NASD Dispute Resolution

In the Matter of the Arbitration Between

<u>Name of Claimant(s)</u>

Spencer C. Young, III

03-04798

<u>Name of Respondent(s)</u>

Morgan Stanley & Co., Incorporated

MORGAN STANLEY'S ANSWER TO CLAIMANT'S STATEMENT OF CLAIM

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Spencer Young's claim makes him out to be a superstar, a critical source of revenue for Morgan Stanley & Co., Inc. (hereinafter "Morgan Stanley" or "the Firm"), and the leading actor in the Commercial Mortgage Backed Securities group ("CMBS"). In fact, the hyperbole and exaggeration of Young's claims are symptomatic of the many problems that Young had during his employment with the Firm. Far from being a star, Young was a member of a team, a fact he seemingly failed to recognize. Young did stand out, however, in that amongst the senior personnel in his group he alone had no background in executing transactions; he only pitched business to potential clients. Instead of working with his teammates or improving his own skills in that regard, however, Young consistently tried to take credit for work that others had done, exaggerated his own role in projects, and repeatedly pursued transactions that were in neither the best interest of Morgan Stanley nor its clients. As a result, Young alienated an increasing number of his colleagues at the Firm. When the time came to reduce headcount in November 2002, Young was an obvious choice. When Young failed to improve upon his shortcomings, it was no surprise that he was let go during a reduction in force ("RIF") in late 2002. Young's Statement of Claim itself exemplifies the self-aggrandizing pattern of behavior that he consistently exhibited by:

- claiming that the IQ program was his idea, when it was actually just a new name for a type of transaction Morgan Stanley had previously and repeatedly marketed;

- overstating his role in the IQ transactions, when others in the Firm deserve far more credit for the program, given that Young never served as transaction manager, performed no underwriting function, and did not contribute to deal execution;

- claiming for himself earnings attributable to the IQ program by attempting to count revenues that had nothing to do with his contributions;

- taking sole credit for "closing" the AXA agribusiness transaction, when he was only responsible for the client relationship, but made no real contribution to the execution of that transaction and indeed did not "close" a single transaction while at Morgan Stanley because his execution skills were lacking;

- ignoring the contributions of other integral members of the CMBS team; and

- misrepresenting his work history at Morgan Stanley to gloss over the fact that he washed out of the Principal Group because of his repeated errors and lack of teamwork.

In support of his claims, Young points to purported oral "contracts" and "promises" that were never made, that no reasonable person in Young's position could believe ever would be made, and that contradict Young's written agreement with the Firm. Indeed, Young's claims defy common sense; particularly in a down year for the Firm like 2002, no one at Morgan Stanley would have ever made the kinds of "promises" that Young has invented. The people that Young allege made these statements categorically deny doing so. In fact, far from promising Young "outsized" bonuses or promotions to the highest levels of Firm management, they repeatedly warned him that his performance needed substantial improvement and indicated that he had a long way to go before he could be seriously considered for promotion.

I. COUNTER STATEMENT OF FACTS

(a) Young Is Transferred From His Original Position With The Firm After Alienating His Colleagues.

Young was hired in March 1997 by John Westerfield to work for a group at Morgan Stanley that was then called Real Estate Debt Capital Markets ("REDCM"). The group was responsible for executing transactions involving Commercial Mortgage-Backed Securities ("CMBS"), which are bonds backed by pools of real estate mortgages. Young and Liz Haberkorn were tasked with growing the conduit business by expanding business development efforts and organizing aspects of the small loan conduit business. Beginning in 1998, Young also provided support to Warren Friend who at the time was responsible for pitching CMBS transactions to banks and insurance companies.

In 1999, REDCM reorganized into the Principal Group (which was headed by John Westerfield, and was responsible for originating and purchasing commercial loans), and the Finance Group (which was headed by Gail McDonnell and tasked with client coverage and agency deal execution). The Principal Group was further divided into the "large loan" group (which was responsible for originating loans in excess of $50 million), and the "conduit" group (which was responsible for originating smaller loans). At that time, Young and Liz Haberkorn continued to be jointly responsible for introducing clients to Morgan Stanley's conduit loan product and encouraging them to participate in the loans that were principally run by Tom Jackovicz and George Kok.

As "background" information, Young claims that while he worked with the conduit group he "institut[ed] substantial improvements that increased annual production five-fold to $2.5 billion per year." (Claim at 4.) As with the rest of Young's unsupportable allegations, however, it appears that Young is either seeking to take credit for things that he had nothing to do with, or simply misrepresenting the facts. During Young's tenure in conduit lending (January 1999 to August 2000), the group's loan originations totaled about $500 million per year, or a fifth of the amount Young claims. (*See* Morgan Stanley Originations Overview, attached as Ex. A, at 3; *see also* 2000 Firmwide Performance Evaluations Firmwide 360° Process, Spencer C. Young, Ex. B, at 13). ("As co-head of the MSDW conduit for the first half of the year, production was $500mm+."). Although the Principal group's ***total*** originations in 2000 were slightly over $2.6 billion, almost $2.1 billion of that amount was the work of the "large loan" group, which Young had absolutely nothing to do with. (*Id.*, at 1-2.) Notably, it was only after Young had been out of the conduit group for months that its originations significantly increased and even then to less than half the amounts cited by Young. (*Id.*, at 3.) Although much of the decrease in conduit lending in 1999 and 2000, (as well as the subsequent increase that began in 2001), was probably attributable to external economic conditions, Young's colleagues believed

that his inability to work as a productive member of the team compounded an already difficult situation. The group began to show more significant improvements after he transferred out, something Young's colleagues attribute in part to the new sense of teamwork that never existed during his tenure.

Indeed, from almost the beginning of his employment with Morgan Stanley, Young got along poorly with his co-workers. His colleagues frequently complained that he acted as a "lone wolf" and refused to cooperate with others on his team. Young was perceived by many people to be much more interested in advancing his own agenda than improving the performance of the overall group. He was repeatedly criticized for misinforming his co-workers and manipulating information to make a case for his own agenda, even if the actual facts did not support him. In client meetings, Young would deviate from previously agreed-upon approaches, and was known for making unsupportable claims or promises in order to try to complete transactions at any cost. Because the transactions involved exposing Morgan Stanley to risk, and because Young's analytical skills were not strong, other members of his group became increasingly worried that Young could cost the Firm a great deal of money by committing the Firm to the wrong transaction.

For example, in 1998, Young worked with a borrower who was known to have issues relating to his credit. Despite the risk associated with this client, Morgan Stanley owned the borrower's hotel loan at a very low basis rate. When the borrower went into nonmonetary default, instead of alerting his colleagues to this development, which would have permitted the Firm to obtain a higher rate of return (which was justified given the high risk of the investment), Young remained silent and allowed the borrower to circumvent the default. When Young's colleagues confronted him about this, Young denied it at first, further reducing the trust his colleagues felt they could place in him.

Young also created confusion in the origination network by overstating what Morgan Stanley could offer its clients. For example, Young repeatedly sent clients information about a convertible bridge floating rate program that the Firm had already determined would not work. Young continued to send out information on this nonexistent program even after several senior managers had told him not to do so. The group met and explained to Young why this program would not work and instructed him to stop sending out the promotional materials, but Young continued to publicize the program. This forced Young's colleagues into the uncomfortable position of explaining to customers that Morgan Stanley did not actually offer such a program, which damaged the Firm's credibility with clients and caused the Firm negative momentum in new business.

On another occasion, Young pushed the conduit group to work on a loan in Texas for a strip mall with many local shops and restaurants. This mall lacked a large retail establishment to anchor the property, making it a risky investment. There were also pending legal issues involving the borrower that compounded that risk even further. As it became increasingly obvious that the loan posed too great a risk, Young was getting the conduit group more entrenched in the potential transaction. Finally, Young's colleagues were forced to step in to ensure that the loan be restructured, which created tension with the Dean Witter broker who serviced the borrower.

As business stagnated, Young found others to blame. Young even sent a memorandum to Westerfield suggesting that the solution was to fire his colleagues in the conduit group. But Young's finger pointing was not based on the facts. For example, Young had been given responsibility for an initiative called CreditSource that involved an effort to draw upon the Dean Witter retail network for a fresh source of loans. In September 2000, Young circulated a memorandum highlighting how little actual business had closed from this channel compared with the relatively large volume ($625 million) that had been submitted for review. Young made the case that Morgan Stanley was missing out on business due to failures in pricing and credit, which he could attribute to others. In fact, careful analysis of the loans submitted (such as a $125 million casino construction loan) revealed that the low closing rate for CreditSource was due to the relatively lower quality of the loans themselves, which made them poor candidates for CMBS transactions. With better analytical and leadership skills, Young would have recognized and addressed the true nature of the problem instead of creating unnecessary discord within the group.

Westerfield detailed a number of Young's failings in his commentary submitted in connection with Young's 2000 performance review. Westerfield wrote that Young's performance had "many critical development issues," including his lack of teamwork and judgement and "paranoid" behavior. (*See* Ex. B at 13). Westerfield noted that, while Young had certain strengths, he was "perceived by many people to be much more interested in advancing his own agenda than the overall group's" and that he "often misinform[ed] or manipulate[d] information . . . to make the case for his agenda. He often undermines his subordinates and fails to keep his peers informed." *Id.* Westerfield cautioned that Young had a tendency to send materials out without checking their accuracy. *Id.* Westerfield noted that "a broad range of individuals in the conduit find it very difficult to work with Spencer and try to avoid him. *Id.* Despite the fact that "Spencer has been given every possible opportunity to succeed," his paranoia led him to "ha[ve] the feeling that everyone is out to get him and wants him to fail." *Id.* In sum, Young "lack[ed] risk judgment skills, people management skills and often fails as a team player." *Id.*

John Westerfield eventually concluded that, in light of Young's performance issues, a change was needed. But Westerfield (and others at Morgan Stanley) hated simply to give up on Young, particularly because Westerfield was responsible for hiring him. And Westerfield believed that Young had the potential to be a good coverage officer because one area in which he had shown some ability was developing relationships with clients. Accordingly, Westerfield supported giving Young one more chance by moving him over to the agency side of the business, and he pressed the issue with his supervisor, Craig Phillips.

(b) Young Gets A Second Chance With CMBS.

After considering the problems that Young had been experiencing, Craig Phillips asked Friend if he would be willing to let Young resume the agency work he had previously done with Friend in 1998-1999. Phillips suggested that because the two had worked together before, Young might be more successful under Friend than he had been with the Principal Group. Furthermore, it was hoped that Young's experience in servicing clients and his seniority level would be an appropriate fit for the opening in Friend's group that was created when another employee in the group transferred to Australia. Accordingly, on August 7, 2000, Young

transferred into Friend's group to pick up this employee's account portfolio. Many of these accounts were clients for which Young had provided assistance to Friend in 1998 and 1999. In his new role, Young once again was supposed to work under Friend to sell the various CMBS products to his accounts.

Upon joining SPG Finance, Young covered approximately 40 accounts. He was assisted by a junior employee on approximately 30 accounts and co-covered another 10 with Friend. Most of the accounts that Young covered were institutions that Friend had worked with for some time. For example, Friend had worked with Aegon for years to establish senior relationships and convince them to participate in a CMBS transaction with Morgan Stanley. Eventually, Aegon committed itself to learning about new options and hired a new coverage officer. Young took over this account and built a relationship with the new coverage officer, something that was easier to do because of the trust Friend had spent established with Aegon over time.

To properly cover an account, Young had to build a relationship with the real estate groups at his assigned companies. The goal was to motivate the client to seek an analysis that would reveal whether the Firm could offer solutions to the client's needs. These analyses were precursors to obtaining a mandate to engage in a transaction. When an account requested an analysis, Friend would assign a team to perform the necessary work.

If the analysis led to a mandate for the CMBS team, Friend would choose a transaction manager and assign other execution personnel to the deal, which typically took at least three to four months to close. Because Young had no execution skills, he never served as transaction manager, or played a large role in executing the deals. Instead, execution was handled primarily by all of the other members of the group including Tim Gallagher, AJ Sfarra, Ali Nortier, Adrianne Dicker and Andrew Berman (with Friend's overall coordination and supervision). Meanwhile, Young was responsible for keeping the account informed about how the deal was progressing and was supposed to be exploring whether clients were interested in Morgan Stanley's next CMBS transaction.

(c) Young Mischaracterizes IQ.

Young touts the IQ program as his personal achievement. In so doing, he completely misrepresents the genesis of the program (which was created by others), overstates his own role (which was limited to client relationships and did not include any execution), ignores the vital contributions of others (who helped establish client relations and provided all execution support), and misstates the revenue that SPG Finance earned from the program (which was less than a third of the amounts that Young now claims).

