UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

JUDGE STANTON

ELECTRONIC TRADING GROUP, L.L.C., on Behalf of Itself and All Others Similarly Situated,

Plaintiff,

v.

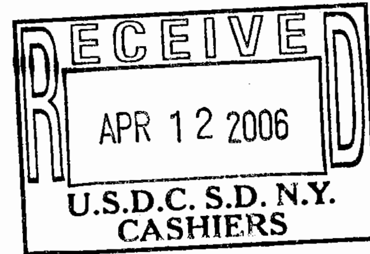
BANC OF AMERICA SECURITIES LLC; BANK OF NEW YORK; BEAR STEARNS COMPANIES, INC.; CITIGROUP INC.; CREDIT SUISSE (USA) INC.; DEUTSCHE BANK SECURITIES, INC.; GOLDMAN SACHS & CO.; LEHMAN BROTHERS, INC.; MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; MORGAN STANLEY & CO., INCORPORATED; UBS FINANCIAL SERVICES, INC.; AND JOHN DOES 1-100,

Defendants.

06 CV 2859

CLASS ACTION COMPLAINT

JURY TRIAL DEMANDED



This is a class action alleging violations of federal and state antitrust laws, breach of fiduciary duty, breach of contract, unjust enrichment and other related claims. Plaintiff makes the following allegations upon information and belief based upon the investigation of its counsel, except as to the allegations specifically pertaining to plaintiff.

NATURE OF THE ACTION

1. This action arises from certain collusive practices employed by defendant broker-dealers to the detriment of clients who engage in legitimate short selling activities. Defendant broker-dealers charged unearned fees, commissions, and/or interest on short sales where defendants in fact failed to borrow and/or deliver the stock, thereby earning illicit profits. "Naked short selling" exists when a stock which has not yet been borrowed is sold and no arrangement has been put in place to borrow the shares. Defendants dominate the market for

prime brokerage services to short sellers and tolerate among themselves chronic failures to deliver by which clients are charged for "borrowing" when in fact no borrowing actually takes place. Defendants collusively condone and engage in these practices to their individual and collective enrichment, routinely alternating among themselves in the roles of prime broker who fails to deliver and third party broker-dealer who permits the fail to persist.

2. As a preliminary matter, short selling is a perfectly legal and accepted stock trading technique that involves coordinated transactions in the marketplace, whereby shares of stock are borrowed -- often from a large financial institution that may own or possess many shares of that stock -- and then sold at the market price. The "short seller" calculates that the price of the stock will decline thereafter so that when the short seller reverses the transaction and closes out the position, the short seller can purchase the same stock at a lower price than the price at which the borrowed stock was sold. If the short seller's calculation is correct, the short seller's gain is the difference between the higher price that it received when it sold the borrowed stock and the lower price at which the short seller repurchased, less any transaction fees and costs. Thus, instead of following the axiom of buying low and selling high, the short seller seeks to do the reverse.

3. In a typical short selling arrangement, the shares at issue will be borrowed by the prime broker on behalf of the client by the settlement date or within some short interval and the transaction is completed. The prime broker charges the short seller interest and/or fees for the borrowing, and holds the cash proceeds of the short sale as collateral. Implicit in this arrangement is that the shares are actually borrowed and delivered to the ultimate purchaser. Otherwise, there is a failure to deliver.

4. In this action, plaintiff alleges that the short sellers of the Class Securities[1] were victims of the anti-competitive conduct of the defendant broker-dealers to profit by engaging in and facilitating a naked short selling scheme whereby plaintiff and other class members -- clients of defendant broker-dealers during the relevant time period -- were charged interest and/or fees, sometimes in the form of commissions, on Class Securities. Payments to the broker in this context are sometimes referred to as "negative rebates." Defendants charged plaintiff and other class members for allegedly "covering" short positions when, in fact, defendants did not cover them and colluded to conceal that fact. In effect, plaintiff and other members of the class were charged and paid costs and fees but did not receive the bargained-for value in return.

5. Defendants are the group of dominant broker-dealers who have been unjustly enriched by their creation of, participation in and facilitation of this wrongful course of conduct. Plaintiff and class members were defendants' direct clients who were damaged by this conduct and are entitled to, *inter alia*, treble damages and injunctive relief.

JURISDICTION AND VENUE

6. Plaintiff brings this action under Section 4 of the Clayton Act, 15 U.S.C. § 15, for treble damages to recover for injuries sustained by plaintiff and class members arising from violations by defendants of the federal antitrust laws, including Section 1 of the Sherman Antitrust Act 15 U.S.C. § 1. This Court has supplemental jurisdiction over the state law claims alleged pursuant to 28 U.S.C. § 1367(a).

7. Venue is proper in this district pursuant to § 12 of the Clayton Act, 15 U.S.C. § 22 and 28 U.S.C. § 1391(b) and (c) because each of the defendants resides, is licensed to do

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[1] "Class Securities" are defined as any equity security of any issuer that is registered under Section 12 of the Securities Exchange Act of 1934, or that is required to file reports under Section 15(d) of the Exchange Act that has been subject to naked short selling as described herein.

business in, or maintains an office in this District and/or the claims alleged herein arose in this District. Many of the wrongful acts alleged herein took place in this District.

8. The laws of the State of New York, including N.Y. Gen. Bus. Law Sections 340 and 349, apply to the claims of all class members. The majority of the named defendants have their principal places of business in New York. The anti-competitive scheme of the defendants was conceived, developed, agreed to, and deployed in and from New York. Most of the defendants' services in connection with the Class Securities were performed in New York.

