

SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK


|                           |   |  |
|---------------------------|---|--|
| -----                     | X |  |
| ELECTRON TRADING LLC,     | : | Index No.:                             |
|                           | : | Date purchased:                        |
| Plaintiff,                | : |  |
|                           | : | <b><u>SUMMONS</u></b>                  |
| -against-                 | : |  |
| MORGAN STANLEY & CO. LLC, | : | Plaintiffs designate New York          |
|                           | : | County as the place of trial           |
| Defendant.                | : |  |
| -----                     | X | Venue is proper pursuant to CPLR § 503 |

**TO THE ABOVE NAMED DEFENDANT:**

**YOU ARE HEREBY SUMMONED** to answer the complaint in this action and to serve a copy of your answer, or, if the complaint is not served with this summons, to serve a notice of appearance, on the plaintiff's attorneys within twenty (20) days after the service of this summons, exclusive of the day of service (or within 30 days after the service is complete if this summons is not personally delivered to you within the State of New York); and upon your failure to answer, judgment will be taken against you by default for the relief demanded in the complaint.

Dated: New York, New York.  
April 23, 2015

KASOWITZ, BENSON, TORRES  
& FRIEDMAN LLP

By: 

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TO: Morgan Stanley & Co. LLC  
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SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK

----- X  
ELECTRON TRADING LLC, :  
 :  
 Plaintiff, : INDEX NO.  
 :  
 -against- : **COMPLAINT**  
 :  
 MORGAN STANLEY & CO. LLC, : JURY TRIAL DEMANDED  
 :  
 Defendant.  
----- X

Plaintiff Electron Trading LLC (“Electron”), for its complaint against defendant Morgan Stanley & Co. LLC (“Morgan Stanley”), alleges as follows:

**PRELIMINARY STATEMENT**

1. This action arises from Morgan Stanley’s egregious conduct in fraudulently inducing Electron to grant Morgan Stanley an exclusive license for Electron’s innovative electronic securities trading system and then, after Electron discovered the fraud, in abjectly and admittedly abandoning and breaching its obligations under the exclusive license agreement to construct, market and operate Electron’s system.

2. Electron designed its system to operate in private trading venues for institutional investors and to broker – and to keep confidential from predatory high frequency traders – so-called “spread” orders, in which institutional investors seek to profit by capturing spreads (or price differences) between related financial instruments.

3. From the beginning of its dealings with Morgan Stanley, an established operator of private trading venues, or so-called “dark pools,” Electron made clear to Morgan Stanley that protecting the confidentiality of client order information in the system and the dark pools in which it is used was key to its success. This was particularly so in view of the increasing concerns among institutional investors and regulators that high frequency traders using high-

speed computers were gaining unfair access to dark pools to siphon off institutional investors' trading profits.

4. Thus, in agreeing, among other things, to grant Morgan Stanley the exclusive license, Electron justifiably relied, as Morgan Stanley knew and intended, on Morgan Stanley's repeated public and private statements to, among others, the SEC and Electron that it opposed predatory high frequency trading practices, and on Morgan Stanley's repeated private representations to Electron that it intended to take all necessary and appropriate steps to prevent high frequency traders from gaining access to its dark pools employing Electron's system.

5. In fact, however – contrary to Morgan Stanley's false public and private representations – Morgan Stanley regularly permitted predatory high frequency traders access to trading information from its dark pools, and it intended to proceed with Electron's system only if it could permit its high frequency trading clients – in Morgan Stanley's own words – to “feast” on the system. When Electron consistently objected to Morgan Stanley's doing so, because Electron knew that that would ultimately lead institutional investors to abandon the system and destroy Electron's business, Morgan Stanley abandoned and breached its obligations to Electron under the license agreement and told Electron, “go ahead, sue us.”

6. Electron therefore brings this action to recover compensatory and punitive damages for Morgan Stanley's fraud and breach of contract.

### **PARTIES**

7. Plaintiff Electron is a corporation formed under the laws of Delaware, with its principal executive office located in New York, New York.

8. Defendant Morgan Stanley is a corporation formed under the laws of Delaware, with its principal executive office located in New York, New York.

