UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

SECURITIES AND EXCHANGE COMMISSION, **450 Fifth St., N.W.** **Washington, D.C. 20549,** **Plaintiff,** **v.** **MORGAN STANLEY & CO. INCORPORATED,** **1585 Broadway** **New York, New York 10036** **Defendant.**	:	**No. 1:05 CV 00166 (HHK)** **COMPLAINT**

Plaintiff Securities and Exchange Commission ("Commission") alleges the following against defendant Morgan Stanley & Co. Incorporated ("Morgan Stanley" or "the firm"):

SUMMARY

1. From March 1999 through November 2000, Morgan Stanley provided allocations of stock to institutional customers ("customers") in hot Initial Public Offerings ("IPOs") it underwrote. Morgan Stanley attempted to induce certain customers to place orders for shares in the aftermarket of IPOs in violation of Rule 101 of Regulation M [17 C.F.R. § 242.101] under the Securities Exchange Act of 1934 ("Exchange Act"). Morgan Stanley did induce certain customers to place such orders during the new issues' first few trading days.

2. Rule 101 of Regulation M, among other things, prohibits underwriters, during a restricted period prior to the completion of their participation in the distribution of IPO shares, from directly or indirectly bidding for, purchasing, or attempting to induce any person to bid for or purchase any offered security in the aftermarket. As a prophylactic rule, Regulation M is designed to prohibit activities that could artificially influence the market for the offered security, including, for example, supporting the IPO price by creating the perception of scarcity of IPO stock or creating the perception of aftermarket demand.

3. During the restricted period, Morgan Stanley attempted to induce certain customers to make aftermarket purchases in violation of Rule 101 of Regulation M by engaging in the following activities. Morgan Stanley communicated to certain customers that expressing an interest in buying shares in the immediate aftermarket and buying shares in the immediate aftermarket would help them obtain good allocations of over-subscribed, hot IPOs. (An expression of interest in buying shares in the aftermarket is hereinafter referred to as "aftermarket interest.") Morgan Stanley solicited aftermarket interest from certain customers who Morgan Stanley knew had no interest in owning stock of the IPO companies long-term. Morgan Stanley proposed to certain customers the aftermarket price limits they should give to obtain a good IPO allocation. In some instances, Morgan Stanley encouraged customers to increase the prices they had originally told Morgan Stanley they were willing to pay in the aftermarket. Morgan Stanley accepted customers' aftermarket interest that they would buy "1 for 1" (or some other ratio) in the aftermarket, meaning that the customers intended to buy in the aftermarket an amount of shares equal to (or greater than) their IPO allocation.

4. After the IPO shares had been allocated and distributed, and at times before aftermarket trading began, Morgan Stanley solicited aftermarket orders by making follow-up calls to customers who previously had provided aftermarket interest. In addition, Morgan Stanley viewed favorably follow-through aftermarket buying in the first few days of trading. After customers bought shares in the immediate aftermarket, some Morgan Stanley sales representatives referred to their customers' aftermarket buying as fulfilling their "promises" or "commitments." Further, Morgan Stanley monitored customers' aftermarket purchases in the first few days of trading. This conduct, taken as a whole, demonstrates that when Morgan Stanley previously had solicited aftermarket interest from these customers, it was attempting to induce customers to make aftermarket purchases in the first few days of trading in violation of Rule 101 of Regulation M.

5. Morgan Stanley also violated Rule 101 of Regulation M in the Martha Stewart Living Omnimedia IPO by soliciting a 350,000 share aftermarket order from a customer before all the IPO shares had been distributed.

6. Morgan Stanley has engaged in, and unless enjoined, will continue to engage in, directly or indirectly, transactions, acts, practices, and courses of business that constitute violations of Rule 101 of Regulation M [17 C.F.R. § 242.101].

NATURE OF THE PROCEEDINGS AND THE RELIEF SOUGHT

7. The Commission brings this action pursuant to authority conferred upon it by Sections 21(d) and 21(e) of the Exchange Act [15 U.S.C. §§ 78u(d) and 78u(e)], to restrain and permanently enjoin Morgan Stanley from violating Rule 101 of Regulation M [17 C.F.R. § 242.101]. In addition, the Commission seeks other relief including, but not limited to, civil penalties.

JURISDICTION AND VENUE

8. This Court has jurisdiction over this action pursuant to Sections 21(d), 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e) and 78aa].

9. Venue lies in this Court pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa]. Morgan Stanley is found and transacts business in this District.

DEFENDANT

10. Morgan Stanley & Co. Incorporated is a Delaware corporation with its headquarters and principal executive offices in New York, New York. Morgan Stanley was registered during the relevant time period, and continues to be registered with the Commission, as a broker-dealer. Morgan Stanley is licensed to conduct securities business on a nationwide basis. Morgan Stanley is an international financial services firm that provides securities underwriting services, sales trading services, merger and acquisition advisory services, private banking services and equity research.