PARTIES

Plaintiff

9. Plaintiff Electronic Trading Group, L.L.C. was charged fees, commissions and/or interest by defendant broker-dealers during the period April 12, 2000 to the present (the "Class Period") for allegedly "covering" short positions when, in fact, defendants did not cover these sales but simply wrongfully charged plaintiff without providing the service that plaintiff was led to believe defendants were providing in exchange for the fees, commissions, and/or interest payments. Plaintiff brings this action on behalf of itself and all other members of the class (the "Class"), who had at least one contract for prime brokerage services with one of the defendants during the Class Period and were harmed by defendants' course of conduct alleged herein.

Defendants

10. Defendant Banc Of America Securities LLC, including all of its predecessors, parents, related and affiliated entities (collectively, "Banc of America"), is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Charlotte, North Carolina. Banc of America is the tenth largest prime brokerage in terms of aggregate client assets (2.0% of the prime brokerage market). *See* HedgeWorld Service Provider Directory and Guide, 2004 Edition, available at

http://globalclearing.com/gcsportal/pdf/ratings_rankings_ 2004.pdf. It is also ranked fifth with regard to the number of funds it services. *Id.* Banc of America offers private banking and other financial services in New York, New York.

11. Defendant Bank of New York, including all of its predecessors, parents, related and affiliated entities (collectively, "BONY"), including, but not limited to, Pershing LLC and its affiliates, is a corporation organized and existing under the laws of New York, with its principal place of business in New York, New York. Bank of New York is the sixth largest securities lender in terms of new assets. ISF Beneficial Owners Survey, March 2006, available at http://www.isfmagazine.com/includes/magazine/PRINT.asp? SID=619359&ISS=21519. It is also ranked third with regard to the amount of income it generates from securities lending. *Id.* In addition, BONY's subsidiary, Pershing LLC, was also commended for its strength in securities lending in the Global Custodian 2001 Prime Brokerage Survey, available at http://www.morganstanley.com/institutional/primebrokerage/2001_global_custodian.pdf. Bank of New York is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

12. Defendant Bear Stearns Companies Inc., including all of its predecessors, parents, related and affiliated entities (collectively, "Bear Stearns"), is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York. Bear Stearns is a multifaceted financial institution and is the second largest prime brokerage in terms of aggregate client assets (20.9% of the prime brokerage market). *See* HedgeWorld Service Provider Directory and Guide, *supra.* It is also ranked third with regard to the number of funds it services. *Id.* Bear is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

13. Defendant Citigroup Inc., including all of its predecessors, parents, related and affiliated entities (collectively, "Citigroup"), is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York. Citigroup is the sixth largest prime brokerage in terms of aggregate client assets (2.7% of the prime brokerage market). *Id.* It is also ranked eighth with regard to the number of funds it services. *Id.* Citigroup is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

14. Defendant Credit Suisse (USA) Inc., including all of its predecessors, parents, related and affiliated entities (collectively, "Credit Suisse"), is a corporation organized and existing under the laws of Delaware, with its principal place of business in New York, New York. Credit Suisse is the ninth largest prime brokerage in terms of aggregate client assets (2.2% of the prime brokerage market). *Id.* It is also ranked sixth with regard to the number of funds it services. *Id.* Credit Suisse is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

15. Defendant Deutsche Bank Securities, Inc., including all of its predecessors, parents, related and affiliated entities (collectively, "Deutsche Bank"), is a corporation organized and existing under the laws of Delaware, with its principal place of business in New York, New York. Deutsche Bank is the eighth largest prime brokerage in terms of aggregate client assets (2.5% of the prime brokerage market). *Id.* It is also ranked seventh with regard to the number of funds it services. *Id.* Deutsche Bank is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

16. Defendant Goldman Sachs & Co., including all of its predecessors, parents, related and affiliated entities (collectively, "Goldman") is a corporation organized and existing

under the laws of the State of Delaware, with its principal place of business in New York, New York. Goldman is ranked as the third largest prime brokerage in terms of aggregate client assets (16.5% of the prime brokerage market) and is ranked second with regard to the number of funds it services. *Id.* Goldman is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

17. Defendant Lehman Brothers, Inc., including all of its predecessors, parents, related and affiliated entities (collectively, "Lehman"), is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York. Lehman is the seventh largest prime brokerage in terms of aggregate client assets (2.6% of the prime brokerage market). *Id.* It is also ranked eighth with regard to the number of funds it services. *Id.* Lehman is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

18. Defendant Merrill Lynch, Pierce, Fenner & Smith, Inc., including all of its predecessors, parents, related and affiliated entities (collectively, "Merrill Lynch"), is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York. Merrill Lynch is the fifth largest prime brokerage in terms of aggregate client assets (4.6% of the prime brokerage market). *Id.* It is also ranked fifth with regard to the number of funds it services which manage greater than $500 million in client assets. *Id.* Merrill Lynch is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

19. Defendant Morgan Stanley & Co., Incorporated, including all of its predecessors, parents, related and affiliated entities, including, but not limited to Morgan Stanley Dean Witter & Co. and related entities (collectively, "Morgan Stanley"), is a corporation organized and

existing under the laws of the State of Delaware, with its principal place of business in New York, New York. Morgan Stanley is the largest prime brokerage in terms of aggregate client assets (23.1% of the prime brokerage market). *Id.* It is also ranked first with regard to the number of funds it services. *Id.* Morgan Stanley is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

20. Defendant UBS Financial Services, Inc., including all of its predecessors, parents, related and affiliated entities (collectively, "UBS"), is a corporation organized and existing under the laws of the State of Delaware, with offices in New York, New York. UBS is also the fourth largest prime brokerage in terms of aggregate client assets (5.9% of the prime brokerage market). *Id.* It is also ranked fourth with regard to the number of funds it services. *Id.* UBS is a multifaceted financial institution that offers, among other things, investment banking and prime brokerage services.

21. Various financial institutions, intermediaries, and others, participated in and profited from the violations alleged herein and performed acts and made statements in furtherance thereof. The true names and capacities of these defendants sued herein as John Does 1 through 100 are other active participants with the above-named participants whose identities have yet to be ascertained.