(i) Instead of being Young's "creation," IQ was simply the natural outgrowth of other long-term CMBS products.

Young asserts that IQ was "a new business idea with great potential: the creation of a wholly-owned high quality, multi-seller brand of CMBS." (Claim at 6.) In reality, IQ was simply a new name for Morgan Stanley products that had previously been marketed as LIFE (which reflected the involvement of insurance companies) and TOP (which stood for "tier one product"). The principal feature of each of these programs is that they provide high-quality

issuers (e.g. insurance companies or their equivalent) a platform to contribute a small amount of loans, yet reap the benefits (such as lower costs and higher liquidity) associated with larger transactions. For example, instead of requiring one issuer to commit $1 billion for a CMBS transaction, these products could allow multiple issuers to each contribute loans valued at several hundred million dollars.

6-1

The first LIFE transaction, which involved John Hancock and Principal Mutual, was executed in 1999. Warren Friend originated the LIFE concept in 1998 and started pitching the product to clients at that time. Warren Friend was the principal client relationship person for these accounts, and he was also the lead of the execution team. In 2000, Wells Fargo joined the original two institutions to engage in the same type of transaction under the name TOP. To date, Morgan Stanley has executed three LIFE and eleven TOP transactions.

6-2

In an effort to diversify the CMBS transactions, Morgan Stanley began to pitch the LIFE and TOP concept to other insurance companies. By offering these types of transactions to a greater array of insurance companies, purchasers could further diversify their holdings. Morgan Stanley began this marketing effort in 2000 while Hancock and Principal were involved in TOP transactions.

6-3

John Hancock and Principal objected to the use of the LIFE name to describe transactions offered to their competitors. Accordingly, [illegible]PG Finance set about developing a new name for the product that could be used with other institutions. The naming process was very much a group effort, and the product of general brainstorming. The group, which consisted of at least five employees, initially came up with the name "INS," which was short for Insurance Company. But the team discarded the name out of a fear that it would be confused with the Immigration and Naturalization Service. After some further discussions between team members in May and June 2001, the group eventually settled upon "IQ," short for "Institutional Quality," which the group decided was a good way to describe the low-risk loans that would be the centerpiece of the program. Initially, Young supported using the name INQ, while Jon Strain pushed for IQ, arguing that it "is better marketing spin implying that you are smarter to buy this." (Email from J. Strain, May 30, 2001, attached as Ex. C, at 1.)

6-4

Whatever role Young played in the naming, however, it is utterly inaccurate for him to suggest that he independently developed or named the product, let alone that IQ represented any type of new "concept." To the contrary, IQ has exactly the same features that originally made LIFE an attractive product, and the transactions are structured identically.

6-5

(ii) Young did not have any ownership rights to the product or to its name.

As set forth above, contrary to Young's assertions, he was hardly "the architect" of the IQ product – or even its namer. Young did worked with the Morgan Stanley law division to obtain a service mark on the name. But Friend explained to him at the time that a mark was probably unnecessary, as Morgan Stanley was retaining control over the product's name, and there would be little motivation for the select group of competitors in this field to copy a name that was associated with Morgan Stanley.

6-6

Young's fanciful claim that promises were purportedly made to him to prevent him from freely marketing IQ to competitors is all the more spurious since, regardless of Young's overstatement of his role, he lacked any ownership rights to the product or its name. The Code of Conduct that Young agreed to as a condition of his employment with Morgan Stanley makes it clear that this mark is Morgan Stanley's property. (*See* Morgan Stanley Dean Witter Code of Conduct 2001, Securities and Asset Management Businesses, relevant portion attached as Ex. D, at 28, ("MSDW owns all rights in any intellectual property developed by you during your employment with MSDW that relates to MSDW's business . . . . For this purpose, the Firm's intellectual property includes . . . trademarks or service marks (and related registrations or applications for registration) . . . ."); *see also* Code of Conduct Acknowledgement, February 9, 2001, attached as Ex. E ("I, **Spencer C. Young**, have received a copy of the Morgan Stanley Dean Witter Code of Conduct 2001. I acknowledge that I have read the Code of Conduct and that I understand and agree to abide by the requirements set forth herein.").)

(iii) Young misrepresents his role in the IQ transactions.

Young claims that he was responsible for the "careful selection and underwriting of portfolio loans." (Claim at 6.) In [illegible] Young made only broad recommendations for winnowing the loans clients selected, recommending elimination of the types of loans that Morgan Stanley obviously did not sell (such as golf courses and gas stations) before passing the rest of the package onto the execution team for an in-depth examination, and Young had no role in underwriting loans; that was handled by a third party contractor, Mortgage Ramp.[1]

Young claims that he "g[ave] presentations to all three rating agencies to describe the attributes of this high-quality brand of CMBS." (Claim at 6.) While Young provided some assistance in developing the rating agency presentations for the IQ deals and the AXA Financial agribusiness transaction he never made the presentations himself. In the case of AXA Financial, Cecelia Tarrant made a small portion of the presentation before turning the floor over to the client. Adrianne Dicker made the rating agency presentation for IQ1, Tim Gallagher made the presentation for IQ2 and IQ3, and Ali Nortier presented the IQ4 transaction. Young attended each presentation with the rest of the deal team, but his representation that he presented these deals to the rating agencies is yet another gross exaggeration.

Young claims that he "develop[ed] a detailed servicing standard with Nationwide, Lincoln National and six master servicers." (Claim at 6.) In fact, this master servicing standard was actually created for TOP. When Nationwide insisted that such a standard be incorporated into IQ, Adrienne Dicker adapted the TOP standard to fit IQ1. The Firm continued to use Dicker's servicing agreement in subsequent transactions.

(iv) Young tries to claim credit for work others did for IQ.

Young goes on to claim that a number of clients "became first-time CMBS clients" for Morgan Stanley "[a]s a result of Spencer's efforts in establishing" IQ. (Claim at 7.) Young's

[1] Formerly known as Univest.

claim puts great emphasis on the fact that particular clients participated in a CMBS transaction during his tenure. But he ignores the key contributions of those who came before him and those who worked with him. Young also fails to recognize the importance of timing; insurance companies are often reluctant to sell their loans until they have the right reason to do so. In many cases, it just so happened that the timing was right for a number of companies to join IQ while Young was the coverage officer. This does not mean that the work of those other than Young who built up the relationships and helped companies become comfortable with CMBS and IQ can, or should be ignored.

For example, long before IQ was launched, Warren Friend had established Morgan Stanley's relationship with John Hancock, convincing them to switch their relationship from JP Morgan and bringing them into the LIFE and the TOP transactions. Similarly, Young inherited Aegon from Friend after serving as the junior coverage officer. Friend also gave Young (along with Adrienne Dicker) responsibility for Allmerica, but only after Friend had established a high level relationship with the client through Bob Towse, a senior banker at Morgan Stanley, who discovered through cross-selling that Allmerica was interested in CMBS. Many people on the CMBS team, including Friend and Louis Colosimo, spent over four years talking to Nationwide. When they finally decided that the timing was right for them to join IQ, Young covered the account, but only with key support from AJ Sfa[illegible]. The MONY relationship was established by Jonathan Frey, who had worked for MONY before joining Morgan Stanley. When Frey temporarily left the group to work in Australia, Young assumed coverage responsibilities for MONY that were limited to providing basic continuing support. State Farm and Union Central Life came to IQ through John Marzonie's efforts at cross-selling products. After Marzonie reported that these accounts wanted to learn more about CMBS, Young was assigned to cover them.[2] But Marzonie had to arrange senior level meetings with Friend before they committed to participating in an IQ transaction. Finally, Young's claim that he was responsible for the participation of the remaining accounts is entirely fanciful. Young had no coverage duties whatsoever for Lincoln, Prudential, Principal, CIGNA, TIAA or CIBC.

(v) Young misstates revenues attributable to IQ.

Young's statement of claim attributes all of the revenue that Morgan Stanley earned on the various IQ transactions to Young. This position is simply beyond the pale. As detailed above, it utterly ignores the fact that Young was part of a team that worked together to land these clients. Moreover, his claims are based upon the same type of "fuzzy math" that he employed to miscalculate the productivity of the conduit group. (*See supra* p. 3.) Here he tries to claim credit for revenue generated by other members of the SPG Finance team and revenue generated by the Principal Group as his own.

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[2] It is worth noting that both of these accounts were on Young's coverage list when Marzonie alerted SPG Finance that they were interested in IQ. Had Young cold-called either of these companies, perhaps he *would* have been able to claim this business. As it turned out, Marzonie's cross-selling earned him credit for State Farm and Union Central Life.

Specifically, Young alleges that "Morgan Stanley is positioned to complete at least 4 deals per year and generate $10 million + per transaction." (Claim at 6.) In reality, Morgan Stanley has launched a total of only 5 IQ deals since its inception in 2001. In 2003, the Firm expects to close three transactions; they have never done four in one year. Currently, it is hoped that three IQ transactions can be conducted in 2004.

Moreover, the new issue fees – the revenue that Morgan Stanley makes in each transaction – from the first four IQ deals has ranged from approximately $2.26 million to $3.03 million. Young's claim that each transaction generates over $10 million dollars is entirely inaccurate. In order to come even close to $10 million, Young must take credit for revenue generated by Morgan Stanley's Principal Group (which participates in the transactions by contributing loans just like the insurance company clients do) to SPG Finance. Such an accounting is entirely inappropriate. All revenue generated by the Principal Group can only fairly be credited back to that group (and not to the Finance Group) because they originated the loans and bear all of the loans' associated risk in each IQ transaction. Simply put, with or without IQ, the Principal Group would still have generated all or most of this revenue. The Principal Group does pay new issue fees just like the other deal participants (which is reflected in the $2.26 to 3.03 million); these fees are the extent of SPG Finance's revenue on Principal Group loans.

(d) Young Exaggerates His Role In The AXA Transaction.

Next, Young claims that he "did close the agribusiness transaction for AXA Financial." (Claim at 5.) At best, this statement is seriously misleading. This language implies that Young worked on the deal's execution. In reality, Young lacked an execution background. Young co-covered AXA with Friend and worked with Sanjeev Khanna and Cecilia Tarrant to determine the appropriate strategy for the client when the agribusiness business transaction evolved. Young helped the team collect the necessary data and talked to people about the data, while Khanna, Tarrant and an analyst processed the data. After some disagreement over the appropriate approach – Young disagreed with Khanna's and Tarrant's recommendation of a whole loan sale – the decision was put to the client, who decided to do a whole loan sale instead of the type of securitization that Young had recommended. The team worked together to develop a presentation for the rating agencies, which the client presented. Once AXA Financial selected a deal structure, Young kept the client updated on the deal's progress. The execution team of Sanjeev Khanna, AJ Sfarra and Betsy Gibson closed the AXA Financial agribusiness transaction.

(e) Young's Tenure at Morgan Stanley Was Marked With Conflict.

Young's claims about the AXA transaction and his role in the IQ transactions expose the fact that he entered SPG Finance (after failing in the Principal group) with a handicap that he never acknowledges in his claim: he lacked deal execution experience. The typical career track in SPG Finance begins with learning the business from the deal execution side and progresses to gaining client exposure on a deal by deal basis. Such experience allowed most coverage officers to speak with clients about their actual experiences executing deals; they had first-hand knowledge of the transactions' intricacies and developed a sense of which features worked well in different situations. Young, however, had no execution experience and did not understand the

technical aspects of the transactions in which his clients participated. When he tried to insert himself into execution work, he often created more problems for his colleagues to solve.

Colleagues did not trust Young because he had a habit of blaming his errors on them. For example, when Young was preparing a pitch for Allstate, he included an analysis of potential reinvestment returns. On the day before the meeting, Friend reviewed Young's analysis and determined that it might be in error. Accordingly, Friend instructed Young not to present it during the meeting, but to simply indicate to the client that they were working on a more thorough analysis. Despite Friend's clear instructions, which he reiterated prior to the meeting, Young arose from the table in the middle of the meeting, opened up a flip chart, and walked the client through the exact calculations Friend had instructed him to omit. When Young finished, Friend recovered by explaining that they still needed to check on the analysis and would get back to Allstate with more details. As it turned out, Young's analysis was indeed flawed. This incident made all three of them look silly in front of a tough account.