FACTS

The IPO Process at Morgan Stanley

11. An IPO is the first public issuance of stock of a company that has not previously been publicly traded. A "hot" IPO is one in which the stock trades at a premium on the first day of aftermarket trading. An IPO is likely to be hot if it is well over-subscribed (*i.e*., the demand for IPO shares far exceeds the supply of IPO shares in the offering).

12. Among the reasons that certain investors sought to obtain IPO stock was the large profit to be earned by flipping the shares if the IPO was hot. "Flipping" refers

to the practice of investors selling IPO shares in the, thereby realizing quick profits if the price has increased. first few days of aftermarket trading

13. During the relevant time, Morgan Stanley's Equity Capital Markets ("ECM") department was primarily responsible for the underwriting and distribution of IPOs. Syndicate managers within ECM were responsible for the allocation of the majority of the institutional IPO shares. In addition, the syndicate managers distributed a block of IPO shares to Morgan Stanley's Private Wealth Management Division ("PWM") which included high net worth individuals and also included until mid 2000, "middle markets" accounts, *i.e.*, small institutional accounts and small hedge funds. PWM managers allocated this block of shares. Responsibility for allocating the remaining IPO shares was given to Morgan Stanley's affiliated retail brokerage firm.

14. For approximately ten days to two weeks before each IPO, members of the IPO company's management and Morgan Stanley's investment banking division employees traveled around the country and gave roadshow presentations about the company to institutional investors. Morgan Stanley also marketed IPOs internationally. ECM employees arranged individual meetings between institutional investors and the company's management. These institutional customers included mutual funds, pension funds, and hedge funds. The syndicate desk, which was part of ECM, communicated information about upcoming IPOs to Morgan Stanley's institutional sales force ("sales force") through comments at morning meetings that were broadcast to the sales force.

15. Morgan Stanley's sales force consisted of sales representatives, who provided research to institutional customers and marketed IPOs to them, and sales

traders, who took orders for institutional customers. Middle markets sales representatives marketed IPO shares to smaller institutional customers.

16. To generate institutional customer interest in IPOs, Morgan Stanley created a perception of scarcity of IPO shares. For example, a Morgan Stanley document describing the IPO process states that one of Morgan Stanley's objectives in marketing an IPO company to investors is to "maintain competition and create perception of scarcity." In addition, in describing how Morgan Stanley marketed IPOs it underwrote, a syndicate manager told issuers that Morgan Stanley created a "perception of scarcity."

17. Prior to the pricing and allocation of each IPO, Morgan Stanley's sales force obtained their customers' "indications of interest" as to the number of shares desired by the customers in the IPO at the proposed price range and transmitted these indications to the syndicate desk to be entered into the institutional "pot book" for the IPO. At times, some sales representatives also discussed with customers whether they had met with management in a one on one setting or by attending a roadshow, owned stock of comparable companies, had views on the offering price and intended to flip or hold their IPO allocation.

18. In addition, the sales force obtained certain customers' aftermarket interest in the several days before -- and on the day of -- the determination of the offering price.

19. The sales force often relayed orally and in e-mails to the syndicate desk the information obtained from customers, including customers' aftermarket interest, and sometimes also informed the syndicate desk of their customers' aftermarket purchases in previous offerings. In some instances, Morgan Stanley informed the IPO company of

customers who had provided aftermarket interest and conveyed the customers' aftermarket prices.

20. A syndicate desk employee, sales representatives or sales traders entered customers' indications of interest in the IPO into the IPO institutional pot book through the "syndesk" system, the computer database where all of the institutional indications of interest in the IPO and allocations were recorded. In some instances, the syndicate desk employee or sales traders entered into the pot book customers' aftermarket interest. They also sometimes entered customers' intentions to flip or hold their IPO shares. In addition, some syndicate managers maintained notes reflecting customers' aftermarket interest.

21. On the night before an IPO, the syndicate desk and other members of ECM recommended to the company a price for the IPO and the company and Morgan Stanley agreed on an IPO price. In addition, the syndicate desk made initial allocation determinations. On the morning of the IPO, but before aftermarket trading began, the syndicate desk finalized allocation decisions. Morgan Stanley then told customers their IPO allocations and asked them to confirm acceptance of the amount of shares they were allocated at the IPO price. When all the IPO shares were allocated, and the customers had agreed to their IPO purchases, the distribution was complete. At that point, the syndicate desk would notify the sales representatives and sales traders that the deal was sold by announcing that "syndicate had broken."