SUBSTANTIVE ALLEGATIONS

Prime Brokerage

22. A prime broker is a broker offering professional services to hedge funds and other large institutional clients. Prime brokerage services include securities lending, leveraged trade executions, cash management, fund raising assistance and seeing to special compliance needs, in addition to all of the standard brokerage services.

23. Defendants and their affiliates dominate and control the prime brokerage market in the United States, collectively controlling approximately 83% of the aggregate client assets in that market. *See* HedgeWorld Service Provider Directory and Guide, 2004 Edition, available at http://globalclearing.com/gcsportal/pdf/ratings_rankings_2004.pdf. Therefore, defendants can set prices and institute industry practices in order to benefit themselves at the expense of their clients.

24. Prime brokerage involves three distinct parties: the prime broker, the executing broker and the client (herein, the class member). The prime broker is a registered broker-dealer that clears and finances client trades executed by one or more other registered broker-dealers (the "executing broker") at the behest of the client. The client maintains its funds and securities in an account with the prime broker. Orders placed with the executing broker are effected through an account with the executing broker in the name of the prime broker for the benefit of the client. When a client places a trade order, the executing broker buys or sells securities in accordance with the client's instructions. On the trade date, the client notifies the prime broker of the trade performed by the executing broker. The transaction is recorded in the client's cash or margin account with the prime broker. At the same time, the prime broker records the transaction in a "fail-to-receive/deliver" account with the executing broker.

25. The prime broker issues a confirmation or notification to the client and computes all applicable credit. The executing broker confirms the transaction with the prime broker. The prime broker then will affirm the trade if its information matches the information received from the executing broker. The trade may then be submitted for clearance and settlement.

26. The national clearing and settlement system is run by the Depository Trust Clearing Corporation (the "DTCC"), a for-profit company. The DTCC is owned by the

American Stock Exchange, the New York Stock Exchange ("NYSE"), the National Association of Securities Dealers ("NASD") and the various DTCC-affiliated clearing agencies, in part, and also counts among its shareholders the market participants that use the DTCC for clearing, including defendants herein.

27. This arrangement is considered advantageous for the client because the prime broker acts as a clearing facility and accountant for all of the client's security transactions wherever executed, as well as a central custodian for the client's securities and funds.

28. In accordance with an SEC no-action letter governing the operation of prime brokers, prior to the commencement of any prime brokerage activity, in addition to all written agreements necessary under the federal securities laws, the prime broker and the executing broker, individually, must have contracts with the client which specify the obligations and responsibilities of the parties, and must be in accordance with the no-action letter. Prime Broker Committee, SEC No-Action Letter, 1994 SEC No-Act. LEXIS 466 (January 25, 1994).

Naked Short Selling

29. As described above, naked short selling refers to the practice of selling shares short and not borrowing or arranging to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period after the transaction. As a result, the seller fails to deliver securities to the buyer when delivery is due. This is known in the industry as a "failure-to-deliver" or a "fail."

30. A failure-to-deliver is handled in one of two ways: (1) the stock borrow program at the National Securities Clearing Corporation ("NSCC") (a subsidiary of DTCC) enables that entity to borrow shares from an anonymous pool, and effect delivery to the buyer. The NSCC then creates a debit in the seller's account, and holds the cash from the sale (minus commissions) as collateral. A fee is charged for this. (2) The non-Continuous Net Settlement System or ex-

clearing system, which allows the NSCC to handle the cash for the brokers and pay everyone, but leaves the delivery portion of the transaction outside of the system, between the two brokers, on the honor system. The brokers have ledgers in their back offices where they keep track of the "IOU's" from each other, and this has resulted over time in a phantom float of electronic book entries in the system, with no stock existent to support the transactions.

31. Naked short sales take advantage of this structural deficiency in the system that allows a transaction to occur, and all the monies to be paid, before delivery occurs. As a result, a transaction goes by on the tape (a sale) and it is processed and has an effect on the price of the stock, but the delivery portion of the transaction is left for later.

32. Naked short selling is, in essence, fictitious short selling: plaintiffs were duped into selling unborrowed stocks, stocks that no one has borrowed and possibly never will. The Securities and Exchange Commission ("SEC") allows naked short selling in two cases: to maintain liquidity in hard-to-find shares and in cases where the fails-to-deliver existed prior to the stock becoming a "threshold security" under Regulation SHO, discussed below.

33. Plaintiff does not challenge the practice of naked short selling *per se*, but rather, sues defendants for their anti-competitive actions alleged herein by which they have arrogated to themselves illicit and anti-competitive profits at the expense and without the participation of their clients.

Regulation SHO

34. Regulation SHO (for "Short"), promulgated by the SEC on July 28, 2004, (Release No. 34-50103), was adopted in response to various market developments which occurred since short sale regulation was first adopted in 1938. Regulation SHO attempts to restrict manipulative and abusive naked short selling by implementing a requirement to locate securities before shorting them, and to replace securities for which there has been a delivery

failure for a protracted period of time. Regulation SHO requires a broker-dealer to have reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due before effecting a short sale order in any equity security (a "locate"). This locate must be made and documented prior to effecting the short sale.

35. Regulation SHO imposes additional delivery requirements on broker-dealers for securities in which there are a relatively substantial number of extended delivery failures at a registered clearing agency (known as "threshold securities"). For example, with few exemptions, brokers and dealers that are participants of a registered clearing agency are required to take action to "close-out" failure-to-deliver positions in threshold securities that have persisted for 13 consecutive settlement days. Closing out requires the broker or dealer to purchase securities of like kind and quantity. Until the position is closed out, the broker or dealer and any broker or dealer for which it clears transactions may not effect further short sales in that threshold security without borrowing or entering into a bona fide agreement to borrow the security.

