## In the Matter of FIDELITY MANAGEMENT RESEARCH COMPANY and FMR CO., INC., Respondent

**ADMINISTRATIVE PROCEEDING File No. 3-12976**

**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISORS ACT OF 1940 Release No. 2713;**
**INVESTMENT COMPANY ACT OF 1940 Release No. 28185**

**March 5, 2008**

**ACTION: ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940**

**TEXT:**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act"), against Fidelity Management & Research Company ("FMR") and FMR Co., Inc. ("FMR Co.") (collectively "Respondents" or "Fidelity").

**II.**

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 as set forth below.

**III.**

On the basis of this Order and Respondents' Offer, the Commission finds n1 that:

**A. RESPONDENTS**

1. FMR is a privately held Massachusetts corporation registered with the Commission as an investment adviser pursuant to Section 203(c) of the Advisers Act, with its principal place of business in Boston, Massachusetts. FMR is a wholly owned subsidiary of FMR LLC, a privately held Delaware limited liability company. FMR is an adviser to various institutional clients and has approximately $ 1.25 trillion in assets under management. FMR's institutional clients include a group of approximately 350 registered investment companies marketed under the "Fidelity Investments" trade name and managed by FMR and its affiliates (hereafter "the Fidelity Funds").

2. FMR Co. is a privately held Massachusetts corporation registered with the Commission as an investment adviser pursuant to Section 203(c) of the Advisers Act, with its principal place of business in

Boston, Massachusetts. FMR Co. is a wholly owned subsidiary of FMR and provides portfolio management services as a sub-adviser to certain clients of FMR, including the Fidelity Funds.

**B. OTHER RELEVANT PARTIES** n2

3. Scott E. DeSano, age 47, lives in Boston, Massachusetts. He was associated with FMR Co. from 1991 to July 2005, and was its senior vice president in charge of global equity trading from 1996 until he was reassigned to an affiliate of FMR in July 2005. From at least January 2002 through October 2004, he supervised Fidelity's Boston domestic equity trading desk ("Equity Trading Desk") and other equity trading operations. In all, DeSano supervised more than thirty equity traders. n3 He reported to a senior vice president of FMR Co. (Bart Grenier). He also appeared as a representative of Fidelity in public testimony before Congress, the Commission, and other regulatory bodies.

4. Bart A. Grenier, age 49, lives in Boston, Massachusetts. Aside from a four-month period in 1997, Grenier was associated with FMR Co. from 1991 until June 2005. During the Relevant Period, n4 he was a senior vice president of FMR Co. with supervisory responsibility for Fidelity's equity trading operations and several of its other business groups.

5. Peter S. Lynch, age 64, lives in Marblehead, Massachusetts. He has been associated with FMR and FMR Co. in various capacities since 1969, and was the portfolio manager of Fidelity's Magellan Fund from 1977 to 1990. Since retiring from Magellan, he has been the vice chairman and a director of FMR and FMR Co. He was an interested trustee of the Fidelity Funds from 1990 until February 2003, and has since served as a member of the Advisory Board of the Fidelity Funds.

6. Marc C. Beran, age 38, lives in Southborough, Massachusetts. He was a domestic equity trader at FMR Co. from 1997 until January 2005. During the Relevant Period, he was a sector trader specializing in energy and materials stocks.

7. Thomas H. Bruderman, age 39, lives in Boston, Massachusetts. He was a domestic equity trader at FMR Co. from 1998 until December 2004. During the Relevant Period, he was a sector trader specializing in healthcare and pharmaceuticals stocks.

8. Timothy J. Burnieika, age 38, lives in Cohasset, Massachusetts. He was a domestic equity trader at FMR Co. from 2000 until September 2005, when he was reassigned to other duties that do not involve trading. During the Relevant Period, he was a primary trader reporting to Steven Pascucci.

9. Robert L. Burns, age 46, lives in Brookline, Massachusetts. He was a domestic equity trader at FMR Co. from 1986 until December 2004. During the Relevant Period, he was a sector trader specializing in technology stocks and reporting to David Donovan.

10. David K. Donovan, age 45, lives in Marblehead, Massachusetts. He was a domestic equity trader at FMR Co. from 1992 until March 2005. During the Relevant Period, he was a sector trader specializing in technology stocks, and he was also a team leader of several sector traders, including Robert Burns, Jeffrey Harris and Kirk Smith.

11. Edward S. Driscoll, age 42, lives in Scituate, Massachusetts. Aside from a ten-month stint at another firm, he was a domestic equity trader at FMR Co. from 1997 until March 2005. During the Relevant Period, he was a sector trader specializing in food and beverage, household items, materials, and capital goods stocks.

12. Jeffrey D. Harris, age 35, lives in Charlestown, Massachusetts. He was a domestic equity trader at FMR Co. from 1998 until July 2005. During the Relevant Period, he was a sector trader specializing in technology stocks and reporting to David Donovan.

13. Christopher J. Horan, age 37, lives in Boston, Massachusetts. He was a domestic equity trader at FMR Co. from 1999 until September 2005, when he was reassigned to other duties that do not involve

trading. During the Relevant Period, he was a sector trader specializing in insurance, capital goods, and restaurant stocks.

14. Steven P. Pascucci, age 41, lives in Concord, Massachusetts. He was a domestic equity trader at FMR Co. from 1997 until September 2005, when he was reassigned to other duties that do not involve trading. During the Relevant Period, he was a primary trader, and from 1998 until early 2005, he was a team leader of the other primary traders, including Timothy Burnieika.

15. Kirk C. Smith, age 43, lives in Walpole, Massachusetts. He was a domestic equity trader at FMR Co. from 1997 until September 2005, when he was reassigned to other duties that do not involve trading. During the Relevant Period, he was a sector trader specializing in technology stocks and reporting to David Donovan.

**C. FACTS**

**Summary**

16. During the period from at least January 2002 through October 2004, two Fidelity senior executives (DeSano and Grenier) and ten Fidelity equity traders (Beran, Bruderman, Burnieika, Burns, Donovan, Driscoll, Harris, Horan, Pascucci and Smith) in aggregate accepted approximately $ 1.6 million worth of travel, entertainment and gifts from brokerage firms that sought and obtained orders to buy or sell securities on behalf of Fidelity's advisory clients. n5 In addition, Lynch requested and received tickets to events from two equity traders, who obtained those tickets from brokers. Those brokerage firms each received millions of dollars in commission revenue for handling orders from Fidelity's advisory clients' accounts. DeSano and the traders in aggregate accepted from brokers dozens of expensive trips, frequently by private jet, including excursions to the Super Bowl, family vacations to Bermuda, Nantucket and the Caribbean, golf outings at exclusive clubs in Florida and South Carolina, weekends in Las Vegas, lodging at fine hotels, and even an extravagant, three-day bachelor party for Bruderman in Miami. Brokers also provided the Fidelity executives and traders with gifts including premium tickets to the World Series, the U.S. Open, Wimbledon, Rolling Stones concerts, and dozens of other sporting events and concerts. In addition, certain traders accepted illegal drugs from brokers and one trader's illegal gambling was facilitated by a broker. n6

17. The ten traders allowed the receipt of travel, entertainment and gifts to influence their selection of brokers to handle transactions for Fidelity's clients. As one trader commented to another, "Word is out that order flow is for sale." In addition, certain traders routinely sent transactions to brokers who were members of their families or brokers with whom they had a romantic relationship. n7

18. DeSano, who supervised Fidelity's equity trading operations, personally accepted travel, entertainment and gifts from brokers who sought and obtained securities transactions for Fidelity's clients. He solicited tickets from brokers for himself and to satisfy requests from his supervisor, Grenier. He accompanied certain traders on several trips by private jet paid for by brokers, including attending part of Bruderman's bachelor party in Miami, and traders told him about some of the other private jet trips and tickets they received from brokers. He also knew that certain traders directed transactions to brokers who were members of their family or with whom they had a romantic relationship. Nevertheless, DeSano failed to monitor the traders' receipt of travel, entertainment and gifts in any systematic way and failed to take reasonable steps to ensure that they were seeking best execution or complying with Fidelity's policy concerning its employees' receipt of gifts and gratuities.

19. Under Section 17(e)(1) of the Investment Company Act, affiliated persons of a registered investment company, such as Fidelity executives and traders, are prohibited from accepting "from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property" of the investment company. The objective of Section 17(e)(1) is to prevent persons affiliated with registered investment companies from having conflicts of interest impair their judgment and loyalty. A violation of Section 17(e)(1) of the Investment Company Act is complete upon receipt of the compensation. During the Relevant Period, two Fidelity executives (DeSano and Grenier) and ten Fidelity traders (Beran, Bruderman, Burnieika, Burns, Donovan, Driscoll, Harris, Horan,

Pascucci and Smith) received compensation in violation of Section 17(e)(1) of the Investment Company Act in the form of travel, entertainment and gifts paid for by brokers who sought and obtained from those traders securities transactions for Fidelity's clients. In addition, another Fidelity executive (Lynch) caused two Fidelity traders' violations of Section 17(e)(1). Fidelity failed to adopt and implement a system of controls sufficient to detect, deter, and prevent the receipt by these executives and traders of travel, entertainment and gifts paid for by brokers as described herein. As a result, Fidelity failed reasonably to supervise the executives and traders, within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing their violations of Section 17(e)(1) of the Investment Company Act.

20. Under Section 206 of the Advisers Act, an investment adviser has a fiduciary duty to seek best execution for its clients' securities transactions -- that is, to seek the most favorable terms reasonably available under the circumstances. In determining whether an adviser is seeking best execution, the key criterion is whether the adviser selects the transaction which "represents the best qualitative execution for the managed account." n8 During the Relevant Period, Fidelity allowed certain employees' receipt of travel, entertainment and gifts and certain employees' family or romantic relationships to enter into the selection of brokers. Accordingly, Fidelity willfully violated Section 206(2) of the Advisers Act, resulting in the substantial possibility of higher execution costs for Fidelity's advisory clients. n9

21. Under Section 206 of the Advisers Act, an investment adviser has a fiduciary duty to disclose all material conflicts of interest to its advisory clients. During the Relevant Period, Fidelity failed to disclose to its advisory clients the conflicts of interest arising from the receipt by certain Fidelity executives and traders of travel, entertainment and gifts from, and certain traders' family and romantic relationships with, brokers who sought and obtained securities transactions for Fidelity's clients, and failed to disclose that such travel, entertainment, gifts and relationships became additional factors in the traders' selection of brokers. Accordingly, Fidelity willfully violated Section 206(2) of the Advisers Act.

22. Under Sections 204, 206 and 207 of the Advisers Act and Rule 204-1 thereunder and Section 34(b) of the Investment Company Act, an investment adviser may not make materially false and misleading statements in public disclosure documents, such as an investment adviser's Form ADV and a registered investment company's prospectus and statement of additional information ("SAI"). During the Relevant Period, Fidelity's Forms ADV and the SAIs which it prepared for the Fidelity Funds stated that Fidelity selected brokers for its clients' transactions based on an itemized list of factors but failed to include the additional significant factors considered by certain traders -- their receipt of travel, entertainment and gifts from brokers and their family or romantic relationships with brokers. As a result, Fidelity willfully violated Sections 204, 206(2) and 207 of the Advisers Act and Rule 204-1 thereunder and Section 34(b) of the Investment Company Act.

23. On behalf of Fidelity, DeSano made presentations to committees of the trustees of the Fidelity Funds in which he too identified the factors that Fidelity used in selecting brokers. DeSano also told the trustees that Fidelity required brokers to compete for its brokerage business based on the quality of their trade execution. Those statements were false and misleading because DeSano failed to disclose (1) that certain Fidelity traders selected brokers for Fidelity's business based on additional significant factors of which he was aware -- travel, entertainment and gifts from brokers and family or romantic relationships with brokers, and (2) that brokers competed for Fidelity's business based on those additional factors as well. As a result, Fidelity willfully violated Section 206(2) of the Advisers Act.

24. Under Section 204 of the Advisers Act and Rule 204-2 thereunder, an investment adviser is required to make and keep true, accurate and current books and records relating to its investment advisory business, including originals or copies of certain documents reflecting its communications with brokerage firms relating to the placing or execution of orders to purchase or sell securities. During the Relevant Period, Fidelity traders used an electronic messaging network supplied by Bloomberg L.P. ("Bloomberg") to communicate with brokers. Fidelity failed to make and keep true, accurate, and current originals or copies of such messages. As a result, Fidelity willfully violated Section 204 of the Advisers Act and Rules 204-2(a)(7)(iii) and 204-2(g) thereunder.

**Background on Fidelity's Equity Trading Desk**

25. Fidelity manages one of the largest mutual fund complexes in the United States. Fidelity equity traders buy and sell millions of shares of stock every day for the Fidelity Funds and other institutional clients. As an investment adviser, Fidelity has a fiduciary duty to seek best execution for its clients' securities transactions and to disclose to its clients all material facts concerning conflicts of interest.

26. The Fidelity Funds and certain of Fidelity's other institutional clients' accounts are managed by portfolio managers who make investment decisions on their behalf. The portfolio managers send their orders to equity traders, who are responsible for selecting brokers to handle the transactions. During the Relevant Period, the Equity Trading Desk bought and sold more than 73 billion shares of equity securities (nearly 26 billion shares per year) with a total principal of more than $ 1.4 trillion (nearly $ 500 billion per year). Fidelity's equity trading generated more than $ 2.3 billion in commissions (over $ 800 million per year) paid to brokerage firms by Fidelity's clients, including the Fidelity Funds.

27. During the Relevant Period, FMR Co.'s equity trading operations employed nearly sixty people, including 33 traders (seven "primary" traders and 26 "sector" traders). Under DeSano's supervision, the traders had broad discretion to select brokerage firms to handle securities transactions. The primary limitation was that the traders could only select from a list of approximately 100 firms that had been formally approved by Fidelity.

**Fidelity Executives and Traders Received Travel, Entertainment and Gifts from Brokers Seeking and Obtaining Securities Transactions for Fidelity's Clients**

**Overview**

28. During the Relevant Period, two Fidelity senior executives (DeSano and Grenier) and ten Fidelity equity traders (Beran, Bruderman, Burnieika, Burns, Donovan, Driscoll, Harris, Horan, Pascucci and Smith) in aggregate accepted approximately $ 1.6 million worth of travel, entertainment and gifts from brokerage firms that sought and obtained orders to buy or sell securities on behalf of Fidelity's advisory clients. n10 In addition, Lynch requested and received tickets to events from two equity traders, who obtained those tickets from brokers. Brokers took DeSano and/or certain traders, sometimes in groups, on more than thirty trips to such destinations as the Super Bowl, Las Vegas, Florida, the Caribbean, and Nantucket. These excursions sometimes included travel by private jet, lodging at fancy resorts, entry to exclusive golf courses, tickets to major sporting events, limousine service, expensive dinners, other amenities such as spa services, and, for certain traders, adult entertainment and illegal drugs. Bruderman even organized, and brokers paid for, his own extravagant, three-day bachelor party in Miami, part of which DeSano attended and which cost brokers approximately $ 160,000.

29. One brokerage firm seeking and obtaining Fidelity's business, Jefferies & Co., Inc. ("Jefferies"), gave one of its brokers, Kevin W. Quinn, a travel and entertainment budget of $ 1.5 million per year. From that budget, Quinn entertained DeSano and several Fidelity traders, primarily by taking them on weekend excursions by private jet. n11 For example, Quinn organized an annual trip he called the "Fall Classic," which included private jet travel, exclusive golf outings, lodging at expensive resorts, and other activities. During the November 2002 Fall Classic, for example, Quinn took DeSano, Bruderman and Harris by private jet to Las Vegas. Quinn provided accommodations at the Bellagio Hotel, several thousand dollars worth of golf merchandise, a private band, meals, golf, and entertainment at a nearby strip club. The group continued by private jet to Cabo San Lucas, Mexico, where Quinn provided accommodations in villas at the Esperanza Hotel, meals, more golf, and other entertainment. Jefferies paid approximately $ 200,000 for the expenses incurred on this trip.

30. Brokers other than Quinn also took Fidelity traders on a variety of trips. For example, each year during the Relevant Period, various brokers took several Fidelity traders to the Super Bowl. Brokers often provided the traders with travel by private jet, lodging at expensive hotels, admission to exclusive pre-game parties, tickets to the Super Bowl, golf greens fees, limousines, and other lavish entertainment. Even when they did not provide private jets, brokers often took traders on trips to Las

Vegas and on golf weekends to Florida and other warm-weather locations, usually paying for the traders' lodging and meals and sometimes paying for other travel expenses such as commercial airfare.

31. On more than twenty other occasions, brokers made a private jet available for personal use by DeSano and/or certain traders (and at times, their families), without accompanying the Fidelity employee on the trip. Some of the private jet trips were short (such as weekend excursions to Nantucket), but others were quite long (such as flights to Florida and the Caribbean) and cost brokers up to $ 50,000 or more per trip.

32. Besides the trips, brokers provided to the Fidelity employees identified herein a total of approximately 900 tickets for some of the best seats to more than 270 sporting events, concerts, and other events, none of which the broker attended with the recipient. The events included the World Series, prominent tennis tournaments (Wimbledon, the U.S. Open, and the French Open), Broadway shows, concerts by nationally-known performers (such as the Rolling Stones and Bruce Springsteen), and dozens of sporting events, including baseball, basketball, football and hockey playoff and regular season games. n12

33. Most of the tickets were for premium or exclusive seats (such as luxury boxes or seats close to the stage, court or field). Brokers frequently provided multiple tickets to the event, so that the recipient could bring his family or friends. The tickets often cost the brokers hundreds of dollars each, and tickets to special events such as playoff games often cost them more than $ 1,000 each.

34. In addition, brokers sent certain traders expensive wine (including cases that cost from $ 1,000 to $ 7,700 each delivered straight to their homes), and other costly items such as entry to a racing school (over $ 5,000) and a humidor filled with cigars (approximately $ 1,300).

**The Individual Executives and Traders**

35. DeSano received more than $ 145,000 worth of travel, entertainment and gifts from brokers during the Relevant Period. He received the personal use of Quinn's private jet for at least two trips, and he went on at least six private jet trips with brokers, primarily Quinn. The trips by private jet included the "Fall Classic" in Las Vegas and Mexico in November 2002, Bruderman's bachelor party in Miami in March 2003, and golf trips to locations such as Sea Island, Georgia, West Palm Beach, Florida, and the Winged Foot Golf Club in Mamaroneck, New York. Brokers also gave DeSano nearly fifty tickets to more than twenty events, including several Bruins, Celtics, Patriots and Red Sox playoff games.

36. Grenier received approximately $ 38,500 worth of tickets from brokers during the Relevant Period. The tickets were to approximately twenty events, including a Super Bowl ticket package worth approximately $ 9,000 and premium seats to numerous Celtics and Red Sox games. On several occasions, Grenier asked DeSano to get the tickets for him, and DeSano obliged him by procuring the tickets from brokers who sought and obtained securities transactions for Fidelity.

37. Lynch was the portfolio manager of Fidelity's Magellan Fund from 1977 to 1990. During the last five years of his tenure at Magellan, Burns was one of the traders assigned to handle transactions for the Magellan Fund. During the Relevant Period, Lynch periodically asked Burns to get him tickets to concerts, theater and sporting events -- often to sold-out events. Lynch knew that Burns obtained the tickets from brokers handling securities transactions for Fidelity. (On one occasion, Lynch obtained tickets to a Santana concert from Harris, who had taken his call when Burns was out.) From 1999 through October 2004, Lynch received tickets worth approximately $ 15,948 that Burns or Harris had obtained from brokers, and he did not reimburse. He received 61 tickets to approximately one dozen sporting, theater and concert events, including fourteen, three-day passes to the Ryder Cup golf tournament in Brookline, Massachusetts in 1999, eleven tickets to a U2 concert, and at least six tickets to the Ryder Cup golf tournament in Michigan in 2004. In addition to Burns and Harris, at least seven other members of the Equity Trading Desk were aware during the Relevant Period that Lynch obtained tickets to events from brokers through the Equity Trading Desk. Each of those members of the Equity Trading Desk accepted gifts for themselves from brokers.

38. Beran received more than $ 11,000 worth of travel, entertainment and gifts from brokers during the Relevant Period. These included tickets to out-of-town theater and local professional sporting events that the brokers did not attend. Beran and his family also went on two trips to Bermuda with a broker who paid for the family's luxury hotel accommodations, associated expenses, and for one trip, their commercial airfare.

39. Bruderman received more than $ 450,000 worth of travel, entertainment and gifts from brokers during the Relevant Period. n13 One example was his bachelor party in Miami, Florida in March 2003. Bruderman solicited certain brokers to arrange and pay for the event, and the brokers complied -- at a total cost of approximately $ 160,000. The festivities included private jet travel, luxury accommodations at the Breakers Hotel, a chartered yacht, golf, a limousine, and other entertainment such as expensive dinners and strip clubs. Brokers hired two women to entertain the attendees at the party and provided a bag filled with illegal drugs (ecstasy pills) to Bruderman. n14 DeSano, who attended the bachelor party and flew to Miami on the private jet with Bruderman, several brokers, and the two women, believed that the women hired by the brokers were prostitutes. In addition to his bachelor party and other wedding-related expenses, brokers paid all or part of Bruderman's share of approximately 25 other trips. Bruderman obtained private jet travel on more than twenty of those occasions. The trips included such destinations as the Super Bowl (twice), the Caribbean, and Cabo San Lucas, Mexico (on the November 2002 "Fall Classic"). On approximately ten of the trips, brokers were not present and simply provided Bruderman and/or his fiancee with the use of a private jet. These included trips to Puerto Rico, Florida, and his honeymoon in Los Angeles. Brokers also provided Bruderman with lodging on at least fourteen occasions, airfare on commercial jets on at least six occasions, and other gifts such as entry to a racing school (over $ 5,000), thousands of dollars worth of wine, a humidor with cigars ($ 1,300), and limousine service. Finally, brokers gave Bruderman at least thirty tickets to at least seven events, including the U.S. Open tennis tournament and front-row seats at a Dave Matthews concert. Bruderman failed to inform DeSano or any other Fidelity manager of his receipt of illegal drugs from brokers.

40. Burnieika received more than $ 55,000 worth of travel, entertainment and gifts from brokers during the Relevant Period, mostly consisting of premium tickets to professional sporting events. Indeed, brokers gave Burnieika approximately 175 tickets to more than fifty events that the brokers did not attend, including several Celtics and Red Sox playoff games, numerous other Celtics and Red Sox games, and concerts by the Rolling Stones and Bruce Springsteen. Burnieika also went on ten trips with brokers to such destinations as the Super Bowl, Las Vegas, and Aspen, Colorado. Four of the trips were by private jet, while the other six trips were by commercial jet with brokers who paid for some of his lodging and other travel and entertainment expenses.

41. Burns received more than $ 180,000 worth of travel, entertainment and gifts from brokers during the Relevant Period (not counting the tickets that he obtained for Lynch). Burns received more than 190 tickets to more than forty events that the brokers did not attend, plus fourteen tickets for Burns' friends to attend three events that Burns attended with brokers. Burns received at least $ 140,000 of tickets and other gifts from Quinn at Jefferies, and Quinn did not attend any of the events for which he provided tickets. For example, over a three-year period, Quinn spent more than $ 100,000 so that Burns could attend the Wimbledon tennis tournament. In 2002 and 2003, Quinn simply gave Burns tickets to the tournament. In 2004, he not only gave Burns tickets that cost more than $ 38,000, but he also paid for Burns and his friends to stay at the Lanesborough Hotel in London, at a cost of nearly $ 13,000. Quinn also had cases of expensive wine delivered to Burns' home as Christmas gifts -- at a cost of more than $ 5,900 in December 2002 and more than $ 7,700 in December 2003.

