

**NASD
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	
	:	
v.	:	Disciplinary Proceeding No. 2005001449202
	:	
MORGAN STANLEY DW, INC., (BD No. 7556),	:	Hearing Officer --
	:	
Respondent.	:	

Note for electronic delivery of this complaint:

The issuance of a disciplinary complaint represents the initiation of a formal proceeding by NASD Regulation in which findings as to the allegations in the complaint have not been made and does not represent a decision as to any of the allegations contained in the complaint. Because this complaint is unadjudicated, you may wish to contact the respondent before drawing any conclusions regarding the allegations in the complaint.

COMPLAINT

The Department of Enforcement alleges:

SUMMARY

1. For a three-and-a-half year period, from October 2001 through at least March 2005, respondent Morgan Stanley DW, Inc. (MSDW) routinely failed to provide e-mails to arbitration claimants and regulators in response to discovery obligations and regulatory inquiries. After the firm's e-mail servers in New York City were destroyed on September 11, 2001, the firm restored millions of e-mails by using back-up tapes. Many other e-mails, moved from servers onto individual users' computers, were not affected by the events of September 11. Nevertheless, MSDW routinely failed to provide pre-September 11, 2001 e-mail in numerous

customer arbitration proceedings and in response to regulatory inquiries, falsely claiming that its pre-September 11, 2001 e-mail had been destroyed.

2. In addition to failing to produce e-mail in numerous arbitrations and regulatory matters, and falsely stating that such e-mail had been destroyed, MSDW later destroyed many of the same e-mails. Instead of preserving the e-mail back-up tapes that had been used to restore its servers, MSDW put those tapes back into use, overwriting and permanently erasing their contents. The firm also allowed the e-mails that had been restored to the firm's servers to be permanently deleted by users of the firm's e-mail system over an extended period of time. As a result, between September 2001 and March 2005, millions of pre-September 11, 2001 e-mails that had been available to the firm were lost.

3. By virtue of the conduct set forth herein, MSDW violated NASD rules by failing to comply with its obligations to produce documents both to claimants in discovery in arbitration proceedings and to regulators, and by falsely representing that documents in its possession did not exist. MSDW also violated the recordkeeping requirements of the federal securities laws and NASD rules by erasing millions of those same documents. MSDW also failed to establish and maintain systems and written procedures to supervise the activities of its employees and the types of business in which it engages, which were reasonably designed to ensure compliance with the recordkeeping requirements and with its obligations to respond completely and truthfully to regulatory requests and to discovery requests in arbitration proceedings.

THE RESPONDENT

4. MSDW is a full-service broker-dealer and, through predecessor entities, has been registered with NASD since October 16, 1936.

5. MSDW has a history of prior disciplinary action for failure to comply with discovery obligations in arbitration proceedings. NASD issued a Letter of Acceptance, Waiver, and Consent (AWC) in May 1998 finding that Dean Witter Reynolds, Inc., which merged with Morgan Stanley & Co., Inc. in 1997 to form MSDW, had violated Conduct Rule 2110 as a result of its failure to comply with (i) an order of an arbitration panel requiring the firm to produce documents and (ii) provisions of the Code of Arbitration Procedure. The firm was censured and fined \$10,000. In July 2004, NASD issued another AWC finding that MSDW failed to comply with its discovery obligations in various arbitration proceedings. The firm was censured, fined \$250,000, and ordered to undertake certain remedial measures. MSDW also has a history of prior disciplinary action for failure to comply with the supervisory requirements imposed by NASD rules.

FACTS AND VIOLATIONS

FIRST CAUSE OF ACTION

Providing False Information and Failing to Produce E-Mails in Response to Requests from Claimants and Regulators

Violations of Conduct Rule 2110, Procedural Rule 8210, and IM-10100 Under the Code of Arbitration Procedure

6. When e-mails were created and sent on MSDW's system, they "existed" on e-mail servers. They could be viewed by recipients by opening their Microsoft Outlook "Inboxes" or by senders opening their "Sent Items" mailboxes. These items, although viewable by the users, were not physically present on the users' computers, but were actually stored in "mailboxes" on "servers." When a user moved a "sent" or "received" e-mail into a folder, it was effectively deleted from the server and moved onto the user's hard drive, viewable in Microsoft Outlook under Personal Folders. The servers were backed up on a daily basis, resulting in the

creation of a “mirror image” of the content of the servers, which would include the contents of users’ Inboxes and Sent Items folders. The back-up tapes were disaster recovery tapes, to be used for restoration of the e-mail system in case of its destruction or loss. In addition, as an e-mail was sent or received by the MSDW system, a copy was automatically made and stored on one of two archive servers. The archive system was designed to be used for responding to discovery and regulatory requests. The content of the archive servers was also copied onto back-up tapes on a daily basis and sent offsite for storage.