After the meeting, Young blamed the faulty analysis on his junior colleague AJ Sfarra, claiming that Sfarra's calculations were inaccurate. When Friend noted that Sfarra had only followed Young's instructions, Young then tried to blame the incident on his inability to reach Friend during the pitch development process. Young even went so far as to prepare a self-serving chronology of events in an effort to cover his tracks; Friend recalls telling Young that the chronology did not accurately reflect what happened. By that point, it had become apparent to Friend that Young was repeating the same pattern of conduct that had gotten him into trouble with his colleagues in the Principal Group.

Similarly, as he had done in the past, Young continued to ignore direct instructions and remained intent on doing things his way, despite the harm his plans caused to the Firm. For example, clients often inquired about their ability to minimize their risk when they investigated CMBS transactions. One theoretical method of minimizing risk was known as the "inverted Y." That structure was used once by Morgan Stanley in a transaction between two clients who knew each other well, but it was ultimately decided that it would not be appropriate for the vast majority of SPG's deals because the costs of the transaction outweighed the potential savings. Friend spoke with Young and Louis Colosimo shortly before they did a pitch for a client, making his hesitation clear and instructing Young ***not*** to talk about the inverted Y structure. However, Young ignored this instruction and suggested the inverted Y structure to the client during the pitch. Friend learned this from Colosimo, who called to express his disbelief that Young had brought up the transaction despite Friend's instructions.

In a typical inverted Y structure, the non-investment grade bonds are kept separate from investment grade bonds and each party executes a side agreement promising to pay the other party back should their lesser bonds erode their own side of the transaction and start to affect the joint assets. In Young's proposed inverted Y transaction, there were multiple clients who were new to CMBS transactions. This would have required separate side agreements between a number of clients that did not know each other and were unfamiliar with CMBS issues; there was no guarantee that everyone would honor their commitment – or be around long enough – to reimburse the others for any losses. After Young's meeting, the execution team had to go back and explain to clients why this structure would not work, creating more work for them and discrediting them in front of clients.

11-1

Young also claimed credit for work others did. Young passed out sheets at budget meetings listing revenue he had supposedly generated or revenue he could potentially earn from the clients he covered, prompting Gail McDonnell to remind him that "there is no I in team" and to ask him pointedly who else worked on those accounts with him. On another occasion, Young's colleague Andrew Berman came up with the idea of offering clients a retained yield contract. Young heard this and began calling on clients without Berman and telling them that it was his idea. Friend investigated and, upon discovering that Young was in fact passing off Berman's idea as his own, confronted Young. Friend was forced to explain to Young something that should have been obvious to anybody in Young's position: Young should have given Berman credit and included him in meetings with clients to whom Young wanted to pitch the idea.

(f) Young's Incessant Focus On His Compensation Undermined His Work.

11-2

Central to Young's claim are his allegations that he was promised and earned an "outsized bonus" for 2002. But neither Friend nor McDonnell – nor any other Morgan Stanley employee – ever promised Young an "outsized bonus" at "the next level" or anything similar in 2002 or any other year. To the contrary, Young's supervisors repeatedly made it clear to Young that he was not on track for more pay unless he was able to significantly improve his work (which he failed to do). Of course, bonus payments were also tied to the overall performance of the Firm, which had a down year in 2002.

11-3

When Young worked for Friend, he repeatedly set up meetings with Friend to discuss his desire to get paid and promoted.[3] These meetings began in January or February of 2002 – after Young received a 2001 bonus that he felt was inadequate – and occurred approximately every other month. At the initial meeting, Young thanked Friend for "saving" him from his last department. Despite the fact that he clearly needed "saving," due to his performance in the Principal Group, Young went on to complain that he felt that his 2001 bonus was low because people in the Principal Group did not like him. Friend explained to Young that, if anything, his 2001 bonus had been overly generous because Young was not responsible for almost any revenue at that time; nevertheless he had received a substantial bonus, which Friend explained to him was based on the fact that the Firm and the group were doing well.

11-4

During the meetings that Young arranged, he repeatedly told Friend of his desire to receive higher pay and a promotion and asked Friend for specific ways to accomplish his goals. Consistent with the typical practice at Morgan Stanley, Friend never stated that there were any guarantees of bonus levels or promotion. Friend did explain to Young that Managing Directors typically generated at least $20 million per year, but that they also had to have other significant leadership skills. In addition, Friend pointed out that the level of pay and the opportunity for promotion were contingent on other Morgan Stanley departments making their respective budgets.

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[3] On top of the meetings that Young initiated, McDonnell encouraged Friend to conduct regular meetings with Young because she felt Young needed additional supervision. During these sessions, in addition to discussing client coverage issues, Young would often raise complaints about other employees.

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Far from suggesting that Young had what it took to go to "the next level," Friend reminded Young that he was not even meeting expectations for his then-current position. Friend pointed out that an Executive Director in Young's position should be generating, at the very least, $10 million per year. In the previous year, by contrast, Young generated virtually nothing. Along those lines, Friend mentioned that the AXA Financial agribusiness deal would be a great transaction to help Young increase his revenue because it was worth $3 million. He did *not* promise Young a bonus of any size for simply landing or closing that transaction, which was obviously part of the basic job that Young was expected to perform.

Young also made a practice of discussing his bonus and promotion potential with Gail McDonnell. He complained to her a few times a year that he was underpaid. McDonnell repeatedly explained to Young that, especially in a down year like 2002, nearly everyone at Morgan Stanley felt underpaid. She acknowledged that there were times when other firms on Wall Street paid more and that each person had to evaluate those higher paying opportunities as they came along. Far from promising Young a promotion, McDonnell indicated to Young that he was not under consideration for promotion to Managing Director and that his overall performance needed to improve significantly before he would be considered seriously for such a promotion.

It would, moreover, make no sense for McDonnell or Friend to make the promises claimed by Young. The use of a revenue target alone is an inaccurate measure for promotions at Morgan Stanley. Promotion decisions are based upon many factors other than revenues, including leadership, people management, teamwork, respect for individuals and cultures, integrity, client-centricity, professional skills, innovation, contribution to the Morgan Stanley community, and commercial orientation, as well as whether the role the individual is performing is one that warrants an officer at the Managing Director level. Moreover, proposed promotions are reviewed by numerous levels of Firm management. Even strong candidates, whose promotions are supported by their groups, are often eliminated from contention as the process progresses. Because Friend and the other Managing Directors in SPG do not control the promotion process after they select their own candidates, Young's claim that "Friend and other Morgan Stanley Managing Directors directly promised and represented to Spencer that he would be . . . promoted to 'the next level'" is even more unrealistic. (Claim at 6.)

Gail McDonnell certainly never promised Young that "his bonus would be increased to 'the next level'" if he "convert[ed] new SPG clients." (Claim at 5.) In any event, there is no defined "next level" for bonuses, which are discretionary. Similarly, Warren Friend never promised or represented to Young that "he would receive an 'outsized bonus' at the next level for fiscal year 2002" for his work relating to the AXA Financial agribusiness transaction.[4] *Id.* These alleged promises do not even have the ring of truth. Setting aside the fact that neither

[4] Even Young is unsure of the details involved in the alleged promise he claims Friend made. At one point, Young claims that he would get this outsized bonus "if he were able to ***land*** the AXA Financial agribusiness transaction." (Claim at 5) (emphasis added). Two paragraphs later, Young alleges that he "would receive a 2002 'outsized bonus' . . . if he were ***able to close*** the AXA Financial agribusiness transaction." *Id.* (emphasis added).

McDonnell nor Friend would ever make such promises to any employee – let alone to a low performer like Young – it is well known that direct managers do not even have sole discretion in setting their employees' bonuses and the phrases Young cites have no particular meaning at Morgan Stanley or in the industry.

Moreover, total compensation decreased significantly at Morgan Stanley in 2002 as compared to 2001. Bonuses routinely vary widely depending on the performance of the market, the profitability of the Firm and its various groups, and each individual employee's successes and failures. In 2002, compensation paid to non-exempt employees in SPG declined by 24.5% from 2001.[5] Compensation paid to Executive Directors in SPG decreased by 25.1%, while the Executive Directors in SPG Finance – the group Young worked with – took a 27% pay cut over that same time frame. Every single Executive Director in SPG Finance took a pay cut in 2002. For an employee whose performance was as weak as Young's, Young's claim that he deserved an "outsized" bonus is nothing short of preposterous.

Finally, although Young baldly asserts that Morgan Stanley induced him to stay with the Firm with promises of a bonus and promotion, Young never indicated that he had any competing offers of employment. And certainly Morgan Stanley never induced Young to abandon other offers or made any promises that Young could have reasonably "relied" upon to forego better offers. To the contrary, during Young's 2001 performance evaluation, when Young expressed his unhappiness about the many areas of improvement that were noted by his supervisors, Friend said that if Young did not like what he was doing and wanted to leave, Friend would let him keep his job while he looked for a new one. Young declined Friend's offer, stating that he wanted to work on improving his situation at Morgan Stanley. Unfortunately, Young did not show the necessary improvement in 2002.

(g) Young's Defamation Claims Are Totally Without Merit.

Young's defamation claims are vague and without merit. Morgan Stanley has not defamed him in any way. Presumably in an effort to mask the weakness of his claims, Young offers blanket assertions instead of concrete details that would permit adequate investigation. Young claims that "after Morgan Stanley conveyed to the financial institution false and defamatory information about Spencer, the financial institution withdrew its conditional offer of employment." (Claim at 10.) This allegation is impossibly vague, as it does not identify the purported offer or the supposedly "false and defamatory" information that was supposedly conveyed. Suffice it to say that there is no evidence that anybody at Morgan Stanley made any false statements about Young in any context, and it is impossible to evaluate Young's vaguely worded claim in any greater detail.

[5] These calculations are based on employees who worked for the Firm in both 2001 and 2002.

13-1 13-2 13-3 13-4 3

(h) Ultimately, Young Was Terminated Because of Economic Conditions and His Poor Performance.

2002 was a very difficult year across Wall Street and at Morgan Stanley. The markets were down and the economy was soft. In an effort to right-size the organization and keep the company profitable, Morgan Stanley was forced to let go of a number of employees. The November 20, 2002 Reduction in Force (the "RIF") included many senior level employees in an effort to significantly reduce the Firm's compensation expenditures.

At the time that McDonnell and Friend learned of the RIF, Friend had already been speaking with Human Resources since early in the year regarding concerns about Young's performance. It had already been discussed in the April meeting that Young could not get along with others and that he did whatever he wanted to do, despite the ramification to the Firms. In yet another effort to encourage Young to improve and help him overcome his inability to recognize his performance issues, Friend conducted a special mid-year review of Young. This unusual practice generally is reserved for problem employees. As Friend gathered data for the review, four consistent themes emerged from conversations with Young's co-workers: Young had "team player issues;" he operated according to "his own agenda;" he used "overly aggressive tactics w[ith] clients;" and he demonstrated a "lack of judgment." ([redacted] at 1) As reflected in notes from Friend's midyear review meeting with Young, Friend informed Young that "I don't have a platform for you to move into to make MD" and that Young should "expect comp[ensation] down." (*Id.* at 2.)

As Young had done throughout his tenure at Morgan Stanley, he had alienated many of his colleagues in the Finance Group by 2002. Accordingly, when the RIF was announced to senior management, several people who were familiar with Young's history and performance called Friend to suggest that he consider Young for the RIF. Friend then carefully examined how his department could function with fewer employees. In addition to all of his teamwork, judgment and trust issues, Young lacked the execution skills that Andrew Berman, the other coverage officer, possessed. While Young had strong relationships with certain accounts, Friend realized that those relationships would be easier to replace than the ones Berman had developed. McDonnell, Westerfield and Tufariello all agreed that selecting Young for the RIF was the proper decision.

Morgan Stanley was more than generous to Spencer Young over the course of his employment. Instead of terminating him when he did not succeed at conduit lending, the Firm found him another position under Friend. But Young did not work as a cooperative member of the CMBS team or improve upon the other problems that had consistently plagued him during his time at Morgan Stanley. These recurring performance issues, coupled with his relatively low productivity, made Young a natural candidate for the RIF. And despite all of these facts, Morgan Stanley still offered Young a severance package worth more than $328,975 when he was released.

II. COUNTER STATEMENT OF LAW

A. As An At-Will Employee, The Alleged Promises to Pay Young An Outsized Bonus and Promote Him at the End of 2002 Must Fail.

Young claims that Morgan Stanley's alleged promise to pay him a "non discretionary 'outsized bonus'" and to "compensate[] and promote[]" him to Managing Director constituted an express contract that obligated Morgan Stanley to pay him a bonus and promote him once he "closed the AXA Financial agribusiness transaction" and "developed the IQ Brand into a revenue platform of at least $25 million annually." (Claim at 11.) These allegations do not state a valid claim for relief, and therefore they should be dismissed.