## **JURISDICTION AND VENUE**

9. This Court has jurisdiction over Morgan Stanley pursuant to CPLR § 301 because Morgan Stanley has at all relevant times continuously and systematically conducted business within the State of New York, and has submitted irrevocably to jurisdiction in this Court for disputes arising from the parties' agreements.

10. Venue is proper pursuant to CPLR § 503(c) because Electron and Morgan Stanley both reside in New York County and have consented irrevocably to venue in this Court for disputes arising from the parties' agreements.

## **FACTS**

### **I. Electron's Spread Trading System**

11. Electron is the creator of a unique, patent-pending, method for the configuration of computing software and hardware into a system (the "Spread Trading System") to electronically match buyers and sellers in "spread" trades.

12. Because investors engaging in a spread trade seek to profit by capturing the spread between two or more related financial instruments, the investors often must engage in multiple transactions, or "legs" – the immediate purchase of a financial instrument and simultaneous commitments to sell related financial instruments. Because an investor must execute multiple transactions, the investor typically incurs multiple sets of transaction costs and so-called "leg risk" – *i.e.*, the risk that it will complete only one leg of the trade and be unable to find a counterparty for the other leg. Leg risk can result in a partially-completed trade and losses to the investor.

13. Electron designed its Spread Trading System, among other things, to eliminate the need to execute multiple transactions, and instead allow investors to enter a spread trade as a single order. The Spread Trading System's "matching engine" would complete the trade by

matching counterparties for, and pricing and executing, each leg. The Spread Trading System thus would benefit institutional investors by reducing transaction costs and, where there are multiple transactions, eliminating leg risk, because it would fill orders only after locating counterparties for the various legs, and would create new opportunities for investors to engage in sophisticated spread trades not previously available.

14. Electron designed the Spread Trading System to be operated through a private trading venue – or “dark pool” – which is, in effect, a private exchange run by an operator such as an investment bank. When Electron was developing the Spread Trading System, there was (and remains) concern among institutional investors and regulators that technologically-advanced traders who engaged in high frequency trading (“HFT”) sought to exploit leakage of information from dark pools concerning institutional investors’ trades so that they could execute transactions literally nanoseconds ahead of those trades and thereby siphon off the institutional investors’ profits.

15. Thus, to successfully build and maintain a customer base for the Spread Trading System, institutional investors would need to be assured that the dark pool in which the system was operated was truly “anonymous” – *i.e.*, that information concerning customer trades within that dark pool could not be accessed and used by predatory HFT traders or others to profit at institutional investors’ expense. Unless the Spread Trading System’s dark pool was truly anonymous, potential customers would be discouraged from using it for fear of falling prey to HFT traders. Because such fears would damage the Spread Trading System’s marketability and value, it was essential to Electron that potential customers be assured that HFT traders would have no interaction with the Spread Trading System.

## **II. Electron Discusses The Spread Trading System With Morgan Stanley**

16. Electron was a new company formed for the purpose of creating the intellectual property that would underlie the Spread Trading System, and it did not have the resources to construct and operate the necessary computer systems or market the product to institutional investors. Thus, Electron needed to engage an established, reputable firm with the technological, financial, and other resources necessary to operate the Spread Trading System and market it to institutional investors.

17. When considering firms with which to work, Electron focused on Morgan Stanley based on Morgan Stanley's public statements that Morgan Stanley scrupulously observed customer anonymity and that its dark pools were – in Morgan Stanley's words – “truly dark.” Indeed, among the various potential operators of the system, Morgan Stanley had been among the most vocal in its purported commitment to protecting investors from predatory traders.