42. Donovan received more than $ 270,000 worth of travel, entertainment and gifts from brokers during the Relevant Period, mostly consisting of trips by private jet to the Super Bowl, Las Vegas, the Bahamas, Florida, and other vacations. In total, brokers paid all or most of Donovan's expenses on 24 trips, including travel by private jet to at least sixteen destinations, first-class flights on the Concorde on at least two occasions, and lodging on eighteen occasions. For example, in June 2002, one broker took Donovan to Paris for the French Open tennis tournament and paid for his lodging at the Hotel George V, and in August 2003, the same broker took Donovan and his wife to London for the Wimbledon tennis tournament and paid for their lodging in the Ritz Hotel. On six occasions, the broker did not attend but simply provided Donovan with the use of a private jet for himself and sometimes his family. In addition,

brokers gave Donovan a case of wine valued at approximately $ 1,000 on two separate occasions, as well as more than sixty tickets to more than twenty events.

43. Driscoll received more than $ 45,000 worth of travel, entertainment and gifts from brokers during the Relevant Period. This included the exclusive use of Quinn's private jet, as well as car service, for a family vacation to DisneyWorld in Florida, at a cost to Jefferies of approximately $ 25,000. Driscoll also went on four trips with brokers to the Super Bowl and Las Vegas, two of which included private jet travel and three of which included lodging. Brokers also gave Driscoll more than 55 tickets to at least sixteen events that the brokers did not attend, primarily Celtics games. In addition, one broker facilitated Driscoll's illegal gambling by delivering his bets to a bookie and even, at one point, by initially covering Driscoll's $ 10,000 debt to the bookie. Driscoll failed to inform DeSano or any other Fidelity manager of his illegal gambling through a broker.

44. Harris received more than $ 125,000 worth of travel, entertainment and gifts from brokers during the Relevant Period, including some or all of the costs associated with more than twenty trips. On three occasions, the brokers did not attend but simply provided Harris with the use of a private jet, such as a March 2004 trip with Horan to Turks & Caicos in the Caribbean. On eight other occasions, brokers took Harris by private jet on trips such as the "Fall Classic" in 2002 and 2003, the Super Bowl, various other golf trips, and vacations to places such as Nantucket and Florida. On nearly all the trips, brokers paid for his lodging and other expenses. In addition, brokers gave Harris more than thirty tickets to at least fourteen events, including several Patriots and Red Sox games and concerts by Santana and Fleetwood Mac.

45. Horan received more than $ 120,000 worth of travel, entertainment and gifts from brokers during the Relevant Period, including some or all of his lodging and other travel expenses on at least 24 trips. Eleven of the trips were by private jet, including excursions to the Super Bowl, one "Fall Classic" sponsored by Quinn, and trips to destinations such as Las Vegas, Martha's Vineyard, and the Pebble Beach golf course in California. On three occasions, the brokers did not attend but simply provided Horan with the use of a private jet. For example, Quinn provided a private jet for Horan and his girlfriend (as well as Harris) to return from a weekend in Florida in February 2003, and the flight cost Jefferies more than $ 56,000. In addition, brokers gave Horan more than seventy tickets to at least 25 events, including Super Bowl and several Celtics and Red Sox playoff games. In addition, Horan received over twenty gifts from brokers, including a case of wine valued at $ 400-$ 500 and other items such as gift certificates and clothing.

46. Pascucci received more than $ 50,000 worth of travel, entertainment and gifts from brokers during the Relevant Period, consisting primarily of more than 165 tickets to more than fifty events that the broker did not attend, including several Patriots and Red Sox playoff games, numerous Celtics and Red Sox regular season games, and a performance of "The Producers." Brokers also paid for some of Pascucci's lodging and other travel expenses on at least five trips, including one trip to Dallas involving a stay at the Four Seasons Hotel, attendance at a Dallas Cowboys football game, a meeting with Bill Parcells (then the Cowboys coach), a return flight to Boston on a broker's private jet, and limousine service to and from the airport.

47. Smith received more than $ 85,000 worth of travel, entertainment and gifts from brokers during the Relevant Period. In November 2003, Quinn provided Smith with the use of a private jet so that Smith and his wife could take a vacation in the Caribbean, and the trip cost Jefferies more than $ 46,000. In addition to paying some of Smith's lodging and other travel expenses on two other trips, brokers gave Smith more than 150 tickets to more than forty events that the broker did not attend, including several Celtics, Patriots and Red Sox playoff games, numerous other Patriots and Red Sox games, several college hockey games, and concerts by the Rolling Stones and Van Morrison.

**Violation of Section 17(e)(1) of the Investment Company Act**

48. Under Section 17(e)(1) of the Investment Company Act, affiliated persons of a registered investment company, such as Fidelity executives and traders, are prohibited from accepting "from any

source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property" of the investment company.

49. During the Relevant Period, two Fidelity executives (DeSano and Grenier) and ten Fidelity traders (Beran, Bruderman, Burnieika, Burns, Donovan, Driscoll, Harris, Horan, Pascucci and Smith) received compensation in violation of Section 17(e)(1) of the Investment Company Act in the form of travel, entertainment and gifts paid for by brokers who sought and obtained from the traders securities transactions for the Fidelity Funds. In addition, another Fidelity executive (Lynch) caused two Fidelity traders to receive compensation in violation of Section 17(e)(1) of the Investment Company Act.

**Fidelity Failed Reasonably to Supervise its Employees' Receipt of Travel, Entertainment and Gifts from Brokers**

**The Executives' and Traders' Violations of Fidelity's Gifts and Gratuities Policy**

50. During the Relevant Period, Fidelity had a gifts and gratuities policy for its employees. The policy stated that it was designed to avoid "any actual or apparent conflict of interest or impropriety."

> a. The policy prohibited employees from "condition[ing] any business or other transaction on the giving or acceptance of any gift or favor," from "accept[ing] gifts or other gratuities with a value of more than $ 100 per calendar year to or from any Company or individual" doing business with Fidelity, and from "accept[ing] tickets valued at more than $ 100 per calendar year if the one giving does not attend the event with the recipient." Employees were required to submit written requests for approval to receive gifts beyond the $ 100 limit.
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> b. The policy prohibited employees from "soliciting any gift, favor or other form of preferential treatment" and from "accept[ing] transportation (other than local ground transportation), lodging or other travel-related expenses to attend an athletic, cultural, social or entertainment event with a current or prospective vendor, customer, or supplier" unless the employee reimbursed the giver. Further, this section of the policy required "[a]n employee invited to attend such an event (whether attending with the giver or not) [to] either pay his or her own way, or reimburse the vendor, customer or supplier for these expenses."
>
> c. The policy permitted "[o]ccasional business entertainment (such as a meal or a recreational activity) where the giver attends the event with the recipient and the primary purpose is to discuss business or build a business relationship."

51. The three Fidelity executives and ten traders repeatedly violated Fidelity's gifts and gratuities policy when they accepted travel, entertainment and gifts paid for by brokers who sought and obtained securities transactions from Fidelity. For example:

> a. Many of the travel and entertainment events and gifts that the Fidelity employees received from brokers were worth more than $ 100, yet none of the employees ever submitted a written request for approval.
>
> b. The Fidelity employees frequently solicited brokers for tickets to a particular event. In fact, they sometimes asked for tickets so close to the date of the event that the brokers had to obtain the tickets from ticket agencies at exorbitant prices.
>
> c. On many occasions, the traders did not reimburse the brokers for the private jets, lodging, and other travel expenses, in violation of Fidelity's gifts and gratuities policy. On some occasions, brokers refused to accept reimbursement checks from traders; and on other occasions, the broker accepted a check not intending to cash it and informed the trader the check was just for "paper trail" purposes.

**DeSano's Failure to Supervise the Traders' Receipt of Travel, Entertainment and Gifts under Section 17(e)(1) of the Investment Company Act**

52. As Fidelity's head of equity trading, DeSano's duties included supervision of the traders' compliance with applicable legal requirements and with Fidelity's policies and procedures, including its gifts and gratuities policy.

53. DeSano knew that some traders received travel, entertainment and gifts from brokers, in part because he accompanied them on several trips, in part because he communicated regularly with Bruderman and several other traders about trading desk matters, and in part because he made sporadic attempts to have the traders tell him about their upcoming trips with brokers. For example, each year he asked the traders about their plans for the Super Bowl.

54. DeSano took only limited and ineffective steps to police the traders' receipt of travel, entertainment and gifts from brokers. For example:

a. At one point, DeSano caused Fidelity to issue credit cards to the traders so they could pay for their own business entertainment, but the traders did not use the cards or submit expenses for approval, and he did not follow up. At another point, he suggested to senior management of Fidelity that Fidelity might consider adopting a formal policy concerning its employees' use of private jets provided by brokers and other vendors, but again he did not follow up.

b. In early May 2004 (after a weekend when brokers had taken Harris to Las Vegas and Burnieika and Horan to Florida), he announced that traders would have to notify him in advance about all trips with brokers. A month later, he announced that traders would have to pay their own way on all future events with brokers. However, he did not enforce these policies, and traders continued to go on trips without informing him in advance and without reimbursing the brokers. For example, Quinn took DeSano and Bruderman golfing on Nantucket in June 2004, providing them with hundreds of dollars worth of golf items and arranging for Bruderman to take a private jet home from Nantucket. Similarly, Quinn took DeSano, Harris and his wife, and Horan to a charity golf event on Nantucket in August 2004. Quinn provided lodging for the group at his home, and gave the Harrises and Horan the use of his private jet to return to Boston. There is no evidence that the Fidelity employees reimbursed Quinn for these trips.

c. DeSano instructed the traders to reimburse brokers for private jet travel at the rate for first-class commercial airfare to the same destination, but he did not require proof of reimbursement, and, as a result, the traders rarely made reimbursement to brokers for their trips on private jets.

55. Indeed, far from effectively supervising the traders' receipt of travel, entertainment and gifts from brokers, DeSano actually made matters worse, in several respects.

a. DeSano personally asked brokers for tickets or asked traders to ask brokers for tickets, sometimes for himself and sometimes for other senior Fidelity executives like Grenier, and he personally went on several trips paid for by brokers without reimbursing his full share of the expenses. His conduct sent the clear message that the traders could engage in similar activities, and because soliciting brokers for tickets and traveling at a broker's expense were violations of Fidelity's gifts and gratuities policy, his conduct also sent the message that the traders too could violate Fidelity's policy with impunity.

b. DeSano traveled frequently with Quinn, the most significant source of travel and gifts for the traders. n15 For example, DeSano attended both the November 2002 "Fall Classic" and part of Bruderman's bachelor party in March 2003 -- two visible and extravagant excursions for which brokers picked up the tab. (Jefferies paid approximately $ 200,000 for the former, and several brokers including Quinn paid a total of approximately $ 160,000 for the latter.)

c. DeSano also took steps to conceal his and others' participation in the 2002 "Fall Classic." In an October 2002 email to Quinn, DeSano asked, "What happens when I get fired for this?" Quinn

responded, "SEC rule first class plane fare and we are all set. n16. . . Plus noone is allowed 2 say anything . . . Last yr never got out . . . If someone talks, we kill . . . said, "Brudy [Bruderman] will be on a trip with [his fiancee]. You [Quinn] will be trying to qualify for a tourney somewhere down south. Harris has to make something up. And what I do is no one's G.D. business!" In a subsequent email, DeSano told Harris, "This needs to be excessively covert . . . Not even your desk can know. Make something else up. " Harris responded, "I will, but when Brudy [Bruderman] and I are out and Kevin [Quinn] is out . . . people start talking. I am going to Seattle to see [my wife's] grandmother with her parents . . . That's my story and I am sticking to it." DeSano then gave Harris the cover stories for Bruderman and Quinn. Harris replied, "Sounds good."

56. DeSano failed to monitor the traders' receipt of travel, entertainment and gifts from brokers on any systematic basis, and he failed to take reasonable steps to enforce Fidelity's gifts and gratuities policy or to ensure that the traders did not receive compensation from brokers for purposes of Section 17(e)(1) of the Investment Company Act. Certain traders violated Section 17(e)(1) by receiving compensation in the form of gifts, travel, and entertainment from brokers. As a result, Fidelity, through DeSano as its head of equity trading, failed reasonably to supervise the traders, within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing their violations of Section 17(e)(1) of the Investment Company Act.

**Fidelity's Failure to Supervise its Executives' and Traders' Receipt of Travel, Entertainment and Gifts under Section 17(e)(1) of the Investment Company Act**

57. As shown above, the practice of accepting travel, entertainment and gifts paid for by brokers was well established at Fidelity throughout the Relevant Period -- not just by the ten traders named above, who handled more than 50% of Fidelity's equity trading, but also by three senior Fidelity executives with ties to the Equity Trading Desk.

58. At least nine members of Fidelity's Equity Trading Desk were aware that Lynch -- vice chairman and a director of FMR and FMR Co., interested trustee of the Fidelity Funds and former portfolio manager -- solicited tickets by calling the Equity Trading Desk, primarily Burns. All nine of those employees obtained gifts that violated Fidelity's policy. Lynch's conduct was the subject of comment between certain traders.

59. Likewise, Grenier and DeSano -- the two senior officers with primary responsibility for equity trading -- personally solicited and received tickets from brokers. In addition, DeSano personally went on numerous trips at a broker's expense, sometimes while accompanying traders under his supervision. n17 In a January 2004 email, Pascucci wrote to Smith, ". . . The jet stuff bothers me but the big guy [DeSano] is OK with it all the way."

60. Despite the fact that brokers who sought and obtained securities transactions from Fidelity were providing certain executives and traders with travel, entertainment and gifts as described herein, Fidelity failed to adopt and implement procedures reasonably designed to detect and prevent its employees' receipt of travel, entertainment and gifts that violated Fidelity's gifts and gratuities policy and that constituted compensation for purposes of Section 17(e)(1) of the Investment Company Act.

61. Fidelity failed to supervise its employees' compliance with the gifts and gratuities policy. Fidelity did not provide adequate training concerning the gifts and gratuities policy. In addition, Fidelity had virtually no monitoring mechanisms in place. For example, the policy required employees to submit a written request for an exception to the $ 100 limit on gifts, but even though the three executives and ten traders repeatedly received travel, tickets and other gifts worth more (often much more) than $ 100, none of them ever submitted such a request -- a clear sign that the policy was being ignored. Nevertheless, Fidelity did not take meaningful steps to curtail the receipt of gifts and entertainment by its executives or equity traders.

62. Fidelity thus failed to monitor its employees' receipt of travel, entertainment and gifts from brokers on any systematic basis, and it failed to take reasonable steps to ensure that its employees complied with its gifts and gratuities policy and did not receive compensation from brokers for purposes of Section 17(e)(1) of the Investment Company Act. As a result, Fidelity failed reasonably to supervise the three

executives and ten traders named above, within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing their violations of Section 17(e)(1) of the Investment Company Act.

Fidelity Failed to Seek Best Execution for its Clients' Securities Transactions Because the Traders Allowed the Receipt of Travel, Entertainment and Gifts from Brokers, and Familial and Romantic Relationships with Brokers, to Influence Their Selection of Brokers

**The Traders Sent Securities Transactions to Brokers from Whom They Received Travel, Entertainment and Gifts**

63. The receipt by ten equity traders, by DeSano (the traders' supervisor) and by Grenier (DeSano's supervisor) of travel, entertainment and gifts from brokers who sought and obtained securities transactions from Fidelity created a material conflict of interest that influenced the traders' selection of brokers to execute securities transactions on behalf of Fidelity's clients. In addition, Lynch (senior officer of FMR and FMR Co. and trustee of the Fidelity Funds) solicited and received tickets to sporting and entertainment events from two members of the Fidelity Equity Trading Desk, who in turn solicited those tickets from brokers who sought and obtained securities transactions from Fidelity, resulting in a material conflict of interest that influenced those traders' selection of brokers to execute securities transactions on behalf of Fidelity's clients.

64. In their emails to each other and to brokers, DeSano and the traders acknowledged the connection between the traders' receipt of travel, entertainment and gifts from brokers and their direction of business to brokers. For example:

> a. In January 2002, Bruderman asked DeSano not to approve a certain brokerage firm that wanted to handle some of Fidelity's securities transactions: "Please do not approve him and I am not going anywhere on his or his company's dime. That is the last guy in the world I want to feel indebted to."
>
> b. In April 2002, Pascucci asked a broker, "Pls ask the ticketmaster if the firm's single biggest customer cud have 2 tix [to an Andreas Bocelli concert]. (They are for his madre.) " Pascucci received the tickets from the broker.
>
> c. In October 2002, Pascucci told DeSano that a broker was offering two tickets to that night's Celtics game. DeSano replied, "[Name omitted] works there. Bad guy. I wouldn't want to feel obligated."
>
> d. Also in October 2002, a broker made the following offer to Donovan, "SANM [Sanmina-Sci Corp.] -- 500 k at 2.52. 500 trades away at 2.53. Plus 2 50-yard line seats to VA Tech-BC."
>
> e. In January 2003, Pascucci forwarded to Smith an email he received from a broker, "Like 'build it they will come,' the sell side mantra of 'plan fun trip with clients and they will come' still rings true in these parts."
>
> f. In February 2003, Quinn told Bruderman about plans for the upcoming bachelor party and added, "If I do the plane that I might do, you better load me up when it gets busy again."
>
> g. In March 2003, Pascucci commented to Smith that the conflicts between DeSano, Bruderman, Quinn, and others were "a WSJ [Wall Street Journal] article ready for the front page."
>
> h. In March 2003, Beran declined a broker's invitation to a golf trip, saying that he was already going on two trips in the next two months. He added that, although he had heard that the site of his second trip (a private golf club in Maryland) was "great," the "only problem is that I have to trade w/ [the brokerage firm] after I go! " Also in March 2003, Beran told another trader, "I figure I owe [the broker] 3 orders to pay for my annual . . . golf shirt."

i. Also in March 2003, Burns had this email exchange with a broker:

> Broker: . . . You must have a hankering to do a big CSCO [Cisco Systems] trade w/ me. At the very least, your prompt response will be rewarded w/ Celtic playoff seats. Thanks for caring.
>
> Burns: No hankering here, and you can send the tickets over.
>
> Broker: Our friendship has taken a significant step forward this AM. I could not be more pleased.
>
> Burns: Thank you!!!!
>
> Broker: Our friendship is boundless. Now, if you would please think of me next time a big situation appears on your desk, our friendship would be to the moon.

j. In April 2003, a broker told Burnieika, "Keep up the flow and I will get you and [another Fidelity trader] a car to the airport Fri." Two days later, the broker took Burnieika on a golf weekend in North Carolina.

k. In April 2003, a broker told Pascucci, "Nice sales in FBF [FleetBoston Financial], thanks for the bus today, talk to you in AM. If you need any seats for Celts thurs night, I've got 2 courtside if you want them."

l. In August 2003, Smith used an analogy to the team-building techniques of certain baseball teams to explain to Pascucci his theory of how brokers use their travel and entertainment budget to attract Fidelity's business:

If you map out a strategy for "attacking FIDO [Fidelity]" to maximize commission $$, it seems there are 2 strategies. . . attack the generals, i.e. ingratiate yourself w/ the powerbrokers thru extensive use of the expense account (let's call them the Yankees) who curry favor w/ THB [Bruderman], DKD [Donovan], and SCD [DeSano] . . . or recruit youth early (let's call them the A's) by showering the youngsters w/ service and small $$ perks.

m. In April 2004, the broker told Burns that he was sending Red Sox tickets and added "ANDW [Andrew Corp.] 6 figs for sale." Burns thanked him. The broker replied, "Thx for sending over the Sox tix or thx for sending over the ANDW INDI or thx for being such a great guy or all of the above?" Burns responded, "All of the above."

65. Indeed, some of the emails between traders and brokers reflect a shared perception that the job of a so-called "sell side" broker includes the provision of travel and tickets, and that one advantage of being a so-called "buy side" trader is the opportunity to receive such benefits. For example:

a. In May 2002, Burnieika told a broker that he was going to two upcoming Celtics playoff games. The broker commented, "Nice to be king!" Burnieika replied, "Right side of the street when U2 concerts and Celts playoff games come around."

b. In August 2002, Smith observed to Pascucci ". . . Golf, dinners, tickets, Super Bowl, trips. Everything is for sale." Two days later, Smith complained to Pascucci, "It's bad enough w/ SCD [DeSano], DKD [Donovan], and Brudy [Bruderman], but when Horan and JDH [Harris] start in on the exclusive golf dates, it's pathetic." Pascucci replied, "Agreed 500%."

c. In September 2002, Bruderman sent a broker an email concerning plans for his wedding. Bruderman told the broker, "As of this morning you and [a broker at another firm] and Quinn are paying for it. " The broker replied, "Can't wait. Send me the bill." Later that day, Bruderman told

Quinn, "Bad news. You and [another broker] have to pay for the wedding." Quinn replied, "Creative T&E. Again."

d. In May 2003, Pascucci asked a broker, "Who will be first guy on sell side to offer Green Monster seats?" The broker replied, "Me. " (The "Green Monster" was a new area of expensive seats for Red Sox games at Fenway Park.)

e. In September 2003, Bruderman received and forwarded to several brokers an email that parodied a beer company's advertising campaign:

> Here's to you Mr. Institutional Sales Trader. Because you spend all day lying to people with MBA's from Ivy League schools, even though you failed Econ 101 at the Community College. And if the stock goes up or down, you don't care -- as long as you get your nickel. Five cents a share! So crack open an ice cold Bud Light you overpaid sack of sh*t, because without you there would be a lot of buy side guys sitting in bad seats at the concert.

f. In October 2003, Bruderman complained to one broker that a broker at another firm had been unable to get him tickets to a Bare Naked Ladies concert: "Say he has no tickets left. Gave em all to [name omitted] and his hedge fund pals. I think I am going to request a change in coverage."

g. In May 2004, a broker asked Burns, "Are you aware of a guy who delivers Yankee tix to your desk faster than me? Seller of good size CSCO."

h. Also in May 2004, Pascucci offered Driscoll this praise for a broker: "[Name of broker] has not had a misstep for 1 second in his [name of firm] career. Trading is first rate. Research effort is consistent and impactful, and he is 500 times the ticket broker [name omitted] from Friend St. is. The new sales trading model."