1. Young Expressly Acknowledged His Status As An At-Will Employee And The Conditions Under Which The Terms of His Employment Could Be Modified At Any Time.

When Young joined Morgan Stanley on March 17, 1997, he signed an employee profile form acknowledging that he was an at-will employee of Morgan Stanley.

> I understand and agree that ***employment with Morgan Stanley & Co. Incorporated is employment at will.*** Accordingly, I can leave the Firm at any time for any reason, and likewise, the ***Firm may terminate my employment at any time with or without cause.*** I also understand that Morgan Stanley & Co. Incorporated will, from time to time, establish rules, regulations, policies and employee benefits governing my employment. I further understand that these guidelines, and any employee benefits which are currently in effect or may be established, may be changed from time to time at the sole discretion of Morgan Stanley & Co. Incorporated. . . . ***I also understand that no employee or representative of Morgan Stanley & Co. Incorporated has any authority to enter into any agreement contrary to the foregoing, unless such an agreement is in writing and signed by a Principal of the Firm.***"

(*See* Employee Profile, attached as Ex. G, at 4) (emphasis added). Young specifically acknowledged Morgan Stanley's ability to end his employment for any reason. And, he acknowledged that no one could change the terms of his employment without a written agreement signed by a Principal (now called Executive Director) of the Firm. Young fails to prove – or even allege – that any of the alleged promises made to him were reduced to writing and signed by a Principal (now called Executive Director) of the Firm. Thus, Young fails to state a valid claim for altering the terms of his employment with Morgan Stanley and his claims should be dismissed.

2. Because Young Was an At-Will Employee, the Promises Allegedly Made to Him Are Unenforceable.

New York law clearly states "that where an employment is for an indefinite term it is presumed to be a hiring at will which may be freely terminated by either party at any time for any reason or even for no reason." *Murphy v American Home Products Corp.*, 58 N.Y.2d 293, 300-301 (N.Y. Ct. App. 1983). Put another way, "Absent an agreement establishing a fixed

duration, an employment relationship is presumed to be a hiring at will, terminable at any time by either party." *Sabetay v. Sterling Drug*, 69 N.Y.2d 329, 333 (Ct. App. NY. 1987) (citation omitted). Accordingly, employers retain "an unfettered right to terminate the employment [of an at-will employee] at any time." *Murphy*, 58 N.Y.2d at 304. "Absent a constitutionally impermissible purpose, a statutory proscription or an express limitation in the individual contract of employment, an employer's right at any time to terminate an employment at will remains unimpaired." *Wright v. Cayan*, 817 F.2d 999, 1003 (2d Cir. 1987), *cert. denied* 484 U.S. 853 (1987) (quoting *Murphy*, 58 N.Y.2d at 305, 488 N.E.2d at 91, 461 N.Y.S.2d at 237). An express limitation is a "written policy of limitation on the employer's right to discharge" that the employee knew about "at the time the employment commenced and, in accepting the employment, the [employee] relied on the termination only for cause limitation." *Novinger v. Eden Park Health Svcs., Inc.*, 167 A.D.2d 590, 591 (3d Dept. 1990).

Young fails to allege the existence of a contract that fixed the duration of his employment with Morgan Stanley. He also fails to cite any written policy limiting Morgan Stanley's right to terminate him that he was aware of at the time he joined the Firm. Because Young was an at-will employee under New York law, Morgan Stanley had the legal right to alter the terms of his employment at any time. This means that Young could not have an enforceable expectation of either a raise or continued employment with Morgan Stanley. There is no basis on which Young can enforce these alleged promises. Young's breach of contract claim should be dismissed.

B. Promissory Estoppel, Equitable Estoppel And Quantum Meruit.

1. Young's promissory estoppel claim fails because New York does not recognize promissory estoppel in the employment context.

New York does not recognize promissory estoppel as a valid cause of action in the employment context. *Miller v. Citicorp*, 1997 WL 96569, at *10 (S.D.N.Y.); *see also Van Brunt v. Rauschenbuerg*, 799 F. Supp. 1467 (S.D.N.Y. 1992) (dismissing a promissory estoppel claim because "New York does not recognize promissory estoppel as a valid cause [of] action when raised in the employment context."); *Dalton v. Union Bank of Switzerland*, 134 A.D.2d 174, 176-7 (1st Dept. 1987) (holding that promising "plaintiff employment at a certain salary with certain other benefits, which induced him to leave his former job and forego the possibility of other employment in order to remain with defendant, does not create a cause of action for promissory estoppel").

Even if this black letter rule did not apply, Young's claims would fail because he cannot demonstrate the components necessary to sustain a claim of promissory estoppel: "(1) a clear and unambiguous promise; (2) reasonable and foreseeable reliance by the party to whom the promise is made; and (3) injury sustained by the party asserting the estoppel by reason of reliance. *Miller*, 1997 WL 96569, at *10. Young's claims fail under this test, because none of the so-called "promises" Young alleges are sufficiently clear and unambiguous, and there is no evidence that Young reasonably relied on the so-called promises. To the contrary, Young's inability to find work today confirms that he would have been unlikely to find work last year (in a tougher climate) had he sought to leave Morgan Stanley.

2. Equitable Estoppel.

Young's claims for relief based upon equitable estoppel are even weaker, as that doctrine "is to be invoked sparingly and only under exceptional circumstances." *Gross v. New York City Health & Hosps. Corp.*, 122 A.D.2d 793, 794, 505 N.Y.S.2d 678, 679 (2nd Dept. 1986) (holding that failure to identify the person who allegedly misled a mother about the cause of her child's birth defect is "inadequate to support an equitable estoppel claim" *Id.*). The doctrine of equitable estoppel stops a party from denying "any material fact which, by his or her words or conduct, . . . the party has intentionally or negligently induced another, who had a right to rely upon such words or conduct, to believe and act upon them, thereby changing positions in such a way that he or she would suffer injury if a denial or contrary assertion were allowed." 57 N.Y. Jur.2d Estoppel, Ratification and Waiver § 3. Equitable estoppel is appropriate "where a party makes (1) a false representation or conceals a material fact, (2) with the intention that the other party will act upon the false representation or concealment, and (3) knows the real facts." *Unadilla Silo Co. Inc. v. Ernst & Young*, 234 A.D.2d 754, 755, 651 N.Y.S.2d 216, 217-18 (3rd Dept. 1996). However, "in the absence of fraud, ***a mere promise to do something in the future cannot form the basis for an estoppel.***" *Id.* Young has not alleged fraud, yet the promise he seeks to have enforced – to pay him an "outsized" bonus and provide him with "fair compensation" at the end of 2002 – is merely an unenforceable promise to do something in the future. Therefore, his claim of equitable estoppel should fail.

Second, Young misunderstands the effect of equitable estoppel. The doctrine precludes the party being estopped from making particular arguments. It does not, as Young alleges, "apply to enforce Morgan Stanley's promises" to Young that he would receive an "outsized" bonus and "fair compensation for the development of" IQ. (Claim at 13.) Even if Young had stated a claim for equitable estoppel and Morgan Stanley were precluded from arguing they had not promised him the bonus and compensation at issue, Morgan Stanley would still have other arguments at its disposal. Specifically, Young's status as an at-will employee allows Morgan Stanley to terminate him at any time and gives him no reasonable expectation of receiving that bonus or compensation at year end.

3. Quantum Meruit.

In order to prove unjust enrichment, or quantum meruit, Young must demonstrate that (1) Morgan Stanley was enriched; (2) that enrichment occurred at Young's expense; "and (3) the circumstances were such that equity and good conscience require defendant to make restitution." *Universal Acupuncture Pain Svcs., P.C. v. State Farm Mut. Auto. Ins. Co.*, 196 F. Supp.2d 378, 387 (S.D.N.Y. 2002) (citation omitted). As an action brought under quasi-contract theory, quantum meruit is designed "to prevent a party's unjust enrichment." *Mauro v. Orville*, 172 Misc.2d 499, 502, 660 N.Y.S.2d 662, 665 (N.Y. Sup. Ct. 1997) (citation omitted). Once again, Young's efforts to apply this doctrine to his case are entirely misplaced.

In *Freedman v. Pearlman*, 271 A.D.2d 301, 706 N.Y.S.2d 405 (1st Dept. 2000), plaintiff was an investment banker who was paid salary and orally promised a six month review, "a significant year-end bonus," and participation in the deals he worked on. Plaintiff alleged that he relied on promises that he would be "fairly compensated" and reassurances that defendants would give him an interest in particular transactions. *Id.* at 301-02. The Court held that

plaintiff's allegations "that he performed services far greater than the defendants deserved for the compensation he received" failed to state a claim because "none of the services allegedly performed are 'so distinct from the duties of his employment and of such nature that it would be unreasonable for the employer to assume that they were rendered without expectation of further pay.'" *Id.* at 304 (citation omitted).

Likewise, Young's claim of quantum meruit fails. Young was a salaried, at-will employee, much like the broker in *Freedman*. Young's duties before and during the IQ transactions involved marketing CMBS transactions to clients or, as Young alleged, he "headed up new business development on the issuer side for more than two years." (Claim at 4.) He never alleges that his responsibilities increased in 2002. Young was not asked to, nor did he perform, any extraordinary tasks that would warrant additional compensation. Young – and his colleagues on the CMBS team – merely performed their assigned duties as they marketed and executed each IQ transaction. Finally, Young fails to prove that Morgan Stanley was unjustly enriched.

C. Young's Claims Fail Due to A Lack of Definiteness.

In his effort to circumvent the legal deficiencies of his claims, Young cites *Knapp v. McFarland*, 344 F. Supp. 601, 612 (S.D.N.Y 1971) (enforcing a written agreement stating that a "premium 'will' be paid"). Young's reliance on this principle is misplaced because unlike the plaintiff in *Knapp*, he had no such written agreement to support his vague allegations. *See also Harden v. Warner Amex Cable Communications Inc.*, 642 F. Supp. 1080, 1096 (S.D.N.Y. 1986) (finding that the "bonus was an integral part" of claimant's compensation because "Paragraph 2 of the Agreement clearly defined compensation in terms of base salary and bonus"). Without a written agreement, there are no defined terms upon which Young can rely to establish his claim for a bonus. Instead, as an at will employee, whether Young received a bonus was completely within the discretion on Morgan Stanley.

Young notes that "if there exists a reasonable basis for calculating the bonus due an employee, a court may enforce the contract term. Bonus history thus may be used to determine an appropriate bonus amount." *Giuntoli v. Garvin Guybutler Corp.*, 726 F. Supp. 494, 508 (S.D.N.Y. 1989); *see also Harden*, 642 F. Supp. at 1097 (calculating the bonus on the basis of written provision increasing plaintiff's base salary and bonus in the year at issue). Instead of looking to the course of dealing between the parties, as the law requires, however, Young has demanded an amount that does not reflect any basis of dealing established by the parties. Young received five bonuses during his term of employment with Morgan Stanley:

Year	Bonus[6]
1997	$ 522,250
1998	$ 434,375

6 These numbers differ from the bonus amounts provided by Young in his complaint because he presumably includes EICP awards within his bonus numbers. (Claim at 4.) EICP is subject to forfeiture if the employee does not continue employment for a specified periods.

1999	$ 588,250
2000	$ 505,750
2001	$ 473,750

Young's claim that he should receive a bonus of $1.059 million – an amount more than *twice* the size of his previous bonus – is preposterous and inconsistent with his history at Morgan Stanley.

In the alternative, Young suggests considering further compensation in the range of $5.559 million to $12.134 million, nearly ten times the largest bonus he ever received, based on his unsupportable and untrue claims that he created IQ, and his distortion of the revenues attributable to IQ. Not only is this suggestion totally without merit, it yet again highlights Young's distorted view of his self-importance and his self-delusions about his contributions.

D. Morgan Stanley Did Not Promise Young a Bonus or Additional Compensation.

Morgan Stanley denies that it promised Young any additional or future compensation and denies that the same are owed Young. Morgan Stanley had the right to terminate Young, an at-will employee at any time. Young analogized Morgan Stanley's obligation to him to that of a diner in a restaurant who is obligated to pay for "the food consumed" before he leaves. (Claim at 15.) Morgan Stanley has done just that by paying Young the salary he rightfully earned while working at the Firm. In fact, Morgan Stanley went beyond its obligations in offering Young a comprehensive separation package.

