-v-

PRUDENTIAL SECURITIES INCORPORATED,  
  
Defendant.

:  
:  
: COMPLAINT  
:  
: Violation of 15  
: U.S.C. § 78j(b) and 78  
: ff; 17 C.F.R. Section  
: 240.10b-5; 18 U.S.C.  
: § 2  
:  
: COUNTY OF OFFENSE:  
: NEW YORK

-----X

SOUTHERN DISTRICT OF NEW YORK, ss.:

DAVID J. QUINN, being duly sworn, deposes and says that he is a Postal Inspector with the United States Postal Inspection Service, and charges as follows:

From in or about September 1983 until in or about April 1990, in the Southern District of New York and elsewhere, the defendant PRUDENTIAL SECURITIES INCORPORATED ("PSI"), unlawfully, wilfully, and knowingly, directly and indirectly, by use of the means and instrumentalities of interstate commerce and of the mails, did employ manipulative and deceptive devices and contrivances in connection with the purchase and sale of securities, by (1) employing devices, schemes and artifices to defraud, (2) making untrue statements of material facts and omitting to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (3) engaging in acts, practices, and courses of business which operated and would operate as a fraud and deceit upon the investing public and other persons and entities.

(Title 15, United States Code, Sections 78j(b) and 78ff; Title 17, Code of Federal Regulations, Section 240.10b-5; 18 United States Code, Section 2.)

The bases for my knowledge and for the foregoing charge, are, in part, as follows:

1. I have been a Postal Inspector with the United States Postal Inspection Service since May 1991 and am the case agent assigned to this case. I am a Certified Public Accountant and practiced public accounting for five years before joining the Postal Inspection Service.

2. In the course of my investigation, I have reviewed numerous documents, such as prospectuses, sales brochures, "internal use only" documents, court papers filed by PSI in various civil actions, and other materials. In addition, I have interviewed numerous present and former executives of PSI, numerous present and former PSI brokers, executives of Graham Resources (see below), and investors in the publicly sold securities which I describe more fully below.

I. Background

3. PSI, formerly known as Prudential-Bache Securities, Inc., is a registered broker-dealer, incorporated in Delaware and headquartered in New York, New York. At all times relevant to this complaint, PSI operated as a retail brokerage firm with offices in most major cities in the United States. At its height, PSI employed approximately 6,000 brokers who sold various securities directly to the public.

4. In or around 1980, PSI formed a tax shelter department which later became known as the Direct Investment Group ("DIG"). The DIG was located in New York, New York and was primarily engaged in the creation and marketing of numerous limited partnerships. Interests in these limited partnerships were sold to the public by PSI through its nationwide retail brokerage system.

5. Beginning in or about September 1983 through about April 1990, PSI sold interests in oil and gas limited partnerships known as the Prudential-Bache Energy Income Partnerships (the "Energy Income Funds"). For the purpose of managing these funds, an affiliate of PSI known as Prudential Bache Energy Production ("Energy Production") was formed. Energy Production, in turn, became a co-general managing partner of these funds together with Graham Royalty, Ltd. ("Graham"), a Louisiana corporation that was wholly-owned by Graham Resources, an independent oil and gas company organized in 1975. The Energy Income Funds were sold in six series, and a total of 35 limited partnerships were sold to the public by PSI's retail brokers throughout the country.

6. The Energy Income Funds were offered by PSI as a way for public investors to participate in the ownership of proven oil and gas reserves. Under the program, these oil and gas reserves were to be sold, and the resulting cash flow was to be distributed

to investors quarterly. Because oil and gas reserves are depleting assets which must be extracted and sold to generate profit, a significant portion of the cash flow from the sale of oil and gas includes a return of original investment capital.

## II. The Marketing

7. To sell the Energy Income Funds, DIG employed a variety of methods to inform its brokers and the public about the investment features of the funds. The DIG disseminated a large volume of uniform sales materials to PSI's broker force on the Energy Income Funds, and I have learned from numerous PSI brokers that PSI encouraged them to rely upon these materials in preparing their sales presentations to existing or prospective PSI customers. In addition, I have learned from numerous brokers and PSI executives that the DIG, together with representatives from Graham, regularly held seminars for brokers and the general public at which the key sales points for the Energy Income Funds were presented. PSI also sponsored regional and national sales conferences at which DIG and Graham representatives gave presentations to brokers on the Energy Income Funds.

8. As a result of its marketing effort, PSI was highly successful in selling the Energy Income Funds. I have learned from various PSI employees and from papers filed in various related civil actions against PSI that from 1983 to 1990, PSI sold approximately \$1.4 billion of the Energy Income Funds to over approximately 100,000 investors throughout the United States and abroad. Investors were charged approximately 15% of the total dollar amount to cover commissions, partnership fees, and costs. I have also learned from various PSI employees responsible for the marketing of the product that sales of these funds were consummated in PSI's offices in New York, New York.