18. For example, Morgan Stanley's Global Co-Head of Electronic Trading, Andrew Silverman, stated publicly in 2008 that “[w]e value our clients' confidence in us to provide them with additional liquidity with no information leakage in the handling of their orders.” In June 2010, Silverman testified to SEC that “truly dark pools ... allow orders to passively interact while eliminating pre-trade information leakage and market impact,” and represented that “Morgan Stanley's [dark pools are] truly dark – and our liquidity pools are carefully constructed and monitored to provide a level playing field and to maximize the potential benefits for our customers.” Also in 2010, the industry publication “The Trade” reported that “[c]lients asked to rank their top electronic-trading partners by their ability to reduce trading costs and level of anonymity named Morgan Stanley Electronic Trading the top provider, according to results from The Trade's 2010 Algorithmic Trading Awards.” In accepting that award on behalf of Morgan Stanley, Silverman pronounced that “our commitment to protecting client orders and maintaining

transparency regarding our order-handling practices is core to our liquidity strategy and a key source of differentiation from competitors.”

19. In or about June 2012, Electron principal David Schanzer met with Morgan Stanley’s Global Head of Equity Trading, Sam Kellie-Smith, to discuss Morgan Stanley’s potential construction, marketing, and operation of the Spread Trading System. Following that meeting, Kellie-Smith introduced Schanzer to Silverman and to Morgan Stanley’s other Global Co-Head of Electronic Trading, William Neuberger. At all relevant times, Neuberger and Silverman, as co-heads of Morgan Stanley’s electronic trading, oversaw HFT transactions conducted by clients through Morgan Stanley. Based on Silverman’s public statements, and statements made directly to Schanzer, Schanzer understood that Silverman and Neuberger were among those who ensured that Morgan Stanley’s HFT clients could not use predatory tactics to siphon institutional investors’ profits.

20. In July 2012, Electron filed U.S Provisional Patent Application No. 61/666,714 titled “System And Method For Trading Paired Securities As A Single Instrument In An Anonymous Execution Venue,” for the Spread Trading System.

21. Between July and October 2012, Schanzer, Neuberger, and Silverman met numerous times to discuss the Spread Trading System. In numerous meetings, including in PowerPoint presentations, Schanzer emphasized to Morgan Stanley the critical importance to Electron of, and the role of its system in, ensuring that dark pools were kept truly dark.

22. Consistent with Silverman’s earlier public statements, Neuberger and Silverman represented to Schanzer repeatedly that Morgan Stanley’s dark pools were “truly dark,” and that its established business practice was to protect customer anonymity scrupulously to prevent its HFT clients from engaging in predatory trading through Morgan Stanley. Neuberger and



Silverman represented to Schanzer repeatedly that Morgan Stanley intended to employ this established business practice with respect to customers using the Spread Trading System.

23. Further, Neuberger and Silverman addressed directly Electron's concern that HFT interaction with the Spread Trading System would discourage customers from using the system and thus, damage its marketability and value. To demonstrate their understanding and agreement with this concern, Neuberger and Silverman referred Schanzer to a letter Morgan Stanley had written to the SEC in March 2010 arguing against certain proposed regulations concerning dark pools. In that letter, Neuberger and Silverman stated to the SEC that "[e]ven sequential, small prints to the tape identifying the individual dark pool source [*i.e.*, exposing customer trade information] may signal that there is a large order resting in that dark pool." Neuberger and Silverman concluded that, "[i]n effect, the proposed requirement encourages predatory activities and would discourage customers from using dark pools to find natural liquidity. We do not believe that this is in the best interest of investors or the equity marketplace."

24. During this period, Morgan Stanley asked Electron to confirm, and in reliance on Morgan Stanley's representations Electron did confirm, that it would not discuss the Spread Trading System with other potential operators.

25. Morgan Stanley also continued what would amount to nearly one year of operational and legal due diligence concerning Electron and the Spread Trading System. During that due diligence, Morgan Stanley told Electron that it projected – based on highly-conservative assumptions – that Electron's Spread Trading System would generate annual revenues in the tens of millions of dollars.

**III. Electron and Morgan Stanley Negotiate and Execute the Exclusive License Agreement And Consulting Agreement**

26. The parties also negotiated the terms of the license agreement, as well as a related Consulting and Services Agreement (the “Consulting Agreement”). During those negotiations, which took place from October 2012 to August 2013, Morgan Stanley repeated the representations to Electron set forth above that if Electron granted it exclusive control over the Spread Trading System, Morgan Stanley intended, among other things, to ensure confidentiality and anonymity of user information and prevent predatory high frequency traders from exploiting the systems, as well as to develop and implement the software, market the system to its current and prospective customers, and provide customers access to the system through Morgan Stanley’s own computer systems.