E. Defamation.

1. Young fails to state a claim for slander under new york law.

New York law requires that "[i]n an action for libel or slander, the particular words complained of shall be set forth in the complaint." N.Y. C.P.L.R. Rule 3016(a). An action for slander "is required to state *in haec verba* the particular defamatory words claimed to have been uttered by defendants. This requirement is strictly enforced and the exact words must be set forth." *Gardner v. Alexander Rent-A-Car, Inc.*, 28 A.D.2d 667, 280 N.Y.S.2d 595 (1st Dept. 1967). A party fails to state a claim when he "fail[s]to set forth the particular defamatory words." *Well v. Rambam*, 300 A.D.2d 580, 581, 753 N.Y.S.2d 512, 514 (2nd Dept. 2002). Merely "paraphrasing of defendant's alleged statements" does not satisfy the particularity requirement in Rule 3016(a). *Ramos v. Madison Square Garden Corp.*, 257 A.D.2d 492, 493, 684 N.Y.S.2d 212, 213 (1st Dept. 1999).

Furthermore, the complaint "must allege the time, place and manner of the false statement and specify to whom it was made." *Dillon v. City of New York*, 261 A.D.2d 34, 38, 704 N.Y.S.2d 1, 5 (1st Dept. 1999). Therefore, when the alleged defamatory remarks "were alleged to have been made by unknown persons to certain unspecified individuals, at dates times and places left unspecified," the claim will be dismissed for lack of definiteness. *Bell v. Alden Owners, Inc.*, 299 A.D.2d 207, 208, 750 N.Y.S.2d 27, 28 (1st Dept. 2002).

Young fails to meet this strict pleading requirement. He claims that "Morgan Stanley, through Warren Friend, conveyed to the financial institution false and defamatory information about Spencer;" that "Morgan Stanley conveyed to the financial institution false and defamatory information about Spencer;" and that "Morgan Stanley has provided Spencer's prospective employers and/or others with false and defamatory statements regarding Spencer's employment with, achievements at and/or termination from Morgan Stanley." (Claim at 10.) Young never alleges the "exact words" required under Rule 3016(a), *Gardner,* 28 A.D.2d at 667, 280 N.Y.S.2d at 595; instead, he makes conclusory statements about unspecified, but allegedly-false and defamatory information. The Statement of Claim also fails to identify the "time, place and manner" of the alleged defamatory statements. *Dillon,* 261 A.D.2d at 38, 704 N.Y.S.2d at 5. Finally, claiming that these statements were made to prospective employers or financial institutions fails to adequately identify the person or people to whom these statements are made.

2. Even if Young states a claim, his claim of slander per se is not actionable.

An actionable claim for slander per se must be "incompatible with the proper conduct of the business, trade, profession or office itself. The statement must be made with reference to a matter of significance and importance for that purpose, rather than a more general reflection upon the plaintiff's character or qualities." *Culverhouse v. Cooke Center for Learning and Dev., Inc.,* 177 Misc.2d 365, 370, 675 N.Y.S.2d 776, 780 (N.Y. Sup. Ct. 1998) (quoting *Liberman v. Gelstein,* 80 N.Y.2d 429, 436, 590 N.Y.S.2d 857 (1985)). Young alleges that Morgan Stanley's ***intent*** was to harm his reputation within his profession; he offers no proof that the alleged statement met that standard.

F. Tortious Interference with Prospective Business Relations

To state a claim for tortious interference with prospective business relations, Young must show that 1) there was a business relationship between Young and a third party; 2) Morgan Stanley, "knowing of that relationship, intentionally interfere[d] with it;" 3) Morgan Stanley "act[ed] with the sole purpose of harming [Young], or failing that level of malice, use[d] dishonest, unfair, or improper means; and 4) [the] relationship [was] injured." *Schultz v. North American Ins. Group,* 34 F. Supp.2d 866, 869 (W.D.N.Y. 1999). Parties alleging such claims generally have the option of proving that the defendant interfered by way of unlawful or wrongful means; wrongful means include "physical violence, fraud or misrepresentation, civil suits and criminal prosecutions, and some degrees of economic pressure." *Schultz,* 34 F. Supp. at 869 (citation omitted). However, in an action for interference with an at-will business relationship, a claimant must prove either malice or the use of unlawful means. *NRT Metals, Inc. v. Laribee Wire, Inc.,* 102 A.D.2d 705, 476 N.Y.S.2d 335 (1st Dept. 1984); *see also Volmar Distribs. v. New York Post Co., Inc.,* 825 F. Supp. 1153, 1169 (S.D.N.Y. 1993).

Young's claim for tortious interference with prospective relations fails because he merely pleaded that Morgan Stanley's conduct was "wrongful." (Claim at 16.) As a claim made in the context of an at-will employment relationship, Young must prove that Morgan Stanley used malice or unlawful means when interfering. The wrongful standard of conduct that Young alleges is insufficient in the context of at-will employment.

Alternatively, Young's claim fails because his allegation of injury is merely conclusory. In *Scholastic, Inc. v. Stouffer*, 124 F. Supp. 2d 836, 851-2 (S.D.N.Y. 2000), a claim for tortious interference failed where the charging party failed to provide "any details as to the identity of the third parties or plaintiff's dealings with them" outside of an assertion that she "'was involved in business relations' with one potential publisher." Accordingly, the court determined that the "conclusory allegation . . . is not sufficient to apprise plaintiffs of Stouffer's claims." *Id.* at 852. Similarly, Young fails to name the third parties with whom Morgan Stanley allegedly interfered, the details of such interference, or the manner in which the information in question was disseminated. Young's allegations are insufficient and his claim of tortious interference with prospective business relations should fail.

III. YOUNG IS NOT ENTITLED TO DAMAGES

A. Young is not entitled to recover any additional bonus.

Morgan Stanley denies Young's claim that he is entitled to an "outsized" bonus "of at least $1.059 million" because Morgan Stanley never established either the conditions or agreement that Young alleges (and, as set forth above, Young did not even satisfy the imaginary conditions that he alleges). At all times during his employment with Morgan Stanley, Young was an at-will employee who could be terminated at will. Bonuses for such employees are discretionary. *Plantier v. Cordiant*, 1998 WL 551474, at *3 (S.D.N.Y. 1998). No fixed bonus amount was due Young at the time of his termination because Morgan Stanley had not yet set annual bonus levels. Thus, no additional monies are due him.

B. Young is Not Entitled to Liquidated Damages or Statutory Attorneys Fees Under New York Law.

As an executive, Young is not eligible to bring an action under § 198 of the New York Labor Laws. The court in *Rice v. Scudder Kemper Investments* reasoned that "subdivision (7) of § 190 modifies subdivision (2) by including all employees not included in the previous subdivisions "'*except* any person employed in a bona fide executive, administrative or professional capacity.'" *Rice*, 2003 WL 21961010, at *3 (S.D.N.Y. 2003) (citations omitted, emphasis in original). Therefore, he is not entitled to recover either liquidated damages or attorneys' fees and his claim should be denied.

Additionally, Young's bonus does not fall within the definition of wages under New York law. New York's highest court has made clear that wages exclude "certain forms of 'incentive compensation' that are more in the nature of a profit-sharing arrangement and are both contingent and dependent, at least in part, on the financial success of the business enterprise." *Truelove v. Northeast Capital & Advisory, Inc.*, 95 N.Y.2d 220, 223-24, 738 N.E.2d 770, 721-22, 715 N.Y.S.2d 366, 367-68 (Ct. App. 2000) (holding that "[d]iscretionary additional remuneration, as a share in a reward to all employees for the success of the employer's entrepreneurship, falls outside the protection" of New York Labor Law). Young's bonus claim is precisely the type that is intentionally excluded from this statute.

C. Young is Not Entitled to Vesting in All EICP shares.

Young is not entitled to immediate vesting of his EICP awards. According to the Plan's rules, terminated employees' unvested stock units and unvested stock options are cancelled upon termination. Any vested stock options can only be exercised by their scheduled expiration date or 90 days after termination, whichever comes first. Part III, Section 11 of the plan states that "Upon termination of your employment by the Firm as a result of a reduction in force, your unvested stock units and stock options will not be canceled, but instead will vest on the Scheduled Vesting Date irrespective of your termination of employment, *provided* that you sign an agreement and release satisfactory to the Firm." (Morgan Stanley Dean Witter & Co. Institutional Securities, Equity Incentive Compensation Plan, attached as Ex H, at 5.) Because Young has rejected the express condition of signing an acceptable agreement and release, he cannot receive benefits under this rule.

D. Severance.

Morgan Stanley denies that Young is entitled to severance under Morgan Stanley's Severance Pay Plan. The Severance Pay Plan explicitly states that "[p]ayments under the Plan are discretionary and determined on a case by case basis." (Severance Pay: 2001, April 1, 2001, attached as Ex. I.) Morgan Stanley reserves sole discretion to determine whether an employee will receive severance pay. *Id.* at 1.

Young's claim that "the plan provides for severance to him in an amount of twenty 24 *(sic.)* months salary and continuation of all benefits" is wrong. The plan states that "severance pay may be given to an Eligible Employee . . . in an amount determined in the sole discretion of the Company." *Id.* at 2. When severance pay is awarded, it is typically based on an employee's length of service. The plan suggests that an employee may receive severance pay at the rate of "3 weeks Pay . . . for each year of Continuous Service, up to twenty-six (26) weeks of Pay." *Id.*

Finally, Morgan Stanley denies that Young is entitled to the "continuation of all benefits." The Severance Pay Plan specifically states that "[b]enefits coverage for Eligible Employees and their covered family members will terminate as a result of termination of employment." *Id.* at 3. However, it is within Morgan Stanley's discretion to "continue the payment of health insurance premiums and other welfare benefits on behalf of an Eligible Employee during the Severance Period," which is defined as "the number of weeks of pay used to determine the amount of the severance payment." *Id.*

Nevertheless, Morgan Stanley offered Young a comprehensive separation offer of $328,975 when he was terminated in the RIF. In commending this proceeding, Young rejected that offer and waived his right to it.

E. Young is Not Entitled to be Designated a Managing Director.

Morgan Stanley denies that the condition specified by Young was ever set forth regarding Young's promotion to Managing Director. In the alternative, Young failed to perform that condition when he failed to generate the specified amount of revenue. Young was an at-will employee whom Morgan Stanley could terminate at any time. Thus, Young is not entitled to be designated Managing Director.

F. Morgan Stanley Has the Right to Purchase Young's Interest in MSREF IV.

As a terminated employee, Young does not have an absolute right to remain as an investor in the MSREF IV plan. The plan rules give Morgan Stanley the right, among other things, to purchase terminated employee's interests in MSREF IV at a price set under the MSREF IV plan. Thus, Young's claim to the contrary is misplaced.

G. Young is not entitled to Attorney's Fees, Pre-Award Interest, or Costs and Disbursements.

As discussed previously, Young is not entitled to receive attorneys' fees under the New York Labor Laws. Morgan Stanley also denies that Young is entitled to receive attorneys' fees, interest, costs or disbursements under NYCP 5001.

H. Young is not entitled to damages related to Defamation and interference with contractual relationships.

Morgan Stanley denies that Young has stated for defamation of that Friend or others defamed Young to potential employers. Therefore, Young is not entitled to damages for such causes of action.

I. Young is not entitled to recover punitive damages for breach of contract or defamation.

"[P]unitive damages are not available in a breach of contract action." *Egan v New York Care Plus Ins. Co., Inc.*, 277 A.D.2d 652, 653, 716 N.Y.S.2d 430, 432 (3d Dept. 2000). Young's request for punitive damages for Morgan Stanley's alleged breach of contract should be denied.

Punitive damages can be recovered on an actionable tort claim only when the tortious conduct is of the "egregious nature" established in *Walker v. Sheldon*, that conduct is "directed to plaintiff" and is "part of a pattern directed at the public generally." *New York University v. Continental Ins. Co.* 87 N.Y.2d 308, 316, 662 N.E.2d 763, 767, 639 N.Y.S.2d 283, 287 (1995). *Walker* sets the standard for egregious tortious conduct as a wrong that is "morally culpable or is actuated by evil and reprehensible motives." *Walker v. Sheldon*, 10 N.Y.2d 401, 404, 223 N.Y.S.2d 488, 490, 179 N.E.2d 497, 498 (1961). The facts that Young alleges do not reach the required level of egregious conduct. Young request for punitive damages for defamation should be denied.

IV. AFFIRMATIVE DEFENSES

Morgan Stanley asserts the following affirmative and other defenses:

(a) The Statement of Claim must be dismissed on the principal of laches, waiver and estoppel.

(b) The Statement of Claim fails to set forth a claim upon which relief can be granted.