66. As reflected by the traders' conduct and their email communications with brokers and each other, the conflicts of interest were not merely theoretical, and the traders did in fact allow their receipt of travel, entertainment and gifts to influence their selection of brokers to handle securities transactions for Fidelity's clients. For example:

a. In January 2002, Driscoll told another trader that he was going to the Super Bowl in New Orleans with a certain broker and added, "The good news is, the TYC [Tyco] order paid for [the broker's] jet." That day, Driscoll sent orders to the broker's firm (including more than 8 million shares of Tyco stock) that generated more than $ 487,000 in commissions. Driscoll's Tyco trade did not go unnoticed on the Equity Trading Desk. Smith observed to Pascucci: "[P]oor broker selection. Superbowl trip should not affect judgment" and "7 million shares of TYC [actually, 8 million shares] buys you a seat on a private jet."

b. Also in January 2002, Bruderman told a broker, "This BSX [Boston Scientific] order works to 1 mill. That should get us part of the way to paying for the band. How much is it so I know what I need to do to pay for it? " The broker responded that the band (Counting Crows) would cost "3 bills + love."

c. In March 2002, Smith commented to Pascucci that Bruderman sent most of his business to Quinn and brokers at two other firms who took him on trips and asked "Who says Fido can't be bot?" Pascucci responded, "No comment on record. Off record, THB [Bruderman] has killed the integrity of this desk." Smith replied, "How that does not raise red flags, I do not know."

d. In April 2002, Pascucci complained to Smith, "Here's the truth. Image on street at all time low. We are VWAP n18 robots and gift whores."

e. A broker told Burns in a May 2002 email, "For better or for worse, I am [a] liquidity provider of stocks and tickets. Please do not hesitate to knock on my door for either. My door is open to you

24 hours a day 7 days a week." Burns took him up on the offer. Indeed, that same month, after the broker provided Burns with tickets to a Celtics playoff game, Burns sent 1.2 million shares to the broker -- his first orders to the firm all year. The trades generated more than $ 60,000 in commissions.

f. In June 2002, a broker offered Burnieika tickets to a Red Sox game for his parents. One hour later, Burnieika began sending orders to the broker. While Burnieika had traded the same security with that broker the prior two trading days, his total for the day exceeded 860,000 shares -- his heaviest single trading day with the firm during the entire 2002-2004 period. The trades generated $ 43,000 in commissions.

g. In June 2002, a broker took Donovan to Paris for the French Open tennis tournament, and Donovan's expenses cost the broker more than $ 24,000. The day he returned, Donovan sent more than 1.8 million shares to the broker. The trades generated $ 90,750 in commissions.

h. In August 2002, Harris thanked a broker for their recent trip to the Red Tail resort in Toronto: "I owe you bro. Can't thank you enough for including me in such a special trip. Place is over the top!" That day, Harris sent trades involving more than two million shares to the broker's firm, and the trades generated $ 103,000 in commissions.

i. In September 2002, several brokers from the same firm took Smith for a weekend in Illinois and Michigan that included a Notre Dame-Michigan college football game. During the two weeks after the trip (ten trading days), Smith sent nearly 19.3 million shares to the brokers (more than 1.9 million shares per day). The trades generated nearly $ 456,000 in commissions.

j. In September 2002, Harris told Quinn that he might not be able to attend the upcoming "Fall Classic". Quinn complained, "Pls don't do this 2 me." Harris replied, "Bro, I may have to but I will make it up with a lot of shares."

k. In September 2002, Smith asked Pascucci, "2 guesses who is paying for BB's [Burns] Super Saturday [U.S.] Open tickets." Pascucci answered, "Jeff Reece [Jefferies]. " Smith observed that Quinn had taken four months off after leaving another firm, and that Burns had greeted his arrival at Jefferies in September 2002 with a million-share order.

l. In September 2002, Quinn gave Burns tickets to the US Open tennis tournament. Two days before the event, Burns sent 2.1 million shares to Quinn. The next day, Burns sent another 2.8 million shares. The trades on these two days generated more than $ 160,000 in commissions.

m. In November 2002, a broker told Harris, "Thx for the order. Have some B's tix for tomorrow if interested."

n. In November 2002, Smith complained in an email that "Brudy and Jeff [Harris] load up Jeff [Jefferies] for 2 weeks before the trip [the "Fall Classic"]. THB [Bruderman] has clearly made it known that his order flow is for sale to the highest bidder, and nobody else in the room would get away w/ that sh1t."

o. Quinn provided a private jet to Driscoll for a family Disney World trip. In a November 2002 email, Driscoll asked Quinn, "You did not tell anyone about this, did you?" Later, Quinn responded, "By the way, I view private travel as one of the great perks of this biz and am more than willing to do it for a few guys when I can, just as long as they keep it low." Driscoll replied, "We are on the same page." Driscoll also rewarded Quinn for his generosity. In the two weeks (seven trading days) before the Disney World trip, Driscoll sent more than 8.9 million shares to Quinn (almost 1.3 million shares per day). The trades generated more than $ 445,000 in commissions.

p. In December 2002, Driscoll thanked a broker for a holiday gift certificate. The broker replied, "No. Thx u. Wish was for more. Wud be luggin furniture if not for u."

q. In January 2003, a broker offered Pascucci tickets to "Disney on Ice." Pascucci asked for five tickets for his brother and his children. The broker replied, "No problem. And Steve, don't EVER hesitate to ask for tix if u need 'em. That's one of the beni's of my job. U've done a lot for me, I am more than happy to help you out." On the two days after the event, Pascucci sent more than 1.1 million shares to the broker (more than 550,000 shares per day). The trades generated more than $ 44,000 in commissions.

r. In January 2003, Quinn offered Burns a package with first class airfare to Wimbledon, which Burns declined. The same day, Burns sent Jefferies a total of 2.2 million shares, which generated $ 70,000 in commissions, and told Quinn "I am totally committed to assisting you in your efforts."

s. In February 2003, Smith commented to a Fidelity trader about "the obvious pattern of loading up a broker, then disappearing on a golf trip, etc. It used to be Red Sox tickets and a dinner, now it's private jets to the Masters."

t. In April 2003, Bruderman told a broker, "I owe you money. Paying it today w/ SGP [Schering Plough]." That day, Bruderman asked the broker to sell 100,000 shares of SGP, generating a $ 5,000 commission.

u. In June 2003, Quinn told Bruderman, "You're welcome for the Sox tix by the way." Bruderman replied, "You're welcome for the house in Needham [the location of Quinn's residence]."

v. In June 2003, Smith asked a broker for tickets to a Van Morrison concert. The broker offered him two front-row seats. Smith responded. "Right on. " Two minutes later, Smith wrote "Work 250m MSFT [Microsoft] for me."

w. Shortly after Quinn joined Jefferies, Quinn asked if Smith was upset with him. Smith replied, "Never have been. Just shocked how the red carpet has been rolled out to you. Your 'new' firm offers me nothing that I don't already get from every other firm in the Top 30, so I apologize if I don't drink the Kool-Aid." Indeed, from September 2002 until mid-October 2003, Smith traded with Jefferies very infrequently. In mid-October 2003, however, that changed. On or about October 20, 2003, Smith began exchanging emails with Quinn about a trip to the Caribbean that Smith was planning with his wife. During the course of that exchange, Quinn offered to provide Smith with a private jet for his vacation. On the day Quinn offered to supply the jet, Smith sent more than 1.5 million shares to Jefferies. The next day, Smith sent nearly 1.4 million shares. All told, Smith traded with Quinn on sixteen of the seventeen trading days between the day Quinn offered his private jet and the day Smith left for his vacation. Smith's heavy use of Jefferies continued after his return. Smith traded with Quinn on fourteen of the first sixteen trading days after the trip, including one day with nearly 1.2 million shares. The three days with orders totaling over 1 million shares were three of Smith's four heaviest trading days with Jefferies during the Relevant Period, and the trades on those days generated nearly $ 190,000 in commissions.

x. In December 2003, Pascucci asked a broker for courtside tickets to that night's Celtics game. The broker offered four tickets. Pascucci told him where to deliver the tickets and added, "Thks. Buy 50K."

y. In February 2004, brokers took several traders to see the New England Patriots play in the Super Bowl in Houston. On the day before he left, Burnieika sent more than 500,000 shares to the broker who took him -- his second largest day with the firm in the entire 2002-2004 period -- and the trades generated more than $ 25,000 in commissions.

z. In July 2004, Quinn provided tickets and a hotel for Burns to attend the Wimbledon tennis tournament in London at a cost of over $ 50,000. During the week after he returned (four trading days), Burns sent more than 7.6 million shares to Jefferies (more than 1.9 million shares per day). On one of the days, he sent 4 million shares -- his second heaviest trading day with the firm in the entire 2002-2004 period. The trades on these four days generated $ 255,000 in commissions.

aa. After the broker who facilitated Driscoll's gambling changed firms in April 2004, Driscoll received the following request from the broker: "If you can find it in your heart not to let me get shut out by the end of the day that would be greatly appreciated. Not a very good first impression. Have to go down to NY for the day tomorrow to meet all the traders." Driscoll forwarded the broker's message to Horan and commented, "How is it that we owe all these fuking millionaires something after we got them where they are?" Despite his griping, Driscoll began sending regular trades to the broker's new firm two days later.

67. The decision of Harris to start sending business to Jefferies after Quinn joined the firm reflects how the receipt of travel, entertainment and gifts influenced his selection of brokerage firms.

a. In May 2002, Harris learned that Quinn was moving to Jefferies after rejecting an offer from a major brokerage firm that handled a substantial amount of Fidelity business. Harris was unhappy about Quinn's choice and complained to Bruderman, "Between me and you, I am frustrated he put me in this situation. It compromises your position on the desk to do a lot of bus with a firm like Jeff [Jefferies]. [The other firm] is easy because you can justify it. The desk will be pissed, especially now that commission dollars are under a microscope . . ." n19

b. Despite his misgivings, Harris began sending a substantial amount of business to Jefferies in September 2002 after Quinn started working there. In late November 2002, however, Harris complained to Quinn about his trade execution:

Harris: Just went out back . . . You were my 3rd broker for the month and 30th on [Fidelity's trader performance measurement] and I was still number 3 on the desk . . . Guys wanted to know what Jeff[eries] was and why I was doing all the volume, hurting my [performance statistics] when I could have taken number 1. Reminds me of my [name of firm] numbers. [Harris named the firm where Quinn had worked before joining Jefferies.]

Quinn: Pick up [the dedicated phone line between Fidelity and Jefferies].

Harris: One of 2 things will change: 1. your volume will drop. 2. my numbers will go up.

Quinn: You're right. It is all my fault.

c. Nevertheless, Harris continued trading -- and traveling -- with Quinn. In December 2002, Quinn and another Jefferies broker took Harris for a golf weekend in South Carolina. The week he returned (three trading days), Harris sent more than 2.6 million shares to the brokers (almost 870,000 shares per day). The trades generated more than $ 118,000 in commissions.

d. In two July 2003 emails, Harris again complained to Quinn about his performance. In the first, Harris "thank[ed]" Quinn "for all the crummy [trader performance statistics] for last year and this year." In the second, Harris warned Quinn that the "[t]ech guys in back are on to you. Brudy's [Bruderman] numbers suk with you too."

e. Despite his complaints, Harris's trading with Jefferies remained heavy throughout Quinn's employment at the firm. Harris sent nearly 142 million shares to Jefferies after Quinn arrived, and the trades generated more than $ 6.5 million in commissions.

68. During the Relevant Period, the ten traders each directed equity trading business generating millions of dollars in commissions to brokers from whom they received travel, entertainment and gifts. The influence of travel, entertainment and gifts on Fidelity's order flow is particularly apparent with respect to Jefferies:

a. In the second quarter of 2002 (before Quinn's arrival), Jefferies handled 12.9 million shares of securities for Fidelity. With this volume, Jefferies ranked 44th among the brokerage firms used by Fidelity. Jefferies' volume rose quickly after Quinn's arrival. In the fourth quarter of 2002 (Quinn's

first full quarter of employment), Jefferies' ranking had risen to 12th. In the third quarter of 2004 (Quinn's final full quarter of employment), Jefferies handled 112.9 million shares of securities, and its volume ranking was 13th.

b. The brokerage commissions that Jefferies received from Fidelity increased in a similar fashion. In the first six months of 2002, just prior to Quinn's arrival, Jefferies received nearly $ 888,000 in commissions, ranking it 42nd among the firms used by Fidelity. By contrast, in the first nine months of 2004, Jefferies received $ 20.7 million in brokerage commissions from the Fidelity Funds, improving its ranking to 10th among the firms used by Fidelity. During the period of Quinn's employment, Jefferies received over $ 60 million in commissions from Fidelity's client accounts.

c. Most of the brokerage business that Jefferies received from Fidelity came from four traders (Bruderman, Donovan, Harris and Horan), who went on most of Quinn's golf and other excursions, and from a fifth trader (Burns), who received expensive wine and expensive tickets to sporting events such as Wimbledon and the U.S. Open. During the period of Quinn's employment at Jefferies (September 2002 to October 2004), these five traders alone sent trades generating approximately $ 39.4 million in commissions for Jefferies.

**Certain Traders Sent Securities Transactions to Brokers with Whom They Had a Family or Romantic Relationship**

69. During the Relevant Period, five Fidelity traders sent securities transactions to brokers with whom they had a family or romantic relationship. In each instance, the trader sent millions of shares of transactions to the broker's firm, and the trades generated millions of dollars of commissions.

a. One of Donovan's family members was a broker who covered (i. e., handled transactions for) several Fidelity traders, including Donovan himself. During the Relevant Period, Donovan sent more than 678 million shares to his family member's firm, and the trades generated more than $ 31 million in commissions.

b. A family member of Driscoll's was a broker who changed firms in January 2003 and thereafter covered several Fidelity traders. The family member did not cover Driscoll himself, but the family member's compensation depended in part on the firm's total commissions from Fidelity's business. Driscoll sent no trades to the new firm before his family member joined it, but from January 2003 through October 2004, he sent more than 56 million shares to the firm, and the trades generated more than $ 2.7 million in commissions.

c. A family member of Pascucci's was a broker who changed firms in late December 2002 and thereafter covered several Fidelity traders, including Pascucci himself. Pascucci did little business with the new firm before his family member joined it, but from late December 2002 through October 2004, he sent more than 138 million shares to the firm, and the trades generated more than $ 6.8 million in commissions.

d. In addition, two Fidelity traders not named in this Order were involved in romantic relationships with brokers to whom they sent trades generating, in aggregate, several million dollars in commissions.

e. In October 2003, Smith commented to Pascucci, "so 2 of our . . . [brokerage firms] are absolutely zero value-added on research and mkt intelligence, but loaded to the gills w/ nepotism, incestual relationships, and issues of conflict." Pascucci replied, "I cannot poke a hole in that."

**Fidelity's Violation of Section 206(2) of the Advisers Act**

70. As set forth above, DeSano was aware of significant conflicts of interest involving Fidelity's equity traders. He knew that some traders sent securities transactions to brokers from whom they received

travel, entertainment and gifts. He also knew that some traders sent securities transactions to brokers with whom they had a family or romantic relationship. For example, he knew that one of Donovan's family members was a broker at one of the largest firms handling transactions for Fidelity. He also knew that a Fidelity trader not named in this Order was romantically involved with a broker because the trader told him about the relationship and asked him for permission to continue sending business to the broker's firm, and he approved.

71. Section 206(2) of the Advisers Act provides that an investment adviser shall not "engage in any transactions, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." n20 One aspect of an investment adviser's fiduciary duty under Section 206(2) of the Advisers Act is the duty to seek best execution for its clients' securities transactions -- that is, to seek the most favorable terms reasonably available under the circumstances.

72. As set forth above, Fidelity traders allowed their receipt of travel, entertainment and gifts from brokers and their family or romantic relationships with brokers to influence their selection of brokers to handle Fidelity's securities transactions. As a result, Fidelity failed to seek best execution for its clients' securities transactions and thereby willfully violated Section 206(2) of the Advisers Act.

**Fidelity Made Materially False and Misleading Public Disclosures about its Conflicts of Interest with Respect to its Selection of Brokers**

**Fidelity's Failure to Disclose Its Conflicts of Interest**

73. Under Section 206(2) of the Advisers Act, an investment adviser has a fiduciary duty to disclose all material conflicts of interest to its advisory clients. During the Relevant Period, Fidelity failed to disclose to its clients, including the Fidelity Funds, the material conflicts of interest arising from the receipt by certain Fidelity executives and traders of travel, entertainment and gifts from brokers (including illegal drugs for Bruderman and the facilitation of illegal gambling for Driscoll) and certain traders' family and romantic relationships with brokers seeking and obtaining securities transactions for Fidelity's clients. As a result, Fidelity willfully violated Section 206(2) of the Advisers Act.

**Material Misrepresentations and Omissions in Form ADV and Statements of Additional Information**

74. Section 204 of the Advisers Act and Rule 204-1 thereunder require an investment adviser annually to amend and file with the Commission its Form ADV. Section 207 of the Advisers Act prohibits any person from willfully making any untrue statement of material fact or omitting to state any material fact required to be stated in any report filed with the Commission under Section 204.

75. Form ADV requires the disclosure of certain material information about the investment adviser. For an investment adviser like Fidelity with discretion to select brokers to execute its clients' securities transactions, Item 12.B of Part II of Form ADV requires a description of the factors that the adviser considers when selecting brokers.

76. Section 34(b) of the Investment Company Act prohibits any person from willfully making an untrue statement of material fact in any document filed with the Commission.

77. Fidelity provides copies of its Form ADV to the independent trustees acting on behalf of the Fidelity Funds and to other clients. As investment adviser to the Fidelity Funds, Fidelity prepares Statements of Additional Information ("SAIs") that supplement the Fidelity Funds' prospectuses and are made available to shareholders upon request.

78. During the Relevant Period, the Forms ADV and the SAIs prepared by Fidelity contained virtually identical language to the effect that Fidelity selected brokers for its clients' transactions "on the basis of professional capability and the value and quality of services." The Forms ADV and the SAIs also listed specific factors that Fidelity considered when selecting brokers, including: (a) price, size and type of

transaction; (b) reasonableness of commissions; (c) speed and certainty of trade executions; (d) nature and character of the markets for the security; (e) liquidity and depth offered by a market center or market-maker; (f) reliability of the market center or broker; (g) the degree of anonymity that the broker or market center can provide; (h) the broker's execution services rendered on a continuing basis; and (i) the execution efficiency, settlement capability, and financial condition of the brokerage firm. The Forms ADV and the SAIs were materially misleading because they failed to disclose that, as set forth above, the traders' receipt of travel, entertainment and gifts (including illegal drugs for Bruderman and the facilitation of illegal gambling for Driscoll) and their family and romantic relationships were also factors in the traders' selection of brokers for Fidelity's clients' transactions, including transactions for the Fidelity Funds, and that Fidelity did not have a sufficient system of controls to detect, deter, and prevent such factors from entering into the selection of brokers. As a result, Fidelity willfully violated Sections 204 and 207 of the Advisers Act, and Rule 204-1 thereunder; and Section 34(b) of the Investment Company Act.

**Material Misrepresentations and Omissions by DeSano to the Fidelity Funds' Trustees**

79. During the Relevant Period, DeSano made periodic presentations to the trustees of the Fidelity Funds concerning equity trading operations and the selection of brokers for the Fidelity Funds' transactions. For example:

> a. On September 19, 2002, DeSano attended a meeting of the Brokerage Committee of the Fidelity Funds' trustees and presented Fidelity's annual report on equity trading and the use of brokerage commissions. DeSano's written report to the trustees stated that the "sole criterion" for broker selection was "execution capability" and that "brokers compete on [the] basis of execution quality."
>
> b. On September 18, 2003, DeSano attended a meeting of the Shareholder Services, Brokerage and Distribution Committee of the Fidelity Funds' trustees and presented Fidelity's annual report on equity trading and the use of brokerage commissions. According to the minutes of the meeting:
>
> > Mr. DeSano provided an overview of the equity trading process, stating that FMR's approach to trading is to focus solely on execution quality, trade with the best brokers and closely manage the impact of the funds' trades on the market. He stated that as a result of the "broker segmentation" program implemented over five years ago, FMR now trades with a relatively small number of core brokers, which reduces information leakage and allows the brokers to compete based on the quality of their execution. [Emphasis added]
>
> c. On September 16, 2004, DeSano attended a meeting of the Shareholder Services, Brokerage and Distribution Committee of the Fidelity Funds' trustees and presented Fidelity's annual report on equity trading and the use of brokerage commissions. According to the minutes of the meeting:
>
> > Mr. DeSano provided an overview of the equity trading process, stating that FMR's highest priority in trading for the funds is execution quality. He stated that FMR seeks to trade with the best brokers and closely manage the impact of the funds' trades on the market. He stated that as a result of broker segmentation program in place for the last six years, FMR trades with a relatively small number of core brokers, which reduces information leakage and allows the brokers to compete based on the quality of their execution. [Emphasis added]

80. Section 206(2) of the Advisers Act provides that an investment adviser shall not "engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." The statements by Fidelity, through DeSano, to the trustees of the Fidelity Funds were materially misleading because DeSano failed to disclose that, as set forth above, the traders' receipt of travel, entertainment and gifts and their family and romantic relationships were also factors in the selection of brokers for the Fidelity Funds' transactions, and brokers competed for Fidelity's business

on the basis of travel, entertainment and gifts in addition to execution performance. As a result, Fidelity, through DeSano, willfully violated Section 206(2) of the Advisers Act.

**Fidelity Failed to Supervise Certain Employees and Officers**

81. Under Section 17(e)(1) of the Investment Company Act, affiliated persons of a registered investment company are prohibited from accepting "from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property" of the investment company. During the Relevant Period, two Fidelity executives (DeSano and Grenier) and ten Fidelity traders (Beran, Bruderman, Burnieika, Burns, Donovan, Driscoll, Harris, Horan, Pascucci and Smith) each received compensation in violation of Section 17(e)(1) of the Investment Company Act in the form of travel, entertainment and gifts paid for by brokers who sought and obtained securities transactions for Fidelity's clients. In addition, another Fidelity executive (Lynch) caused two Fidelity traders' violations of Section 17(e)(1). Fidelity failed to adopt and implement a system of controls sufficient to detect, deter, and prevent the receipt by these executives and traders of travel, entertainment and gifts paid for by brokers as described herein. As a result, Fidelity failed reasonably to supervise the executives and traders, within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing their violations of Section 17(e)(1) of the Investment Company Act.

**Fidelity's Failure to Make and Keep True, Accurate and Current Copies of Certain Communications Concerning the Purchase or Sale of Securities for its Clients**

82. Section 204 of the Advisers Act and Rule 204-2 thereunder require an investment adviser to make and keep true, accurate and current certain books and records relating to its investment advisory business, including originals or copies of certain documents reflecting its communications with brokerage firms relating to the placing or execution of orders to purchase or sell securities.

83. During the Relevant Period, Fidelity did not maintain a complete record of all its employees' communications with brokers regarding the placing or execution of orders to purchase or sell securities. Fidelity contracted with Bloomberg to retain copies of all communications sent through Bloomberg's email network between Fidelity's equity traders and the brokers who handled securities transactions for Fidelity. Those email records were incomplete and inaccurate because when retrieved they did not include the names of individual email users who had terminated their employment with either Fidelity or a brokerage firm, such that in certain messages those users' names would not be displayed.

84. Because, as set forth above, the emails maintained by Bloomberg on Fidelity's behalf were incomplete, Fidelity failed to make and keep true, accurate, and current originals or copies of its communications with brokers concerning the placing or execution of orders to purchase or sell securities. As a result, Fidelity willfully violated Section 204 of the Advisers Act and Rules 204-2(a)(7)(iii) and 204-2(g) thereunder.

**Fidelity's Breach of Fiduciary Duty Resulted in the Substantial Possibility of Higher Execution Costs to its Advisory Clients**

85. As set forth above, Fidelity breached its fiduciary duty to its advisory clients, including the Fidelity Funds, in several respects. First, as described herein Fidelity allowed certain executives' and traders' receipt of travel, entertainment and gifts from brokers and certain traders' family or romantic relationships with brokers to influence its selection of brokers to handle its clients' transactions, resulting in the substantial possibility of higher execution costs to Fidelity's advisory clients. Second, it failed to disclose to its clients the conflict of interest arising from its executives' and traders' receipt of travel, entertainment and gifts from brokers and certain traders' family or romantic relationships with brokers. Finally, it made materially false and misleading statements in public disclosure documents and to the Fidelity Funds' trustees about the factors considered in the selection of brokers.

86. After being informed that some equity traders had accepted travel, entertainment and gifts from some brokers, the independent trustees of the Fidelity Funds retained a former federal judge, then an attorney at a prominent national law firm, to conduct an independent assessment of the adverse impact

on the Fidelity Funds, if any, resulting from trades initiated by some Fidelity traders in recognition of improper travel, entertainment and gifts. The attorney was assisted by a team of economic consultants. The attorney submitted his report to the independent trustees in November 2006. (A copy of the final report is available on the SEC Web site.) n21

87. The report to the independent trustees concluded that "Fidelity clearly breached its duty to the Fidelity Funds to ensure that its traders acted solely for the benefit of the Funds." The report found that, while "it is impossible to 'prove' statistically that the traders' receipt of TEGG [travel, entertainment, gifts and gratuities] did or did not result in excessive execution costs for the Funds, ... both logic and contemporaneous evidence suggest that there is a substantial possibility that the traders' acceptance of TEGG could have resulted in higher execution costs for the Funds." The report further noted that "the question to be answered here is not whether the Funds were in fact harmed by the traders' receipt of TEGG, but how the Trustees should respond to the traders' breach of fiduciary duty that put the Funds in harm's way."

88. The report recommended that the independent trustees seek payment from Fidelity to the Fidelity Funds in the amount of $ 40.7 million for potential harm to the Fidelity Funds in order "to ensure with reasonable confidence that the Funds do not end up being undercompensated for the improper conduct that indisputably took place." Using the same methodology, the report recommended that a payment of approximately $ 10.2 million for potential harm be made to non-Fund advisory clients of FMR LLC's affiliates. In addition, the report recommended that Fidelity pay $ 8.2 million for reimbursement of Fund expenses incurred in connection with the independent trustees' investigation, and $ 4.5 million of interest through November 30, 2006.