27. In justifiable reliance on Morgan Stanley’s repeated public and private representations, on August 27, 2013, Electron granted Morgan Stanley exclusive rights to its Spread Trading System by executing an Exclusive License Agreement with Morgan Stanley, and the parties also executed the Consulting Agreement. Copies of the Exclusive License Agreement and Consulting Agreement are attached hereto as Exhibits A and B, respectively.

**A. The Exclusive License Agreement**

28. Under the Exclusive License Agreement, Electron granted Morgan Stanley an exclusive royalty-bearing license for, among other things, Electron’s U.S Provisional Patent Application No. 61/666,714 titled “System And Method For Trading Paired Securities As A Single Instrument In An Anonymous Execution Venue,” filed July 29, 2012, U.S. Patent Application No. 13/933,116 titled “Spread Trading Systems And Methods,” filed July 1, 2013, and its computer software, programs, algorithms and work product.

29. Pursuant to Section 3.2 of the Exclusive License Agreement, Morgan Stanley “agree[d] and covenant[ed] to use commercially reasonable efforts to:

- (a) develop and implement the software and systems necessary for the operation of the [Spread Trading System] and the related front-end access tools and connectivity;
- (b) operate the [Spread Trading System] and the related front-end access tools;
- (c) market or promote the use of the [Spread Trading System] among its and its Affiliates’ existing and prospective customers ...;
- (d) provide access to the [Spread Trading System] through [Morgan Stanley]’s or its Affiliates’ systems (as applicable);
- (e) develop a graphical user interface for use by end users of the [Spread Trading System];
- (f) provide adequate capacity, processing and connectivity for the [Spread Trading System]; and
- (g) launch the [Spread Trading System] prior to the later of (i) the one-year anniversary date of the Effective Date and (ii) the one-year anniversary of the execution date of the first Task Order (as such term is defined in the Consulting Agreement).”

(Ex. A at 7-8.)

30. Pursuant to Section 4.1 of the Exclusive License Agreement, Morgan Stanley agreed to “pay [Electron] a running royalty of 25% of Net Revenue.” (*Id.* at 10.)

31. Because, as the parties recognized, no other potential qualified operator would commit to develop and market a proprietary trading product, such as the Spread Trading System, if an institution of Morgan Stanley’s stature licensed and then abandoned the system prematurely, they agreed in Section 5.4 that Morgan Stanley would operate it for a minimum of three years. The three-year provision would allow time for the Spread Trading System to

develop an operating history that would make it attractive to other institutions if Morgan Stanley no longer wished to operate it.

**B. The Consulting Agreement**

32. Under the Consulting Agreement, Morgan Stanley retained Electron to provide consulting services that were to be defined in mutually agreed “Task Orders.” (Ex. B at 2 (Section 2.1).)

33. On September 30, 2013, the parties executed a Task Order (the “Task Order”), a copy of which is attached hereto as Exhibit C. As consideration for its consulting services, the Task Order provided for payments to Electron of up to \$600,000 per year. (*Id.*)

**IV. Morgan Stanley’s Fraud and Breaches of the Exclusive License Agreement**

**A. Morgan Stanley’s Fraud**

34. In October 2013, when Schanzer and Tan made themselves available to Morgan Stanley to provide services in connection with constructing the Spread Trading System, they discovered that Morgan Stanley had not allocated resources essential to constructing the system and had not taken other steps necessary to perform its contractual obligations.

35. When Schanzer asked Neuberger, Silverman and Morgan Stanley Managing Director Marc Rosenthal how Morgan Stanley intended to construct the Spread Trading System without these resources, they advised Schanzer that, contrary to its repeated representations prior to executing the Exclusive License Agreement, Morgan Stanley had no intention of developing or launching the system in accordance with the terms of the Exclusive License Agreement.