(c) The claims asserted in the Complaint are barred by the applicable statutes.

(d) The claims asserted are barred by the Statute of Frauds.

(e) Claimant's claims are barred in whole or in part because Claimant failed to make reasonable efforts to mitigate his injuries or damages.

(f) The claims asserted in the Complaint are barred by the Claimant's inequitable conduct and unclean hands.

V. CONCLUSION

For the foregoing reasons, Morgan Stanley respectfully requests that the NASD issue an Order dismissing the Statement of Claim with prejudice prior to any hearing on the merits and award Morgan Stanley costs and attorneys' fees. Morgan Stanley respectfully requests that plaintiff's requested relief be denied in its entirety.

Respectfully submitted,
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Spencer Young's claim makes him out to be a superstar, a critical source of revenue for Morgan Stanley & Co., Inc. (hereinafter "Morgan Stanley" or "the Firm"), and the leading actor in the Commercial Mortgage Backed Securities group ("CMBS"). In fact, the hyperbole and exaggeration of Young's claims are symptomatic of the many problems that Young had during his employment with the Firm. Far from being a star, Young was a member of a team, a fact he seemingly failed to recognize. Young did stand out, however, in that amongst the senior personnel in his group he alone had no background in executing transactions; he only pitched business to potential clients. Instead of working with his teammates or improving his own skills in that regard, however, Young consistently tried to take credit for work that others had done, exaggerated his own role in projects, and repeatedly pursued transactions that were in neither the best interest of Morgan Stanley nor its clients. As a result, Young alienated an increasing number of his colleagues at the Firm. When the time came to reduce headcount in November 2002, Young was an obvious choice. When Young failed to improve upon his shortcomings, it was no surprise that he was let go during a reduction in force ("RIF") in late 2002. Young's Statement of Claim itself exemplifies the self-aggrandizing pattern of behavior that he consistently exhibited by:

- claiming that the IQ program was his idea, when it was actually just a new name for a type of transaction Morgan Stanley had previously and repeatedly marketed;

- overstating his role in the IQ transactions, when others in the Firm deserve far more credit for the program, given that Young never served as transaction manager, performed no underwriting function, and did not contribute to deal execution;

- claiming for himself earnings attributable to the IQ program by attempting to count revenues that had nothing to do with his contributions;

- taking sole credit for "closing" the AXA agribusiness transaction, when he was only responsible for the client relationship, but made no real contribution to the execution of that transaction and indeed did not "close" a single transaction while at Morgan Stanley because his execution skills were lacking;

- ignoring the contributions of other integral members of the CMBS team; and

- misrepresenting his work history at Morgan Stanley to gloss over the fact that he washed out of the Principal Group because of his repeated errors and lack of teamwork.

In support of his claims, Young points to purported oral "contracts" and "promises" that were never made, that no reasonable person in Young's position could believe ever would be made, and that contradict Young's written agreement with the Firm. Indeed, Young's claims defy common sense; particularly in a down year for the Firm like 2002, no one at Morgan Stanley would have ever made the kinds of "promises" that Young has invented. The people that Young allege made these statements categorically deny doing so. In fact, far from promising Young "outsized" bonuses or promotions to the highest levels of Firm management, they repeatedly warned him that his performance needed substantial improvement and indicated that he had a long way to go before he could be seriously considered for promotion.

I. COUNTER STATEMENT OF FACTS

(a) Young Is Transferred From His Original Position With The Firm After Alienating His Colleagues.

Young was hired in March 1997 by John Westerfield to work for a group at Morgan Stanley that was then called Real Estate Debt Capital Markets ("REDCM"). The group was responsible for executing transactions involving Commercial Mortgage-Backed Securities ("CMBS"), which are bonds backed by pools of real estate mortgages. Young and Liz Haberkorn were tasked with growing the conduit business by expanding business development efforts and organizing aspects of the small loan conduit business. Beginning in 1998, Young also provided support to Warren Friend who at the time was responsible for pitching CMBS transactions to banks and insurance companies.

In 1999, REDCM reorganized into the Principal Group (which was headed by John Westerfield, and was responsible for originating and purchasing commercial loans), and the Finance Group (which was headed by Gail McDonnell and tasked with client coverage and agency deal execution). The Principal Group was further divided into the "large loan" group (which was responsible for originating loans in excess of $50 million), and the "conduit" group (which was responsible for originating smaller loans). At that time, Young and Liz Haberkorn continued to be jointly responsible for introducing clients to Morgan Stanley's conduit loan product and encouraging them to participate in the loans that were principally run by Tom Jackovicz and George Kok.

As "background" information, Young claims that while he worked with the conduit group he "institut[ed] substantial improvements that increased annual production five-fold to $2.5 billion per year." (Claim at 4.) As with the rest of Young's unsupportable allegations, however, it appears that Young is either seeking to take credit for things that he had nothing to do with, or simply misrepresenting the facts. During Young's tenure in conduit lending (January 1999 to August 2000), the group's loan originations totaled about $500 million per year, or a fifth of the amount Young claims. (*See* Morgan Stanley Originations Overview, attached as Ex. A, at 3; *see also* 2000 Firmwide Performance Evaluations Firmwide 360° Process, Spencer C. Young, Ex. B, at 13). ("As co-head of the MSDW conduit for the first half of the year, production was $500mm+."). Although the Principal group's ***total*** originations in 2000 were slightly over $2.6 billion, almost $2.1 billion of that amount was the work of the "large loan" group, which Young had absolutely nothing to do with. (*Id.*, at 1-2.) Notably, it was only after Young had been out of the conduit group for months that its originations significantly increased and even then to less than half the amounts cited by Young. (*Id.*, at 3.) Although much of the decrease in conduit lending in 1999 and 2000, (as well as the subsequent increase that began in 2001), was probably attributable to external economic conditions, Young's colleagues believed

that his inability to work as a productive member of the team compounded an already difficult situation. The group began to show more significant improvements after he transferred out, something Young's colleagues attribute in part to the new sense of teamwork that never existed during his tenure.

Indeed, from almost the beginning of his employment with Morgan Stanley, Young got along poorly with his co-workers. His colleagues frequently complained that he acted as a "lone wolf" and refused to cooperate with others on his team. Young was perceived by many people to be much more interested in advancing his own agenda than improving the performance of the overall group. He was repeatedly criticized for misinforming his co-workers and manipulating information to make a case for his own agenda, even if the actual facts did not support him. In client meetings, Young would deviate from previously agreed-upon approaches, and was known for making unsupportable claims or promises in order to try to complete transactions at any cost. Because the transactions involved exposing Morgan Stanley to risk, and because Young's analytical skills were not strong, other members of his group became increasingly worried that Young could cost the Firm a great deal of money by committing the Firm to the wrong transaction.

For example, in 1998, Young worked with a borrower who was known to have issues relating to his credit. Despite the risk associated with this client, Morgan Stanley owned the borrower's hotel loan at a very low basis rate. When the borrower went into nonmonetary default, instead of alerting his colleagues to this development, which would have permitted the Firm to obtain a higher rate of return (which was justified given the high risk of the investment), Young remained silent and allowed the borrower to circumvent the default. When Young's colleagues confronted him about this, Young denied it at first, further reducing the trust his colleagues felt they could place in him.

Young also created confusion in the origination network by overstating what Morgan Stanley could offer its clients. For example, Young repeatedly sent clients information about a convertible bridge floating rate program that the Firm had already determined would not work. Young continued to send out information on this nonexistent program even after several senior managers had told him not to do so. The group met and explained to Young why this program would not work and instructed him to stop sending out the promotional materials, but Young continued to publicize the program. This forced Young's colleagues into the uncomfortable position of explaining to customers that Morgan Stanley did not actually offer such a program, which damaged the Firm's credibility with clients and caused the Firm negative momentum in new business.

On another occasion, Young pushed the conduit group to work on a loan in Texas for a strip mall with many local shops and restaurants. This mall lacked a large retail establishment to anchor the property, making it a risky investment. There were also pending legal issues involving the borrower that compounded that risk even further. As it became increasingly obvious that the loan posed too great a risk, Young was getting the conduit group more entrenched in the potential transaction. Finally, Young's colleagues were forced to step in to ensure that the loan be restructured, which created tension with the Dean Witter broker who serviced the borrower.

As business stagnated, Young found others to blame. Young even sent a memorandum to Westerfield suggesting that the solution was to fire his colleagues in the conduit group. But Young's finger pointing was not based on the facts. For example, Young had been given responsibility for an initiative called CreditSource that involved an effort to draw upon the Dean Witter retail network for a fresh source of loans. In September 2000, Young circulated a memorandum highlighting how little actual business had closed from this channel compared with the relatively large volume ($625 million) that had been submitted for review. Young made the case that Morgan Stanley was missing out on business due to failures in pricing and credit, which he could attribute to others. In fact, careful analysis of the loans submitted (such as a $125 million casino construction loan) revealed that the low closing rate for CreditSource was due to the relatively lower quality of the loans themselves, which made them poor candidates for CMBS transactions. With better analytical and leadership skills, Young would have recognized and addressed the true nature of the problem instead of creating unnecessary discord within the group.

Westerfield detailed a number of Young's failings in his commentary submitted in connection with Young's 2000 performance review. Westerfield wrote that Young's performance had "many critical development issues," including his lack of teamwork and judgement and "paranoid" behavior. (*See* Ex. B at 13) Westerfield noted that, while Young had certain strengths, he was "perceived by many people to be much more interested in advancing his own agenda than the overall group's" and that he "often misinform[ed] or manipulate[d] information . . . to make the case for his agenda. He often undermines his subordinates and fails to keep his peers informed." *Id.* Westerfield cautioned that Young had a tendency to send materials out without checking their accuracy. *Id.* Westerfield noted that "a broad range of individuals in the conduit find it very difficult to work with Spencer and try to avoid him. *Id.* Despite the fact that "Spencer has been given every possible opportunity to succeed," his paranoia led him to "ha[ve] the feeling that everyone is out to get him and wants him to fail." *Id.* In sum, Young "lack[ed] risk judgment skills, people management skills and often fails as a team player." *Id.*

John Westerfield eventually concluded that, in light of Young's performance issues, a change was needed. But Westerfield (and others at Morgan Stanley) hated simply to give up on Young, particularly because Westerfield was responsible for hiring him. And Westerfield believed that Young had the potential to be a good coverage officer because one area in which he had shown some ability was developing relationships with clients. Accordingly, Westerfield supported giving Young one more chance by moving him over to the agency side of the business, and he pressed the issue with his supervisor, Craig Phillips.

(b) Young Gets A Second Chance With CMBS.

After considering the problems that Young had been experiencing, Craig Phillips asked Friend if he would be willing to let Young resume the agency work he had previously done with Friend in 1998-1999. Phillips suggested that because the two had worked together before, Young might be more successful under Friend than he had been with the Principal Group. Furthermore, it was hoped that Young's experience in servicing clients and his seniority level would be an appropriate fit for the opening in Friend's group that was created when another employee in the group transferred to Australia. Accordingly, on August 7, 2000, Young

transferred into Friend's group to pick up this employee's account portfolio. Many of these accounts were clients for which Young had provided assistance to Friend in 1998 and 1999. In his new role, Young once again was supposed to work under Friend to sell the various CMBS products to these accounts.

Upon joining SPG Finance, Young covered approximately 40 accounts. He was assisted by a junior employee on approximately 30 accounts and co-covered another 10 with Friend. Most of the accounts that Young covered were institutions that Friend had worked with for some time. For example, Friend had worked with Aegon for years to establish senior relationships and convince them to participate in a CMBS transaction with Morgan Stanley. Eventually, Aegon committed itself to learning about new options and hired a new coverage officer. Young took over this account and built a relationship with the new coverage officer, something that was easier to do because of the trust Friend had spent established with Aegon over time.

To properly cover an account, Young had to build a relationship with the real estate groups at his assigned companies. The goal was to motivate the client to seek an analysis that would reveal whether the Firm could offer solutions to the client's needs. These analyses were precursors to obtaining a mandate to engage in a transaction. When an account requested an analysis, Friend would assign a team to perform the necessary work.

If the analysis led to a mandate for the CMBS team, Friend would choose a transaction manager and assign other execution personnel to the deal, which typically took at least three to four months to close. Because Young had no execution skills, he never served as transaction manager, or played a large role in executing the deals. Instead, execution was handled primarily by all of the other members of the group including Tim Gallagher, AJ Sfarra, Ali Nortier, Adrianne Dicker and Andrew Berman (with Friend's overall coordination and supervision). Meanwhile, Young was responsible for keeping the account informed about how the deal was progressing and was supposed to be exploring whether clients were interested in Morgan Stanley's next CMBS transaction.