22. The aftermarket performance of Morgan Stanley IPOs was important to Morgan Stanley. Morgan Stanley touted the first-day rise in price and over-subscription levels of its IPOs in marketing underwriting services to prospective IPO issuers and in marketing additional services to issuers it brought public.

Morgan Stanley Communicated to Certain Customers That Expressing An Interest in Buying Shares in the Immediate Aftermarket and Buying Shares in the Immediate Aftermarket Would Help Them <u>Obtain Good Allocations of Over-subscribed, Hot IPOs</u>

23. Morgan Stanley stated in some pitch books marketing its underwriting services to certain prospective IPO companies that as part of its "Allocation Strategy," it would "Scale back all allocations" and "Secure aftermarket orders."

24. During the restricted period, Morgan Stanley's syndicate desk communicated to the sales force and the sales force communicated to customers that expressing an interest in buying shares in the immediate aftermarket and buying shares in the immediate aftermarket would help customers obtain good allocations of over-subscribed, hot IPOs.

25. For example, in the Transmeta IPO, an over-subscribed deal, a syndicate manager told a sales representative that the sales representative's customer would "get a good allocation IF they care and will be in the aftermarket." The Transmeta institutional pot book reflects that the customer said it would be an aftermarket buyer and the customer thereafter received a 100,000 share allocation.

26. In addition, prior to the allocation of shares in the Brocade IPO, an over-subscribed deal, an administrative assistant for PWM, which allocated its own block of IPO shares, sent a global e-mail to all PWM sales representatives warning them that if they had requested that an account be put into the institutional pot "and have not provided aftermarket feedback – your account will not be put into the [institutional] Pot." Accounts in the institutional pot typically received larger allocations than PWM accounts.

27. In the Webmethods IPO, a sales representative sent e-mails to the head of syndicate informing him that his customer "has had an extensive relationship with

Webmethods mgmt" and that the customer "wants to commit to making it their biggest position and will hold it long term." Two days before the Webmethods IPO, the sales representative sent the customer an e-mail informing the customer that:

> Although you've done everything you can on this one, allocations are still going to be very very tight. Call me and we can talk. Basically the book is already 20x oversubscribed, and there are 4.1 mm shares being offered. On [the] Avanex [IPO], which finished 20 times [over-subscribed] prior to pricing and which offerred (sic) 6mm shares, accounts that do $2.5m in commissions, who did the work and were willing to pay up to $190 in the aftermkt (mind you it priced at $36) received 15,000 share[ ] [allocations]. What price are you willing to buy the [Webmethods] stock in the aftermarket?

28. In another instance, a sales representative sent his customers an e-mail informing them that, "[the Quantum Effect Devices IPO] will be hot. . . . The range is probably going up tomorrow and I will need aftermarket feedback if you want a good allocation." In the same e-mail, the sales representative told his customers that "Avanex [IPO] . . . could be one of the hottest IPOs of the year . . . . Another one that I will need [aftermarket] feedback on to get a good allocation."

29. In yet another example, a sales representative informed her customer that the "De Code (sic) [IPO] is multiple, multiple times over-subscribed. . . . The better allocations will have plenty of guidance on valuation (what's your target?) and where you'd support it in the aftermarket." The syndicate desk had identified this customer as a "trading account," *i.e.*, a customer that normally or always flipped its IPO holdings rather than take a long-term position in the stock.

30. Additionally, a Morgan Stanley sales representative asked one institutional customer for aftermarket interest in every IPO and the customer understood from its dealings with Morgan Stanley that it needed to give aftermarket interest in order to get a good allocation. The customer further understood from its dealings with Morgan Stanley

that Morgan Stanley expected it to follow through on its aftermarket interest and buy in the immediate aftermarket. The syndicate desk had identified this customer as a trading account. The customer flipped virtually all of its IPO allocations and aftermarket purchases.

31. Another customer understood that it needed to give aftermarket interest to get a good allocation as a result of its dealings with Morgan Stanley. The customer provided aftermarket interest in a number of IPOs, received IPO allocations and bought in the immediate aftermarket. One of the reasons that the customer followed through and bought in the aftermarket was to keep a good relationship with Morgan Stanley so that Morgan Stanley would give the customer better allocations of future IPOs.

32. As a result of Morgan Stanley's sales representatives' communications to customers that providing aftermarket interest and buying shares in the immediate aftermarket would help them obtain good allocations of over-subscribed, hot IPOs, certain customers responded by "committing" to buy in the aftermarket.