36. Over the next several months, as Electron continuously pressed Morgan Stanley to perform its obligations in accordance with the terms of the Exclusive License Agreement, Neuberger, Silverman, and Rosenthal maintained that, although Morgan Stanley would not develop or launch the system in accordance with its representations and obligations, it would

proceed if Morgan Stanley could allow its HFT clients – in Morgan Stanley’s words – to “feast” on spread traders using the system. In fact, Morgan Stanley told Electron that it already had begun to investigate adapting the system for that purpose. Electron repeatedly and consistently objected and insisted that Morgan Stanley honor its contractual obligations.

**B. Morgan Stanley Admits Its Breach of the Exclusive License Agreement**

37. Ultimately, on April 22, 2014, Neuberger, with Silverman present, told Schanzer that Morgan Stanley would not proceed with the Spread Trading System, and Kellie-Smith later confirmed that to Schanzer. Schanzer reminded Kellie-Smith that the Exclusive License Agreement obligated Morgan Stanley to launch the Spread Trading System within one year and to operate the system for a minimum of three years. Kellie-Smith admitted to Schanzer that Morgan Stanley had breached the Exclusive License Agreement and invited Schanzer to “go ahead, sue us.” However, Kellie-Smith advised Schanzer that “I wouldn’t recommend it. We’ll roll right over you.”

38. The next day, on April 23, 2014, Matthew Berke, Chief Operating Officer of Morgan Stanley’s Institutional Equities Division, also admitted to Schanzer that Morgan Stanley had breached the Exclusive License Agreement and offered Electron a nominal payment in return for terminating the agreement. Neuberger advised Schanzer to accept Morgan Stanley’s offer, stating in words or substance that “you don’t want to go up against a behemoth. You’ll get crushed.”

**V. Morgan Stanley Breaches The Consulting Agreement**

39. After admitting that it was breaching the Exclusive License Agreement, Morgan Stanley informed Electron that it was terminating the Consulting Agreement.

40. The Consulting Agreement obligates Morgan Stanley to make a payment to Electron in “immediately available funds” in the event Morgan Stanley unilaterally terminates

that agreement. (Ex. B at 9 (Section 9.5).) Pursuant to the agreement's terms, the amount currently due and owing from Morgan Stanley to Electron is \$600,000. (Id.; Ex. C at 1.)

41. By letter dated June 18, 2014, Electron demanded that Morgan Stanley make the payment of \$600,000 to Electron required by the Consulting Agreement. Morgan Stanley has refused to make that payment.

**FIRST CAUSE OF ACTION**  
**(Breach of Contract – Exclusive License Agreement)**

42. Electron repeats and realleges the allegations of paragraphs 1 through 41 as if fully set forth herein.

43. The Exclusive License Agreement is a valid, binding, and enforceable contract.

44. Electron has performed and has been ready, willing, and able to perform all of its obligations in connection with the Exclusive License Agreement.

45. Morgan Stanley has breached the Exclusive License Agreement by, among other things, failing and refusing to perform its covenants as enumerated at Sections 3.2(a) through (g) of the Exclusive License Agreement. Among other things, Morgan Stanley has failed to develop and implement the software and systems necessary to operate the Spread Trading System, market the Spread Trading System to Morgan Stanley's customers, create a graphical user interface through which customers can trade spreads, or provide the necessary computer capacity, processing, and connectivity for customers to trade spreads through the Spread Trading System.

46. As a result of Morgan Stanley's breaches, Electron has been damaged in an amount to be proven at trial.

**SECOND CAUSE OF ACTION**  
**(Breach of Contract – Consulting Agreement)**

47. Electron repeats and realleges the allegations of paragraphs 1 through 41 and 43 through 46 as if fully set forth herein.

48. The Consulting Agreement is a valid, binding, and enforceable contract.

49. Electron has performed and has been ready, willing, and able to perform all of its material obligations in connection with the Consulting Agreement.

50. Morgan Stanley has breached the Consulting Agreement by failing to pay Electron \$600,000 due and owing to Electron thereunder.