Persistence of Fails-to-Deliver Post-Regulation SHO

36. Before Regulation SHO was promulgated in September 2004, an average of about 155 million shares a day failed to deliver on the NYSE and NASDAQ, excluding the over-the-counter ("OTC") and Pink Sheet Markets. After the passage of Regulation SHO, delivery failures rose, averaging 205 million shares a day in December of 2004, and rising as high as 259 million on December 22, 2004 alone. Since the regulation went into effect on January 3, 2005, delivery failures are now only about 20% below their levels of the prior year.

37. The July 2004 SEC Release that promulgated the final rule version of Regulation SHO also announced that compliance with the location and delivery requirements would be delayed until January 3, 2005 (SEC Release No. 34-50103). Regulation SHO also elected to

"grandfather" in any failed deliveries that existed before January 3, 2005, and, as a result, this led to yet another problem. The grandfathering provision gave defendant broker-dealers a generous period of time to build up naked short positions in stocks before the regulation became effective.

38. Regulation SHO has not meaningfully diminished naked short selling practices and may have actually fostered them by:

- grandfathering pre-adoption, abusive conduct;
- failing to impose any consequences for causing companies to stay on the threshold list for prolonged periods; and
- incorporating vague, non-binding provisions for short selling firms to locate shares to borrow: Regulation SHO §242.203(b)(ii) allows a broker or dealer to effect a short sale if it has "reasonable grounds" to believe the security can be borrowed so that delivery can be made on the date that delivery is due.

Concentration of Market Power and Collusion by Defendants --
the Charging of Excessive Commissions, Fees and/or Interest Payments

39. Each defendant has thousands of clients with brokerage accounts who entrust it with various monies, properties and orders to buy securities. Plaintiff and other class members, the clients for whose business defendants purportedly compete, are located throughout the United States and worldwide. Plaintiff and class members' orders for Class Securities with defendant broker-dealers during the Class Period involved interstate commerce. Defendants transacted with class members with respect to many billions of dollars worth of Class Securities across state lines, including in connection with short sales.

40. This action arises from anti-competitive and unlawful conduct in the market for prime brokerage and clearing services with respect to the lending of securities for purposes of facilitating short selling activity. Defendants account for the vast majority of prime brokerage

and clearing services with respect to the total assets of hedge funds services -- over 83% of a market of approximately $302 billion. Together with their instrumentalities, defendants control the means and mechanisms for selling short and covering/failing to cover such sales and act in a collusive manner which could not persist in a free market. Defendants' combination, conspiracy, and restraint of trade is permitted, promoted and facilitated by agreements -- including oral or implied-in-fact agreement -- for tacit coordination and parallel conduct which no defendant could or would evade. If any defendant sought to reject this conspiracy, it could readily be penalized by other defendants who could seek to reverse the increasing fails/open positions involving such defendant. All defendants earned super-competitive profits through the charging of fees, commissions, and/or interest through phantom securities transactions which merely constituted book entries in their respective ledgers.

41. Defendants capitalized on their market power during the Class Period and reduced competition among themselves by agreeing that they would take turns acting as the prime broker who would charge the excessive fees, commissions, and/or interest payments to a hedge fund or other institutional client for allegedly covering a short position when in fact they did not cover the position but rather charged a commission for providing no service whatsoever, simply to make a profit. Defendants effectively operated in a tag team fashion -- rotating in the roles of prime broker, clearing agent or counterparty that enabled the short sale transaction to go forward without the expectation of delivery.

42. In this regard, a recent study authored by Dr. Leslie Boni, then a visiting financial economist at the SEC, which analyzes NSCC data to investigate the pervasiveness and cause of persistent delivery failures, is illustrative. Leslie Boni, Strategic Delivery Failures in U.S. Equity Markets, 9 J. of Fin. Mkts 1 (2006). Dr. Boni notes that any clearing member with a failure-to-

receive position has the option of notifying the NSCC that it wants to try to force delivery of (or "buy-in") some or all of that position. *Id.* at 19. However, buy-ins are rarely requested. *Id.* Dr. Boni documented that persistent fails-to-deliver increase with a firm's persistent fails-to-receive and concluded that many firms do not want to earn a reputation for forcing delivery and hope to receive a like *quid pro quo* when they are faced with the same situation, but on the other side of the transaction. *Id.* at 24. "[M]any...firms that allow others to fail to deliver to them are responsible for fails-to-deliver in other stocks." *Id.* at 1.

43. Defendants worked individually and in concert among themselves to increase, through their unlawful agreement and course of conduct, their power and domination over the relevant market.

44. Prior to and throughout the Class Period, defendants combined, conspired and agreed to require from the Class members the anti-competitive charges for the Class Securities.

45. The wrongful anti-competitive charges caused the actual consideration paid to defendants for loans of Class Securities to be higher than such charges should have been and, correspondingly, inflated defendants' revenues.

46. Defendants' combination, conspiracy and agreement unreasonably restrained interstate trade and commerce by inflating defendants' charges and revenues for Class Securities in connection with billions of dollars worth of interstate transactions.

The Broker-Dealer Defendants Breached Their Fiduciary Duties to Plaintiff and Other Members of the Class

47. The broker-dealer defendants owed fiduciary duties of reasonable care, utmost good faith, integrity and loyalty to their clients, including plaintiff and other class members herein.

48. In violation of their duties, when broker-dealer defendants facilitated the naked short sales of the members of the Class, defendants: (1) obtained wrongful and excessive fees, commissions, and/or interest payments from plaintiff and other members of the Class to the detriment of plaintiff and other class members; (2) failed to disclose their charging of wrongful, trumped-up fees, commissions, and/or interest payments; (3) failed to disclose their conflict of interest; (4) misrepresented facts material to the transactions; and (5) failed to actually consummate the transactions as approved by their clients.

