

FINANCIAL SERVICES

Costly disclosure?

Morgan Stanley may face onslaught of lawsuits after admitting it withheld e-mail evidence in arbitration cases

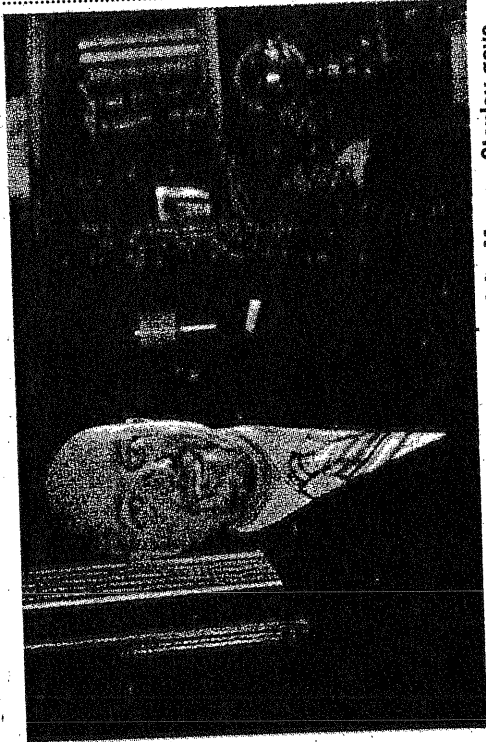
by **Jordana Mishory**
jmishory@a1m.com

Attorneys say they are gearing up to file hundreds of lawsuits against Morgan Stanley for allegedly hiding evidence from clients who filed arbitration claims.

The planned suits follow a settlement last month between Morgan Stanley and the Financial Industry Regulatory Authority in which Morgan Stanley conceded it did not provide e-mails to claimants in arbitration proceedings from October 2001 to March 2005.

The nation's second-largest securities firm falsely claimed it lost the e-mail records when its servers were destroyed in the 2001 terrorist attack in New York City.

A high-profile Palm Beach Circuit fraud case brought by billionaire financier Ronald O. Perelman against Morgan



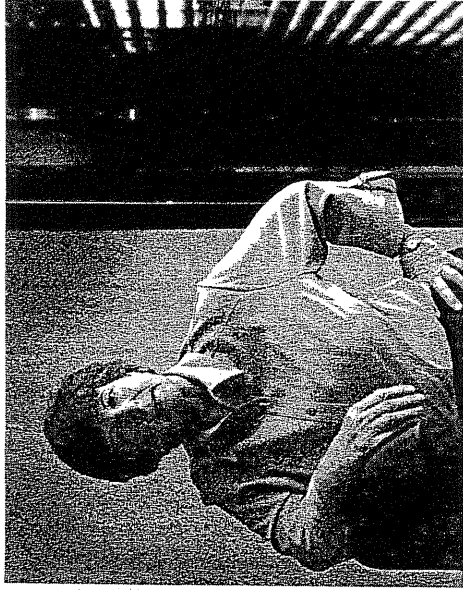
Darren Blum represents investors who claim Morgan Stanley gave them bad advice. 'We're showing how they cheated us in arbitration,' he said.

Stanley uncovered the existence of backup e-mail files.

In the regulatory case, Morgan Stanley agreed to pay \$12.5 million for the violation, including \$9.5 million for claimants' fund and \$3 million in FINRA penalties.

But that won't be the last money the financial services

giant will shell out for its indiscretion if plaintiff attorneys can help it. Investors who claim bad advice from Morgan Stanley caused them to lose hundreds of thousands of dollars couldn't prove their cases in arbitration without incriminating e-mails, attorneys say. They contend settlement payouts of \$3,000 to \$5,000 per claim doesn't come



Securities defense attorney Kathy Klock says investors will have to prove their cases were hurt by missing evidence.

close to making their clients whole again.

Attorneys intend to file new cases on behalf of claimants for spoliation of evidence and are gunning for punitive damages.

Attorneys for investors are banking on a line in a letter of acceptance, waiver and consent (AWC) in the FINRA settlement signed by Morgan Stanley stating it can't take any action "denying directly or indirectly any finding in this AWC or create the impression that the AWC is without factual basis."

Coral Springs attorney Darren Blum said all he has to do to prove his upcoming cases is walk into an arbitration panel waving the consent settlement, even though Morgan Stanley neither admitted nor denied the facts set out in it.