51. As a result of Morgan Stanley's breach, Electron has been damaged in the amount of \$600,000, plus interest.

### **THIRD CAUSE OF ACTION (Fraud)**

52. Electron repeats and realleges the allegations of paragraphs 1 through 41, 43 through 46, and 48 through 51 as if fully set forth herein.

53. Morgan Stanley fraudulently induced Electron to (a) forebear from offering the Spread Trading System to any of its competitors while it engaged Electron in protracted due diligence and contract negotiations and (b) enter into the Exclusive License Agreement with Morgan Stanley by falsely representing to Electron repeatedly between June 2012 and August 2013 that, among other things:

- Morgan Stanley's dark pools were "truly dark" (*i.e.* anonymous); its established business practice was to protect customer anonymity scrupulously to prevent its HFT clients from engaging in predatory trading through Morgan Stanley; and that it intended to employ this established business practice with respect to customers using the Spread Trading System; and
- Morgan Stanley intended to fulfill its obligations under the Exclusive License Agreement, including to develop and implement the software and provide the capacity, processing and connectivity needed to operate the system, create a

graphical user interface through which its customers could place orders in the system, market the system to its current and prospective customers, provide customers access to the system through Morgan Stanley's own computer systems, and launch the system within one year.

54. Morgan Stanley knew or was reckless in not knowing that each of the foregoing representations of purported fact was false at the time it made such representations.

55. As a result of Morgan Stanley's fraud, Electron has been damaged in an amount to be proven at trial.

56. Electron justifiably relied on Morgan Stanley's misrepresentations, including but not limited to the misrepresentations Morgan Stanley had also made publicly and to the SEC.

57. Because Morgan Stanley committed its actions knowingly, willfully, and in wanton and reckless disregard of Electron's rights, Electron is entitled to recover punitive damages in an amount to be determined at trial.

#### **FOURTH CAUSE OF ACTION (Unfair Competition)**

58. Electron repeats and realleges the allegations of paragraphs 1 through 41, 43 through 46, 48 through 51, and 53 through 57 as if fully set forth herein.

59. Prior to granting Morgan Stanley exclusive rights to the Spread Trading System, Electron had invested substantial time, skill, knowledge, and other resources to create the Spread Trading System as is reflected in, among other things, U.S. Provisional Patent Application No. 61/666,714 titled "System And Method For Trading Paired Securities As A Single Instrument In An Anonymous Execution Venue," filed July 29, 2012, and U.S. Patent Application No. 13/933,116 titled "Spread Trading Systems And Methods," filed July 1, 2013.



60. Prior to licensing exclusive rights to the Spread Trading System to Morgan Stanley, Electron was the sole and exclusive holder of those rights and thus, entitled to the full commercial value of the Spread Trading System.

61. Through its false representations of its business practices and intent with respect to the Spread Trading System, Morgan Stanley misappropriated Electron's rights in the Spread Trading System, including but not limited to Electron's rights to market the Spread Trading System to Morgan Stanley's competitors.

62. Morgan Stanley's conduct has destroyed the value to Electron of the Spread Trading System.

63. Because Morgan Stanley acted in bad faith, and in a way that it knew or should have known would inflict significant competitive injury on Electron, Morgan Stanley's actions constitute unfair competition.

64. As a result of Morgan Stanley's wrongful conduct, Electron has been damaged in an amount to be proven at trial.

65. Because Morgan Stanley committed its actions knowingly, willfully, and in wanton and reckless disregard of Electron's rights, Electron is entitled to recover punitive damages in an amount to be determined at trial.

**REQUEST FOR RELIEF**

WHEREFORE, Electron demands judgment against Morgan Stanley awarding Electron:

- (i) on the first, third, and fourth causes of action, compensatory damages in an amount to be determined at trial;
- (ii) on the second cause of action, compensatory damages in the amount of \$600,000;
- (iii) on the third and fourth causes of action, punitive damages in an amount to be determined at trial;
- (iv) interest, costs and attorneys' fees; and
- (v) such other and further relief as the Court may deem just and proper.

Dated: New York, New York  
April 23, 2015

KASOWITZ, BENSON, TORRES  
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