49. When the broker-dealer defendants improperly approved and executed short sales for members of the Class and did not cover them, defendants removed a core cost from their securities lending business: the cost of providing the security, thereby wrongfully boosting the aggregate fees, commissions, and/or interest payments paid by the Class, in breach of defendants' fiduciary duty. In addition, defendants created a direct conflict of interest between themselves and the class members who did not know that they were being used as pawns in defendants' naked short selling scheme to their detriment, and to the direct benefit of defendants. In addition, the failure of the broker-dealer defendants to disclose this conflict of interest and wrongful course of conduct to their clients constituted a further breach of their fiduciary duties.

50. Defendant broker-dealers also breached their fiduciary duties to the members of the Class by failing to disclose the additional fees, commissions, and/or interest generated by secretly ignoring the need to cover the securities lent and allowing the fails to persist. Defendant broker-dealers violated their duties to their clients by recording phantom short sales and receiving the cash proceeds from the sales, which they held as "collateral" for the loan of such securities to the short sellers. They were thereby able to earn interest on the proceeds of such securities without having borrowed the shares.

51. Defendant broker-dealers also breached their fiduciary duties owed to the members of the Class by misrepresenting facts material to the transactions they undertook. Defendant broker-dealers failed to disclose that: (1) the securities purportedly lent were not, and would not, be located or covered and were "issued" by a process contrary to applicable rules and regulations; (2) the short sales that the members of the Class had ordered would result in fails-to-deliver; (3) defendants had engaged in phantom short sales to the detriment of plaintiff and the Class.

52. Finally, defendant broker-dealers breached their fiduciary duties to the members of the Class by failing to obtain proper authorization for the naked short selling. A broker handling a nondiscretionary account is under a duty to his client not to buy or sell securities unless the client gives prior approval for each transaction.

53. In addition to the foregoing, defendants, and each of them, knowingly and substantially assisted the breaches of fiduciary duties committed by each of them and aided and abetted these breaches of fiduciary duties owed by each of them to the Class members.

Defendants Breached Their Contracts and Undertakings with Plaintiff and Other Members of the Class

54. Plaintiff and other members of the Class entered into prime brokerage service agreements (the "Contracts") with defendants which governed the contractual relationship between the prime broker and the class member during the Class Period.

55. Through these Contracts, the prime brokers and the members of the Class entered into arrangements whereby the client class member appointed the prime broker to establish a prime brokerage account and to perform certain services for the client in connection with the settlement and clearance of such transactions.

56. These Contracts included language regarding short sales and delivery failures and the responsibilities of the parties to the contract with respect to such transactions.

57. Plaintiff and other members of the Class fulfilled their contractual obligations in connection with these Contracts.

58. Defendants, and each of them, breached these Contracts by failing to fulfill their contractual obligations with respect to short sales and delivery failures. Among other things, defendants charged wrongful and excessive fees, commissions and/or interest to the members of the Class which were purportedly charged for the cost of securities lending when in fact defendants did not "cover" the short sales but simply charged plaintiff and other members of the Class trumped-up fees, commissions, and/or interest. In other words, clients were charged and paid fees, commissions, and/or interest but did not receive the consideration that was to be provided in return -- namely, coverage for the short sale. Therefore, plaintiff and class members were charged fees, commissions and/or interest for nothing and defendants breached their contracts.

Market Impact

59. Academic analysis has established that naked short selling poses a threat to the integrity of equity markets. The recent study by Dr. Leslie Boni, *supra,* analyzed NSCC data and found that on three random days, an average of more than 700 listed stocks had short selling failures-to-deliver of 60 million to 120 million shares that persisted for at least two months. In addition, over 800 unlisted stocks on any day had short selling fails of 120 million to 180 million shares that also had persisted for at least two months. The total number of naked shorts, including those persisting for less than two months, presumably is greater.

60. Fails-to-deliver and fails-to-receive amount to about $6 billion daily, including both new fails and aged fails. Naked Short Selling and the Stock Borrow Program, http://www.dtcc.com/publications/dtcc/mar05/naked_short_selling.html.

61. Securities markets permit short selling because it allows investors to: (1) speculate and profit from an overpriced stock or market; and (2) hedge long positions they may have. The prices of securities that are being properly short sold are not distorted because short sellers borrow the security before selling it, and therefore the total float of a security does not change. Among other things, by not having to deliver securities, naked short sellers can take on larger short positions than would otherwise be permissible.

62. Academics have concluded that naked short selling can distort market prices by creating artificial supply-demand imbalances.

CLASS ACTION ALLEGATIONS

63. Plaintiff brings this action on behalf of itself and all similarly situated persons or entities who had at least one contract with defendants during the Class Period and who were wrongfully charged fees, commissions, and/or interest by defendants for "covering" short sales when in fact no such coverage was obtained.

64. Excluded from the Class are defendants, and each of their respective officers and directors, members of their immediate families, their legal representatives, heirs, successors or assigns and any entity in which any of the defendants or any excluded person has a controlling interest.

65. Members of the Class are so numerous that joinder of all members is impracticable. While the precise number of members of the Class is unknown at this time, it is believed to number at least in the tens of thousands of members. Defendants charged fees, commissions, and/or interest in connection with their naked short selling scheme to thousands of

institutional investors amounting to billions and billions of dollars in wrongful overcharges during the Class Period.

66. Plaintiff will fairly and adequately protect the interests of the members of the Class and has no interests which are contrary to or are in conflict with those of the Class that it seeks to represent. Plaintiff has retained competent counsel experienced in class action litigation of this type to protect the Class and prosecute this action vigorously.

67. Plaintiff's claims are typical of the claims of the other members of the Class since all of their damages arise from and were caused by the same unlawful conduct engaged in by defendants.