33. In a number of instances, Morgan Stanley sales representatives conveyed customers' "commitments" to the syndicate desk. For example, in conveying a new small hedge fund customer's "keen[ ] interest in any allocation of [W]ebmethods," a sales representative stated that "[the customer] [has] committed to me to buy 5,000-10,000 shares of each of our IPO's in the after market to prove themselves as a worthy client [to Morgan Stanley]. . . . . This is not a flipping situation." The customer received a 250 share allocation of Webmethods and bought another 7,250 shares in the aftermarket on the first day. Subsequently, the syndicate desk identified this customer as a trading

account. In conveying this customer's request for an allocation in a secondary offering of another deal, Internap, another sales representative reported:

> We [meaning the customer] have indicated for 100,000 shares of [this secondary offering]. Ideally, if we could get 20,000-40,000, [the customer] will follow through in the aftermarkets. Some examples of previous deal follow-through:
>
> (Received/Follow-through)
> [Artist Direct]: (5,000/10,000)
> [Drugstore.com]: (25,000/50,000)
> [Sycamore]: (1,000/10,430)
> [Avenue A]: (750/5,000)
> [Savvis Communications]: (1,000/7,000)
> [Webmethods]: (250/57,750)

34. Another sales representative sent an e-mail to the syndicate desk, stating that in the Southern Energy IPO, his customer had "been steadily increasing his energy weighting throughout the summer" and had "committed aftermarket support up to $26." The customer received a 20,000 share allocation. On the first day of trading, but before trading began, the customer followed through and placed a $26 limit order for Southern Energy. The stock opened at $28.25 and the limit order was not executed. In a subsequent e-mail to the syndicate desk conveying this customer's aftermarket interest in the Proton IPO, the same sales representative noted that this customer "[had] been steadily increasing his energy weighting through the summer . . . . & did play [Southern Energy] this week (put in a limit order to purchase at $26 as committed) [and] has committed after market support [in the Proton IPO] to $30." The customer received a 15,000 share allocation of Proton. On the first day of trading in the Proton IPO, the customer followed through and bought shares in the aftermarket at between $29 and $30 per share.

35. In the Akamai IPO, a Morgan Stanley sales representative told the syndicate desk in an e-mail that his customer "would be a buyer into the $90-$100 range. They are good on their aftermarket should the shares trade higher." The customer received a 5,000 share allocation and flipped it on the first day of aftermarket trading. It followed through and bought additional shares on the third day of aftermarket trading at $188 per share and sold all the aftermarket shares at a loss later the same day.

Morgan Stanley Solicited Aftermarket Interest from Certain Customers It Knew had No Interest in Holding the Stock of the IPO Companies Long-Term

36. During the restricted period, Morgan Stanley solicited aftermarket interest from customers it knew had no interest in owning the stock of the IPO companies long-term.

37. For example, the syndicate desk was aware that one customer was "fast money," that is, a trading account primarily engaged in day trading. Morgan Stanley nonetheless solicited aftermarket interest from the customer in every IPO. The only reason that the customer gave aftermarket interest and bought in the immediate aftermarket was because it understood from Morgan Stanley that this would help it get a good IPO allocation. For example, this customer received a 50,000 share allocation in the Transmeta IPO and bought 70,000 shares in the aftermarket on the first day of aftermarket trading. The customer flipped its allocation and aftermarket purchases that same day.

38. Morgan Stanley's syndicate desk and its sales representative knew that another customer flipped all of its IPO holdings. Nevertheless, Morgan Stanley solicited aftermarket interest from the customer in at least six IPOs. The customer only gave aftermarket interest in order to get a better allocation of IPO shares. In the Agilent IPO,

the customer received a 20,000 share allocation, bought 230,000 shares in the aftermarket and flipped its allocation and aftermarket purchases on the day of the IPO.

39. Morgan Stanley's syndicate desk sought aftermarket interest from a customer who had informed Morgan Stanley that it had no genuine investment intent. In the Proton IPO, the syndicate desk e-mailed a sales representative that "[the customer] just in [the Proton institutional pot book] for 100k/trade. Would love some [aftermarket] color if you can get it."

40. In addition, Morgan Stanley's syndicate desk managers knew that many IPO customers were trading accounts. Nevertheless, Morgan Stanley solicited aftermarket interest from some of these customers.

Morgan Stanley Proposed to Certain Customers the Aftermarket Price Limits They Should Give to Obtain A Good IPO Allocation

41. During the restricted period, some Morgan Stanley sales representatives proposed to certain customers the aftermarket price limits they should give to obtain a good IPO allocation.

42. For instance, in the Avanex IPO (which Morgan Stanley priced at $36), a sales representative e-mailed his customer:

> Aftermkt on [the Avanex IPO] goes into the 100's from lots of customers . . . . How is this for a strategy: put in aftermkt for $150, the stock runs to about $110, you buy it there - even if it pulls back and you lose some on the shares short term, you a) got more stock on the deal since your aftermkt was so freakin big b) if you[']re going to own it longer anyway so what if you buy at the peak on the first day and who[']s to say in this market the stock can[']t go even higher[.] The more outlandish the aftermkt, I would definitely figure the more stock you get.