(c) Young Mischaracterizes IQ.

Young touts the IQ program as his personal achievement. In so doing, he completely misrepresents the genesis of the program (which was created by others), overstates his own role (which was limited to client relationships and did not include any execution), ignores the vital contributions of others (who helped establish client relations and provided all execution support), and misstates the revenue that SPG Finance earned from the program (which was less than a third of the amounts that Young now claims).

(i) Instead of being Young's "creation," IQ was simply the natural outgrowth of other long-term CMBS products.

Young asserts that IQ was "a new business idea with great potential: the creation of a wholly-owned high quality, multi-seller brand of CMBS." (Claim at 6.) In reality, IQ was simply a new name for Morgan Stanley products that had previously been marketed as LIFE (which reflected the involvement of insurance companies) and TOP (which stood for "tier one product"). The principal feature of each of these programs is that they provide high-quality

issuers (e.g. insurance companies or their equivalent) a platform to contribute a small amount of loans, yet reap the benefits (such as lower costs and higher liquidity) associated with larger transactions. For example, instead of requiring one issuer to commit $1 billion for a CMBS transaction, these products could allow multiple issuers to each contribute loans valued at several hundred million dollars.

The fi[illegible] transaction, which involved John Hancock and Principal Mutual, was executed in 1[illegible] [illegible]arren Friend originated the LIFE concept in 1998 and started pitching the product to clients at that time. Warren Friend was the pri[illegible] client relationship person for these accounts, and he was also the lead of the execution te[illegible] [illegible] 2000, Wells Fargo joined the original two institutions to engage in the same type of transaction under the name TOP. To date, Morgan Stanley has executed three LIFE and eleven TOP transactions.

In an effort to diversify the CMBS transactions, Morgan Stanley began to pitch the LIFE and TOP concept to other insurance companies. By offering these types of transactions to a greater array of insurance companies, purchasers could further diversify their holdings. Morgan Stanley began this marketing effort in 2000 while Hancock and Principal were involved in TOP transactions.

John Hancock and Principal obj[illegible] to the use of the LIFE name to describe transactions offered to their competitors. Accordin[illegible] [illegible]PG Finance set about developing a new name for the product that could be used with other institutions. The naming process was very much a group effort, and the product of general brainstorming. The group, which consisted of at least five employees, initially came up with the name "INS," which was short for Insurance Company. But the team discarded the name out of a fear that it would be confused with the Immigration and Naturalization Service. After some further discussions between team members in May and June 2001, the group eventually settled upon "IQ," short for "Institutional Quality," which the group decid[illegible] a good way to describe the low-risk loans that would be the centerpiece of the prog[illegible] [illegible]itially, Young supported using the name INQ, while Jon Strain pushed for IQ, argu[illegible] it "is better marketing spin implying that you are smarter to buy this." (Email from J. Strain, May 30, 2001, attached as Ex. C, at 1.)

Whatever role Young played in the naming, however, it is utterly inaccurate for him to suggest that he independently develop[illegible] named the product, let alone that IQ represented any type of new "concept." To the cont[illegible] [illegible]Q has exactly the same features that originally made LIFE an attractive product, and the transactions are structured identically.

(ii) Young did not have any ownership rights to the product or to its name.

As set forth abo[illegible] [illegible]ontrary to Young's assertions, he was hardly "the architect" of the IQ product – or even its namer. [illegible]ung did worked with the Morgan Stanley law division to obtain a service mark on the na[illegible] But Friend explained to him at the time that a mark was probably unnecessary, as Morgan [illegible]anley was retaining control over the product's name, and there would be little motivation for the select group of competitors in this field to copy a name that was associated with Morgan Stanley.

Young's fanciful claim that promises were purportedly made to him to prevent him from freely marketing IQ to competitors is all the more spurious since, regardless of Young's overstatement of his role, he lacked any ownership rights to the product or its name. The Code of Conduct that Young agreed to as a condition of his employment with Morgan Stanley makes it clear that this mark is Morgan Stanley's property. (*See* Morgan Stanley Dean Witter Code of Conduct 2001, Securities and Asset Management Businesses, relevant portion attached as Ex. D, at 28, ("MSDW owns all rights in any intellectual property developed by you during your employment with MSDW that relates to MSDW's business . . . . For this purpose, the Firm's intellectual property includes . . . trademarks or service marks (and related registrations or applications for registration) . . . ."); *see also* Code of Conduct Acknowledgement, February 9, 2001, attached as Ex. E ("I, **Spencer C. Young**, have received a copy of the Morgan Stanley Dean Witter Code of Conduct 2001. I acknowledge that I have read the Code of Conduct and that I understand and agree to abide by the requirements set forth herein.").)

(iii) Young misrepresents his role in the IQ transactions.

Young claims that he was [illegible]onsible for the "careful selection and underwriting of portfolio loans." (Claim at 6.) In [illegible]oung made only broad recommendations for winnowing the loans clients selected, recommending elimination of the types of loans that Morgan Stanley obviously did not sell (such as golf courses and gas stations) before passing the rest of the package onto the execution team for an in-depth examinat[illegible]nd Young had no role in underwriting loans; that was handled by a third party contractor, [illegible]rtgage Ramp.[1]

Young claims that he "g[ave] presentations to all thre[illegible]ting agencies to describe the attributes of this high-quality brand of CMBS." (Claim at [illegible]hile Young provided some assistance in developing the rating agency presentations for the IQ deals and the AXA Financial agribusiness transaction he never made the presentations himself. In the case of AXA Financial, Cecelia Tarrant made a small portion of the presentation before turning the floor over to the client. Adrianne Dicker made the rating agency presentation for IQ1, Tim Gallagher made the presentation for IQ2 and IQ3, and Ali Nortier presented the IQ4 transaction. Young attended each presentation with the rest of the deal team, but his representation that he presented these deals to the rating agencies is yet another gross exaggeration.

Young claims that [illegible]develop[ed] a detailed servicing standard with Nationwide, Lincoln National and six master servicers." (Claim at 6.) In fact, this master servicing standard was actually created for TOP. When Nationwide insisted that such a standard be incorporated into IQ, Adrienne Dicker adapted the TOP standard to fit IQ1. The Firm continued to use Dicker's servicing agreement in subsequent transactions.

(iv) Young tries to claim credit for work others did for IQ.

Young goes on to claim that a number of clients "became first-time CMBS clients" for Morgan Stanley "[a]s a result of Spencer's efforts in establishing" IQ. (Claim at 7.) Young's

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1 Formerly known as Univest.

claim puts great emphasis on the fact that particular clients participated in a CMBS transaction during his tenure. But he ignores the key contributions of those who came before him and those who worked with him. Young also fails to recognize the importance of timing; insurance companies are often reluctant to sell their loans until they have the right reason to do so. In many cases, it just so happened that the timing was right for a number of companies to join IQ while Young was the coverage officer. This does not mean that the work of those other than Young who built up the relationships and helped companies become comfortable with CMBS and IQ can, or should be ignored.

For example, long before IQ was launched, Warren Friend had established Morgan Stanley's relationship with John Hancock, convincing them to switch their relationship from JP Morgan and bringing them into the LIFE and the TOP transactions. Similarly, Young inherited Aegon from Friend after serving as the junior coverage officer. Friend also gave Young (along with Adrienne Dicker) responsibility for Allmerica, but only after Friend had established a high level relationship with the client through Bob Towse, a senior banker at Morgan Stanley, who discovered through cross-selling that Allmerica was interested in CMBS. Many people on the CMBS team, including Friend and Louis Colosimo, spent over four years talking to Nationwide. When they finally decided that the timing was right for them to join IQ, Young covered the account, but only with key support from AJ Sfa[illegible]. The MONY relationship was established by Jonathan Frey, who had worked for MONY before joining Morgan Stanley. When Frey temporarily left the group to work in Australia, Young assumed coverage responsibilities for MONY that were limited to providing basic continuing support. State Farm and Union Central Life came to IQ through John Marzonie's efforts at cross-selling products. After Marzonie reported that these accounts wanted to learn more about CMBS, Young was assigned to cover them.[2] But Marzonie had to arrange senior level meetings with Friend before they committed to participating in an IQ transaction. Finally, Young's claim that he was responsible for the participation of the remaining accounts is entirely fanciful. Young had no coverage duties whatsoever for Lincoln, Prudential, Principal, CIGNA, TIAA or CIBC.

(v) Young misstates revenues attributable to IQ.

Young's statement of claim attributes all of the revenue that Morgan Stanley earned on the various IQ transactions to Young. This position is simply beyond the pale. As detailed above, it utterly ignores the fact that Young was part of a team that worked together to land these clients. Moreover, his claims are based upon the same type of "fuzzy math" that he employed to miscalculate the productivity of the conduit group. (*See supra* p. 3.) Here he tries to claim credit for revenue generated by other members of the SPG Finance team and revenue generated by the Principal Group as his own.

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2 It is worth noting that both of these accounts were on Young's coverage list when Marzonie alerted SPG Finance that they were interested in IQ. Had Young cold-called either of these companies, perhaps he *would* have been able to claim this business. As it turned out, Marzonie's cross-selling earned him credit for State Farm and Union Central Life.

Specifically, Young alleges that "Morgan Stanley is positioned to complete at least 4 deals per year and generate $10 million + per transaction." (Claim at 6.) In reality, Morgan Stanley has launched a total of only 5 IQ deals since its inception in 2001. In 2003, the Firm expects to close three transactions; they have never done four in one year. Currently, it is hoped that three IQ transactions can be conducted in 2004.

Moreover, the new issue fees – the revenue that Morgan Stanley makes in each transaction – from the first four IQ deals has ranged from approximately $2.26 million to $3.03 million. Young's claim that each transaction generates over $10 million dollars is entirely inaccurate. In order to come even close to $10 million, Young must take credit for revenue generated by Morgan Stanley's Principal Group (which participates in the transactions by contributing loans just like the insurance company clients do) to SPG Finance. Such an accounting is entirely inappropriate. All revenue generated by the Principal Group can only fairly be credited back to that group (and not to the Finance Group) because they originated the loans and bear all of the loans' associated risk in each IQ transaction. Simply put, with or without IQ, the Principal Group would still have generated all or most of this revenue. The Principal Group does pay new issue fees just like the other deal participants (which is reflected in the $2.26 to 3.03 million); these fees are the extent of SPG Finance's revenue on Principal Group loans.

(d) Young Exaggerates His Role In The AXA Transaction.

Next, Young claims that he "did close the agribusiness transaction for AXA Financial." (Claim at 5.) At best, this statement is seriously misleading. This language implies that Young worked on the deal's execution. In reality, Young lacked an execution background. Young co-covered AXA with Friend and worked with Sanjeev Khanna and Cecilia Tarrant to determine the appropriate strategy for the client when the agribusiness business transaction evolved. Young helped the team collect the necessary data and talked to people about the data, while Khanna, Tarrant and an analyst processed the data. After some disagreement over the appropriate approach – Young disagreed with Khanna's and Tarrant's recommendation of a whole loan sale – the decision was put to the client, who decided to do a whole loan sale instead of the type of securitization that Young had recommended. The team worked together to develop a presentation for the rating agencies, which the client presented. Once AXA Financial selected a deal structure, Young kept the client updated on the deal's progress. The execution team of Sanjeev Khanna, AJ Sfarra and Betsy Gibson closed the AXA Financial agribusiness transaction.

(e) Young's Tenure at Morgan Stanley Was Marked With Conflict.

Young's claims about the AXA transaction and his role in the IQ transactions expose the fact that he entered SPG Finance (after failing in the Principal group) with a handicap that he never acknowledges in his claim: he lacked deal execution experience. The typical career track in SPG Finance begins with learning the business from the deal execution side and progresses to gaining client exposure on a deal by deal basis. Such experience allowed most coverage officers to speak with clients about their actual experiences executing deals; they had first-hand knowledge of the transactions' intricacies and developed a sense of which features worked well in different situations. Young, however, had no execution experience and did not understand the

technical aspects of the transactions in which his clients participated. When he tried to insert himself into execution work, he often created more problems for his colleagues to solve.