68. A class action is superior to other available methods, if any, for the fair and efficient adjudication of this controversy because, among other reasons, joinder of all members of the Class is impracticable. Furthermore, the expense and burden of individual litigation make it impracticable for the members of the Class individually to redress the wrongs done to them. Plaintiff knows of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

69. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual Class members. Such questions include:

a. whether defendants entered into the combination, conspiracy and agreement complained of herein;

b. whether the alleged combination, conspiracy and agreement violated federal and state antitrust laws;

c. whether the combination, conspiracy and agreement caused injury to the business or property of plaintiff and the other members of the Class;

d. whether defendants violated New York General Business Law §§340 and 349;

e. whether defendants breached their fiduciary duties to plaintiff and the Class;

f. whether defendants aided and abetted a breach of fiduciary duty;

g. whether defendants breached their contracts with plaintiff and the Class;

h. whether defendants breached the covenant of good faith and fair dealing;

i. whether defendants breached their implied duty of care;

j. whether defendants were unjustly enriched;

k. whether the principles of promissory estoppel apply;

l. whether defendants engaged in a conspiracy;

m. the appropriate measure of damages; and

n. whether plaintiff and other members of the Class are entitled to declaratory relief.

70. Because defendants have acted on grounds generally applicable to the entire Class, final injunctive and/or corresponding declaratory relief is appropriate with respect to the Class.

FIRST CLAIM FOR RELIEF FOR VIOLATION OF SECTION 1 OF THE SHERMAN ACT AGAINST ALL DEFENDANTS

71. Plaintiff incorporates by reference the allegations of paragraphs 1 through 70, as if fully set forth herein.

72. The activities of defendants, as described herein, were conducted within the flow of interstate trade and commerce, had a substantial effect on interstate trade and commerce, and unreasonably restrained interstate trade and commerce.

73. During the Class Period, plaintiff and other class members throughout the United States gave orders to defendants to buy, borrow and sell Class Securities. These transactions were conducted and the prices were reported in interstate commerce.

74. Defendants are located in various states, and purportedly compete with one another across state lines for the business of investors, including plaintiff and other class members. Plaintiff and other class members, likewise, are located throughout the United States.

75. Among other unreasonable restraints on interstate trade and commerce, defendants' combination and conspiracy has caused the Class to pay illegal anti-competitive fees, commissions, and/or interest for which class members reasonably believed they were receiving coverage for their short sales but in fact no such coverage was obtained and plaintiff and class members were deprived of the benefits of competition among broker-dealers, free market prices.

76. Defendants entered into a combination, conspiracy and agreement in unreasonable restraint of trade in violation of Section 1 of the Sherman Act.

77. The purpose and effect of defendants' unlawful combination, conspiracy and agreement was to require plaintiff and the Class to pay anti-competitive charges to defendants.

78. By reason of the foregoing, plaintiff and the other members of the Class have been damaged in their business and property, and pursuant to the Clayton Act, 15 U.S.C. § 15, should recover threefold the damages sustained, and the cost of this suit, including reasonable attorneys' fees.

SECOND CLAIM FOR RELIEF FOR VIOLATION OF NEW YORK GENERAL BUSINESS LAW SECTION 340 AGAINST ALL DEFENDANTS

79. Plaintiff incorporates by reference the allegations of paragraphs 1 through 70 above as if fully set forth herein.

80. Defendants' unlawful conduct constitutes a violation of N.Y. General Business Law ("GBL")§ 340. Through such conduct, which defendants engaged in in New York, defendants restrained competition and the free exercise of activities in the conduct of business, trade and commerce and in the furnishing of services in New York.

81. Defendants' restraints of business, trade and commerce have substantially affected business, trade and commerce in the State of New York.

THIRD CLAIM FOR RELIEF FOR VIOLATION OF NEW YORK GENERAL BUSINESS LAW SECTION 349 AGAINST ALL DEFENDANTS

82. Plaintiff incorporates by reference the allegations of paragraphs 1 through 70 above as if fully set forth herein.

83. Defendants engaged in unfair competition and/or unfair, unconscionable, deceptive or fraudulent events and/or practices in violation of New York GBL § 349 by which they purportedly lent shares, charged anti-competitive fees, and facilitated the occurrence of failures-to-deliver in furtherance of their naked short selling scheme.

84. By reason of the foregoing, plaintiff and other members of the Class have been damaged in their business and property.

FOURTH CLAIM FOR RELIEF FOR BREACH OF FIDUCIARY DUTY AGAINST ALL DEFENDANTS

85. Plaintiff incorporates by reference the allegations of paragraphs 1 through 70 above as if fully set forth herein.

86. The broker-dealer defendants owe their principals, the members of the Class, a duty of reasonable care, utmost good faith, integrity and loyalty. As broker-dealers acting for their clients, the broker-dealer defendants had a fiduciary duty to the members of the Class to consummate the securities lending transactions requested by the broker-dealer defendants and not to facilitate the naked short selling of the Class Securities to the detriment of the Class and for the unlawful and improper benefit of defendants owed their clients.

87. The broker-dealer defendants breached their fiduciary duties to the members of the Class by reason of the acts alleged herein, including: (1) charging excessive and trumped-up fees, commissions, and/or interest to plaintiff and other members of the Class in order to make illicit profits at the direct expense of plaintiff and other members of the Class; (2) failing to disclose their conflict of interest; (3) failing to disclose their excessive fees, commissions, and/or interest payments; (4) misrepresenting facts material to the transactions; and (5) failing to actually consummate the transactions as approved by their clients.

88. The broker-dealer defendants have breached those duties by acting in their own pecuniary interest in disregard of the interests of class members.

89. The members of the Class have been specifically injured as a direct, proximate and foreseeable result of such breach on the part of the broker-dealer defendants and have suffered substantial damages.

90. Because the broker-dealer defendants acted with reckless and willful disregard for the rights of the members of the Class, the broker-dealer defendants are liable for punitive damages in an amount to be determined by the jury.