The comment in the Avanex institutional pot book reflects that the customer indeed followed the sales representative's advice and indicated that it would be an "[aftermarket buyer] to 150." This customer received a 20,000 share allocation of the Avanex IPO and bought an additional 48,300 shares between $172.875 and $175 on the first day of aftermarket trading.

43. In the Avanex IPO, another sales representative e-mailed a customer "Early feedback to me indicates an opening probably between $80-100/ share. I would be comfortable seeing you in there buying at $60-65 minimum. Books close at noon Thursday but put the order in today." The customer received a 50,000 share allocation of Avanex.

Morgan Stanley Encouraged Certain Customers to
Increase the Price Limits of Their Aftermarket Interest

44. As Morgan Stanley generated interest in deals and they became more over-subscribed, Morgan Stanley encouraged certain customers to increase the price limits of their aftermarket interest.

45. During the restricted period, in some instances, Morgan Stanley syndicate managers communicated to sales representatives that their customers' aftermarket interest price limits were not high enough to receive a good allocation. For example, in the Mainspring IPO, on the day of pricing, the syndicate manager cautioned a sales representative that her:

> [Customer's] [aftermarket price] limit will not work. [The Mainspring IPO] is HEAVILY oversubscribed and we are likely to be top end or slightly through it. [A]ll of the accounts seem to have realized that we put a VERY cheap price in the cover. [M]ost of the aftermarket is in the high teens or low twenties.

A few hours later, another sales representative for the same customer responded to the syndicate manager by e-mail "[The customer] [will be] real [aftermarket buyer]. [The customer] lifted limit. [Customer] wants to own and will be buying [in the aftermarket] tomorrow within reason (up $2-3)." The customer subsequently received a 25,000 share allocation of Mainspring.

46. In another instance, in the Proton IPO, the syndicate manager e-mailed a sales representative that a customer "is in the book with a 20 top . . . get it changed if it's higher." The following day, a sales representative e-mailed the syndicate manager that the customer now will be an "[aftermarket] buyer up to $25." The customer thereafter received a 30,000 share allocation of Proton.

47. In addition, in response to aftermarket feedback from a customer in the Sycamore IPO, the head of syndicate responded to the customer's salesperson, "thx but opening trade is well north of 100!"

48. During the restricted period, some Morgan Stanley sales representatives encouraged certain customers to increase the price limits of their aftermarket interest.

49. For example, a sales representative e-mailed the syndicate desk that a customer's aftermarket price limit in the Avici IPO was in the mid $60's but, "I told [the customer] its (sic) going to open well above $100 so trying to get them bumped." Morgan Stanley priced Avici at $31. Morgan Stanley allocated 2,000 shares to this customer.

50. In the Webmethods IPO (which Morgan Stanley priced at $35), the same sales representative reported to the head of syndicate: "[A customer is] in for 10% (20,000 would be great); aftermkt: $65; I am trying to push them higher and [another Morgan Stanley employee] will update you." The head of syndicate's notes reflect that the customer increased its aftermarket interest to $100. The customer received a 10,000 share allocation of Webmethods.

51. In the Avenue A IPO (which Morgan Stanley priced at $24), the same sales representative sent an e-mail to the syndicate desk attaching a chart reflecting deal feedback including aftermarket interest -- on an account-by-account basis. In the column titled "aftrmkt interest," the sales representative reported that one customer was at "$50+; trying to push it up" and also reported that a second customer was at "$50+; trying to push up." These customers received, respectively, 15,000 share and 10,000 share allocations of Avenue A.

52. The same sales representative also asked the syndicate desk for guidance about whether he should encourage his customer to raise its aftermarket interest in the Silicon Labs IPO (which Morgan Stanley priced at $31): "[Customer] -- order for their small cap fund -- looking for 10,000 shares; willing to pay $35 in aftermarket. Do I need to get them more aggressive?" Morgan Stanley gave the customer a 7,000 share allocation of Silicon Labs.

53 A different sales representative e-mailed the head of syndicate that his customer "is still doing valuation work" and would buy Webmethods in the aftermarket up to $23, but "I'm chatting with him tomorrow, and my guess is that the aftermarket price increases." The sales representative sent a follow up e-mail reporting that [the customer] had increased its aftermarket price limit to $64. The customer received a 7,000 share allocation of Webmethods.

54. In the Aspect Medical Systems IPO (which Morgan Stanley priced at $15), a representative e-mailed the syndicate desk: "[the customer's] total position is 1.1 MM shares and he's a[n aftermarket] buyer [of Aspect Medical Systems] up to $18-19[.] [W]e are trying to get that raised. [The customer] wants to be as aggressive as he needs

to be so he will follow our guidance." The customer received a 25,000 share allocation of Aspect Medical Systems.