7. All of MSDW’s e-mail servers, including its archive servers and archive tapes, were destroyed on September 11, 2001. E-mails that users had moved into personal folders on individual computers for all employees located outside of the World Trade Center were not affected.

8. MSDW was able to rebuild its e-mail system in a new location by September 17, 2001, by using back-up tapes that had been created in the normal course of business after the close of business on August 30, 2001 (which were the most recently-created back-up tapes still in existence). By using these tapes, MSDW was able to restore 11 of its 12 servers. These tapes contained millions of e-mails. Due to technology problems, MSDW was unable to reload the data from the 12th server’s back-up tapes until 2006.

9. When MSDW’s e-mail system was restored on September 17, 2001, the system contained the e-mails that had been on the system as of the close of business on August 30, 2001, with the exception of those on the 12th server. MSDW restored to its system millions of pre-September 11, 2001 e-mails. When MSDW employees logged onto the firm’s e-mail system on or after September 17, 2001, their mailboxes, including their Inboxes and Sent Items folders, contained whatever e-mails had been there as of the close of business on August 30, 2001, with

the exception of those on the 12th server. All users of MSDW's e-mail system were thus able to see those e-mails on their computers as of September 17, 2001.

10. MSDW's Messaging Team within the Technology Department was responsible for repairing the messaging system and restoring the e-mail to MSDW's system. Personnel on the Messaging Team knew that pre-September 11, 2001 e-mail had been restored to the firm's servers and was available to respond to requests for e-mail. In fact, a senior member of the Messaging Team, out of an apparent concern that such e-mail could have been modified, decided not to place the restored e-mails into an archive for use in responding to requests or even to retain the tapes used to restore the e-mails to the message system, and discussed his decision not to do so with at least one high ranking Compliance official. As described above, the e-mail was still available, however, on the firm's servers.

11. For over three-and-a-half years, from October 2001 through March 2005, MSDW routinely told claimants in arbitration proceedings and regulators that it had no pre-September 11, 2001 e-mails. In fact, millions of such e-mails had been recovered from back-up tapes and restored to the firm's e-mail servers and were available to respond to requests for e-mail. Still more were available on individual users' hard drives on their computers.

12. MSDW failed to produce pre-September 11, 2001 e-mail, and falsely represented that such e-mail had been destroyed, in numerous arbitration proceedings brought against the firm during the three-and-a-half year period from 2001 through March 2005. As a result, documents subject to discovery requests in numerous customer arbitration proceedings were not provided to claimants. Numerous arbitration proceedings were therefore concluded without the benefit of potentially valuable evidence that MSDW possessed but falsely denied having.

13. MSDW also failed to provide pre-September 11, 2001 e-mail to NASD when NASD requested it pursuant to NASD Procedural Rule 8210 and falsely represented to NASD that the firm had no such e-mails. In response to a March 11, 2004 Rule 8210 request for e-mails as part of an NASD investigation into MSDW's fee-based brokerage practices, MSDW falsely asserted, in a letter from counsel dated March 27, 2004, that pre-October 9, 2001 "external e-mails were maintained in the World Trade Center and destroyed on September 11, 2001." Moreover, even after MSDW discovered in March 2005 that it had sources of pre-September 11, 2001 e-mail that should have been produced to regulators and claimants, MSDW did not tell NASD investigative staff working on the fee-based brokerage case that it had falsely stated that pre-September 11, 2001 e-mail had been destroyed or that it had failed to produce such e-mail. In fact, MSDW entered into a settlement with NASD of the fee-based brokerage matter, issued in August 2005, without telling the investigative staff working on that case of the existence of pre-September 11, 2001 e-mail or producing e-mails responsive to NASD's request in the case. Later in 2005, after the settlement of the fee-based brokerage case, NASD staff requested, in connection with the investigation that led to the filing of this complaint, that MSDW produce e-mail responsive to the prior request in the fee-based brokerage case. MSDW then produced over 12,000 e-mails and attachments that should have been produced in response to NASD's March 2004 request. By the time the firm searched for those e-mails, many millions of restored e-mails had already been deleted from the firm's servers.