FIFTH CLAIM FOR RELIEF FOR AIDING AND ABETTING BREACH OF FIDUCIARY DUTY AGAINST ALL DEFENDANTS

91. Plaintiff incorporates by reference the allegations of paragraphs 1 through 70 above as if fully set forth herein.

92. As alleged above, a fiduciary relationship was owed by defendants to plaintiff and other class members as defendants provided prime brokerage services to plaintiff and other class members.

93. Defendants each breached this fiduciary duty by acting in their own pecuniary interests and in disregard of the interests of plaintiff and other class members when they charged members for borrowing the securities to cover their short sales when, in fact, they did not borrow and failed to deliver the shares.

94. Defendants, and each of them, also acted in concert with the other defendants as the broker-dealer representing the buyer in connection with other defendants' naked short sales.

95. Defendants had actual knowledge of defendants' scheme and of their own and other defendants' breaches of duty.

96. Defendants substantially participated in and acted in concert with the other defendants to produce and induce breaches by others by choosing not to force a delivery 'buy-in,' so as not to earn a reputation for forcing delivery and in hopes of receiving future similar consideration from other defendants as described above.

97. Plaintiff and other class members have suffered damages proximately caused by defendants' participation in the other defendants' breaches.

98. Accordingly, defendants, and each of them, are liable to plaintiff and other class members for aiding and abetting the other defendants to breach their fiduciary duties to plaintiff and other class members and are liable for damages in an amount to be proven at trial.

SIXTH CLAIM FOR RELIEF FOR
BREACH OF CONTACT AGAINST ALL DEFENDANTS

99. Plaintiff incorporates by reference the allegations of paragraphs 1 through 70 above as if fully set forth herein.

100. Defendants have entered into contracts with members of the Class under which defendants agreed, *inter alia,* to lend securities to the members of the Class in exchange for fees, commissions, and/or interest charges.

101. The members of the Class performed all obligations under their contracts with defendants.

102. Defendants have breached the terms of their contracts with the members of the Class by charging wrongful fees, commissions, and/or interest payments under the rubric of securities lending, when in fact, defendants did not lend securities and failed to deliver the securities necessary to cover the short sales to the members of the Class.

103. The members of the Class have been deprived of the benefits of their agreements with defendants.

104. As a result of defendants' breaches of contract, the members of the Class have suffered damages.

105. Defendants are accordingly liable to the members of the Class for breaches of contract for damages in an amount to be proved at trial.

SEVENTH CLAIM FOR RELIEF FOR
BREACH OF THE COVENANT OF GOOD FAITH AND FAIR DEALING

106. Plaintiff and the Class incorporate herein by reference paragraphs 1 through 70 as though fully set forth herein.

107. Under New York law, all contracts imply a covenant of good faith and fair dealing in the course of performance.

108. Plaintiff and class members entered into the Contracts with defendants to obtain prime brokerage services, including, among others, coverage for their short sales. Through these Contracts and their relationship with plaintiff and other class members, defendants owed plaintiff and other class members duties and covenants of good faith and fair dealing and a duty to act reasonably to fulfill the intent of the parties to the Contracts. Specifically, throughout the Contracts, defendants undertook a duty in good faith to timely cover plaintiff and Class members' short sales.

109. Defendants have materially and fundamentally breached their duties of good faith and fair dealing owed to plaintiff and other class members in, among others, the following respects:

- unreasonably and in bad faith opting not to cover plaintiff's and other class members' short sales in order to reap the wrongful fees, commissions, and/or interest;
- unreasonably and in bad faith failing to disclose to plaintiff and class members that their short sales were unlawfully failing-to-deliver; and
- unreasonably and in bad faith placed their own interests ahead of those of plaintiff and other class members.

110. Plaintiff and the other class members entered into the Contracts with the reasonable expectation that defendants would deal with them in good faith, putting the interests of their clients first. Plaintiff and other class members reasonably understood that they would receive the coverage for their short sales for which they were specifically being charged. Defendants did not disclose to plaintiff and other class members that they would engage in naked short selling and thereby defeat the very purpose of the Contracts.

111. Defendants represented that their prime brokerage services were being operated in accordance with the governing regulations, including, but not limited to, Regulation SHO.

112. Plaintiff and the other members of the Class have been damaged by defendants' actions because they were charged fees, commissions, and/or interest payments to cover plaintiff's short selling when, in fact, defendant broker-dealers did not cover such short positions, nor did they intend to do so. This behavior of defendants destroyed the right of plaintiff and other members of the Class to receive the benefits of the Contracts.

EIGHTH CLAIM FOR RELIEF FOR NEGLIGENCE AGAINST ALL DEFENDANTS

113. Plaintiff and other members of the Class incorporate herein by reference paragraphs 1 through 70 as though fully set forth herein.

114. Defendants held themselves out as fiduciaries in the exercise of their professional responsibilities on behalf of plaintiff and other members of the Class. By offering prime brokerage services to their clients in exchange for the fees, commissions and/or interest payments, defendants owed their clients, including plaintiff and class members a duty of care in the provision of such services. Defendants, each acting in a fiduciary capacity, have neglected to fulfill their duties of care to plaintiff and other members of the Class as set forth by law.

115. The affirmative conduct by defendants in purporting to arrange short sales that remained uncovered and nevertheless charging interest on loans for shares that were never borrowed constituted, *inter alia*, a violation of the duty of care which prime broker defendants owned to their clients, and which is subject to liability in tort. Defendants knew or were negligent in not knowing, by failing to cover plaintiff and class members short sales, such sales would cause failures-to-deliver. Defendants' negligence was the direct, legal and proximate

cause of plaintiff and class members pointless expenditure of the fees, commissions, and/or interest payments for which they received notice.