55. In the McAfee IPO, a Morgan Stanley sales representative e-mailed the syndicate desk that his customer's aftermarket "would range around $20 a share," but the customer "understand[s] they might have to pay higher initially." The customer received a 10,000 share allocation at the IPO price of $12 and on the first day of aftermarket trading, the customer bought an additional 40,000 shares at $44 per share. The customer flipped its allocation and all of its aftermarket shares later the same day.

56. Two other sales representatives each informed their customers of the aftermarket prices provided by other customers and encouraged them to raise their aftermarket prices. The first customer increased its aftermarket prices in such circumstances because, based on its dealings with Morgan Stanley, the customer believed that it would increase its chances of getting an allocation of "reasonable size" in the IPO. In the Agilent Technologies IPO, this customer increased its aftermarket prices from the $30-$32 range to the $33-$35 range. This customer received a 150,000 share IPO allocation and bought additional shares on the first day of aftermarket trading at the higher price of $45.80. This customer sold all of its shares of Agilent within two weeks of the IPO. In the Avanex IPO (which Morgan Stanley priced at $36), the second customer's sales representative informed that customer that it should buy shares in the aftermarket at $80 per share. That customer increased its aftermarket price from the $60-$70 range to $80. That customer subsequently received a 20,000 share allocation of Avanex and bought Avanex in the aftermarket at more than $80 per share within three days of the IPO.

57. Morgan Stanley obtained aftermarket interest from customers at increasing prices that were well above the IPO price range to attempt to induce aftermarket orders and purchases at prices higher than the IPO price. A syndicate manager explained to an IPO company's management "that aftermarket interest from IPO customers was a factor that could cause the stock to trade up in the aftermarket."

Morgan Stanley Accepted Customers' Aftermarket Interest that They Would Buy "1 for 1" (or Some Other Ratio) in the Aftermarket

58. During the restricted period, Morgan Stanley accepted aftermarket interest of "1 for 1" from a small number of customers in each IPO, meaning that the customers said that they intended to buy in the aftermarket an amount of shares equal to their IPO allocation. At the time Morgan Stanley accepted this aftermarket interest, it had not determined the final allocations. Ratios of 2 to 1, meaning the customer intended to buy two times their allocation in the aftermarket, 3 to 1 and even as high as 10 to 1 were also accepted and noted in the IPO pot books on occasion.

59. The "1 for 1" or other similar aftermarket interest did not provide Morgan Stanley with information as to a customer's desired position size or whether a customer intended to be a long-term holder. Nonetheless, some customers who gave this type of aftermarket interest subsequently received allocations.

60. By accepting this type of aftermarket interest, Morgan Stanley attempted to induce customers to place aftermarket orders and buy in the aftermarket in accordance with their aftermarket interest. Morgan Stanley obtained "1 for 1" or other similar aftermarket interest from some customers who subsequently purchased stock in the aftermarket on the first day in accordance with the aftermarket interest they had given.

Some of those customers sold their IPO allocation and aftermarket purchases within days of the IPO.

61. For example, in the Avici IPO, the pot book reflects the following aftermarket interest from one customer: "will buy 1 for 1 up to 125 $." Morgan Stanley allocated the customer 7,000 shares of Avici. On the first day of trading, the customer purchased 11,500 shares of Avici in the aftermarket between $98 and $99. The customer sold its allocation and aftermarket purchases on the first day of aftermarket trading.

62. There are also several examples in the Proton IPO. For instance, the Proton IPO pot book indicates aftermarket interest for a customer: "1x allocation with no limit." The customer was allocated 10,000 shares and then purchased 10,000 more shares on the first day of trading. The customer sold its allocation and its aftermarket purchase on the first day of aftermarket trading. In another instance, the Proton pot book reported that a customer was "real, want[s] to build position, will buy 1x allocation on first day." The customer was allocated 15,000 shares and on the first day of trading the customer also purchased 15,000 shares. Still another customer was allocated 10,000 shares in the Proton IPO. The pot book comment for the customer states: "[aftermarket] buyer for 50% of alloc. @ the mkt [at the market]." On the first day of trading, the customer purchased 5,000 shares at $30 per share.

63. Morgan Stanley also accepted "1 for 1" aftermarket interest from some customers who placed orders on the first day in accordance with the aftermarket interest they had given. The stock traded above the aftermarket price provided by the customer, however, and those orders were not executed.