89. During the course of his 14-month investigation, the independent trustees monitored the work of the attorney, heard reports from him and his economic consultants and heard presentations from Fidelity and its economic consultant. After reviewing the attorney's final report, on December 14, 2006, the independent trustees issued their report and conclusions. (A copy of the independent trustees' report and conclusions is available on the SEC Web site.)

90. The independent trustees' report accepted the attorney's final report. The independent trustees' report concluded that, "in spite of the absence of proof that the Funds experienced diminished execution quality as a result of traders' receipt of improper TEGG, the conduct at issue was serious, is worthy of redress and, as [the attorney] concluded, any uncertainty should be resolved in favor of the Funds." The independent trustees determined that it would be "appropriate" for Fidelity to pay the Fidelity Funds $ 42 million plus interest and expenses.

91. On December 21, 2006, Fidelity's parent company, FMR LLC, disclosed the independent trustees' report on its public Web site and announced that Fidelity had agreed to make the payment to the Fidelity Funds requested by the independent trustees (see para. 90, above) and that it had committed to make comparable payments to institutional and other accounts that are advised by FMR LLC affiliates.

**D. RESPONDENTS' REMEDIATION**

92. Fidelity took several remedial actions after the Commission staff began its investigation:

> a. Fidelity disciplined approximately two dozen equity traders and other employees based on written surveys, which were requested by the Commission staff, of the traders and other employees concerning their receipt of travel, entertainment and gifts received from brokers during the Relevant Period.
>
> b. Fidelity changed several of its policies and procedures concerning conflicts of interest. First, Fidelity adopted supplemental standards of conduct applicable to all Fidelity employees that required management approval of all private jet travel, clarified the rules on permissible business entertainment, and required employees to report to the ethics office all business entertainment exceeding $ 250 in value. Later, with input from the independent trustees and an ethics consultant retained by the independent trustees, Fidelity's parent company, FMR LLC revised its

firm-wide business entertainment and workplace gifts policy. Subsequently, Fidelity also adopted a new relationship policy, requiring traders to notify their managers and the ethics office promptly if certain family members become employed in certain specified positions by any broker-dealer with which Fidelity does business.

c. Fidelity also reorganized the management of its equity trading operations. Among other changes, in February 2005, Fidelity established a new level of management oversight between the head of equity trading and the traders. Subsequently, Fidelity appointed a new manager for its equity trading operations.

d. Fidelity's parent company, FMR LLC, substantially increased its ethics office's funding for technology and personnel and hired a new management team to run the ethics office, including an employee whose sole responsibility is to manage compliance with FMR LLC's gifts and entertainment policies for Fidelity and other FMR LLC subsidiaries.

**E. VIOLATIONS**

93. As described above, Fidelity failed reasonably to supervise three Fidelity executives (DeSano, Grenier and Lynch) and ten Fidelity equity traders (Beran, Bruderman, Burnieika, Burns, Donovan, Driscoll, Harris, Horan, Pascucci and Smith), within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing their committing and/or causing violations of Section 17(e)(1) of the Investment Company Act.

94. As described above, Fidelity failed to seek best execution for its clients' securities transactions by allowing its traders' receipt of travel, entertainment and gifts and the traders' family or romantic relationships to enter into their selection of brokers. Accordingly, Fidelity willfully violated Section 206(2) of the Advisers Act.

95. As described above, Fidelity willfully violated Section 206(2) of the Advisers Act, in that Fidelity failed to disclose to its clients, including the Fidelity Funds, the material conflict of interest arising from the receipt by certain Fidelity executives and traders of travel, entertainment and gifts (including illegal drugs for Bruderman and the facilitation of illegal gambling for Driscoll) from, and certain traders' family or romantic relationships with, brokers seeking and obtaining securities transactions for Fidelity's clients.

96. As described above, Fidelity willfully violated Sections 204, 206(2) and 207 of the Advisers Act and Rule 204-1 thereunder and Section 34(b) of the Investment Company Act, in that Fidelity made materially false and misleading statements and omissions in its Forms ADV and in Statements of Additional Information for the Fidelity Funds about its selection of brokers.

97. As described above, Fidelity willfully violated Section 206(2) of the Advisers Act, in that Fidelity, through DeSano, made materially false and misleading statements and omissions to the trustees of the Fidelity Funds concerning the factors considered in its selection of brokers and the bases upon which brokers competed for the Fidelity Funds' brokerage business.

98. As described above, Fidelity willfully violated Section 204 of the Advisers Act and Rules 204-2(a)(7)(iii) and 204-2(g) thereunder, in that Fidelity failed to make and keep true, accurate, and current originals or copies of certain communications with brokers concerning the placing or execution of orders to purchase or sell securities.

**IV.**

**UNDERTAKINGS**

Respondents have undertaken to:

**A. Independent Compliance Consultant.**

1. Within 30 days of the entry of the Order, Fidelity shall retain an Independent Compliance Consultant ("ICC") not unacceptable to the staff of the Commission and the independent trustees. The ICC's compensation and expenses shall be paid exclusively by Fidelity. Fidelity shall cause the ICC to conduct a comprehensive review of Fidelity's current policies and procedures designed to prevent and detect violations of Section 17(e)(1) of the Investment Company Act and Fidelity's securities trading with respect to the following: (i) remediation actions relating to its equity trading operations; (ii) gifts and gratuities policies and procedures; and (iii) other current policies and procedures designed to prevent undisclosed conflicts of interest. Fidelity shall cooperate fully with the ICC and comply with all of the ICC's reasonable requests for access to Fidelity's files, books, records, and personnel.

2. Fidelity shall require that, at the conclusion of the review, which in no event shall be more than 120 days after the date of entry of this Order, the ICC shall submit a Report to Fidelity, the independent trustees, and to the staff of the Commission. Fidelity shall require the ICC to address in the Report the issues described in paragraph (1) of these undertakings, and to include a description of the review performed, the conclusions reached, the ICC's recommendations for changes in or improvements to Fidelity's policies and procedures for implementing the recommended changes in or improvements to Fidelity's policies and procedures.

3. Fidelity shall adopt all recommendations contained in the Report of the ICC; provided, however, that within 150 days from the date of the entry of this Order, Fidelity shall in writing advise the ICC, the independent trustees, and the staff of the Commission of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that Fidelity considers unnecessary or inappropriate, Fidelity need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose.

4. As to any recommendation with respect to Fidelity's policies and procedures on which Fidelity and the ICC do not agree, such parties shall attempt in good faith to reach an agreement within 180 days of the date of the entry of this Order. In the event Fidelity and the ICC are unable to agree on an alternative proposal acceptable to the staff of the Commission, Fidelity will abide by the determinations of the ICC.

5. Fidelity (i) shall not have the authority to terminate the ICC, without prior written approval of the staff of the Commission; (ii) shall compensate the ICC, and persons engaged to assist the ICC, for services rendered pursuant to this Order at their reasonable and customary rates; and (iii) shall not be in and shall not have an attorney-client relationship with the ICC and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the ICC from transmitting any information, reports, or documents to the staff of the Commission.

6. Fidelity shall require the ICC to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the ICC shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Fidelity, or with any of Fidelity's present or former affiliates, directors, officers, employees, or agents acting in such capacity. The agreement will also provide that the ICC will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the ICC in performance of his/her duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Fidelity, or with any of Fidelity's present or former affiliates, directors, officers, employees, or agents acting in such capacity for the period of the engagement and for a period of two years after the engagement.

**B. Certification.** No later than twelve months after the date of entry of this Order, the chief compliance officer of Fidelity shall certify to the Commission in writing that Fidelity has fully adopted and complied in all material respects with the undertakings set forth in this section IV and with the recommendations of the ICC or, in the event of material non-adoption or non-compliance, shall describe such material non-adoption and non-compliance.

**C. Recordkeeping.** Fidelity shall preserve for a period not less than six years from the end of the fiscal year last used, the first two years in an easily accessible place, any record of Fidelity's compliance with the undertakings set forth in this section IV.

**D. Deadlines.** For good cause shown, the Commission staff may extend any of the procedural dates set forth above.

**E Other Obligations and Requirements.** Nothing in this Order shall relieve Fidelity of any other applicable legal obligation or requirement, including any rule adopted by the Commission subsequent to this Order.

**F. Payment of the penalty** referenced in paragraph V.C, below, shall not reduce the amount Fidelity has committed, as set forth in paragraph 91 above, to pay to the Fidelity Funds and institutional and other accounts.

In determining whether to accept the Offer, the Commission has considered these undertakings and Fidelity's commitment to make payments to the Fidelity Funds and institutional and other accounts, as set forth in paragraph 91, above.

**V.**

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, and Section 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondents FMR and FMR Co. cease and desist from committing or causing any violations and any future violations of Sections 204, 206(2) and 207 of the Advisers Act and Rules 204-1 and 204-2 thereunder and Section 34(b) of the Investment Company Act;

B. Respondents FMR and FMR Co. be, and hereby are, censured;

C. FMR (as parent of FMR Co.) shall, within 10 days of the date of entry of this Order, pay a civil money penalty in the amount of $ 8 million to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies FMR as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to David P. Bergers, Regional Director, Division of Enforcement, U.S. Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, 23rd Floor, Boston, MA 02110; and

D. Respondents shall comply with the undertakings enumerated in Section IV above.

By the Commission.

**Footnotes**

n1 The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

n2 The persons identified by name below are respondents in other administrative and cease-and-desist proceedings instituted today. See In the Matter of Scott E. DeSano, Thomas H. Bruderman, Timothy J. Burnieika, Robert L. Burns, David K. Donovan, Edward S. Driscoll, Jeffrey D. Harris, Christopher J. Horan, Steven P. Pascucci, and Kirk C. Smith; In the Matter of Peter S. Lynch; In the Matter of Bart A. Grenier; and In the Matter of Marc C. Beran.

n3 As discussed below, the Equity Trading Desk included "primary" traders, who worked closely with certain Fidelity portfolio managers, and "sector" traders, who were responsible for trading equities in certain industries.

n4 The term "Relevant Period" means the time period of January 1, 2002 through October 31, 2004.

n5 A significant portion of this figure consists of the cost of private jet travel, which was calculated based on the cost to brokerage firms of chartering aircraft.

n6 The primary recipient of drugs was Bruderman, who received ecstasy pills and marijuana from brokers on a number of occasions.

n7 Two traders not named in this Order sent Fidelity business to brokers with whom they were having romantic relationships.

n8 Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Rel. No. 23170, 1986 SEC LEXIS 1689, at *38 (Apr. 23, 1986) ("1986 Soft Dollar Release"); see also Market 2000 Report: Study V, Best Execution, 1994 SEC LEXIS 136, at *42 n.65 ("Market 2000 Report") ("[M]oney managers in fulfilling their duties of best execution . . . must evaluate periodically the performance of the broker-dealers that execute their transactions."); Renberg Capital Management, Inc., Advisers Act Rel. No. 2064, 2002 WL 31174796, *2 (Oct. 1, 2002); Portfolio Advisory Services, LLC, Advisers Act Rel. No. 2038, 2002 WL 1343823, *2 (June 20, 2002).

n9 "Willfully" as used in this Order means intentionally committing the act that constitutes the violation. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts. Id.

n10 The cost to brokerage firms was approximately $ 3 million, primarily because they sent one or more brokerage firm employees on entertainment trips with Fidelity employees.

n11 Quinn signed an employment agreement with Jefferies in May 2002 and began working in the firm's Boston office on September 3, 2002. On December 1, 2006, the Commission instituted settled administrative proceedings against Jefferies, a Jefferies senior executive, and Quinn with respect to Quinn's provision of substantial travel, entertainment and gifts to DeSano and certain Fidelity traders. See Matter of Jefferies & Co., Inc. et al., Release No. 34-54861 (Dec. 1, 2006), and Matter of Kevin W. Quinn, Release No. 34-54862 (Dec. 1, 2006).

n12 Most of the sporting events involved the Boston-area professional teams: the Bruins, Celtics, Patriots and Red Sox.

n13 One broker at a firm that provided Bruderman with extravagant trips and gifts expressed the firm's attitude as, "Whatever Brudy wants, Brudy gets."

n14 Brokers sometimes offered illegal drugs to Bruderman. For example, in February 2002, a broker through whom Bruderman executed securities transactions for Fidelity clients sent him an email asking, "U want beans." (Certain traders and brokers used slang such as "beans" and "Scooby snacks" to refer to ecstasy.) On other occasions, Bruderman solicited drugs from brokers. For example, in January 2004, he asked a broker, "Long any snacks?" The broker responded, "For the Superbowl??? I most likely will b able to take care of that." Bruderman replied, "I would like to order 10 if you have a guy?"

All communications among DeSano, traders and brokers cited in this Order are from the email network maintained by Bloomberg for Fidelity and are quoted with their original spelling and punctuation. Brackets are used to clarify abbreviations or other terms and to indicate where names have been omitted.

n15 The demoralizing effect for the trading desk of DeSano's travels with Quinn is apparent from Pascucci's comment to Smith in December 2003, "How can u enforce the no nepotism rule when SCD [DeSano] is such buddies with Quinn? It is absurd the one guy gets so [much] favored treatment from the head."

n16 There is no such SEC rule.

n17 Traders gossiped about DeSano's frequent absences. In January 2003, for example, Pascucci commented to another trader that DeSano had been on his "129th golf junket of last year."

n18 VWAP is "volume weighted average price." VWAP is one of the methods that Fidelity used to measure the execution quality of the Equity Trading Desk.

n19 Harris was not the only trader to worry about Quinn's move to Jefferies. Beran observed to Pascucci, "Don't ask THB [Bruderman] about Jeffco . . . I think he is trying to figure out how he is going to justify laying all those orders into Quinn!"

n20 A violation of Section 206(2) of the Advisers Act does not require a finding of scienter and may be established by a showing of negligence. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); SEC v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992).

n21 The following categories of information have been redacted from the final report: names of certain individuals and entities not otherwise referred to in this Order, commercially sensitive and/or proprietary information; and specific citations to sources.

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**Report of the Hon. John S. Martin, Jr.**

**To the Fidelity Independent Trustees Respecting Potential Harm to Fidelity Funds From Traders' Receipt of Improper Travel, Entertainment, Gifts and Gratuities**

## I. Executive Summary

### A. The Investigation

During a period beginning in or before January 2002 and extending through October 2004, some traders employed on the equity trading desk of Fidelity Management & Research Company (together with its subsidiary FMR Co., Inc., "Fidelity") disregarded Fidelity's policies and ethical guidelines to accept extravagant travel, entertainment, gifts and gratuities ("TEGG") from brokers with whom they placed trades in securities held by Fidelity funds. The Staff of the Securities & Exchange Commission ("SEC") n1 and Fidelity have extensively investigated traders' receipt of improper TEGG. Their investigations have included examining the nature and extent of the TEGG provided, identifying the traders and brokers whose relationships were affected by TEGG and determining who committed the most serious infractions. Fidelity's Independent Trustees have asked us to consider how the traders' behavior affected the mutual funds advised by Fidelity (the "Funds"), and in particular to assess whether and to what extent the traders' conduct may have resulted in harm for which Fidelity should compensate the Funds and to make a recommendation as to the amount, if any, of reimbursement that the Funds should seek from Fidelity.

In addressing this question, I and colleagues working under my supervision at Debevoise & Plimpton LLP ("Debevoise") have examined brokers' trading practices with Fidelity, studied material provided by Fidelity to the SEC, interviewed traders who were not implicated in the receipt of TEGG, reviewed available SEC deposition transcripts and summaries of testimony, reviewed electronic communications to and from the equity trading desk, and obtained and considered the perspectives of Fidelity management and the SEC (and their expert advisors). This Report generally accepts, with limited modifications discussed below, the SEC Staff's preliminary analyses (which Fidelity largely does not contest) respecting the nature and extent of improper receipt of TEGG and the nature of consequently conflicted or "tainted" relationships between traders and brokers. We also retained CRA International ("CRA") to attempt, through a statistical analysis of trading data, to generate objective, statistically reliable measures of the potential for harm resulting from traders' decisions to place trades with a broker as a result of TEGG.

**B. The Issues Raised**

Answering the question posed by the Trustees required considering two issues: (1) the likelihood that the Funds suffered as a result of the fact that traders acting on their behalf accepted TEGG from brokers they used to execute trades for the Funds; and (2) whether any potential damage to the Funds can be estimated reasonably. It is not possible to answer either of these questions with certainty.

In attempting to answer these questions, we have focused primarily on two types of potential harm: (i) execution quality harm -- that is, potential harm in the form of traders' receiving poorer execution performance from brokers selected based on receipt of TEGG than the traders would have obtained from choosing brokers without regard to TEGG; and (ii) order flow harm -- that is, potential harm from traders' diversion of orders to brokers in return for benefits provided to the traders personally, when those orders could alternatively have been directed elsewhere in return for benefits the brokers provided to the Funds.

**1. Execution Harm**

As we will demonstrate in detail below, it is impossible to "prove" statistically that the traders' receipt of TEGG did or did not result in excessive execution costs for the Funds. The lack of certainty inherent in any attempt to measure harm does not mean, however, that there was no harm; nor does it alleviate the need to attempt to ascertain, to the degree possible, whether and to what extent harm occurred. This is particularly true since both logic and contemporaneous evidence suggest that there is a substantial possibility that the traders' acceptance of TEGG could have resulted in higher execution costs for the Funds.

As a fiduciary, Fidelity had an obligation to seek to achieve the best possible ( trading results for its Funds and their shareholders. However, once a trader accepted TEGG his desire to seek best execution may have been compromised by the desire to reward the broker to whom he was indebted. When traders were motivated by their desire or gratitude for TEGG, it is likely that they chose brokers based at least in part on the brokers' ability to provide them with personal benefits, rather than choosing brokers solely because of the quality of their trade execution. Traders' mixed motives mean their actions must be viewed with skepticism, and their trades scrutinized for potentially damaging decisions and unwarranted costs. In short, if we know traders were not single-mindedly seeking the best possible execution on each trade, we cannot assume they got it.

More than logic suggests that there is a substantial possibility that the receipt of TEGG by Fidelity traders resulted in execution harm to the Funds, however. During the period when Fidelity traders were regularly accepting TEGG, people in the trading room exchanged a number of email messages which suggest that these individuals believed that the traders' receipt of TEGG was hurting the Funds.

At least one series of trades mentioned in those email messages, the eight million share Tyco trades of January 30, 2002, provides evidence that traders' actions in response to the receipt of TEGG could have resulted in execution harm to the Fidelity Funds. Email traffic we reviewed indicates that Fidelity trader Edward Driscoll used one broker, [TEXT REDACTED BY THE COURT] to purchase eight million shares of

Tyco just days before [TEXT REDACTED BY THE COURT] of [TEXT REDACTED BY THE COURT] was to fly Driscoll by private jet to the Super Bowl in Houston, Texas. In his own emails, Driscoll indicated that he used [TEXT REDACTED BY THE COURT] for the trade because they were flying him to the Super Bowl. The total cost to the Funds of Driscoll's performance on the Tyco trade was as much as $ 18 million, although as noted below this poor outcome may have been a function of unpredictable market events. While no one can say that Fidelity could have obtained better execution from some other broker, the Tyco trade demonstrates the magnitude of the cost that the Funds could incur from a single trade in which the receipt of TEGG may have influenced broker selection.

In addition, we have found several instances where substantial orders were placed by traders with brokers in close temporal proximity to times when those brokers had provided lavish TEGG to the traders. In a few of those instances the execution costs were surprisingly high, given that the market was moving in a favorable direction during the trade. While further investigation indicated that the apparent excessive costs during favorable market conditions may have resulted from unique circumstances surrounding the trade, one cannot exclude the possibility that one or more of these trades resulted in execution harm to the Funds.

**2. Order Flow Harm**

The second type of harm that may have resulted from a trader's sending trades to a broker in recompense for TEGG is harm in connection with the diversion of order flow. The flow of orders from the Funds has value for brokers in terms of the commissions and opportunity for profit that it brings, and has value for the Funds as a means of rewarding brokers for service to the Funds and encouraging exceptional performance on behalf of the Funds. Fidelity has described the value of order flow in detail, noting among other things that it is sometimes used to reward brokers who commit capital to assist in the execution of large orders and that brokers agree to accept lower commissions from the Funds in order to become "core brokers" because they believe that they will then receive greater order flow from the Funds. Given the value of order flow to Fidelity, if a trader uses the Funds' order flow to repay TEGG, he deprives the Funds of the ability to use that order flow for their own economic advantage. It is evident from Fidelity's own statements, therefore, that order flow is an asset -- the value of which is also demonstrated by the Tyco trade, where the commission the broker received exceeded $ 250,000. In effect, in a trading room order flow is "the coin of the realm."

**C. The Uncertainty of Any Assessment of Harm**

Although logic and evidence suggest that harm was possible, from the investigation's early stages we have recognized the lack of certainty that necessarily accompanies the attempt to determine whether the Funds in fact suffered execution quality harm or order flow harm. In the context of seeking to measure execution quality harm, this uncertainty arises from several different factors:

- Except in a small number of instances of an unusual spike in trading activities directly linkable to an unusually extravagant TEGG event (or instances where emails indicate a linkage between a TEGG event and a trade), it is generally impossible to say that individual trades between a tainted trader and a tainted broker would not have been placed with that broker but for the taint, or that all such trades were made as a result of the receipt of improper TEGG. Tainted and untainted traders alike extensively used the tainted brokers, and even tainted traders could have had good reasons for selecting a TEGG-providing broker for most trades without regard to receipt of TEGG. While it seems clear (and Fidelity has acknowledged) that tainted traders sent some trades to tainted brokers for reasons related to TEGG, it is impossible to specify and isolate for analysis of harm the trades improperly directed to brokers as a result of TEGG, as distinguished from other trades that even the tainted traders legitimately placed with those brokers.

- Any attempt to measure execution quality harm by comparing the outcome of a notionally tainted trade against an untainted trade must recognize that no two trades are precisely identical, and that marketplace factors will often play a more important role than the execution skills of the broker in determining the execution performance of a trade. CRA has employed

highly sophisticated analyses to address differences among trades, by controlling for a wide range of variables that have the potential to differentiate trades, but that resourceful and exhaustive effort only narrows the problem somewhat, without overcoming it.

- Any measure of execution quality harm is necessarily limited by the sufficiency of the data used to identify, characterize, and distinguish a trade and the degree to which the available data enables precise comparisons between trades and sets of trades. The enormity of Fidelity's trading business, array of trading mechanisms, combination of mechanized and human elements, number of individuals and entities involved and potential for error all affect the precision of the data associated with each trade and every comparison of trades. While the data can be sufficient without being perfect, the unavoidable imperfections in the inputs contribute a level of imprecision to any measurement of harm.

While potential execution harm is difficult to quantify, it is even more difficult to quantify the potential cost to the Funds of misdirected order flow. Any measurement process will inescapably depend on an assessment, based at least as much on intuition as on statistics, of what portion of the order flow provided by any individual tainted trader to a tainted broker would not have been provided but for the TEGG. Even if the misdirected order flow could be measured, having to ask whether and to what extent the Fidelity Funds would have achieved net benefits had that order flow been sent to another broker adds another layer of uncertainty. Generally, the tainted brokers were sufficiently strong and proven performers to have achieved some form of preferred broker status or the potential to be granted that status, and Fidelity had negotiated with each of its brokers nearly uniform low net commission rates that would not generally be sensitive to or altered by the marginal quantities of order flow implicated by the traders' assumed favoritism. Other forms of potential benefits to a Fund associated with directing order flow to one broker instead of another -- from tangible benefits like increased willingness to commit capital to intangible ones like greater broker responsiveness -- are difficult or impossible to measure even though intuition suggests they exist.