116. All defendants are individual and joint tortfeasors as to all breaches of duty.

117. Defendants are consequently liable for all resulting harms of a pecuniary nature or otherwise.

NINTH CLAIM FOR RELIEF FOR
UNJUST ENRICHMENT AGAINST ALL DEFENDANTS

118. Plaintiff and the other members of the Class incorporate by reference herein Paragraphs 1 through __ as if fully set forth herein.

119. As described above, defendants were unjustly enriched by their practice of naked short selling the Class Securities and failing to deliver.

120. Plaintiff and other members of the Class suffered a direct detriment in the amount that defendants profited from the recording of phantom short sales of Class Securities.

121. There is no justification for defendants' conduct.

122. Plaintiff and other members of the Class have no adequate remedy at law.

TENTH CLAIM FOR RELIEF FOR
PROMISSORY ESTOPPEL AGAINST ALL DEFENDANTS

123. Plaintiff incorporates by reference the allegations of paragraphs 1 through 70 above as if fully set forth herein.

124. Through both a course of performance and dealing between plaintiff and defendants, and the clear and unambiguous promises made by defendants to plaintiff and the other members of the Class, defendants promised: (1) that defendants would borrow securities to cover plaintiff and the Class' short positions; (2) that defendants would use the skill and care of a reasonably competent prime broker to cover their transactions; and (3) that defendants would comply with all applicable laws.

125. Plaintiff and other class members reasonably and foreseeably relied on defendants' promises by: (1) contracting with defendants for their services; (2) directing their trading business to the defendants; and (3) allowing the short selling transactions to be carried out on their behalf. Plaintiffs' and other class members' reliance was reasonable because of the explicit nature of the promises, defendants' previous reputation for honesty and integrity, the fact that the promises to cover short sales were the principal basis for the agreement, and for defendants to break their promises, defendants would also be concurrently violating securities and industry regulations.

126. Defendants knew or reasonably should have known that their promises and conduct would induce Plaintiff's and other class members' actions and reliance. Plaintiff and other class members' reliance was unequivocally referable to the promises made by defendants.

127. Plaintiffs and other class members have suffered damages as a result of their reliance upon defendants' promises, including, but not limited to, the loss of the commissions paid to defendants.

128. Defendants are liable to plaintiff and other class members under the doctrine of promissory estoppel, and, as such, injustice and an unconscionable injury can only be avoided by compelling defendants to compensate plaintiff and other class members:

a. for the aggregate of the fees, commissions, and/or interest payments paid by plaintiff and other class members to defendants;

b. for compensatory and punitive damages;

c. for such value of lost good will or reputation as deemed appropriate by the Court;

d. to indemnify plaintiff and the other members of the Class and reimburse them for any damages or penalties arising out of defendants' failure to cover the short sales; and

e. for all costs incurred and fees expended by plaintiff and the other members of the Class in enforcing its rights under the Contracts.

ELEVENTH CLAIM FOR RELIEF FOR CIVIL CONSPIRACY AGAINST ALL DEFENDANTS

129. Plaintiff and the other members of the Class incorporate herein by reference Paragraphs 1 through 70 as though fully set forth herein.

130. A combination of two or more persons and/or entities, including the defendants identified in this Complaint and their co-conspirators, engaged in the unlawful acts described in the preceding paragraphs of this Complaint.

131. The course of conduct described herein was done in furtherance of a conspiracy to harm plaintiff and the other members of the Class in the ways described in this complaint.

132. The conspirators engaged in the practices alleged herein -- including the charging of trumped-up fees, commissions, and/or interest payments in furtherance of this conspiracy.

133. Plaintiff and other members of the Class suffered actual damage as a result of the conspiracy.

JURY DEMAND

Pursuant to Federal Rule of Civil Procedure 38(b) and otherwise, plaintiff respectfully demands a trial by jury.

PRAYER FOR RELIEF

WHEREFORE, plaintiff prays:

a. that the Court determine that this action may be maintained as a class action under Rule 23(b)(2) and (3) of the Federal Rules of Civil Procedure;

b. that the unlawful combination and conspiracy alleged herein be adjudged and decreed to be in unreasonable restraint of trade or commerce in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1;

c. that plaintiff and the other members of the Class recover damages, including but not limited to, compensatory damages as provided by law, and that joint and several judgment in favor of plaintiff and the other members of the Class be entered against the defendants in an amount equal to treble the amount of damages suffered by plaintiffs and the other members of the Class as proven at trial in accordance with the antitrust laws;

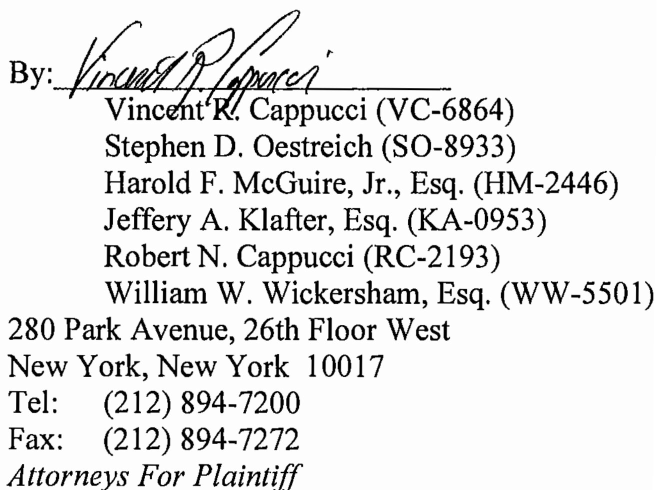
d. that defendants be preliminarily and permanently enjoined from continuing the unlawful combination or conspiracy alleged herein;

e. that plaintiff and other members of the Class recover their costs of this suit, including reasonable attorneys' fees, interest, and expenses, as provided by law; and

f. that plaintiff and other members of the Class be granted such other or further relief as the nature of the case may require or as may seem just and proper to this Court.

Dated: April 12, 2006

ENTWISTLE & CAPPUCCI LLP



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