9. Through its uniform sales literature and oral presentations on the Energy Income Funds, PSI falsely instructed its brokers that the investment was safe, low risk, and suitable for all investors including those with investment objectives of "safety of principal," and "tax sheltered income," even though the publicly filed prospectus for the funds specified substantial investment risks and noted that there were no significant tax benefits to be derived from the partnerships' activities. PSI intended that its brokers would uniformly present such false statements to their customers and that these customers would thereby be induced to purchase interests in the Energy Income Funds. Specifically, PSI made the following material

misrepresentations concerning the Energy Income Funds:

III. Specific Misrepresentations

a. Return of Original Investment  
Capital at the End of the Program

10. PSI represented to investors that investors could expect to receive 3 to 3 1/2 times their investment through their receipt of regular quarterly "income," plus the return of their original investment capital at the end of the partnership life. However, because oil and gas are depleting assets, investors could not, absent unusual and consistent price jumps--which were not anticipated by PSI--receive their original investment capital back in a lump sum at the end of the partnership lives.

11. For example, in a tape recording of a seminar given in or around July 1986, to which I have listened, an individual identified to me by a PSI executive as a Graham employee compared the Energy Income Funds to a municipal bond and told investors that in addition to receiving regular quarterly cash distributions, they would receive a lump sum payment of their original investment capital at the end of the partnership life. PSI brokers to whom I have spoken have confirmed that other seminars at which this claim was repeated were also attended by DIG employees knowledgeable about the true investment features of the Energy Income Funds, and in some cases, the claim of a return of capital at the end of the program was repeated by these PSI employees.

b. Comparison of Energy Income Fund Rates  
of Return to Fixed Income Rates of Return

12. In many instances, PSI directly compared the rates of return available on fixed income instruments and bank deposits with the rate of cash distributions that had been made by the Energy Income Funds to limited partners. Such comparisons were misleading because the cash distributions received by Energy Income Fund investors contained a return of capital component due to the depleting nature of oil and gas, and thus were not comparable to the interest payments on bonds or bank deposits which do not include any amount of an investor's original capital.

13. For example, in or about August 20, 1985, the former head of DIG marketing wrote the following in a memorandum that was sent to all of PSI's brokers on the Energy Income Funds:

One last thought: to put this all into perspective, we would remind you of the general downward direction interest[] [rates] have taken during the past year -- in many cases, a one-third reduction in yield. Consider what the bond market, CDs, and money

market funds have seen happen to their double digit yields over the past 24 months. This has not been the case with the Prudential-Bache Family of Energy Income Funds. Distributions have averaged in the mid-teens. Not too many income-oriented investments can make that statement -- particularly in light of the tax benefits derived from oil and gas income funds. How many investment[s] do you know of with current tax-sheltered yields above 10%?

c. Claim that Partnerships Produced Tax-Advantaged, Tax-Sheltered, and Tax Free Income

14. PSI frequently used the terms "tax free," "tax sheltered," and "tax advantaged," to describe the quarterly cash distributions made to investors. The use of these terms implied that there was profit from the operation of the partnerships which was not to be taxed to investors, when in fact, that portion of the distributions received by investors for which PSI claimed a tax advantage, was not profit, but a return of investor capital.

15. For example, in documents called "Fact Sheets," which I have reviewed, PSI regularly informed its broker force that in the first year of an Energy Income Fund partnership, distributions would be 100% tax advantaged, or tax sheltered. This so-called tax advantage, however, was only due to the fact that investors were receiving their own investment capital back as oil reserves owned by the partnerships were sold and therefore depleted. No part of an investor's profit, however, was sheltered or free from taxation.

16. Furthermore, I reviewed a January and a November 1989 "D.I.G.EST," distributed nationally, in which PSI set forth information from which its broker force would conclude that investors would require a substantially higher rate of return on other investments to surpass the rate of return on the Energy Income Funds due to the claimed tax benefits for those partnerships: "Historically, distributions have been 100% sheltered in year one, 80% sheltered in year two, and 70% to 80% sheltered in year three. Assuming an average 13% cash distribution, with 80% sheltered during the first three years, the fully taxable equivalent yield would be 16.75%." (D.I.G.EST, January 1989, at 13) (underlining added). The January and November 1989 D.I.G.EST also included a "Taxable Equivalent Yield" table from which brokers could compute what a fully taxable investment product would have to yield to achieve the same after-tax income as the Energy Income Funds for a variety of cash distribution rates. PSI distributed these and other similar materials to its broker force even though in its publicly filed prospectus PSI acknowledged that profit from the partnerships was fully taxable.

d. Interchangeable Use of "Yield,"  
"Return on Investment," and "Income"

17. In oral presentations and in marketing literature, PSI routinely used the terms "yield," "return on investment," and "income" to describe the quarterly cash distributions received by investors in the Energy Income Funds. PSI routinely used such terms in its marketing materials even though PSI knew, as evidenced by its disclosure in a footnote in the partnership prospectus, that the cash distributions did not constitute pure profit or interest, but instead also contained a return of original investment capital, which from my review of partnership financial records was substantial.

18. For example, on or about April 1, 1986, a DIG newsletter distributed to brokers in PSI's Southwest Region (which included Texas, New Mexico, Utah, Colorado, Arkansas, Oklahoma, and Kansas), stated:

Remember this time last year when CD yields were higher than they are now? Many of us placed IRA money into one year CDs -- and those CDs are beginning to rollover now. How about rolling those CD dollars into higher-yielding PB Energy Income Fund? Distributions are made quarterly, and the yield is several basis points [higher] than most-fixed income investments.

*David J. Quinn*

---

DAVID J. QUINN  
Postal Inspector  
United States Postal  
Inspection Service

Sworn to before me this  
27th day of October 1994.

---

UNITED STATES MAGISTRATE JUDGE