The uncertainty associated with the analysis of harm is partially evident in CRA's statistical conclusions. CRA's variety of analytic approaches repeatedly yielded ranges of possible harm in which the median of the range was indicative of some positive harm but a 95% statistical confidence interval with respect to possible outcomes included zero or nearly zero harm, or even net benefit. The conclusion that as a matter of statistics the null hypothesis that the traders' behavior caused zero harm could not be ruled out is highly significant, but so is the array of results suggesting a median result of some harm under a wide variety of different measurement approaches. So also is the conclusion that the upper ends of the confidence interval, indicating the possibility of substantial harm, are as statistically likely to reflect the reality as the zero or negative numbers at the bottom of the range.

**D. Conclusions and Recommendations**

In my view, the question to be answered here is not whether the Funds were in fact harmed by the traders' receipt of TEGG, but how the Trustees should respond to the traders' breach of fiduciary duty that put the Funds in harm's way. In these circumstances, the burden of proof and the weight to be given to what is arguably equivocal statistical evidence should be substantially different than the burden applied or weight given by a court attempting to determine whether harm in fact occurred.

Where, as here, a fiduciary has breached its duty to act solely in the interest of the funds, the inescapable uncertainty in measuring the harmful effects of taint arising from TEGG should not result in a finding that there is no remedy. The Independent Trustees should not refrain from asking Fidelity to recompense the Funds for the harm the Funds may have suffered. Here, the traders' self-reported record of improper instances of TEGG and the spontaneous email communications obtainable from the trading desk's electronic archives evidence a pervasive atmosphere of casualness about the receipt of TEGG and inattention to its potentially corrupting effects. Fidelity developed and articulated its TEGG policies, inadequately enforced as they were, not only to prevent violations of statutory prohibitions against "quid pro quo" trading decisions by mutual fund traders but also to avoid the appearance and the possibility of corrupting harm, in a context where the possibility must be avoided because the actuality is difficult to detect. Thus where the traders engaged in conduct giving rise to a substantial possibility that the Funds were harmed, fairness suggests that Fidelity, as the manager responsible for

the conduct of those traders, should not seek to avoid its fiduciary duty to ensure that the Funds were not harmed simply because of the difficulty in quantifying the harm.

That is particularly the case when the Trustees (as fiduciaries to the Fidelity Funds and Fund shareholders) and Fidelity itself (as a fiduciary to those same Funds and shareholders) have a responsibility to ensure with reasonable confidence that the Funds were not harmed by what Fidelity has conceded to be wrongdoing by traders. Under settled legal principles that permit applying less stringent standards of certainty to the assessment of amount of harm than to determinations of liability and the existence of some harm, even a judge in a court of law facing the inexactitude just described would be able to make findings of harm based on estimates. It is appropriate for the Trustees as fiduciaries to go further than even that approach to damages would suggest, in order to obtain a higher level of assurance that after any corrective payments are made the Funds will not have suffered uncompensated harm.

Under this approach, the determination of whether and to what precise extent shareholders suffered harm, which might be the central issue in a litigation governed by rules of evidence and issues of burden of proof, becomes subordinate to the issue of what payment should be made to the Funds to ensure with reasonable confidence that the Funds do not end up being undercompensated for the improper conduct that indisputably took place.

CRA's statistical analysis, considered in its own right and in light of the thoughtful commentaries provided on it by the SEC and Fidelity, provides guideposts for estimating the amount of payment by Fidelity that would be appropriate to compensate the Funds for possible execution quality harm under this approach. While the analysis has obvious limitations (arising from the intractability of the exercise, not from any lack of quality in CRA's work), Fidelity's critiques do not point to a superior alternative methodology for quantifying execution quality harm. Similarly, the commissions that tainted brokers received from their dealings with tainted traders provide a baseline for a rough estimate of the separate form of possible harm arising from redirections of order flow.

As explained in more detail in the conclusion at pages 66-74 below, I recommend that the following payments be sought from Fidelity:

Execution Quality issue - all accounts $ 28.4 million

Order Flow issue - all accounts $ 22.5 million

Subtotal $ 50.9 million

Portion of subtotal allocated to mutual funds $ 40.7 million

Reimbursement of expenses borne by the mutual funds $ 8.2 million Interest (as of November 30, 2006) $ 4.5 million

Total $ 53.4 million

**II. Scope of the Investigation**

Our consideration of whether and to what extent traders' receipt of TEGG may have affected the Funds has included examination of the behavior, contemporaneous communications, decision-making, explanations and trading records of traders on Fidelity's equity trading desk, as well as consideration of the SEC's and Fidelity's evaluations of these events. For the examination of trading records and efforts to analyze the results of tainted traders' transactions using tainted brokers, we have primarily looked to CRA (and to its consultant Prof. Mark Ready, former Chief Economist of the SEC), which has devoted approximately 25,000 hours to this effort. CRA has conducted an exhaustive analysis of an enormous quantity of data, attempting to isolate reliable trading data, to develop responsible methodologies for measuring harm and to ensure that its analysis takes into account factors affecting individual trades as

necessary to compare the costs of one set of trades against the costs of others. [TEXT REDACTED BY THE COURT] My role, and that of my Debevoise colleagues, with respect to this important component of the analysis has been to oversee and direct CRA, to consider and comment on its proposed approaches, to identify lines of inquiry, to receive and critique regular interim reports, to evaluate issues presented by Fidelity, the SEC and their experts, to consult about questions that arise and to evaluate and comment on proposed conclusions.

While, as described below, we have conducted a detailed review of available investigative transcripts, interview memos and internal Fidelity documents, we have not conducted an independent investigation to determine whether there were additional instances in which Fidelity traders accepted TEGG. Given the passage of time and the fact that we lacked the power to subpoena witnesses or documents, we doubted that we would be able to uncover instances of TEGG that had not been disclosed to the SEC. In addition, since Fidelity's traders had already provided reports of the TEGG they received and been questioned by the SEC, it was extremely doubtful that re-interviewing the traders would uncover evidence of additional TEGG, particularly after Fidelity employees had been disciplined for the receipt of TEGG which they had self-reported.

Therefore, in attempting to determine whether the Funds were harmed as a result of the traders' receipt of TEGG, we accepted, with one exception, the tainted pairs of traders and brokers identified by the SEC and limited our inquiry to the time period for each tainted pair identified by the SEC. The one exception was that we identified one additional tainted pair -- Driscoll/[TEXT REDACTED BY THE COURT] -- based on the facts surrounding the Tyco trade.

With respect to the narrower issue of whether and to what extent the Funds may have been harmed by trades undertaken as a result of TEGG, though, we have pursued numerous factual lines of inquiry independently of Fidelity and the SEC, along with and separately from the CRA analysis. These activities have involved over 2,000 hours of work since this investigation began under my direction in September 2005.

Debevoise's work has included the following activities, among others:

> (i) We have reviewed over eight thousand electronic communications from, to and among traders on Fidelity's equity trading desk. These included emails and Bloomberg messages identified by Fidelity for review by the SEC, [TEXT REDACTED BY THE COURT] at [TEXT REDACTED BY THE COURT], as having particular bearing on the effect of TEGG. We also obtained and reviewed emails we specifically requested from Fidelity by date range, trading name, stock name or other search terms because of their potential to help us understand traders' perspectives or to illuminate particular areas of concern, including Bloomberg messages and emails sent or received on each of the twenty days on which any tainted trader executed a trade of three million shares or more with a broker with whom he had a tainted relationship.
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> (ii) We studied the summaries of traders' self-reported responses to Fidelity's Business Gifts and Entertainment Survey, to identify from the many listed events nearly one hundred TEGG events of a scale most likely to have had a potential to influence traders' selection of brokers. We and Fidelity were able to identify specific or fairly specific dates for sixty of these events, after extensive inquiries by Fidelity at our request going beyond the trader self-reports to traders' Microsoft Outlook and hardcopy calendars, information provided by SEC staff attorneys, expense information provided by counsel for Jefferies & Co., emails and Bloomberg messages previously produced to the SEC, Fidelity trade data, credit card statements that traders had provided to Fidelity, transcripts of testimony taken by the SEC and internet searches. [TEXT REDACTED BY THE COURT] While we ran into several impediments that prevented us from developing a comprehensive list of all TEGG events and their precise dates -- including the absence of personal access to traders (many of whom have left Fidelity and are not voluntarily providing information to it), the passage of time and the fading of traders' memories -- we believe that we were able to review a sufficient representative sample to permit an examination of possibly event-driven trading patterns surrounding major TEGG events.

(iii) We reviewed sixteen transcripts or summaries of depositions taken by the SEC in connection with its investigation -- a number limited only by Fidelity's lack of access to the testimony of witnesses who declined to share their testimony with Fidelity. Fidelity provided and we reviewed transcripts of the testimony of [TEXT REDACTED BY THE COURT] We did not directly interview any tainted traders -- the most significantly tainted traders no longer work at Fidelity, and almost all tainted traders were represented by counsel who placed limits on access to them. We did not consider this gap an insuperable obstacle to our investigation, though, because (i) we accepted the SEC's preliminary analyses about what relationships were tainted, n2 (ii) we assumed that every tainted trader would say that although he sometimes directed trades to a broker in gratitude for a TEGG event he never intentionally compromised his focus on achieving best execution for the Funds in using that broker, and (iii) we did not view tainted traders as likely to be objectively reliable sources for determinations of whether and to what extent their TEGG-related trading decisions caused any harm to shareholders.

(iv) We frequently obtained and carefully considered factual information and analytical perspectives provided by Fidelity, and to some extent by the SEC. Our fact-gathering from Fidelity included observation of trading desks and interviews of its Head of Equity Trading and untainted traders. It also included numerous meetings with representatives of Fidelity [TEXT REDACTED BY THE COURT] to hear presentations and perspectives regarding such matters as methodology for analyzing trades, trader compensation and incentives, Fidelity's broker selection system, commissions, order flow, fund costs, equity trading desk culture and practices, and the reliability and limitations of electronic records. In addition, I met with or spoke to representatives of the SEC on a number of occasions, to hear their perspectives and to share generally the direction of our investigation. We also reviewed numerous suggestions from Independent Trustees, in meetings during which we provided status reports and in separate conversations with individual trustees, about proposed lines of inquiry or approaches to considering the issues.

(v) We sought and considered Fidelity's information and perspectives, and those of several experts it retained, regarding the impact of the traders' conduct and the circumstances in which trades took place. Fidelity shared with us the analyses conducted and presented to the SEC by several economic experts, including [TEXT REDACTED BY THE COURT] We also met with each of these experts, n3 in some instances on numerous occasions, to obtain their inputs on such matters as the likelihood and amount of possible harm, appropriate or inappropriate methodologies for measuring harm, the difficulties associated with measuring harm, the reliability of Fidelity's trading data and the asserted failings in CRA's analysis. These experts also had direct conversations with counterparts at CRA, and CRA representatives also solicited and obtained reports from SEC economists and staff attorneys.

(vi) We reviewed Fidelity's numerous submissions to and correspondence with the SEC regarding the impact of traders' receipt of TEGG on the Funds, [TEXT REDACTED BY THE COURT]

(vii) To check Fidelity's records against those of a selected broker, we met with Jefferies & Co., Inc. on November 10, 2005, and attempted to obtain certain trading information. When Jefferies was not able to provide the requested information in a timely manner, I determined that the limited relevance of the information did not justify a delay in this report.

CRA participated actively in these information exchanges. It also conducted an extensive separate review of trading activities that included gathering comprehensive records from Fidelity's equity trading desk, external market materials and limited materials provided by brokers, as set forth in more detail in its report. [TEXT REDACTED BY THE COURT] CRA had numerous discussions and meetings with Fidelity personnel in an effort to understand Fidelity's systems for recording and reporting trades, and several conversations with SEC counterparts in an effort to understand the SEC's analysis. As CRA approached the conclusion of its inquiries, it had two sets of meetings with Fidelity and the SEC. It met separately with Fidelity and the SEC staff in June 2006 to describe its proposed analytical methodology in detail, to answer questions about that methodology and to invite critiques it should consider when applying that methodology to the trading data. It then met with each of Fidelity and the SEC once again in late August and early September, to present the results of its statistical analysis of execution quality harm, again with the aim of answering questions and receiving comments to consider in finalizing its analysis. In

connection with each of these meetings, I instructed CRA to proceed and it did proceed with complete transparency, providing Fidelity and the SEC with its complete database and all programs used in performing its execution quality analysis and extensively answering all questions that Fidelity or the SEC presented to it.

While the sheer volume of information underlying the trading practices in issue makes the exercise of placing limits on the factual investigation a difficult one, I believe that our investigation has been thorough, objective and sufficient to support the conclusions presented in this report.

## III. Attempts to Measure Potential Harm from TEGG

### A. The Capacity for Trader Actions in Response to TEGG to Cause Harm

Our analysis of potential harm started with consideration of the ways a trader's selection of a particular broker based on TEGG might have the capacity to cause harm. We have accepted Fidelity's presentations to the effect that generally the placement of trades with brokers is a highly "trader-centric" process, in which traders typically place tight controls on the numbers of shares brokers are asked to trade and the prices at which those orders are to be executed. We have also accepted that the variations in individual brokers' overall execution records (which Fidelity carefully monitors) from one period to another make it difficult to identify which of the group of Fidelity's "core brokers" can be expected to achieve the best or the worst performance on any particular set of trades. We understand that Fidelity's selection of firms as core brokers provides a basis for concluding that they were each viewed as satisfying threshold requirements of skill, that commission rates were essentially uniform among core brokers, and that there were often good reasons to place trades with non-core brokers.

Despite these facts, it appears self-evident that selection of a particular broker to engage in a trade based on the receipt of TEGG carried potential for adversely affecting shareholder interests, in at least three ways:

1. It would be an error to assume that the choice of a broker for a trade will not affect the execution costs of that trade and to view all brokers, or even all core brokers, as interchangeable in skill. Traders developed business relationships with brokers in part because they believed the individual brokers were particularly skilled at reading the marketplace, delivering counterparties for trades, placing large volumes of trades with minimal effect on market prices (a skill of particularly substantial importance to a high-volume trader like Fidelity), detecting and advising about trading momentum, knowing about trends or developments in a business sector, and performing the logistics of a trade responsibly and effectively. If these skills had not been viewed as a highly important point of differentiation among brokers, Fidelity would undoubtedly have done more of its trading at lower commissions through electronic brokers or other discount facilitators. While the desire to spread trades among different brokers to avoid moving market prices with Fidelity trades was part of the reason for not concentrating all trades among a handful of brokers, the different brokers were also available because they had particular talents to offer. Fidelity's compensation system linking components of traders' pay to their success in placing trades inexpensively implicitly recognizes that differences in broker quality and in traders' interactions with brokers can affect results. Internal Fidelity emails commenting on "poor broker selection" for particular trades tend to confirm that these brokers were not viewed as mechanically interchangeable and that the choice of the wrong broker may have a significant impact on the execution cost of a trade.

2. There were many ways a trader could reward a broker for a TEGG event that could adversely effect the execution cost of a trade. Traders could excuse a favored broker from committing capital to reduce Fidelity's risk on a trade, or could allow a commitment of capital that was essentially risk free in ways that would increase the broker's commissions (because capital committed trades are not subject to commission rebates). Such actions could have caused virtually undetectable shareholder harm, in the form of missed opportunities to achieve better execution.

3. Order flow was, in its essence, the "coin of the realm" for Fidelity traders. Ideally, it should be used to reward brokers who provide exceptional service to the Funds or to induce them to do so. A trader could

direct order flow to a favored broker for no difference in commission cost and often for little or no readily perceptible difference in execution cost, but to the substantial benefit of the broker (who would not only obtain the Fidelity commission but also often earn commissions from the opposite side of the same trade). Brokers' provision of TEGG to tainted traders inherently reflected, at least in part, the brokers' belief that their economic returns from the TEGG would exceed the cost of the gifts. In principle, the order flow that traders gave to TEGG-giving brokers should have been used for the benefit of the Funds, not for the benefit of individual traders.

These intuitions about the ways the Funds and their shareholders could theoretically be harmed as a result of traders' directing trades in recompense for TEGG have formed the foundations for our attempts to measure harm.

**B. Attempts to Measure Execution Harm**

Fidelity offered the view [TEXT REDACTED BY THE COURT] that "it may be impossible to do a reliable regression concerning the relationship, if any, between TEGG/relationships and execution quality harm." [TEXT REDACTED BY THE COURT] This contention, for all of the analytical rigor that may lie behind it, is ultimately unsatisfactory. The implication it carries -- that the extraordinarily complex difficulties associated with attempting to measure execution quality harm warrant abandoning the effort -- would result in the unacceptable outcome that even if the Funds suffered substantial harm, they must be left uncompensated because of the imperfections of any method for measuring its likelihood and magnitude. The alternative approach of pursuing the most comprehensive statistical analysis possible seems preferable, even despite the expectation from the outset that the results would invariably involve some approximation, would inescapably be susceptible to critics' proposal of yet another variable to be considered, and would yield answers at confidence intervals reflecting a fairly broad range of uncertainty.

We retained CRA on September 20, 2005 to do a thorough analysis of tainted traders' performance in transactions with tainted brokers, and to see whether any conclusions emerged about the probability of harm caused by traders' receipt of improper TEGG. We understood that this analysis would require review of an enormous volume of data, and that the combination of imperfect data, confounding variables, results affected by external market forces outside any trader's or broker's control and need for some approximation would make generation of statistically definitive conclusions about the magnitude of harm unlikely. I nevertheless believe that this type of analysis is an essential component of any serious investigation of harm.

CRA's work involved selecting and applying a methodology for measuring tainted traders' execution performance in trades with tainted brokers, then comparing the results against the execution performance that the same traders could have expected to achieve if they had placed the same trades with untainted brokers. Each component of this exercise involved a carefully considered judgment about the preferred way to proceed, and these judgments appear to have been well-founded.

**1. Measuring Tainted Traders' Performance Wwth Tainted Brokers**

As explained in CRA's report, we elected to measure tainted traders' performance with tainted brokers through an "implementation shortfall" analysis. [TEXT REDACTED BY THE COURT] Implementation shortfall compares the quoted price of shares as of a determined starting point of a trade to the ultimate full cost of executing the trade, characterizing the difference as the "execution cost" of engaging in the purchase or sale transaction. Andre F. Perold, The Implementation Shortfall: Paper vs. Realty, The Journal of Portfolio Management, Spring 1998, at 4-5. Execution costs include fixed costs, such as commissions and other costs associated with price impacts -- the difference between the quoted price for the shares at the starting point and what is paid for them, which can be positive or negative. n4

For the temporal starting point in CRA's implementation shortfall analysis, CRA selected the moment when a trader conveyed an order to a broker -- initially, the time of the first order placed with respect to a block of shares, and then later, as CRA's analysis embraced different orders from within a trading block that were placed at different times, the placement time of each separate order in the "creeping

blocks." [TEXT REDACTED BY THE COURT] CRA chose this point on the basis that it marked the beginning of the broker's performance with the trader, reasoning that earlier actions of traders between their receipt of orders from portfolio managers and their placement of orders with the brokers did not particularly bear on the broker's performance.

To employ this approach, CRA had to be able to identify reliably the times when Fidelity's traders placed their trades with particular brokers, the prices of the shares at these times, and the total ultimate execution costs of the trades. CRA obtained this information from different sources. [TEXT REDACTED BY THE COURT] Fidelity's records provided good data on the electronically recorded times and costs of completions of trades, and CRA was able to circumvent Fidelity's lack-of generally reliable data respecting quotes at the times of order placement by resort to records of these quotes on the stock exchanges' internally maintained databases. [TEXT REDACTED BY THE COURT] The central issue respecting data reliability in this context related to identifying the precise times when traders placed their orders with brokers.

Fidelity initially expressed the belief that its records did not contain reliable information about broker order placement times. Fidelity apparently formed this view because it doubted that information requiring the human intervention of traders instead of being entered automatically was generally reliable, and because the personnel who initially made the checks into whether Fidelity's system generated reliable placement times looked only at individual tickets for orders from portfolio managers rather than at the block level where Fidelity's trades were ordinarily placed. CRA nevertheless tested the recorded placement times for orders to brokers in Fidelity's system at the block level -- initially for the first trades in a block ("top block"), and later for each incremental trade in a block ("creeping block") -- and found them sufficiently reliable to support pursuing an implementation shortfall analysis. [TEXT REDACTED BY THE COURT] CRA's tests included not only confirming that the overwhelming majority of broker placement times reported in Fidelity's records were properly sequenced between the recorded times for receipt of orders from portfolio managers and completion of the trades, but also determining that there was close agreement between Fidelity's internal records of broker placement times and the times recorded in execution reports that the brokers provided to Fidelity, with the majority of recorded times at the top block level within one minute of precise agreement and over 80% of recorded times within five minutes of precise agreement. [TEXT REDACTED BY THE COURT] In addition, CRA compared the time of placement from Fidelity's internal trade history records with the time of placement in Fidelity's audit log, and found that 98% of the blocks had broker placement times that exactly matched the time of the first-placed tranche recorded in the audit log, and 99.96% of all blocks had placement times within five seconds of the first-placed tranche recorded in the audit log. [TEXT REDACTED BY THE COURT]

Fidelity has criticized CRA's "implementation shortfall" approach to measuring a trader's performance with a broker in a particular trade by contending that the better measure of relative quality of execution performance is the "AVWAP" measure Fidelity has used in deteunining a portion of the performance-based component of its traders' compensation. The AVWAP measure compares the price at which a trade was completed against the stock's Available Volume Weighted Average Price for the period between the trader's first receipt of the order from the portfolio manager and the end of the trading day. [TEXT REDACTED BY THE COURT] The AVWAP measure has the advantage that by looking at an average of share prices, it is less susceptible to the vagaries of sudden price movements.

Nevertheless, CRA has made a persuasive case that its proposed "implementation shortfall" approach is preferable. CRA has pointed out that traders' performance between the times they receive an order from a portfolio manager and the times they place a corresponding order with a broker -- a period included within Fidelity's AVWAP analysis but not within CRA's implementation shortfall analysis -- does not bear on the performance of a tainted trader-broker pair. [TEXT REDACTED BY THE COURT] CRA has also identified substantial professional literature crediting the merits of the implementation shortfall approach and discussing how readily AVWAP-based performance measures can be "gamed" to skew reported results. Although Fidelity has suggested that it is unfair to measure tainted traders' performance with tainted brokers using criteria different from that which determined the traders' compensation (and that consequently motivated traders' actions at some level), our mission is to determine possible harm to the Funds: Implementation shortfall, which focuses on broker performance, appears to be a better method of assessing that potential harm. n5

Fidelity's further contention that broker placement times on which CRA relies should not be considered reliable because placement times entered by hand rather than mechanically are too susceptible to error, and because much can happen to a stock's price within the broad five minute window that CRA has accepted as close enough to support a finding of reliability, has only limited validity. While every instance of tolerating approximations undeniably introduces additional possibility for error, acceptance of a time range of up to five minutes as indicating that Fidelity's broker placement times are generally reliable at the block level should not alter the ultimate results unless there was a difference in accuracy rate between tainted traders' recorded order placement times with tainted brokers and the same traders' recorded placement times for other trades, and if that difference in accuracy affected measures of execution cost. There is no indication or reason to suspect that any such differences existed.

### 2. Comparing Tainted Relationship Performance with Untainted Performance

Once CRA was able to generate data respecting the execution costs and implementation shortfall outcomes for all trades between tainted traders and tainted brokers during the period of identified taint, it sought to compare these results against the implementation shortfall results the same traders could have been expected to obtain by placing the trades with untainted brokers. This effort required two steps: (i) determining the tainted traders' execution costs in all of their trades with untainted brokers, then (ii) using statistical regression techniques to compare the results of these untainted trades with the results of those traders' tainted trades, in ways that statistically accounted for a broad range of possible differences between the benchmark tainted relationship transactions and the untainted relationship transactions to which they were being compared. CRA applied this process of comparison to 239,291 trades made by the thirteen traders identified as "tainted," after excluding about 135,000 trades that involved uncertain data or were otherwise not effectively comparable. [TEXT REDACTED BY THE COURT]

Fidelity's experts have suggested, in the early stages of the process, that the more appropriate comparison would be between each tainted trader's performance with the corresponding tainted broker and all untainted traders' implementation shortfall performance, not just between the tainted trader's performance with the tainted broker and the same trader's performance with untainted brokers. Fidelity's proposed comparison could readily obscure execution quality impairment, though, because several of the traders who were the most substantial recipients of improper TEGG were also among the highest performing Fidelity traders overall. The Funds were entitled to these traders' best work. Poorer performance by these traders with tainted brokers than they would have obtained in an environment free from taint would support a finding of execution quality harm even if that performance was still stronger than less skilled traders achieved with untainted brokers.