Colleagues did not trust Young because he had a habit of blaming his errors on them. For example, when Young was preparing a pitch for Allstate, he included an analysis of potential reinvestment returns. On the day before the meeting, Friend reviewed Young's analysis and determined that it might be in error. Accordingly, Friend instructed Young not to present it during the meeting, but to simply indicate to the client that they were working on a more thorough analysis. Despite Friend's clear instructions, which he reiterated prior to the meeting, Young arose from the table in the middle of the meeting, opened up a flip chart, and walked the client through the exact calculations Friend had instructed him to omit. When Young finished, Friend recovered by explaining that they still needed to check on the analysis and would get back to Allstate with more details. As it turned out, Young's analysis was indeed flawed. This incident made all three of them look silly in front of a tough account.

After the meeting, Young blamed the faulty analysis on his junior colleague AJ Sfarra, claiming that Sfarra's calculations were inaccurate. When Friend noted that Sfarra had only followed Young's instructions, Young then tried to blame the incident on his inability to reach Friend during the pitch development process. Young even went so far as to prepare a self-serving chronology of events in an effort to cover his tracks; Friend recalls telling Young that the chronology did not accurately reflect what happened. By that point, it had become apparent to Friend that Young was repeating the same pattern of conduct that had gotten him into trouble with his colleagues in the Principal Group.

Similarly, as he had done in the past, Young continued to ignore direct instructions and remained intent on doing things his way, despite the harm his plans caused to the Firm. For example, clients often inquired about their ability to minimize their risk when they investigated CMBS transactions. One theoretical method of minimizing risk was known as the "inverted Y." That structure was used once by Morgan Stanley in a transaction between two clients who knew each other well, but it was ultimately decided that it would not be appropriate for the vast majority of SPG's deals because the costs of the transaction outweighed the potential savings. Friend spoke with Young and Louis Colosimo shortly before they did a pitch for a client, making his hesitation clear and instructing Young ***not*** to talk about the inverted Y structure. However, Young ignored this instruction and suggested the inverted Y structure to the client during the pitch. Friend learned this from Colosimo, who called to express his disbelief that Young had brought up the transaction despite Friend's instructions.

In a typical inverted Y structure, the non-investment grade bonds are kept separate from the investment grade bonds and each party executes a side agreement promising to pay the other party back should their lesser bonds erode their own side of the transaction and start to affect the joint assets. In Young's proposed inverted Y transaction, there were multiple clients who were new to CMBS transactions. This would have required separate side agreements between a number of clients that did not know each other and were unfamiliar with CMBS issues; there was no guarantee that everyone would honor their commitment – or be around long enough – to reimburse the others for any losses. After Young's meeting, the execution team had to go back and explain to clients why this structure would not work, creating more work for them and discrediting them in front of clients.

Young also claimed credit for work others did. Young passed out sheets at budget meetings listing revenue he had supposedly generated or revenue he could potentially earn from the clients he covered, prompting Gail McDonnell to remind him that "there is no I in team" and to ask him pointedly who else worked on those accounts with him. On another occasion, Young's colleague Andrew Berman came up with the idea of offering clients a retained yield contract. Young heard this and began calling on clients without Berman and telling them that it was his idea. Friend investigated and, upon discovering that Young was in fact passing off Berman's idea as his own, confronted Young. Friend was forced to explain to Young something that should have been obvious to anybody in Young's position: Young should have given Berman credit and included him in meetings with clients to whom Young wanted to pitch the idea.

(f) Young's Incessant Focus On His Compensation Undermined His Work.

Central to Young's claim are his allegations that he was promised and earned an "outsized bonus" for 2002. But neither Friend nor McDonnell – nor any other Morgan Stanley employee – ever promised Young an "outsized bonus" at "the next level" or anything similar in 2002 or any other year. To the contrary, Young's supervisors repeatedly made it clear to Young that he was not on track for more pay unless he was able to significantly improve his work (which he failed to do). Of course, bonus payments were also tied to the overall performance of the Firm, which had a down year in 2002.

When Young worked for Friend, he repeatedly set up meetings with Friend to discuss his desire to get paid and promoted.[3] These meetings began in January or February of 2002 – after Young received a 2001 bonus that he felt was inadequate – and occurred approximately every other month. At the initial meeting, Young thanked Friend for "saving" him from his last department. Despite the fact that he clearly needed "saving," due to his performance in the Principal Group, Young went on to complain that he felt that his 2001 bonus was low because people in the Principal Group did not like him. Friend explained to Young that, if anything, his 2001 bonus had been overly generous because, Young was not responsible for almost any revenue at that time; nevertheless he had received a substantial bonus, which Friend explained to him was based on the fact that the Firm and the group were doing well.

During the meetings that Young arranged, he repeatedly told Friend of his desire to receive higher pay and a promotion and asked Friend for specific ways to accomplish his goals. Consistent with the typical practice at Morgan Stanley, Friend never stated that there were any guarantees of bonus levels or promotions. Friend did explain to Young that Managing Directors typically generated at least $20 million per year, but that they also had to have other significant leadership skills. In addition, Friend pointed out that the level of pay and the opportunity for promotion were contingent on other Morgan Stanley departments making their respective budgets.

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[3] On top of the meetings that Young initiated, McDonnell encouraged Friend to conduct regular meetings with Young because she felt Young needed additional supervision. During these sessions, in addition to discussing client coverage issues, Young would often raise complaints about other employees.

Far from suggesting that Young had what it took to go to "the next level," Friend reminded Young that he was not even meeting expectations for his then-current position. Friend pointed out that an Executive Director in Young's position should be generating, at the very least, $10 million per year. In the previous year, by contrast, Young generated virtually nothing. Along those lines, Friend mentioned that the AXA Financial agribusiness deal would be a great transaction to help Young increase his revenue because it was worth $3 million. He did *not* promise Young a bonus of any size for simply landing or closing that transaction, which was obviously part of the basic job that Young was expected to perform.

Young also made a practice of discussing his bonus and promotion potential with Gail McDonnell. He complained to her a few times a year that he was underpaid. McDonnell repeatedly explained to Young that, especially in a down year like 2002, nearly everyone at Morgan Stanley felt underpaid. She acknowledged that there were times when other firms on Wall Street paid more and that each person had to evaluate those higher paying opportunities as they came along. Far from promising Young a promotion, McDonnell indicated to Young that he was not under consideration for promotion to Managing Director and that his overall performance needed to improve significantly before he would be considered seriously for such a promotion.

It would, moreover, make no sense for McDonnell or Friend to make the promises claimed by Young. The use of a revenue target alone is an inaccurate measure for promotions at Morgan Stanley. Promotion decisions are based upon many factors other than revenues, including leadership, people management, teamwork, respect for individuals and cultures, integrity, client-centricity, professional skills, innovation, contribution to the Morgan Stanley community, and commercial orientation, as well as whether the role the individual is performing is one that warrants an officer at the Managing Director level. Moreover, proposed promotions are reviewed by numerous levels of Firm management. Even strong candidates, whose promotions are supported by their groups, are often eliminated from contention as the process progresses. Because Friend and the other Managing Directors in SPG do not control the promotion process after they select their own candidates, Young's claim that "Friend and other Morgan Stanley Managing Directors directly promised and represented to Spencer that he would be . . . promoted to 'the next level'" is even more unrealistic. (Claim at 6.)

Gail McDonnell certainly never promised Young that "his bonus would be increased to 'the next level'" if he "convert[ed] new SPG clients." (Claim at 5.) In any event, there is no defined "next level" for bonuses, which are discretionary. Similarly, Warren Friend never promised or represented to Young that "he would receive an 'outsized bonus' at the next level for fiscal year 2002" for his work relating to the AXA Financial agribusiness transaction.[4] *Id.* These alleged promises do not even have the ring of truth. Setting aside the fact that neither

[4] Even Young is unsure of the details involved in the alleged promise he claims Friend made. At one point, Young claims that he would get this outsized bonus "if he were able to *land* the AXA Financial agribusiness transaction." (Claim at 5) (emphasis added). Two paragraphs later, Young alleges that he "would receive a 2002 'outsized bonus' . . . if he were *able to close* the AXA Financial agribusiness transaction." *Id.* (emphasis added).

13-1

McDonnell nor Friend would ever make such promises to any employee – let alone to a low performer like Young – it is well known that direct managers do not even have sole discretion in setting their employees' bonuses and the phrases Young cites have no particular meaning at Morgan Stanley or in the industry.

13-2

Moreover, total compensation decreased significantly at Morgan Stanley in 2002 as compared to 2001. Bonuses routinely vary widely depending on the performance of the market, the profitability of the Firm and its various groups, and each individual employee's successes and failures. In 2002, compensation paid to non-exempt employees in SPG declined by 24.5% from 2001.[5] Compensation paid to Executive Directors in SPG decreased by 25.1%, while the Executive Directors in SPG Finance – the group Young worked with – took a 27% pay cut over that same time frame. Every single Executive Director in SPG Finance took a pay cut in 2002. For an employee whose performance was as weak as Young's, Young's claim that he deserved an "outsized" bonus is nothing short of preposterous.

13-3

Finally, although Young baldly asserts that Morgan Stanley induced him to stay with the Firm with promises of a bonus and promotion, Young never indicated that he had any competing offers of employment. And certainly Morgan Stanley never induced Young to abandon other offers or made any promises that Young could have reasonably "relied" upon to forego better offers. To the contrary, during Young's 2001 performance evaluation, when Young expressed his unhappiness about the many areas of improvement that were noted by his supervisors, Friend said that if Young did not like what he was doing and wanted to leave, Friend would let him keep his job while he looked for a new one. Young declined Friend's offer, stating that he wanted to work on improving his situation at Morgan Stanley. Unfortunately, Young did not show the necessary improvement in 2002.

(g) Young's Defamation Claims Are Totally Without Merit.

13-4

Young's defamation claims are vague and without merit. Morgan Stanley has not defamed him in any way. Presumably in an effort to mask the weakness of his claims, Young offers blanket assertions instead of concrete details that would permit adequate investigation. Young claims that "after Morgan Stanley conveyed to the financial institution false and defamatory information about Spencer, the financial institution withdrew its conditional offer of employment." (Claim at 10.) This allegation is impossibly vague, as it does not identify the purported offer or the supposedly "false and defamatory" information that was supposedly conveyed. Suffice it to say that there is no evidence that anybody at Morgan Stanley made any false statements about Young in any context, and it is impossible to evaluate Young's vaguely worded claim in any greater detail.

[5] These calculations are based on employees who worked for the Firm in both 2001 and 2002.

(h) Ultimately, Young Was Terminated Because of Economic Conditions and His Poor Performance.

2002 was a very difficult year across Wall Street and at Morgan Stanley. The markets were down and the economy was soft. In an effort to right-size the organization and keep the company profitable, Morgan Stanley was forced to let go of a number of employees. The November 20, 2002 Reduction in Force (the "RIF") included many senior level employees in an effort to significantly reduce the Firm's compensation expenditures.

At the time that McDonnell and Friend learned of the RIF, Friend had already been speaking with Human Resources since early in the year regarding concerns about Young's performance. It had already been discussed in the April meeting that Young could not get along with others and that he did whatever he wanted to do, despite the ramification to the Firms. In yet another effort to encourage Young to improve and help him overcome his inability to recognize his performance issues, Friend conducted a special mid-year review of Young. This unusual practice generally is reserved for problem employees. As Friend gathered data for the review, four consistent themes emerged from conversations with Young's co-workers: Young had "team player issues;" he operated according to "his own agenda;" he used "overly aggressive tactics w[ith] clients;" and he demonstrated a "lack of judgment." ([illegible] F, at 1) As reflected in notes from Friend's midyear review meeting with Young, Friend informed Young that "I don't have a platform for you to move into to make MD" and that Young should "expect comp[ensation] down." (*Id.* at 2.)

As Young had done throughout his tenure at Morgan Stanley, he had alienated many of his colleagues in the Finance Group by 2002. Accordingly, when the RIF was announced to senior management, several people who were familiar with Young's history and performance called Friend to suggest that he consider Young for the RIF. Friend then carefully examined how his department could function with fewer employees. In addition to all of his teamwork, judgment and trust issues, Young lacked the execution skills that Andrew Berman, the other coverage officer, possessed. While Young had strong relationships with certain accounts, Friend realized that those relationships would be easier to replace than the ones Berman had developed. McDonnell, Westerfield and Tufariello all agreed that selecting Young for the RIF was the proper decision.

Morgan Stanley was more than generous to Spencer Young over the course of his employment. Instead of terminating him when he did not succeed at conduit lending, the Firm found him another position under Friend. But Young did not work as a cooperative member of the CMBS team or improve upon the other problems that had consistently plagued him during his time at Morgan Stanley. These recurring performance issues, coupled with his relatively low productivity, made Young a natural candidate for the RIF. And despite all of these facts, Morgan Stanley still offered Young a severance package worth more than $328,975 when he was released.