14. MSDW also failed to produce pre-September 11, 2001 e-mail to other regulators, and falsely told other regulators that such e-mail had been destroyed. For example, on October 8, 2001, the New York Stock Exchange (NYSE) issued Information Memo No. 01-34, requiring member firms whose books and records had been maintained at the World Trade Center to

“prepare a list of the types of books and records required to be maintained pursuant to NYSE Rule 440 and [Securities Exchange Act] Rules 17a-3 and 17a-4 (and time periods affected) that were permanently destroyed.” By letter dated November 28, 2001, MSDW told the NYSE that it “lost e-mails sent to or from the World Trade Center complex....” On May 1, 2002, MSDW supplemented this response in another letter, stating that “our Communications Group informed me that storage of our E-mail records were also lost.” In September 2002, MSDW partially corrected this statement by informing the NYSE that some e-mails existed on individual users’ hard drives, but failed to mention that many more pre-September 11, 2001 e-mails existed on the firm’s servers or that pre-September 11, 2001 e-mails existed on back-up tapes which were constantly being erased and reused to store more recently created e-mails. MSDW waited until April 2005 to inform the NYSE that its servers contained pre-September 11 e-mails.

15. In response to a subpoena issued by the Massachusetts Securities Division on September 5, 2003 calling for the production of e-mails sent to or received by five specified individuals from June 2000 through the date of the subpoena, MSDW produced external e-mails from October 9, 2001 forward. Counsel stated in the cover letters, dated October 2, 2003 and October 6, 2003, that “[e]arlier external emails were maintained in the World Trade Center and destroyed on September 11, 2001.”

16. In responding to requests for e-mails from claimants and regulators, MSDW failed to search its exchange servers for the e-mails that had been restored by September 17, 2001, notwithstanding the fact that there were millions of e-mails restored to the system that could have been searched.

17. In addition, MSDW failed to regularly search user hard drive folders when responding to requests for e-mail. The firm instead left the decision as to whether to search hard

drive folders to individuals conducting those searches, including in-house counsel, outside counsel, paralegals, and branch office employees. Moreover, outside counsel were not routinely told about this potential source of documents until 2004, and the firm did not provide training to the branch personnel who were often relied upon to conduct searches for e-mails.

18. Notwithstanding the fact that potentially responsive e-mails existed on the restored e-mail servers and on user hard drives, MSDW routinely responded to requests for e-mails with the false statement that “All e-mails sent to or received from third parties that were previously stored by the firm at the World Trade Center and that predate October 9, 2001 [when the new archive began capturing e-mail] were destroyed,” or similar language. This response was false because millions of those e-mails had in fact been recovered from the back-up tapes and restored to the firm’s servers. In addition, although MSDW told numerous arbitration claimants that it would search hard drives in branch offices, it did not inform all requestors of that potential source of e-mails, leading them to believe that there was no potential source for pre-October 2001 e-mails.

19. MSDW violated NASD Conduct Rule 2110 by falsely telling numerous arbitration claimants that all pre-October 2001 e-mail had been destroyed, when in fact millions of such e-mails existed on the firm’s e-mail servers, back-up tapes, and hard drives, and by failing to conduct an adequate search of those sources in responding to requests for e-mails in arbitration proceedings. MSDW also violated Rule 2110 and IM-10100 of the Code of Arbitration Procedure by failing to produce documents in its possession in response to discovery requests in numerous arbitration proceedings.

20. MSDW violated Procedural Rule 8210 and Conduct Rule 2110 by falsely telling NASD that pre-October 9, 2001 e-mail had been destroyed when in fact the firm possessed

millions of such e-mails, by failing to conduct an adequate search of sources of e-mail in responding to an NASD Procedural Rule 8210 request for e-mails, and by failing to produce documents in its possession called for by an NASD Procedural Rule 8210 request. MSDW separately violated Conduct Rule 2110 by falsely telling other regulators, such as the NYSE and the Massachusetts Securities Division, that pre-October 2001 e-mail had been destroyed and by failing to produce such e-mail in response to requests by regulators.

SECOND CAUSE OF ACTION

Failure to Preserve Required Books and Records

Violation of Section 17(a) of the Securities Exchange Act of 1934, Rule 17a-4 Thereunder, and NASD Conduct Rules 2110 and 3110

21. Paragraphs 1 through 20 are repeated and re-alleged herein.
22. In addition to misrepresenting the availability of pre-September 11, 2001 e-mail and failing to produce such e-mail in arbitration proceedings and to regulators, MSDW allowed millions of those e-mails to be deleted, in violation of its recordkeeping obligations. After restoring the e-mail to its servers, MSDW took no steps to ensure that the e-mails were retained and even allowed users to permanently delete the e-mails from MSDW's systems. In fact, it made the affirmative determination not to preserve the restored messages or the tapes used to restore them to the servers. As a result, by March 2005, millions of e-mails that had been restored to the firm's systems after September 11, 2001 had been permanently deleted, leaving only approximately 500,000 of the e-mails on the servers.
23. When MSDW put its archive system back into operation on October 9, 2001, the archive did not have any initial content, because the earlier archive and the back-up for that content had been destroyed. It did, however, have server back-up tapes (which held the current

content of the users' Inboxes and Sent Items folders, but not the historical archives) that could have been used to restore a substantial portion of the archive.