### 3. CRA's Regression Analysis

The architecture of the regressions CRA designed to compare the excess execution costs of trades by tainted pairs against what could have been expected without taint is exceedingly complex, and is described in CRA's report. [TEXT REDACTED BY THE COURT] In its essence, the goal of the regression analysis was to identify and process variables between trades, to make them as statistically comparable as reasonably possible, and then to look at the resulting performance comparisons from a number of alternative perspectives to see if they individually or collectively indicate a range of statistically probable implementation shortfall deficits for the tainted relationships. CRA's regression architecture, and in particular its sets of control variables, sought to take statistical account of three broad categories of potential differences requiring adjustments to make non-identical trades statistically comparable: differences in (i) types of trades, (ii) properties of the stock being traded, and (iii) trading environment at the time of the trade.

As detailed more fully in CRA's report, CRA's recognition of the particular attributes of different types of trades led it to apply control variables for:

> (i) relative size of the trade as compared to average adjusted stock volume; (ii) the dollar value of the placement; (iii) the degree to which capital was committed to the trade; (iv) whether the trade was a sale or purchase; (v) whether the broker was a core or non-core broker; (vi) whether the trade was placed with more than one broker; (vii) during which half-hour of the trading day

> the trade was placed; as well as (viii) a cubic polynomial variable to capture the interrelationship of the principal traded, the total shares traded in the stock on the day of the trade, and the price of the stock. [TEXT REDACTED BY THE COURT]

To account for differences in stock properties, CRA included control variables for:

> (i) the market capitalization of the stock; (ii) the reciprocal of the stock price; (iii) the turnover of the stock, measured in terms of average volume over outstanding shares; (iv) the degree to which the stock's movement correlated with the market movement over the previous twenty trading days; (v) the degree to which the stock had moved independently of the market over the same period; (vi) the exchange the stock traded on; and (vii) the stock's industry sector. [TEXT REDACTED BY THE COURT]

To limit the confounding effect of differences in trading environments, CRA controlled for:

> (i) the return on the stock price; (ii) the market return; (iii) the volume of the stock relative to the volume of the market as a whole; (iv) volatility measured as the difference between the highest and lowest NBBO mid-points; (v) volatility measured as the standard deviation of NBBO mid-points; and (vi) volatility measured as the absolute value of return on NBBO mid-points. [TEXT REDACTED BY THE COURT]

**C. CRA's Various Approaches to Considering Execution Quality Harm**

Rather than rely on a single regression to assess possible execution quality harm, we asked CRA to look at the data in several different ways, because each seemed potentially informative and because viewing the data in different ways could help indicate the degree to which changes in methodology affected the results. CRA obtained and reported results under each variant of the following frameworks (some of which reflected inputs from Fidelity's experts):

1. Benchmarks of Trade Performance. CRA recognized that traders' aggregate performance results might vary depending on whether trading volumes with particular brokers were measured by number of orders, by dollar value of Fidelity placements or by number of shares placed with the brokers. Number of shares placed seemed potentially the most informative measure, since a trader seeking to reward a broker for TEGG might have been expected to focus on the number of shares placed because commissions were calculated on that basis. CRA also looked at the other measures because different traders and brokers might have measured their business with each other in these ways.

2. Equally Weighted vs. Principal-Weighted. The "equally-weighted" regression approach assumes that the extra cost (or benefit) associated with each trade routed to a TEGG-providing broker is a constant number of basis points. The "principal-weighted" approach allows for the possibility that this extra cost (or benefit) might vary according to the dollar value of the trade. CRA viewed each of these measurement approaches as potentially informative, although the equally weighted measure seems somewhat more hinged to likely trader behaviors respecting tainted trades. [TEXT REDACTED BY THE COURT]

3. Top Block vs. Creeping Block. Initially CRA measured all broker performance based on an assumption that all trades in a block were placed with brokers at the time of the first trade in the block. As CRA learned about block placements made in increments and found the records of these "creeping block" trades in Fidelity's audit logs, CRA concluded that it should measure performance on that basis, too. Because the creeping block measures of broker placement time are more closely tied to the times when traders actually gave specific orders to brokers it would appear to be a better measure of broker performance. Top block measures may still have some informative value, though, if the traders told the brokers about entire blocks when placing the first tranche of a creeping block, or to the extent broker performance on the first tranche affected the timing of placement of later tranches. [TEXT REDACTED BY THE COURT]

4. Adjustments for Untainted Broker Heterogeneity. CRA suggested and [TEXT REDACTED BY THE COURT] accepted that it would be preferable to take account of differences among untainted brokers, rather than to treat all brokers as identical, through an adjustment for untainted broker heterogeneity. Adjusting for the variations among the untainted brokers' performances reduces the risk that any identified discrepancy in execution cost between tainted and untainted pairs might be due to differences in the skills, expertise, specialization, brokerage firm, or trading platform of the untainted pairs. When the regression analyses are adjusted for the differences among untainted brokers, they provide a better sense of both the degree to which TEGG may have affected execution cost and the confidence that can be attached to that measure. CRA calculated results with and without this adjustment, although it concluded (as seems reasonable) that the results after making the correction would appear more reliable. [TEXT REDACTED BY THE COURT]

5. Controls for Stock Return. CRA wrestled with the issue of how to segregate differences in execution performance based on trader-broker skill at placing trades from differences in performance attributable to market moves during the period between order placement and execution. As one approach to addressing this issue, CRA added a variable that adjusted performance results based on differences between stocks' quoted market prices at the time of order placement and at the time of execution. CRA understood, and [TEXT REDACTED BY THE COURT] has correctly pointed out, that this adjustment presented reliability concerns. Those concerns arose because the market moves for which this control was making compensating adjustments could have been caused by the trades being looked at, rather than by external market forces. CRA nevertheless believes it is useful to look at the regression results both with and without consideration of this variable.

CRA ultimately has not identified a unitary measurement approach that it believes yields the definitive benchmark measure of possible execution quality harm. While different potential approaches have greater or lesser value, there is some value in looking at all of them, not only because they show the consequences of considering different measurement approaches but also because they illustrate the tendency of these variables -- the most substantial and important ones CRA could identify - to alter the measured results only within a relatively narrow range.

**D. The Results of CRA's Regression Analysis**

**1. Overall Results**

Table A below summarizes the results of CRA's regression analysis using all of these different approaches, as applied to creeping blocks, using the NBBO mid-point between the bid and the ask quotations as the price benchmark. [TEXT REDACTED BY THE COURT] Each set of results is presented in two ways n6: (i) by identifying the dollar figure for estimated harm that emerged from the statistical regressions, which corresponds with the center of the bell curve identifying the range of possible outcomes; and (ii) by identifying the "confidence interval" attached to that estimated harm figure, presented as the dollar figures at the lower and upper limits of the bell curve. Those upper and lower limits correspond with two standard deviations from the estimated harm figure, and thereby reflect the 95% confidence level widely viewed as corresponding with statistical significance.

Confidential Interval Stock Return from Without Adjustment Placement Estimate for Comparison of Tainted to Last Overall Untainted Broker Broker to Untainted Execution Impact Heterogeneity Brokers Based on Plus 5 Mins (Millions) (Millions) Equally Weighted Number of Orders No $ 7.5 -$ 1.8 to $ 16.9 Dollar Value of Placement No $ 11.9 $ 1.9 to $ 21.8 Number of Shares No $ 12.5 $ 2.3 to $ 22.8 Number of Orders Yes $ 7.6 $ 0.4 to $ 14.7 Dollar Value of Placement Yes $ 14.7 $ 7.5 to $ 22.0 Number of Shares Yes $ 15.3 $ 7.8 to $ 22.8 Principal Weighted Number of Orders No $ 31.6 $ 10.4 to $ 52.7 Dollar Value of Placement No $ 9.5 -$ 6.7 to $ 25.7 Number of Shares No $ 10.5 $ 6.0 to $ 27.0 Number of Orders Yes $ 29.0 $ 12.1 to $ 45.8 Dollar Value of Placement Yes $ 14.0 $ 12.7 to $ 26.7 Number of Shares Yes $ 14.4 $ 1.8 to $ 27.5

Comparison of Tainted With Adjustment for Broker to Untainted Untainted Broker Brokers Based on Heterogeneity (Millions) Equally Weighted Number of Orders -$ 6.6 to $ 21.7 Dollar Value of Placement -$ 1.9 to $ 25.6 Number of Shares -$ 1.5 to $ 26.6 Number of Orders -$ 5.2 to $ 20.3 Dollar Value of

Placement $ 2.7 to $ 26.6 Number of Shares $ 3.2 to $ 27.3 Principal Weighted Number of Orders $ 5.1 to $ 58.0 Dollar Value of Placement -$ 11.9 to $ 31.0 Number of Shares -$ 11.0 to $ 32.0 Number of Orders $ 21 to $ 55.8 Dollar Value of Placement -$ 7.6 to $ 35.5 Number of Shares -$ 7.3 to $ 36.1

While each of the mathematical results summarized in Table A speaks for itself, the collection of results permits three general observations:

1. In almost all instances (and particularly in the instances involving the measurement approaches that seemed most reliable), the statistical regression yielded an estimate of some adverse effect on execution performance from tainted traders' activities with tainted brokers -- with estimated levels generally ranging between $ 7.5 million and $ 31.6 million, and a very general clustering of results around about $ 14 million.

2. In several instances, the bottom number in the confidence interval at a 95% confidence level is at or below zero. As a matter of statistics, this result means, in each case where it appeared, that the statistical results preclude a rejection of the "null hypothesis" of zero harm -- or, in more colloquial terms, preclude a finding that harm occurred at a 95% confidence level. On the other hand, the fact that the bottom ranges of about half the confidence intervals are above zero points away from the hypothesis that no harm occurred.

3. The top ends of the confidence intervals for the various measurement approaches ranged between $ 14.7 million and $ 58 million, with some appearance of general clustering (particularly for the most reliable measurement approaches) in the general vicinity of $ 25 million. As a statistical matter, the regressions identify these outcomes of relatively substantial harm as no less likely than the zero harm (or net benefit) figures at the other end of the confidence interval. n7

**E. The Clustering of Indications of Harms and Benefits among Tainted Pairs**

In an effort to test the significance of the apparently consistent pattern of positive estimates of harm regardless of which different approach to measurement was employed, CRA asked, for each of its different measurement approaches, how many of the results from testing individual tainted pairs showed harm from trading in the tainted relationship (and whether that harm was "significant" measured at the 95% confidence levels), and how many showed no harm or benefit (and whether that benefit was "significant"). The results are summarized in Table B. [TEXT REDACTED BY THE COURT] Tainted Pairs with Harm Stock Return from Placement Comparison of Tainted to Last Number of Broker to Untainted Execution Number of Significant Brokers Based on Plus 5 Mins Pairs Pairs Equally Weighted Number of Orders No 27 6 Dollar Value of Placement No 31 7 Number of Shares No 31 7 Number of Orders Yes 29 7 Dollar Value of Placement Yes 32 9 Number of Shares Yes 33 9 Principal Weighted Number of Orders No 31 3 Dollar Value of Placement No 28 4 Number of Shares No 29 4 Number of Orders Yes 33 5 Dollar Value of Placement Yes 30 4 Number of Shares Yes 31 4

Tainted Pairs with Benefit Comparison of Tainted Number of Broker to Untainted Number of Significant Brokers Based on Pairs Pairs Equally Weighted Number of Orders 15 0 Dollar Value of Placement 11 1 Number of Shares 11 0 Number of Orders 13 0 Dollar Value of Placement 10 0 Number of Shares 9 0 Principal Weighted Number of Orders 11 0 Dollar Value of Placement 14 0 Number of Shares 13 0 Number of Orders 9 1 Dollar Value of Placement 12 0 Number of Shares 11 0

The results were remarkably consistent. Among all the measurement approaches within the "equally weighted" group of results, for example, between 27 and 33 of the 42 tainted pairs reviewed had results indicating harm (of which between six and nine were significant), while pairs with individual results showing no harm or benefit ranged between nine and fifteen (of which only one was "significant").

These clustering results appeared to indicate a strong tendency for the statistical analysis to indicate the probable presence of at least some level of poorer implementation shortfall in the tainted pairs than would have been expected in an environment without taint, even despite the zero and negative harm results identified as mathematically possible at the bottom of the statistical confidence interval. [TEXT REDACTED BY THE COURT]

**F. Sensitivity Analyses**

CRA devised on its own, and [TEXT REDACTED BY THE COURT] urged it to consider, a number of alternative measurement approaches to be applied to its data. While CRA has not accepted any of these approaches as superior to the approaches it employed, CRA performed the regression analysis using these proposed approaches, in effect as a sensitivity test to see if they yielded significantly different results from the ones CRA obtained. These alternative analytical approaches included the following:

- Without Outliers: CRA performed variations on its analyses that trimmed outliers from the results at different levels of deviation from conventional results. This is a typical analytical technique, to avoid allowing results to be skewed by a small number of incongruous, unrepresentative and extreme outcomes. Trimming outliers generally had little effect on the calculations of estimated overall adverse impact, but also tended to narrow the confidence intervals. [TEXT REDACTED BY THE COURT]

- Employing Stock-Date Controls : [TEXT REDACTED BY THE COURT] has contended that CRA's various control variables are inadequate to make different stock trades effectively comparable against each other, and that the only fair comparison would be between trades in the same stock and on the same dates as individual trades between tainted traders and tainted brokers. CRA has not agreed with this view, on the bases that (i) [TEXT REDACTED BY THE COURT] proposed approach excludes a potentially pivotal set of trades -- where a tainted trader placed all purchases or sales of a particular stock with only a tainted broker on a particular day; (ii) CRA believes its control variables permit comparability; and (iii) looking only at this much smaller subset of trades creates much more difficulty in achieving statistically significant results, and correspondingly widens significantly the confidence interval attached to such results. Nevertheless, CRA conducted the analysis to determine the results of a regression including a control for stock and date. [TEXT REDACTED BY THE COURT]

- Without Relative Capital Commitment: CRA calculated their results excluding the associated control variable for relative capital commitment because some concerns had been raised over the accuracy of the data obtained from Fidelity that identified capital committed trades. [TEXT REDACTED BY THE COURT]

- AVWAP from Placement Time: In response to Fidelity's repeated suggestions that an AVWAP measure is preferable to an implementation shortfall measure in evaluating the execution performance of any individual trade, CRA repeated its analysis using AVWAP costs from broker placement time. This is not the same as Fidelity's AVWAP measure for tracking trader performance, which begins the clock for AVWAP measurement at the time of the trader's receipt of orders from the portfolio manager rather than from the trader's later placement of orders with the broker, but it does adopt the averaging approach to assessing performance reflected in the AVWAP measure. [TEXT REDACTED BY THE COURT]

- Modified Benchmark for Order Placement Price and Execution Price: [TEXT REDACTED BY THE COURT] has criticized CRA's use of the NBBO mid-point between bid and ask quotations as the benchmark share price at the time when a trader placed an orders with a broker, and suggested using the ask price when Fidelity was buying shares and the bid price when Fidelity was selling shares, contending that Fidelity's trading methods and its trades' size and capacity to affect the market warranted the use of a side-specific benchmark. n8 [TEXT REDACTED BY THE COURT] Professor Ready agreed with this and it showed a somewhat higher level of possible harm at the upper range of the confidence interval. Since both [TEXT REDACTED BY THE COURT] and Ready agreed that this approach was more statistically valid than using the NBBO midpoint for all trades, we believe it appropriate to use these results to calculate the payment to be requested from Fidelity. The results of this analysis are as follows: Confidence Interval Stock Return from Without Adjustment Placement Estimate of for Untainted Comparison of Tainted to Last Overall Broker Broker to Untainted Execution Impact Heterogeneity Brokers Based on Plus 5 Mins (Millions) (Millions) Number of Orders No $ 11.1 $ 0.6 Dollar Value of Placement No $ 16.1 $ 3.7 Number of Shares No $ 16.9 $ 4.1

Comparison of Tainted With Adjustment for Broker to Untainted Untainted Broker Brokers Based on Heterogeneity (Millions) Number of Orders -$ 2.6 to $ 24.8 Dollar Value of Placement $ 1.4 to $ 30.7 Number of Shares $ 1.8 to $ 32.0

The results of these various analyses are summarized in CRA's report [TEXT REDACTED BY THE COURT] In general terms, they show a continuation of the consistent pattern of positive numerical estimates of harm, with lower ends of the confidence interval at zero or below and the upper ends of the interval in the tens of millions of dollars (with a particularly wide confidence interval associated with controlling the stock and date, as was predictable). To the extent these different suggested measurement approaches are viewed as a form of sensitivity tests applied against CRA's analysis, they broadly reinforce the analysis.

**G. Unavoidable Limitations of the CRA Analysis**

Despite the thoroughness and professionalism of CRA's analysis, its conclusions are burdened by certain limitations that no amount of further statistical analysis could fully overcome. These include the following:

- Presumption of Taint: CRA's analysis compares all trades handled by each tainted trader/broker pair against the trades placed with untainted brokers. This approach assumes for purposes of the analysis that every tainted trade placed with a tainted broker was affected by TEGG. This analytical presumption does not correspond with human experience or common sense. Although it is reasonable to conclude that receipt of improper TEGG increased the volume of trades placed with tainted brokers or affected the timing of the trades (as described more fully in connection with the analysis of possible order flow harm below), there is no basis for concluding that but for TEGG, the tainted traders would have placed no trades with the tainted brokers. As a result, CRA's regression analysis inescapably included trades not individually motivated by TEGG in the set of "tainted trades" for which CRA measured the net excess costs. There is no available way of excluding these untainted trades from the tainted ones, because it is impossible to say which particular trades were influenced by TEGG. The execution performance results from analyzing only trades truly influenced by TEGG might be quite different, and possibly considerably worse, but those trades cannot be isolated for analysis.

- Definition of Tainted Pairs: When the SEC identified "tainted" relationships between brokers and traders, it did so on an individual basis, concluding that individual traders on Fidelity's equity trading desk had conflicted relationships with individuals employed by various brokerage firms. CRA's analysis did not adhere to this definition of taint, but instead looked at all trades between individual tainted traders and the entire firms at which the individual tainted brokers worked. For example, Thomas Bruderman of Fidelity and Kevin Quinn of Jefferies had a tainted relationship, but CRA treated all trades that Bruderman placed with Jefferies as tainted. This approach was entirely reasonable to the extent that a trader placed trades only with a single broker at a firm, or only with brokers who were part of the TEGG process or for whose performance the broker causing the tainted relationship would receive some credit. That may have covered a substantial majority of tainted pairs, but a potential factual gap in CRA's assumptions nevertheless remains.

- Confounding Factors: Even with the array of control variables CRA used to take account of the differences caused by variations in the properties of stock, trading environment and trade, it is impossible to mute entirely the noise created by the enormous range of factors that can affect the cost of a trade. The depth of the market, mercurial price changes, unexpected news, volume, liquidity, trader instructions, other investors, discretionary choices and numerous other human and market-based interventions all had the capacity to affect execution cost. As the confidence intervals for each estimate of impact confirm, the regression analysis cannot completely account for these confounding factors.

While these limitations in CRA's analyses are undeniable, and necessarily affect the confidence that can be attached to its conclusions, certain other critiques of CRA's analysis by Fidelity and [TEXT REDACTED BY THE COURT] do not as clearly undermine that analysis. Most significantly, [TEXT REDACTED BY THE COURT] contention that CRA's analysis is fundamentally flawed because it did not include a control for

broker effects -- examining whether traders performed worse with tainted brokers than untainted traders did with those brokers -- is unpersuasive for both logical and statistical reasons. Given both trader and broker specialization, there is no reason to believe that each broker occupies the same relative cost position across all traders, because traders used brokers in different ways and because brokers themselves may have altered their approaches when dealing with different traders. Even if certain brokers were more expensive when used by tainted and untainted traders alike, it would be inappropriate to exonerate the tainted traders who directed orders to those brokers because of TEGG for the excess execution costs they incurred simply because trading with those brokers generally entailed higher costs. CRA tested the assumption that each broker had the same relative cost position across all traders and found it to be rejected by the data. [TEXT REDACTED BY THE COURT]

**H. Conclusions Respecting Possible Execution Quality Harm Based on CRA's Statistical Analysis**

**1. The Statistical Evidence Standing Alone**

Taken in the aggregate, the outcome of CRA's statistical analysis standing alone suggests, but does not prove, harm to the Funds. At one level, the numerical outcomes from looking at the data in multiple different ways fall within a sufficiently narrow range to suggest that those results collectively have a measure of self-reinforcing robustness. The single-number center of the bell curve of statistically likely outcomes is consistently positive within a relatively narrow range, and the array of harm vs. benefit results on an individualized tainted pair basis is heavily weighted in the direction of showing weaker execution performance in tainted trader-broker pairs than the statistics suggest would have occurred from trading in an entirely untainted environment.

While there is some temptation to view the scale of results reflected in CRA's report as so small in the context of Fidelity's massive trading activities as to fall within the category of probable rounding error, a rough benchmarking suggests that these results fall within the range of intuition and expectation about what the scale of execution quality harm from trading tainted by TEGG considerations might have been. In very round terms, the dollar value of the over 160,000 trades CRA considered in its analysis was about $ 525 billion. The 19,000 trades executed by the 42 tainted broker-trader pairs aggregated approximately $ 63 billion in value. Again in very round terms, total execution costs associated with trades made by the tainted traders generally averaged approximately 44 basis points. This suggests that the total execution costs of the trades by the tainted pairs amounted, very roughly, to $ 280 million. A finding that the CRA data statistically suggests possible harm from tainted trading of about $ 15 million would suggest this harm amounted to almost 6% of execution costs.

As already indicated, though, there is an obvious danger, recognized by CRA itself, in attaching too much conclusive weight to CRA's statistical results. The data CRA has processed reflects assumptions, estimates and analytical leaps that affect its ultimate reliability, and the consistent inclusion of zero harm results in the confidence intervals surrounding CRA's estimates would be generally recognized to preclude a finding of harm at a 95% confidence level. Because of all of these limitations, the statistical evidence alone does not support a finding of an amount of harm attributable to trading motivated by TEGG.

**2. Considerations in Addition to Statistics**

The statistical record does not stand alone in this matter, though. Instead, the statistics are properly viewed through the lens of the acknowledged substantial receipt of TEGG, violations of Fidelity policy that supervisors tolerated and sometimes even joined, email records indicating substantial attention to TEGG events and memorializing suspicions from colleagues that these events were influencing trading decisions, and identified individual "event driven" trades in which a broker appeared to have been selected for reasons related to TEGG and the trade turned out badly (as discussed in Section IV below). In circumstances like these, even in the context of a court proceeding where amounts of harm must be proved by a preponderance of the evidence, "it is well-established that the breaching defendant, who has created the uncertainties as to damages, must bear the risk of these uncertainties." Western

Geophysical Co. of America v. Bolt Assoc., Inc., 584 F.2d 1164, 1173 (2d Cir. 1978). Here, Fidelity clearly breached its duty to the Funds to ensure that its traders acted solely for the benefit of the Funds.

Courts have recognized that inconclusive evidence can be considered in fixing an amount of damages, when other evidence in the record supports a finding of probable harm. As the United States Supreme Court has explained, "there is a clear distinction between the measure of proof necessary to establish the fact that [a] petitioner had sustained some damage, and the measure of proof necessary to enable the jury to fix the amount." Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 563 (1931). Where the injury "itself is of such a nature as to preclude the ascertainment of damages with certainty, it would be a perversion of fundamental justice to deny all relief to the injured person . . . . In such cases, while the damages may not be determined by mere speculation or guess, it will be enough if the evidence show (sic) the extent of the damages as a matter of just and reasonable inference, although the result be only approximate." Id.

