Regulator Says Morgan Stanley Withheld E-Mail in Cases

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The NASD, the nation's largest self-regulatory organization for the securities industry, accused Morgan Stanley yesterday of routinely failing to provide e-mail messages to aggrieved customers who had filed arbitration cases against the firm over three and a half years and with making false claims that millions of e-mail messages in its possession had been lost in the Sept. 11 attack on the World Trade Center.

The regulator also contended in its complaint against Morgan Stanley that the firm regularly destroyed millions of e-mail messages by overwriting its backup tapes and by allowing employees to delete messages. Securities and Exchange Commission rules require that firms keep all e-mails and business communications for three years.

Morgan Stanley's failure to provide e-mail messages relating to arbitration cases began in October 2001, the NASD said, and extended through March 2005. While claiming that the World Trade Center disaster had destroyed many of its e-mail messages, Morgan Stanley actually held millions of pre-Sept. 11 e-mail messages that were restored to its system from backup tapes shortly after the attack, NASD said.

Many other of the firm's e-mail messages were maintained on individual users' computers and therefore were not affected by the attacks, regulators said. Yet Morgan Stanley often failed to search those computers when responding to document requests.

"We think what happened here was unprecedented," said James S. Shorris, head of enforcement at NASD. "The firm's actions undermined the integrity of the regulatory and arbitration processes, potentially leaving in question the validity of the outcomes in hundreds of cases."

Rather than ask that Morgan Stanley pay a fine to settle the case, NASD has asked that it be required to provide relief to arbitration claimants whose cases might have been helped by the e-mail that was missing or not produced.

"Our principle objective here is to help the aggrieved parties, the individuals," Mr. Shorris said. That could include asking for payments to be made to claimants, he said, or for a process to be established where aggrieved investors could bring their cases to a neutral party.

During the three and a half years that Morgan Stanley failed to produce e-mail messages, more than 1,000 arbitration cases were filed against the firm. It is not clear how many of

those involved missing or unproduced e-mail, but Mr. Shorris estimated the number as "sizable." Because arbitration cases are almost never overturned, reopening customer cases against Morgan Stanley would be highly unusual.

A Morgan Stanley spokesman said the firm had made extensive efforts to settle the NASD matter, but that the NASD's "disproportionate and unprecedented demands" left it no choice but to litigate.

"The 9/11 attacks destroyed the firm's legacy Dean Witter e-mail servers and archives," Morgan Stanley said in a statement. "When prior management learned there were still backup e-mails from that era that might bear on arbitrations, it informed regulators, plaintiffs' counsel and outside counsel; built searchable databases; produced newly discovered e-mails; and cooperated fully with the NASD's review."

The firm has a month to respond to the complaint; the case will then be assigned to an NASD hearing officer who will preside over it with two securities industry officials.

NASD also noted in its complaint that Morgan Stanley failed to produce e-mail that was the subject of regulatory requests. For instance, in an investigation by NASD into the firm's fee-based brokerage practices, Morgan Stanley falsely claimed that it did not have pre-October 2001 e-mail and failed to produce over 12,000 e-mail messages and attachments that NASD had requested, the regulator said.

By the time the firm conducted the search that led to the production of the e-mail, the firm had already deleted millions of other messages from its servers and the regulatory matter at issue had been settled, NASD said.

A person briefed on Morgan Stanley's position said that the firm's failure to produce and retain e-mail in the period covered by the NASD case was not intentional, but reflected a miscommunication between information technology employees and the firm's legal department.

But Morgan Stanley has had a history of failing to comply with discovery obligations in arbitration proceedings, NASD said. In 1998, NASD censured and fined the firm $10,000 for violating rules about document production and in 2004, it censured and fined the firm $250,000 for failing to comply with discovery requests. In both cases, Morgan Stanley neither admitted nor denied the allegations.

"To use a terrorist attack to deny claimants documents in arbitration proceedings —that is about as low as you could possibly get," said Steven B. Caruso, a lawyer at Maddox, Hargett & Caruso and president of Public Investors Arbitration Bar Association.

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