Morgan Stanley's Conduct after the Restricted Period Reflects its
<u>Attempts to Induce Customers to Place Orders in the Aftermarket</u>

64. After the distribution of IPO shares was complete, some of Morgan Stanley's sales force made calls and solicited aftermarket orders from certain customers who had provided aftermarket interest. Morgan Stanley viewed favorably follow-through aftermarket buying in the first few days of trading. In addition, after customers bought shares in the immediate aftermarket, some Morgan Stanley sales representatives at times referred to their customers' aftermarket buying as fulfilling their "promises" or "commitments." Finally, Morgan Stanley monitored customers' aftermarket purchases in the first few days of trading. This conduct, taken as a whole, demonstrates that when Morgan Stanley previously had solicited aftermarket interest from these customers during the restricted period, it was attempting to induce customers to place aftermarket orders in the first few days of trading.

A. Morgan Stanley Solicited Aftermarket Orders from Institutional Customers Who Had Provided Aftermarket Interest

65. After the IPO shares had been allocated and distributed, and at times before the stock started trading in the aftermarket, Morgan Stanley's sales force made calls to certain customers from whom it had obtained aftermarket interest and solicited aftermarket orders. During some of these calls, Morgan Stanley informed customers who had given aftermarket interest that the stock was trading within -- or below -- the price levels of aftermarket interest they had given.

66. For one institutional customer who routinely provided aftermarket interest, the customer's sales trader called on the morning of virtually every IPO and said "where's your order?"

67. In addition, a syndicate desk manager encouraged a sales representative to try to get a customer to follow through with an aftermarket order. On the first day of aftermarket trading in the Mainspring IPO, the syndicate desk manager e-mailed a sales representative, "i am looking forward to seeing [your customer] in the aftermarket." The following day, the sales representative replied, "[the customer] is buying in the aftermarket on MSPR…still more to do!" The syndicate manager responded, "thanks for the follow through."

B. Morgan Stanley Viewed Favorably Follow-Through Aftermarket Buying in the First Few Days of Trading

68. Morgan Stanley viewed favorably follow-through aftermarket buying in the first few days of trading. For example, in one IPO, a syndicate manager sent an e-mail to a sales representative stating, "i am glad that [your customer] was pleased with their allocation and i certainly appreciate their aftermarket follow-thru!" The syndicate manager e-mailed another sales representative in the same IPO, "thanks for following up with the [aftermarket] feedback. i am glad to know that the account reciprocated with aftermarket. tell them to keep it up."

69. In another IPO, a syndicate manager e-mailed a sales representative that he had pushed for allocations for the representative's two customers and added that he "hope[d] they [were] happy." The syndicate manager then instructed the sales representative, "Let me know what [the two customers] do in the after mkt [aftermarket] as can use as ammo for future deals."

70. In a third IPO, a sales representative e-mailed the syndicate manager, "just for the record . . . despite a less than stellar allocation [a customer] was in buying decode in the aftermarket yesterday. As they said they would. Almost 200m at $28." The

syndicate manager responded, "i am very aware of their aftermarket. Kudos to them and it will be remembered."

71. In yet another IPO, a sales representative had reported to the syndicate desk that a customer's aftermarket interest was: "500m up to $15, 250 up to $20 aftermarket[,] $20 they are there for another 200m+ [shares] and if it is between $20-$25 then 100m. [H]opefully this helps." On the first day of aftermarket trading in the Proton IPO, the syndicate manager e-mailed a sales representative congratulating her for this customer's aftermarket buying, "you beat me to the email . . . I saw [the customer] on the desk they bought 75 and leave 25 to buy. great to see such follow thru!"

72. In a different IPO, in response to a sale representative's inquiry, "whether [the head of syndicate] and Co.," (meaning the syndicate desk) "would rather see day of activity," the administrative assistant responsible for middle markets customers sent an e-mail to a sales representative stating, "any deal support is good (closer to deal pricing is better) just please send me and [sic] e-mail as soon as you get an order. I am getting a list together for [the syndicate manager] tomorrow for all aftermarket buys [of the IPO]."

C. After Customers Bought Shares in the Immediate Aftermarket, Some Morgan Stanley Sales Representatives Referred to Their Customers' Aftermarket Buying as Fulfilling Their Promises or Commitments

73. After customers bought shares in the immediate aftermarket, some Morgan Stanley sales representatives at times referred to their customers' aftermarket buying as fulfilling their "promises" or "commitments." For example, in response to an e-mail query from the administrative assistant for middle markets accounts about aftermarket buying, a sales representative responded after one IPO that "everyone [sic] of my accounts followed thru on their aftermarket commitments."

74. A sales representative e-mailed the head of syndicate and thanked him for "[his] allocations on [the Webmethods IPO] this morning" and informed the head of syndicate that "[the customer] bought 20,000 in the aftermarket as promised at about $203."

75. In another instance, a sales representative sent an e-mail to the syndicate desk providing a customer's aftermarket feedback in a different IPO and noting that the customer had bought in the aftermarket in prior Morgan Stanley IPOs "as promised."