Viewed from this perspective, the combination of the statistical record, for all its limitations, and other evidence creates a situation in which reaching a conclusion of zero harm would be entirely unsatisfactory. The 95% confidence level that is a recognized indicator of "statistically significant" conclusions is, as CRA has observed in its report, highly protective of the hypothesis of no effect. [TEXT REDACTED BY THE COURT] Only a very high level of statistical proof will support a conclusion that a particular action caused an effect under this rigorous standard. There are many known contexts, though, where less than this level of confidence is required to take actions based on the perception of risk that an action may cause a result. In matters of public health, for example, the inability to say that a particular activity or product is dangerous at the 95% confidence level, because of the presence of tremendous numbers of potentially confounding variables in a study of potential harm, does not always prevent authorities from taking actions to avoid a possible risk.

The particular context of this investigation presents an additional reason for concluding that doubts about possible execution quality harm should be resolved in the direction of ensuring full compensation to the Funds. The dynamics underlying this investigation involve several layers of fiduciary duty, including the fiduciary duties that both the Independent Trustees and Fidelity owe to the Funds and their shareholders. It is a well recognized principle of equity that in cases of breach of fiduciary duty, the remedy should presumptively include "the restoration of the trust beneficiaries to the position they would have occupied but for the breach of trust." Donovan v. Bierwirth, 754 F.2d 1049, 1056 (2d Cir. 1985). While this principle does not require a court seeking to measure harm in the context of a breach of duty to abandon requirements of proof, it does support fiduciaries in seeking to resolve uncertainties in the direction of ensuring that beneficiaries are fully compensated for any breach.

As this investigation has proceeded, the Independent Trustees have indicated that they want a high level of assurance that any remedy they direct Fidelity to employ will leave the Funds fully compensated for possible harms. Since the effort to protect the Funds falls within the scope of the Trustees' duty of care and duty to "exercise good faith and act solely in the interests of the beneficiaries" of the Funds, Rutanen v. Ballard, 678 N.E.2d 133, 139-40 (Mass. 1997), the effort to resolve doubts in favor of that protection also falls within the scope of those duties.

### 3. Other Considerations in the Assessment of Execution Quality Harm

The effort to fix an appropriate compensation measure to ensure full repayment of the Funds for any possible harm incurred from trading decisions made based on TEGG also requires consideration of two other points: the period of time over which improper TEGG was received, and the "netting" issue.

The SEC's investigation, and CRA's analysis, run from January 2002 through the initiation of the SEC investigation and the responses to that investigation in October 2004. CRA has reported that Fidelity trading records for earlier periods may contain gaps, and, for reasons set forth above, this investigation has not sought to consider the presence or consequences of improper TEGG that may have influenced trading decisions from periods before 2002. No information learned in this investigation provides any reason for concluding with confidence, though, that the kinds of TEGG activities that surfaced for 2002-04 were entirely absent in 2001 or earlier periods. Although Fidelity's trading volumes before 2002 were

much smaller than in 2004, and although there is some indication that Fidelity's trading desk underwent cultural shifts near the end of the last decade that suggest a lesser risk of improper TEGG activities in earlier periods, this unresolved area of uncertainty presents another possible area of loss worth taking into account in assessing the amount Fidelity should be directed to pay.

The analysis of the data also requires conclusions about the extent, if any, that the repayment measure should take into account the indications in CRA's regressions that some of the tainted pairs had positive execution costs (indicating the possibility of harm to the Funds) while others had negative execution costs (indicating the possibility of benefit to the Funds). Apart from CRA's reporting of the array of performance results from individual tainted pairs, CRA's analysis otherwise looked at implementation shortfall only on a "net" basis, offsetting instances of apparent statistical harm with instances of apparent statistical benefit. An approach saying that a wrongdoer must compensate for all harms but may not get credit for benefits would yield significantly higher numbers.

Under the law of trusts, losses caused by a breach of duty cannot be reduced by any benefit that "accrued through another and distinct breach of trust; but if the breaches of trust are not separate and distinct, the trustee is accountable only for the net gain or chargeable only with the net loss resulting therefrom." Restatement (Third) of Trusts, § 213. Under this approach to determining whether to "net" results, "a fiduciary is liable for the total aggregate loss of all breaches of trust and may reduce liability for the net loss of multiple breaches only when such multiple breaches are so related that they do not constitute separate and distinct breaches." California Ironworker Field Pension Trust v. Loomis Sayles & Co., 259 F.3d 1036, 1047 (9th Cir. 2001). A court ruling on an Investment Advisers' Act claim has similarly concluded that a plaintiff may not "recover for losses, but ignore his profits, where both result from a single wrong." Abrahamson v. Fleschner, 568 F.2d 862, 878 (2d Cir. 1977).

If it could be established with a reasonable degree of certainty that some traders who received TEGG did not allow it to affect their performance, and in fact had positive execution costs, it would be inappropriate to deduct their positive results from the losses incurred by other traders who did allow their receipt of TEGG to impact their performance negatively. The fact that one group of traders did not allow their receipt of TEGG to influence their performance would not mitigate the harm caused by the tainted brokers whose results were adversely impacted by their receipt of TEGG. Similarly, if one could prove that certain specific trades of an individual trader were the result of TEGG and resulted in higher execution costs to the funds, it would be inappropriate to net those losses with positive execution costs that the same trader had with the same broker.

Here, however, where we are relying on a concededly imprecise statistical analysis in which one would expect that in any random cross section of traders and trades some would have positive execution costs and others would have negative costs, a failure to net out the results would appear to be inconsistent with underlying assumptions of the analysis.

The alternative course of looking at each trade to see whether it had better execution costs or worse execution costs than a benchmark would take inadequate account of the reality that execution costs for any single trade are in some measure affected by happenstance outside any trader's or broker's control, and that, in a statistical analysis, it is only in the aggregate, over time, that overall adverse effects from selecting a broker based on TEGG could emerge and be identified with any degree of reliability. Looking at aggregate performance of trader-broker pairs and declining to net at that level would not reflect a true application of the anti-netting rule, meanwhile, and again would seem too likely to reflect an element of arbitrariness. I specifically asked Professor Ready his views on this issue and it was his opinion that in a statistically valid analysis the gains and losses should be netted.

Nevertheless, the indication that the execution quality harms from trading based on TEGG would be higher than the potential levels reported by CRA if trades that appear to have had unfavorable execution outcomes were not offset by trades apparently having favorable execution outcomes provides an additional reason for directing Fidelity to compensate the Funds at a level corresponding with the high end of the range of possible harm outcomes identified at a 95% confidence level.

**IV. Event-Driven Analysis**

One alternative to treating every trade in a tainted trader-broker relationship as tainted is to seek to identify particular trades that seem to have been influenced by TEGG, and to measure the execution costs of those trades. Although we understood from the outset that it would be impossible to identify all trades that took place as a result of TEGG and segregate them from trades uninfluenced by TEGG, the exercise of identifying and seeking to analyze at least some TEGG-influenced trades seemed worthwhile. We undertook to identify illustrative potentially "event-driven" trades, and to develop a sense of how readily such identifications could be made, in three ways:

1. We reviewed email and Bloomberg communications provided by Fidelity that referred to TEGG events. After locating some messages that appeared to refer to trades placed in gratitude for TEGG, we and CRA reviewed the relevant trading records and attempted to isolate the trades mentioned in the messages.

2. After identifying one highly significant trade (Tyco, discussed below) in this manner, we sought to expand the analysis by identifying the twenty dates when tainted traders placed the largest trades (over three million shares) with tainted brokers, then obtaining and reviewing additional email and Bloomberg messages from Fidelity's archives surrounding each of these trades.

3. We directed CRA to generate a series of charts showing tainted traders' weekly trading volumes with tainted brokers. We then enlisted Fidelity's assistance in scrubbing Fidelity's spreadsheets of all reported TEGG events to pinpoint the dates of major events for which dates were not clear, ultimately identifying the exact or approximate dates of about 100 of the most significant TEGG event dates in Fidelity's records. CRA then superimposed these 100 events, by date, onto its charts of tainted traders' weekly volumes with brokers who paid for these TEGG events, to look for variations in trading patterns in proximity to the TEGG events.

While these searches yielded a number of emails tending to confirm that specific trades or groups of trades were motivated by TEGG, the number of trades that would be identified in this way was small, and our follow-up work on the emails we found did not provide a basis for a conclusion that such TEGG-driven trades were generally characterized by inferior execution performance. Large numbers of trades may have been placed as a result of TEGG -- or, as the next section strongly suggests, TEGG may have significantly affected order flows -- but our analysis yielded no proof that the primary form of response to receiving TEGG was a single trade placed in thanks for a major TEGG event in close temporal proximity to the event. The significant exception was the collection of January 30, 2002 trades in shares of Tyco, as to which the combination of trading records and contemporaneous email traffic provides a powerful illustration of the apparent capacity of TEGG to influence broker relations in ways that opened the traders to a host of adverse inferences when the trade went extraordinarily badly.

**A. The Search of Emails and Trading Records to Identify Apparently TEGG-Driven Trades**

Among the package of Fidelity emails provided to us early in our investigation -- and characterized generally in previous reports to the Independent Trustees and the SEC as the "Greek-chorus" emails -- we saw numerous statements by traders on the equity trading desk, largely having the tone of gossip, to the effect that particular traders were the recipients of extravagant TEGG from brokers, and that TEGG influenced relationships. A small number of these emails suggested a direct linkage between a trade and an instance of TEGG. See, e.g., Jan. 25, 2002 Bloomberg message from Marc Beran to Steven Pascucci, SEC-FID-GG- 25074 (Exhibit 3) ("[n]ice SUNW order[.] That is the cost of US Open seats Saturday"); March 26, 2003 Bloomberg message from M. Beran to EQ Trading, SEC-FID-GG 25126 (Exhibit 4) ("I figure I owe [TEXT REDACTED BY THE COURT] 3 orders to pay for my annual [TEXT REDACTED BY THE COURT] golf shirt"); June 6, 2002 Bloomberg message from Steven Pascucci to Kirk Smith, SEC-FID-GG 25081 (Exhibit 5) ("It is disgraceful how [Bruderman] and [TEXT REDACTED BY THE COURT] cherry pick orders and funnel them towards their social schedule . . . i.e. Fri nite Celts tix=OPWV order for [TEXT REDACTED BY THE COURT] d"). Those statements conveyed an unacceptable flavor of individual trades placed specifically to compensate brokers for providing TEGG. Despite substantial effort, though, we were not able to trace these comments to TEGG-based trades.

In an attempt to expand the email review to search for other instances of discussions like those found in the Greek-chorus emails, we applied a broad collection of search terms to a search of emails written or

received in the period surrounding the twenty largest trades in 2002-04 between tainted traders and tainted brokers -- each over three million shares. That search revealed no instances in which traders admitted about themselves or expressed the view about others that the selection of a broker for a particular trade was a consequence of TEGG. Major trades (other than Tyco) may have reflected selections of a particular broker for reasons related to TEGG, but no such motivations were memorialized or reported by colleagues in Fidelity emails we reviewed.

The check of individual TEGG events against traders' weekly trading volumes to look for patterns of increased order placement around TEGG events similarly did not reveal any consistent pattern of detectable increase in trading volumes placed with tainted brokers around the time of TEGG events. In the overwhelming majority of instances, the weekly trading volumes in the periods just before and after major TEGG events seemed indistinguishable from the normal range of trading patterns. Once again, this does not mean that traders directed no trades to the brokers in recompense for TEGG, but only that any such compensatory trades generally did not reflect aberrations from the traders' general volumes of orders placed with those brokers.

Within this general result, though, the data did show some instances of what appeared to be escalations in trading volumes with TEGG-providing brokers around the time of a TEGG event. Some of these apparent escalations appeared sufficiently consistent with the overall range of variation in the trader's volumes of placements with the broker over time that any assertion of linkage between the increase to a TEGG event would necessarily be equivocal. The same was true for instances when an apparent spike in trading volumes occurred several weeks before a TEGG event, since we could not say whether such spikes reflected early gestures of gratitude for an offer of TEGG that would not be enjoyed for a few weeks (as might have seemed very possible for an event involving several days' travel, for example), or were completely divorced from the future TEGG event. For each of these instances of possible TEGG-related escalation in volumes, CRA reviewed individual trades during the period of increased trading to look for single trades that appeared possibly motivated by TEGG, and to look at execution costs associated with these trades. This exercise proved inconclusive. It did not generally reveal either trades that could be clearly linked to TEGG or atypical execution costs in light of the circumstances surrounding the trade.

Of the roughly 100 largest TEGG events for which dates could be fixed, only twelve fell in close enough proximity to unusual increases in trading volumes placed with the TEGG-providing brokers to present a significant appearance of probably reflecting TEGG-related trades. For each of these twelve, CRA examined the particular trades connected with the significant increase in volume. This examination revealed only four large trades that appeared unusual. [TEXT REDACTED BY THE COURT] In each case, although the costs were low in absolute terms, they were surprisingly high given that the market was moving in a favorable direction during the trade. With each of these four trades, as with the statistical analysis as a whole, the statistics were useful to show relative and directional impact, but could not hope to capture the entirety of the circumstances affecting any trade or stock during any particular day or week. To better understand the four unusually costly trades, we reviewed the media coverage of the stock during the day and week of the trade and found that each of the four trades took place when the stock being traded was experiencing unusual and significant stress. Even with the control variables, such atypical trading days and/or significant news releases are likely to have skewed the measure of (or ability to measure) the effect of TEGG on the execution cost of any particular trade. n9 In all, the confounding factors for each of the four suspect trades were so numerous and so substantial that we could not with any confidence attribute the unusual cost of the trades to inappropriate broker selection brought about by TEGG, although the possibility could not be excluded entirely.

**B. The Tyco Trade**

The most striking example of ways TEGG can affect a trade that emerged from our investigation of possible trades driven by TEGG events related to a collection of trades on January 30, 2002, in which Edward Driscoll placed orders to buy eight million shares of Tyco with [TEXT REDACTED BY THE COURT] just days before the broker flew him by private jet to the Super Bowl in Houston, Texas. Driscoll himself linked the trade to TEGG, stating, "The good news is, the TYC order paid for [TEXT REDACTED BY THE COURT] jet." Jan. 30, 2002 Bloomberg Message from Edward Driscoll to [TEXT REDACTED BY THE COURT], SEC-FID-GG 25024 (Exhibit 6). Driscoll's decisions on the Tyco trade resulted in a potential

total cost to the Funds of as much as $ 18 million, n10 and the execution cost of these trades, as measured on a creeping block basis, amounted to over $ 6 million. These unusual costs resulted primarily because Driscoll placed only a portion of the orders he had received from portfolio managers immediately during the morning when he received those orders, and because there were delays in executing orders placed with [TEXT REDACTED BY THE COURT] in the period following a noontime announcement of a substantial stock buyback during which the share prices rose steeply. While it is impossible to say whether and to what extent any of this unusually high execution cost was attributable to the choice of broker, the mere reality of poor execution outcomes in a context where TEGG appears likely to have affected the choice of broker illustrates the kinds of risk of adverse inferences to which traders exposed themselves by entering into trades linked to provision of TEGG.

The details of the timing and placement of the Tyco orders are set forth in CRA's report, [TEXT REDACTED BY THE COURT]. Driscoll placed the orders not at once, but on a "creeping block" basis with [TEXT REDACTED BY THE COURT], piecing out the purchases of 8,092,280 shares in a total of fourteen placements grouped into five main increments over the course of the day. Most of the orders were executed at prices reasonably close to the prices at the time the order was placed, but one order to buy over a million shares was not executed for about an hour and a half after it was placed at midday, during which the price rose significantly in response to the noon buyback announcement. The delay between the placement and execution was remarkable not only because of the dramatic increase in price, but also because of the extraordinarily heavy volume of trading in Tyco shares that day -- the second day in a row that Tyco had set a stock exchange record for trading in a single issue.

Our inability to interview either Driscoll or [TEXT REDACTED BY THE COURT] about this trade has meant that we (like everyone else considering these Tyco trades) are left to speculate about whether and to what extent the delay in executing Driscoll's order and other adverse execution results on this trade were the result of [TEXT REDACTED BY THE COURT] inadequate skill, poor judgment or mere errors in prediction of a type that even the best brokers can make), or of decisions by Driscoll to wait and see if the stock price stabilized that simply turned out wrong (as even the best traders' assessments sometimes do), or of other causes having nothing to do with broker selection. On the day of the trade, though, at least some Fidelity traders explicitly criticized Driscoll's handling of the order and choice of broker to execute it, with one commenting that "the order that [could] not get fukked (sic) up got fukked (sic) up," and another replying "colossally . . ." and later observing "poor broker selection ... Superbowl (sic) trip should not affect judgment." See Bloomberg messages between Steven Pascucci and Kirk C. Smith, Jan. 30, 2002, SEC-FED-GG 25021 (Exhibit 7). n11

The Tyco trades arose in highly idiosyncratic circumstances. On both the day of the trade and the day before, Tyco had broken market records in volume of shares traded in a single issue. Two days before, the company had disclosed a $ 20 million "finder's fee" payment to an outside director, and during the January 30 trading day the company announced that the CEO and CFO would each buy back 500,000 shares of stock in response to investor concerns about earlier disclosures regarding other stock transactions by those executives. Earlier in the month, Tyco had announced a plan to divide into four separate companies, probably contributing to uncertainty and volatility of trading during a time when the telecommunications and electronics sectors in which Tyco had core businesses were already perceived as weak. In addition to these stock-specific factors undoubtedly affecting trading executions, one portfolio manager,[TEXT REDACTED BY THE COURT], gave particularly explicit directions about the speed, quantity and price he wanted his order, and Driscoll apparently took these instructions into account in placing his early morning orders.

A review of the email and messages requested from Fidelity indicated that many untainted brokers emailed Driscoll throughout the day to inform him that they could fill substantial purchase orders, including several who contacted him prior to the placement of the first two orders for three million shares with [TEXT REDACTED BY THE COURT]. solicited Fidelity's views on these messages, [TEXT REDACTED BY THE COURT] , Fidelity responded by pointing out the lack of price information provided by the emails, the possibility that they were merely exploratory inquiries from brokers seeking to test the depth of the market, and the volatility of the market on the day of the trade. [TEXT REDACTED BY THE COURT] More significantly, Fidelity has argued that Driscoll's incremental purchases of shares through [TEXT REDACTED BY THE COURT] over the course of the day did not reflect an inability to find Tyco shares for sale during the period before the midday announcement. Rather, Fidelity has said, Driscoll's

approach plainly reflected a series of judgments about how and when to trade -- made during the morning without foreknowledge of the price-jolting mid-day announcement, and then with the best professional guess about how the stock would move after the surprise announcement was made -- of a type that exclusively reflected trader decision-making not linked in any respect to the broker's identity or skills.

These idiosyncrasies of the Tyco trade, while confirming that it is in some respects an outlier, also powerfully illustrate the problems that arise when traders placed a major transaction with a major provider of improper TEGG. Under these unquestionably complex conditions, another untainted broker might have done no better with the same orders. It remains probable, though, that Driscoll's choice of broker was influenced by TEGG, and possible that Driscoll's choice resulted in poorer execution than could otherwise have been achieved. Based on the record associated with this trade, our analysis identified Driscoll and [TEXT REDACTED BY THE COURT] as an additional tainted trader-broker pair along with the others identified by the SEC.

While Fidelity has urged that Driscoll's selection of [TEXT REDACTED BY THE COURT] to undertake the trade was justifiable on the merits, Fidelity's statements that [TEXT REDACTED BY THE COURT] was Driscoll's third-largest broker by commission and was well-suited to handle the trade because of its expertise in high-tech stocks and 1130s do not demonstrate that [TEXT REDACTED BY THE COURT] experiences in those areas made it the best broker or even a logical choice for this extraordinarily large and difficult trade. They also do not negate the powerful inference that Driscoll selected [TEXT REDACTED BY THE COURT] based on TEGG. The combination of the trade's relative size (no other Driscoll trade with [TEXT REDACTED BY THE COURT] during the first six months of 2002 was more than half as large), its proximity in time to the free Super Bowl trip [TEXT REDACTED BY THE COURT] was providing, Driscoll's email comment about the linkage and the contemporaneous views of other traders provides no reason to give Driscoll or Fidelity the benefit of the doubt on this point.

The poor execution cost outcome of the trade may also have been entirely a function of unpredictable and uncontrollable market events confirmed with well-reasoned judgments by Driscoll of the type that even the best traders regularly make incorrectly. Once again, though, the taint associated with the use of a TEGG-providing broker so close in time to such an extravagant trip, coupled with the views contemporaneously expressed by colleagues that "poor broker selection" was a factor in the adverse outcome, leave that conclusion subject to doubts that the circumstances present no reason to resolve on Fidelity's favor.

**V. Order Flow**

**A. The Channeling of Orders In Response to TEGG**

Some Fidelity traders undisputedly directed order flow to tainted brokers as a result of TEGG. Fidelity conceded as much, [TEXT REDACTED BY THE COURT], and the email and trading records of the equity trading desk confirm it. Once again, though, measurement of the scale of TEGG-affected order flow and assessment of its possible consequences for the Funds are subject to significant uncertainty and inexactitude.

**1. Contemporaneous Communications**

The contemporaneous electronic communications among traders confirm that it was common practice to direct order flow to brokers who provided TEGG. As one trader bluntly commented: "word is out that order flow is for sale." See Nov. 15, 2002 Bloomberg message from Steven Pascucci to Kirk Smith, SEC-FID-GG 25106 (Exhibit 11). As noted above, other traders expressly stated on occasion that they or others had used order flow to "cover" TEGG, though we were not able, on the most part, to trace these comments to TEGG-based trades. Others on the desk were said to have engaged in "obvious patterns or loading up a broker, then disappearing on a golf trip, etc. . . It used to be Red Sox tickets and a dinner, now it's private jets to the Masters." See Feb. 20, 2003 Bloomberg message from Kirk Smith to 4th-EQ TRDG, SEC-FID-GG 25108 (Exhibit 12). One trader compared brokers' strategies for building business

with Fidelity to the strategies of successful baseball teams -- buying powerful, expensive players or "showering" less expensive advantages on those just starting out:

"If you map out a strategy for 'attacking Fido' to maximize commission $$, it seems there are 2 strategies . . . Attack the generals, i.e., ingratiate yourself w/ the powerbrokers thru extensive use of the expense account (let's call them the Yankees) who curry favor w/ [Bruderman, Donovan and DeSano]. . . or recruit youth early (let's call them the A's) by showering the youngsters with service and small $$ perks . . . .the end goal is being in that sweetspot [sic] between 8 and 12 where there is good, steady, easy flow w/ little risk of capital blow-ups."

Aug. 13, 2003 Bloomberg message from Steven Pascucci to Kirk Smith, SEC-FID-GG 25143 (Exhibit 13). n12

Fidelity has argued that these emails should be evaluated in light of their authors' sworn deposition testimony before the SEC, as reported in deposition summaries provided by Fidelity, and that their comments were consistently in the nature of gossip, made in jest and without knowledge. For example, when asked about Beran's message referring to a 350,000 share trade placed with Jefferies to "cover" a trip, Pascucci reportedly denied that Beran was indicating that he had sent the trade to Jefferies to offset the cost of a ski trip he had taken with people from Jefferies, and Pascucci generally denied entirely knowing about anyone at Fidelity directing trades to a broker based on benefits received. Similarly, Smith described one of his emails about Horan's trip to the Super Bowl as a joke, testifying that he did not really think Horan was going to the Super Bowl with the brokers mentioned in the message and that he did not notice whether Horan's order flow to certain brokers rose in connection with any benefits he had received.

How much weight one should give to post-event explanations given in the context of an ongoing investigation is a matter on which reasonable people may disagree. No reasonable amount of discounting attached to these emails, though, will alter the tone, consistency, duration, specificity and evident unhappiness that characterize the traders' contemporaneous comments about their peers' direction of orders to brokers for reasons apparently related to TEGG.