24. After MSDW restored its e-mail system, the firm, through its technology Vice President responsible for messaging systems, decided not to use the millions of e-mails recaptured from the server back-up tapes to restore its archive, or even to retain the server back-up tapes, but instead put the tapes immediately back into the back-up rotation. This resulted in the tapes being overwritten, and their content permanently lost, beginning shortly after September 17, 2001.

25. In addition, the firm failed to take affirmative steps to ensure that e-mails that had been restored to its systems after September 11, 2001 were retained. This failure covered two categories of e-mails – those that were restored to user mailboxes on September 17, 2001, and those that users had moved out of their Inboxes or Sent Items mailboxes and into folders on their hard drives. MSDW failed to require employees to retain any such e-mails, many of which were the only remaining versions of the e-mail.

26. In addition, MSDW failed to preserve e-mails stored on the computers of departing employees, notwithstanding the fact that employees might have moved e-mails into folders on their hard drives, either before September 11, 2001, or after those e-mails had been restored on September 17. Instead of treating these sole remaining copies of e-mails as communications covered by the books and records provisions, the firm routinely eliminated the e-mails of departing employees who were not currently the subject of pending or anticipated litigation.

27. As a result of these failures, MSDW allowed many e-mails which had been restored to its systems to be deleted by users and destroyed millions of e-mails by overwriting

the back-up tapes from which the e-mail servers had been restored. Between October 9, 2001 and March 2005, at least 7.8 million pre-September 11, 2001 e-mails were deleted from the firm's servers.

28. By virtue of this conduct, MSDW failed to keep electronic communications for three years and to preserve electronic mail communications for the first two years in an accessible place, in violation of Section 17(a) of the Securities Exchange Act of 1934, Rule 17a-4 thereunder, and NASD Rules 2110 and 3110.

THIRD CAUSE OF ACTION

Failure to Establish and Maintain Systems and Written Procedures Reasonably Designed to Preserve Required Records and to Ensure that MSDW Conducted Adequate Searches in Response to Regulatory Inquiries and Discovery Requests for E-Mail

Violation of Conduct Rules 2110 and 3010(a) and (b)

29. Paragraphs 1 through 28 are repeated and re-alleged herein.

30. During the period from 2002 through at least March 2005, MSDW failed to devise any formal procedures requiring employees to retain e-mails for any period of time. The firm's 2001 Code of Conduct, which contained the only document-retention provision applicable to e-mails, contained a general statement on page 15 that employees should "review files periodically to ensure that information is current and essential; and consistent with document retention policies and applicable law, discard drafts, notes, notebooks, diaries, telephone logs, message slips and other documents when they are no longer useful or current." The 2001 Code of Conduct further stated that documents should not be discarded if they are:

documents that must be kept for specific periods of time under applicable laws or regulations (guidance concerning which can be obtained from Law or Compliance); documents that are the subject of a subpoena or document request; or documents that are potentially relevant to a lawsuit or an investigation that has been or may be initiated.

The firm's procedures contained no list of what needed to be retained and no indication that e-mails needed to be kept.

31. By failing to implement any procedures addressing the retention of e-mails, MSDW failed to prevent the destruction of the pre-September 11, 2001 e-mails that had been restored to its system. Instead, the firm allowed employees to delete millions of those e-mails from the firm's e-mail servers or their individual hard drives. In addition, the firm failed to adopt procedures to prevent the overwriting of the back-up tapes that contained pre-September 11, 2001 e-mails.

32. MSDW also did not have adequate systems or procedures governing searches for e-mail in response to discovery requests in arbitration proceedings and regulatory inquiries. For instance, the firm failed to adopt procedures requiring that the firm's e-mail servers or e-mail folders maintained on individual users' hard drives be searched.

33. By virtue of its failure to establish and maintain systems and written procedures to supervise the activities of its employees and the types of business in which it engages that were reasonably designed to achieve compliance with the record keeping requirements for e-mails, and with its obligations to respond completely and truthfully to regulatory requests and to discovery requests in arbitration proceedings, MSDW violated Conduct Rules 3010(a) and (b) and 2110.

PRAYER

WHEREFORE, the Department of Enforcement, respectfully requests that the Hearing Panel:

- A. order that one or more of the sanctions provided under NASD Rule 8310(a), including monetary sanctions, be imposed;

- B. order additional relief appropriate to redress the harm suffered by arbitration claimants;
- C. order that the Respondent bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with NASD Rule 8330; and

- D. impose any other fitting sanction.

Dated: December 19, 2006

Respectfully submitted,

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