D. Morgan Stanley Monitored Customers' Aftermarket Purchases in the First Few Days of Trading

76. Morgan Stanley's syndicate desk monitored customers' aftermarket buying in the first few days of trading. The syndicate desk watched the opening of trading and observed customers' buy orders that were placed through the trading desk. In addition, at times, they obtained from sales traders a verbal list or printout from Morgan Stanley's order management system of aftermarket buyers through Morgan Stanley on the first day and also reviewed "Account Tracker" reports generated for some IPOs that listed the customer and the number of shares purchased or sold on the first day through Morgan Stanley.

77. The syndicate desk noted customers who followed through and bought in the aftermarket in the first day to few days of aftermarket trading. For example, in the Internap IPO, a syndicate manager identified potential aftermarket buyers on the IPO allocation list. The syndicate manager subsequently added the names of first-day aftermarket buyers to that list.

78. Morgan Stanley's head of sales trading was aware of customers' follow through in the aftermarket and provided input in allocation meetings with the syndicate

desk concerning which customers were reliable about following through on their aftermarket interest.

79. In addition, Morgan Stanley's sales representatives received trading reports of all trading activity that their customers did through Morgan Stanley on the previous day.

Morgan Stanley Violated Rule 101 of Regulation M in the Martha Stewart Living Omnimedia IPO by Soliciting an Aftermarket Order from a Customer Before the Distribution of IPO Shares was Complete

80. On the morning of the Martha Stewart Living Omnimedia IPO, and before Morgan Stanley had announced that syndicate had broken, Morgan Stanley contacted a customer and solicited the customer to place an aftermarket order. Morgan Stanley called the customer and told it that Morgan Stanley was concerned because there were no aftermarket orders on Morgan Stanley's trading desk. Morgan Stanley then asked the customer to place an aftermarket order. The customer agreed to Morgan Stanley's request and placed an aftermarket order for 350,000 shares in the period before syndicate broke. Morgan Stanley executed the order later in the day after trading began. The customer sold all of its IPO shares and the shares that it had bought in the aftermarket that same day. At the time that Morgan Stanley solicited the order, not all of the IPO shares had been distributed. Therefore, Morgan Stanley was still in the restricted period and prohibited from attempting to induce customers to place aftermarket orders.

CLAIM FOR RELIEF

VIOLATION OF RULE 101
OF REGULATION M UNDER THE EXCHANGE ACT

81. Paragraphs 1 through 80 are realleged and incorporated herein by reference.

82. Rule 101 of Regulation M, among other things, prohibits underwriters, during a restricted period prior to the completion of their participation in the distribution of IPO shares, from directly or indirectly bidding for, purchasing, or attempting to induce any person to bid for or purchase any offered security in the aftermarket.

83. As a prophylactic antimanipulation rule, Regulation M is designed to prohibit activities that could artificially influence the market for the offered security, including, for example, supporting the IPO price by creating the perception of scarcity of IPO stock or creating the perception of aftermarket demand. Accordingly, it may be violated with or without, among other things, any impact on the trading price for the security or scienter.

84. As described above, during the restricted period, Morgan Stanley attempted to induce certain customers to make aftermarket purchases by engaging in the following activities. Morgan Stanley communicated to certain customers that expressing an interest in buying shares in the immediate aftermarket and buying shares in the immediate aftermarket would help them obtain good allocations over-subscribed, hot IPOs. Morgan Stanley solicited aftermarket interest from certain customers who Morgan Stanley knew had no interest in owning stock of the IPO companies long-term. Morgan Stanley proposed to certain customers the aftermarket price limits they should give to obtain a good IPO allocation. In some instances, Morgan Stanley encouraged customers

to increase the prices they had originally told Morgan Stanley they were willing to pay in the aftermarket. Morgan Stanley accepted customers' aftermarket interest that they would buy "1 for 1" (or some other ratio) in the aftermarket, meaning that the customers intended to buy in the aftermarket an amount of shares equal to (or greater than) their IPO allocation. Furthermore, in the Martha Stewart Living Omnimedia IPO, Morgan Stanley solicited an aftermarket order from a customer before all the IPO shares had been distributed.

85. By reason of the foregoing, Morgan Stanley violated Rule 101 of Regulation M under the Exchange Act [17 C.F.R. § 242.101].

RELIEF REQUESTED

WHEREFORE, the Commission respectfully requests that this Court enter an Order:

I.

Permanently restraining and enjoining Morgan Stanley from violating, directly or indirectly, Rule 101 of Regulation M [17 C.F.R. § 242.101].

II.

Requiring Morgan Stanley to pay a civil penalty pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)].

III.

Granting such other and further relief as the Court may deem just and proper;

IV.

Retaining jurisdiction of this action in order to implement and carry out the terms of any Orders that may be entered herein.

Respectfully submitted,

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