**2. Overall Trading Records**

While CRA's analysis of the trading volumes associated with tainted relationships did not yield evidence of a large number of identifiable single trades with tainted brokers that could be linked in time to single major TEGG events, that analysis did indicate, compellingly, that traders tended to direct significantly higher slices of their total business to TEGG-providing brokers than untainted traders provided to those brokers. CRA compared the percentage of each tainted trader's total volume placed with a tainted broker against the average percentage of all untainted traders' total volumes placed with that broker. In almost every instance, the tainted traders were directing a far higher than average percentage of their trading volumes to the broker that provided them TEGG. [TEXT REDACTED BY THE COURT] For example, Jefferies & Co. handled 12.14% of [TEXT REDACTED BY THE COURT] volume, but only 2.13% of the average untainted traders' volume; [TEXT REDACTED BY THE COURT] handled 5.49% of Timothy Bumeika's volume, but only 1.20% of the average untainted trader's volume [TEXT REDACTED BY THE COURT] handled 6.58% of Steven Pascucci's volume, but only a minuscule 0.07% of the average trader's volume. [TEXT REDACTED BY THE COURT] Other tainted trader/broker pairs showed a similarly striking discrepancy in order flow as a percentage of total shares or dollars traded.

**B. The Value of Order Flow**

Fidelity has never disputed that order flow plays a crucial role in Fidelity's dealings with brokerage firms, and that managing order flow to brokers is a key component of Fidelity's efforts to protect its shareholders' interests. [TEXT REDACTED BY THE COURT] Order flow functions as the "coin of the realm." It can be used to reward brokers who secure particularly advantageous trades for the Funds and thus encourage them to do so again. It can be used to alleviate losses suffered by brokers who executed trades that benefited the Funds at the expense of the brokers' own profits (for example, by committing capital to a trade and suffering a hit when the market moved adversely). It can be used to assure

loyalty, or can be withheld to express dissatisfaction with poor performance. While Fidelity expects and encourages its traders to use order flow for a variety of purposes, all of those purposes should further the single ultimate goal of securing the best possible value for Fidelity's shareholders. We have accepted Fidelity's point that obligations to seek "best execution" are fulfilled by establishing practices that achieve the best execution performance for Funds in the aggregate rather than in every individual trade, but the obligation to seek best execution nevertheless plainly requires a fixed focus on advancing shareholders interests. Order flow is a valuable asset of the Funds, and any trader's redirection of order flow in recompense for TEGG is nothing less than a diversion of Fund assets.

**C. Quantifying the Effect of Diverted Order Flow**

The clarity of the conclusion that order flow is valuable and was sometimes diverted for traders' benefits based on their receipt of TEGG should not obscure the difficulty in discerning either the degree of the diversion or its economic impact. It is impossible, for example, to distinguish the portion of tainted traders' orders placed with tainted brokers in gratitude for TEGG from the portion placed because of legitimate business relationships, respect for the broker's expertise, or perceived unique qualification to handle those trades. The extension of TEGG may have developed alongside the development of a professional relationship founded on traders' belief that a broker was particularly skilled or particularly responsive, and even the increased trading levels CRA identified between tainted traders and tainted brokers cannot be reliably split between the TEGG-based component and the component the trader might have pursued in the absence of TEGG.

It is similarly impossible to quantify how order flow would have been used to the Funds' advantage if not diverted to brokers for personal favors. Redirection of order flow only caused harm to the Funds to the extent that directing that order flow to an untainted broker would have led to a reduction in costs to Fidelity of some kind, in the form of expense-savings (such as an acceptance of market risk through a capital commitment that otherwise would not have been provided), or some intangible consideration (such as more attentive customer service or the assignment to Fidelity of a particularly skilled broker). Common sense suggests that some such benefits were undoubtedly lost as a result of tainted traders' misappropriations of order flow for personal use, but no reliable measure of the cost of such lost benefit can be identified.

**VI. Recommended Compensation to the Funds**

**A. Responsibility and Authority of the Trustees and Fidelity**

The Investment Company Act of 1940 "was designed to place the unaffiliated directors in the role of 'independent watchdogs,' who would 'furnish an independent check upon the management' of investment companies." Burks v. Lasker, 441 U.S. 472, at 484 (1979) (citation omitted). "Congress entrusted to the independent directors of investment companies, exercising the authority granted to them by state law, the primary responsibility for looking after the interests of the funds' shareholders." Id. at 484-85. Under state law, the Independent Trustees, as the trustees and fiduciaries of the Funds and their shareholders, have the authority and responsibility as trustees to "exercise good faith and act solely in the interests of the beneficiaries in administering the trust." Rutanen v. Ballard, 678 N.E.2d 133, 139-40 (Mass. 1997). Trustees are required to act using "sound judgment in the performance of their duties . . . [with] that degree of intelligence and diligence which a man of average ability and ordinary prudence under such responsibility would exercise in like circumstances." Welch v. Flory, 200 N.E. 900, 901 (Mass. 1936). Here, sound business judgment and prudence counsel in favor of resolving doubts in favor of the Funds.

As has been set forth in detail above, the statistical evidence cannot definitively establish the precise amount of the harm, if any, the Funds suffered from the traders' receipt of TEGG. However, given that Fidelity and the Trustees as fiduciaries should resolve doubt in favor of the Funds, an amount should be paid sufficient to compensate the Funds for any possible damages.

**B. Execution Quality**

With respect to execution quality, the statistical evidence, with its recognized limitations, is the best guide available for fixing an appropriate amount of restitution for the Funds. Requiring a payment at the top of the 95% confidence level interval provides a substantial level of confidence that the required payment will fully compensate the Funds for any losses they sustained.

The question that remains is which of the several variations of the statistical analysis should be accepted as most probably reflecting the harm that occurred. While it could be argued that the top block analysis, which measures the performance of the broker from the time the trader places the first order for any portion of the block with the broker, is the best measure of the costs resulting from the performance of that trader/broker pair, we share CRA's view that the creeping block analysis is a better measure of the broker's performance.

CRA has analyzed six variations of the creeping block analysis. They used three different weighting methods to calculate the average cost for the untainted brokers: (i) number of orders; (ii) dollar value of the orders; and (iii) number of shares covered by the order. For each weighting method, they produced separate estimates of harm with and without the return variable, then for each of the six resulting estimates of harm, they calculated confidence intervals with and without an adjustment for broker heterogeneity. CRA has suggested, and we agree, that the results without the return variable, and with the confidence intervals that adjust for broker heterogeneity, provide the more reasonable guide. We also agree with CRA that averaging across the untainted brokers using dollar value of the placement may give undue weight to the larger trades.

There is no clear answer, however, to the question whether the analysis that averages across the untainted brokers based on number of orders or number of shares in an order is better for determining the amount of harm resulting from the receipt of TEGG. Using the number of shares creates the risk that too much weight will be given to large trades. On the other hand, one would expect that a trader seeking to reward a broker for TEGG would focus on the number of shares in the order, since that number determines the commission the broker is paid. Rather than choose either one of these variables, I have determined that it is best to take the average of the two.

The top of the 95% confidence interval for the analysis of creeping blocks based on number of shares, using the bid and ask quotations as the benchmark for sales and buys respectively, with an adjustment for broker heterogeneity, is $ 32.0 million and the comparable figure based on number of orders is $ 24.8 million. Thus, I recommend that the Trustees require a payment from Fidelity of $ 28.4 million to account for possible execution harm.

**C. Order Flow**

There is no reliable statistical method that can be employed to calculate order flow harm. Thus, a determination of the amount of reimbursement that the Trustees should seek from Fidelity to compensate the Funds for possible order flow harm must rely to a large extent on intuition and an overall sense of fairness.

CRA has been able to estimate that the tainted brokers received $ 90 million more in commission business (net of soft dollar and expense reimbursements) from the tainted traders than they would have been expected to receive based on the amount of business sent to those same brokers by non-tainted traders. An argument can be made that Fidelity should be required to pay the Funds the entire amount of the excess commission, which might be the amount of the liability a court would impose on a broker who was sued for making unauthorized payments to a trader. It would seem unfair to tax Fidelity with the entire amount of the excess commissions paid to the tainted brokers, however, since the Funds did receive valuable brokerage services from those brokers, including services and expertise that could have been unique to those brokers and thus have resulted in legitimately larger order flow to that broker. In addition, fairness suggests that some recognition be given to the fact that any deficiency in execution quality will be recompensed through the payment of the amount calculated above for execution harm

and that, as a general matter, Fidelity has placed great pressure on brokers to reduce their commission rate well below industry averages.

Yet, the excess order flow diverted to the tainted brokers in return for TEGG was an asset of the Funds which had economic value, and the Funds should be compensated for the value diverted. There are two statistics that may be useful in attempting to quantify the value of the diverted order flow.

First, it may be useful to consider the profitability to the brokers of excess order flow. Fidelity suggested this measure in a proposal to settle all of the liability issues, and suggested that, on average, brokerage firms have a 30% profit margin on their brokerage business. Another way of measuring the value of order flow to the brokers is to look at the discount in commission rate that a brokerage firm was willing to accept in order to receive the additional order flow that they expected as a result of being designated as a core broker. [TEXT REDACTED BY THE COURT] Accepting these figures, it appears that core brokers determined that it was worth taking [TEXT REDACTED BY THE COURT] an reduction in their commission rate in order to receive increased order flow from Fidelity.

There are problems with using these statistics to quantify the order flow harm the Funds may have suffered. While the average brokerage firm may realize a 30% profit on all of its brokerage business, the marginal costs associated with the additional commission business generated by the payment of TEGG would no doubt be substantially less than 70%, and therefore the excess profit would be substantially more than 30%. However, it is not reasonable to assume that brokers, who had already agreed to an [TEXT REDACTED BY THE COURT] reduction in their commission rate in order to become core brokers, would have agreed to an additional 30% reduction in their commission in order to obtain even more business.

Given all of the uncertainties involved in estimating the dollar value of the order flow harm resulting from the receipt of TEGG, I recommend that the Trustees require Fidelity to pay the Funds an amount equal to 25% of the excess commissions paid to the tainted brokers. Even though it is reasonable to believe that the marginal profit to the brokers from the additional order flow exceeded 30%, I believe a requirement of a 25% payment fairly balances the possibility that a substantial part of the excess order flow probably resulted from a relationship of trust and confidence between the traders and brokers that had nothing to do with TEGG and the difficulty in translating order flow into specific economic benefits to the Funds, with the recognition that order flow which has value was wrongfully diverted to the tainted brokers.

**D. Interest and Cost**

In addition to the specific amounts calculated above as appropriate payments for possible execution harm and order flow harm, I consider it appropriate for Fidelity to pay interest calculated on the basis of the monthly market yield on US treasury securities at a one-year constant maturity from a date representing the midpoint in the period of the harm (approximately July 1, 2003 on a volume-weighted basis). n13

Since Fidelity's failure to supervise adequately its traders created a situation which the Independent Trustees had to investigate in order to perform their fiduciary duty to the Funds, it is entirely appropriate for Fidelity to bear the expenses of the investigation. The expenses figure in the table below reflects Fidelity's estimate of all such costs as of July 31, 2006. This number should ultimately be updated as of the completion of this process and made the subject of a separate accounting by Fidelity to be approved by the Independent Trustees.

**E. Payments**

In light of the above, I recommend that the following payments be sought from Fidelity: Execution Quality issue - all accounts $ 28.4 million Order Flow issue - all accounts $ 22.5 million Subtotal $ 50.9 million Portion of subtotal allocated to mutual funds $ 40.7 million Reimbursement of expenses borne by the mutual funds $ 8.2 million Interest (as of November 30, 2006) n14 $ 4.5 million Total $ 53.4 million

The reference to the subtotal allocated to mutual funds in this chart reflects that all analyses of possible harm have been directed to all trades made by Fidelity's equity trading desk, but not all of these trades have been made in Funds subject to the Independent Trustees' supervisory authority. The adjustment reflected in the chart is an estimate applying an 80% allocation percentage on the basis of numbers furnished by Fidelity. This allocation percentage is subject to adjustment in the submission Fidelity makes to the Independent Trustees respecting a proposed distribution methodology.

**F. Distribution**

The Trustees should direct Fidelity to present to the Trustees, for their review and approval, a proposed methodology for allocating this compensation among the Funds for which Fidelity serves as the adviser.

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**John S. Martin, Jr.**

**Report and Conclusions of the Independent Trustees of the Fidelity Funds on Fidelity Traders' Receipt of Improper Travel, Entertainment, Gifts and Gratuities**

On July 20, 2005, the Independent Trustees of the Fidelity Funds ("Funds") authorized an independent review with the objective of developing an authoritative, independent assessment of whether, and to what extent, the Funds may have been impacted as a result of the acceptance by some traders employed on Fidelity's equity trading desk of travel, entertainment, gifts and gratuities ("TEGG") in violation of Fidelity policies.

The Honorable John S. Martin, Jr. was engaged to conduct the review. The Independent Trustees instructed Judge Martin to conduct a thorough, authoritative and independent assessment of the adverse impact on the Funds, if any, resulting from trades initiated by Fidelity traders in recognition of improper TEGG. To assist Judge Martin in this effort, an economic consultant was engaged in mid-September 2005 to perform an econometric and statistical analysis of Fund trading activity during the relevant period. During the course of this inquiry, Judge Martin met with the Independent Trustees as a group and with the Funds' Governance and Nominating Committee. Judge Martin also spoke frequently with the Chairman of the Independent Trustees.

The Independent Trustees accepted Judge Martin's final report of his investigation on November 16, 2006.

Judge Martin directed the economic consultant to conduct a statistical analysis of trades placed by specific Fidelity traders that had been identified by the Securities and Exchange Commission ("SEC") as having received improper TEGG from specified brokers. Judge Martin also conducted interviews, reviewed email and other communications among traders and brokers, and reviewed testimony that was taken in the course of the SEC inquiry into this matter. At the end of his review and consideration of this material, including the statistical analysis conducted by the economic consultant, Judge Martin concluded that it was not possible to prove statistically that traders' receipt of TEGG did or did not result in excessive execution costs for the Funds. Judge Martin also concluded that certain traders had misdirected order flow among the brokerage firms on Fidelity's approved list. Judge Martin then relied on elements of the statistical analysis as well as other considerations to recommend that Fidelity pay the affected Funds $ 40.7 million, plus interest and expenses of the investigation.

The Independent Trustees believe that Judge Martin's inquiry has provided a thorough, exhaustive and technically sound basis on which to propose a resolution of this matter on behalf of the Funds. The Independent Trustees believe that, in spite of the absence of proof that the Funds experienced diminished execution quality as a result of traders' receipt of improper TEGG, the conduct at issue was serious, is worthy of redress and, as Judge Martin concluded, any uncertainty should be resolved in favor of the Funds. The Independent Trustees further note that inadequate supervision and other shortcomings exposed the Funds to the potential risks of adverse publicity, loss of credibility with their

principal regulators, and loss of Fund shareholders. Drawing on Judge Martin's exhaustive investigation, as well as their own inquiry and deliberations concerning this matter, the Independent Trustees believe that it would be appropriate for Fidelity to pay to the affected Funds $ 42 million, plus interest and expenses.

The Independent Trustees request that Fidelity submit for Independent Trustee approval a proposed allocation among the affected Funds of the amounts payable by Fidelity to them. In reaching these conclusions, the Independent Trustees considered Fidelity's remedial efforts in response to the TEGG matter, and positive actions with respect to brokerage practices generally, including new management in the trading room and other personnel actions, a heightened emphasis on a culture of compliance surrounding the equity trading desk, and the development and implementation of new and more stringent firm-wide TEGG policies. The Independent Trustees also appreciate that Fidelity has been an industry leader in its efforts to reduce Fund trading costs, reduce brokerage commissions paid by the Funds and unbundle research costs from Fund trading costs, all of which efforts have benefited Fund shareholders.

The Independent Trustees, with Fidelity, will continue to monitor the compliance of Fidelity employees with Fidelity's TEGG-related policies and procedures and other ethical guidelines as well as execution quality with respect to the Funds' portfolio transactions, and request that Fidelity continue to make periodic reports on these matters to the Board or the Compliance Committee, as appropriate. Further, the Independent Trustees request that Fidelity remain diligent in its efforts to reduce trading costs and to seek superior execution quality for the Funds.

December 14, 2006

**Footnotes**

n1 As used herein, "SEC" refers solely to the Staff of the Securities & Exchange Commission.

n2 Throughout CRA's analysis, we used the SEC's preliminary analyses as to tainted pairs as set forth in [TEXT REDACTED BY THE COURT] After discussions with Fidelity, the SEC revised its analyses to exclude three pairs it decided were not tainted, [TEXT REDACTED BY THE COURT] Fidelity continued to use the January 17 identification of pairs to some extent, and in an excess of caution, we continued to use the more extensive list.

n3 Some of these meetings with Debevoise attorneys representing the Trustees occurred prior to the time I became involved in the investigation.

n4 Implementation costs theoretically also include the opportunity cost of not trading and transfer taxes, but CRA did not calculate those costs, focusing instead exclusively on comparisons of direct trading costs.

n5 Fidelity has also suggested at various times that it would be irrational for traders to place trades with inferior brokers at poorer execution costs in recompense for TEGG, because the poorer execution would adversely affect traders' compensation. This point would only have force if traders believed the consequences of directing order flow to a less high performing broker would adversely affect their compensation in an amount greater than the value to them of the TEGG that stimulated those trades. CRA has pointed out in its analysis, [TEXT REDACTED BY THE COURT] that even if a tainted trader obtained a trade price from a tainted broker that was $ 5 million worse than the price that he could have obtained from an untainted broker, that poorer performance would have resulted in a direct compensation cost to the trader of only about $ 157.42 to $ 1465.23 in pre-tax compensation depending on whether the trader had already achieved maximum bonus levels based on other trades. The TEGG many traders received was substantially more valuable than that. (We also note that factors besides the formula referred to herein affect a trader's compensation and career prospects).

n6 For reasons set forth below, we ultimately relied upon a version of the creeping block analysis calculated by valuing buys at the ask price and sales at the bid price.

n7 As an additional check, we referred to two adjustments proposed by [TEXT REDACTED BY THE COURT] to CRA's methodology: [TEXT REDACTED BY THE COURT] ran CRA's analysis (i) additionally controlling for certain broker effects and (ii) controlling for broker effects, stock and day, and revising certain benchmark data. The upper 95% confidence interval for the first of these was $ 40.2 million; the upper 95% for the second was $ 34.3 million. The fact that [TEXT REDACTED BY THE COURT] proposed adjustments should not, of course, be taken to imply that he endorses CRA's analysis, but the similarity in results was noteworthy.

n8 CRA recently received clean copies of the files and programs for [TEXT REDACTED BY THE COURT] analysis of this issue, and is continuing to explore and identify the source of differences in their results on this point.

n9 The four trades are as follows:

1. Bristol-Myers Squibb, traded by Bruderman/Jefferies on March 25, 2003: This trade occurred two days before BMS disclosed that the SEC had expanded its investigation into accounting issues, the day after key pharmaceutical analysts downgraded the stock from "buy" to "outperform" and the media reported that the CEO was losing the support of BMS staff, the week after a significant earnings restatement, and two weeks after BMS disclosed that it would revise sales by $ 2.5 billion and restate its financials. The news reports also indicate that investors were skittish and unpredictable throughout the week because the invasion of Iraq had begun on March 20.

2. Motorola, traded by Donovan/ [TEXT REDACTED BY THE COURT] on October 9, 2002: On the day of this trade, Motorola shares fell 15% to a ten-year low. Trading seemed to be driven by investors' anticipation of the third-quarter earnings to be released the following week. During the week of the trade, analysts described the market as "very nervous" and their reports convey their surprise at the sudden one-day decline and attribute it to bearish market fears, not stock-specific concerns. The day after Donovan's trade, the stock was up almost 10% after analysts came out in favor of Motorola, reassuring investors about liquidity and earnings predictions.

3. Microsoft, traded by Smith/Jefferies on October 20, 2003: This trade took place the Monday after Microsoft's Friday submission of a report on its compliance with the terms of its anti-trust settlement agreement with the federal government; the day after the trade, Microsoft's Office 2003 went on sale to the public. Investors, analysts and the media covered the Office 2003 release in detail, and reports contain quite a bit of speculation about how the software would be received, particularly since it was the first Office upgrade in two years and had been delayed several times. Microsoft announced earnings on the Thursday of the week of the trade, another highly anticipated event likely to have affected trading throughout the week.

4. Oracle, traded by Smith/Jefferies on November 20, 2003: During the week of the trade, there was significant media coverage of Oracle's $ 7.3 billion hostile bid to acquire PeopleSoft. On the day of the trade, the European Commission announced that it would conduct a second-phase review of the bid, and the day before the trade, the Delaware court denied Oracle's motion to enjoin PeopleSoft's rebate plan and investors viewed the denial as a setback for the takeover bid.

n10 This cost is calculated using a method that CRA has labeled "Orders Available," which assigns a benchmark price to all shares available to Driscoll at the time he first gave an order to purchase any portion of those shares to the broker. As such, the cost estimate includes the effect of Driscoll's delay in placing the Tyco orders with [TEXT REDACTED BY THE COURT], as well as [TEXT REDACTED BY THE COURT] execution performance. If the execution price of the trade were measured against the NBBO ask quote at the time of the initial placement (CRA's "Major Block" method), the cost would be $ 15.57 million, if measured against the ask quote at the time of placement of each tranche of shares (CRA's "Creeping Block" method), it would be $ 6.02 million. [TEXT REDACTED BY THE COURT]

n11 Our review found, and Fidelity has stressed, that another trader, Thomas Bruderman, wrote to Driscoll during the afternoon of the trade to say "TYC - is the toughest 1 [one] week chart I have ever seen" (Jan. 30, 2002 Bloomberg message from T. Bruderman to E. Driscoll) and commented to third parties that Driscoll had done an excellent job in placing the Tyco trades, stating, "I think ESD is one of the best in the room ... TYC is the toughest chart I have ever seen," see Bloomberg message from T. Bruderman to S. Pascucci, Jan. 30, 2002 (not produced to the SEC) (Exhibit 8). In context, though, the juxtaposition of these comments against the undeniably adverse results of Driscoll's execution of the order at far higher costs than Fidelity would have experienced if Driscoll had completed the order promptly upon receiving orders from the portfolio managers -- a cost estimated to be over $ 18 million -- suggests that these comments may have reflected less of an objective evaluation than an effort to support a valued colleague after an extraordinarily bad day.

n12 Smith is one of the twelve traders identified by the SEC as tainted, and was among the six employees who received a "final written warning" and was required to nay a fine of 520.000. [TEXT REDACTED BY THE COURT] Smith attended ten local events without the giver and without reimbursement, although Fidelity found that the conduct was mitigated by Smith's living near Foxboro Stadium, home of the Patriots and a frequent concert venue, so that tickets were often left for him to use or give away. He reported one instance of private jet travel where the giver was not aboard the aircraft, which he reimbursed only at a "relatively low level." Fidelity also noted that Smith had learned that the reimbursement check was not cashed and concluded that he "should have been more attentive to this." See SED-FID-GG-21225 (Exhibit 14). Fidelity did find that Smith was cooperative and forthcoming during the investigation. Pascucci received a written warning and was required to pay a fine of $ 7.500. [TEXT REDACTED BY THE COURT] Pascucci had attended nine local events without the giver and without reimbursement, had reported one instance of private jet use (for which there were mitigating factors), and had accepted lodging on four occasions when the giver was present. See SEC-FID-GG 21218 (Exhibit 15). In addition to these disciplinary actions, Fidelity reduced the December 2005 bonuses paid and incentive shares awarded to both Smith and Pascucci.

n13 The interest figure in the table on page 73 is based on FRB data through September 2006 and assumes a 5.05% interest rate for October and November 2006, and payment as of the end of November; amounts paid should be adjusted to give effect to the actual payment date and interest rates.

n14 This figure does not include interest on expense reimbursements, which should be calculated separately based on the actual dates of expense payments by the Funds and reimbursed by Fidelity, at the monthly market yield on U.S. Treasury securities at one-year constant maturity.