"You didn't have a fair shot at a hearing because the documents that would have helped your case that [Morgan Stanley] told you were destroyed in 9/11 were either sitting in a warehouse in Brooklyn that [it] knew about and didn't want to tell you, or 25 percent of those e-mails were written over so they were gone forever," said Blum, of Blum & Silver.

Blum uses the eye-catching Internet address SueMorganStanley.com to direct visitors to his law firm's Web site. He said his firm has already spoken to close to 100 clients and expects to file hundreds of lawsuits by year's end.

Fort Lauderdale securities litigator Jeffrey Sonn of Sonn & Erez estimates he has 50 clients whose cases were hurt and they are exploring lawsuits as an option.

"Investors deserve a new day in court and a fair opportunity to present their case," Sonn said. "By not getting these e-mails, which were potentially relevant in these cases, clients only got half a cup of justice, if that."

West Palm Beach securities defense attorney Kathy Klock said she expects a tidal wave of lawsuits but not because claimants were damaged by Morgan Stanley's conduct.

Klock, a partner at Fowler White Burnett, expects most cases will be without merit. She said an investor will have to explicitly demonstrate their case was hurt by the missing evidence, and she doesn't expect most investors to be able to meet that standard.

"It's unreasonable for someone that lost in arbitration to immediately assume that their case was impacted by this conduct and should be able to reopen their case," Klock said. "Our society is very litigious, and [people] have to accept the fact that they didn't have a critical claim and move on."

Morgan Stanley declined to comment through a spokesman. Representatives for FINRA did not provide comment by deadline.

A source familiar with Morgan Stanley's anonymity said FINRA settlements are not considered to have precedential value in future litigation. Claimants still would be required to prove fraud, and the settlement agreement did not say Morgan Stanley actions were fraudulent.

Dot-com aftermath

Investors began suing Morgan Stanley and other brokerages and investment banks after the dot-com bubble burst and the market went sour in 2000.

The lawsuits claimed investors lost hundreds of thousands of dollars because brokers misled them by pumping up Internet and tech stocks as their operations faltered and share values plummeted.

Former New York State Attorney General Eliot Spitzer launched an investigation of major investment houses including Morgan Stanley, Smith Barney and Merrill Lynch.

He was joined by the National Association of Securities Dealers, the Securities and Exchange Commission and other regulators. Their investigations concluded the research and investment banking arms of securities firms overlapped, encouraging bias by research analysts in favor of the banking side.

Morgan Stanley paid \$125 million to settle charges.

But when investors asked for e-mails on behind-the-scenes practices, they were told the electronic records had been destroyed when the World Trade Center towers collapsed after the 9/11 terrorist attacks.

A FINRA investigation concluded many e-mails were unaffected and Morgan Stanley personnel were aware of their existence.

Millions of e-mails were stored on backup tapes. But a number of the tapes were reused, "overwriting and permanently erasing most of their contents," according to Morgan Stanley's consent letter with FINRA that ended the investigation. Others e-mails were simply deleted.

Morgan Stanley also failed to provide updates to its policy and procedure manuals in a number of arbitration proceedings from 1999 to 2005. FINRA censured Morgan Stanley as a result.

Claimants who didn't receive e-mails and whose case closed before June 2005 are eligible for payment of \$3,000 to \$5,000 from the settlement fund.

They also can compel Morgan Stanley to

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produce e-mails in their cases and could receive up to \$20,000.

Claimants whose cases hinged on the policy and procedure manuals can receive \$1,500 to \$2,500 each.

Plaintiff attorneys claim the amounts don't make up for their clients' stock market losses. But the new cases have the potential to go beyond compensatory losses.

"We're not looking to prove anything with underlying stocks," Blum said. "We're showing how they cheated us in arbitration."

Massive punitive damages should be levied against Morgan Stanley for its actions, Blum said.

He is basing that partly on a landmark civil fraud trial in West Palm Beach, where a jury delivered Perelman a \$1.58 billion verdict against Morgan Stanley in May 2005.

The verdict came after Palm Beach Circuit Judge Elizabeth Maass limited Morgan Stanley's defense because of e-mail discovery abuses.

Maass became incensed when she learned Morgan Stanley was secretly reconstructing its old e-mail files and called a deposition by an in-house computer specialist "so misleading as to be false."

Morgan Stanley was sued for advising Sunbeam on its purchase of Perelman's Coleman camping equipment company. A massive accounting fraud was uncovered at Sunbeam a short time later, making

Perelman's Sunbeam shares worthless.

A split 4th District Court of Appeal panel vacated the award in March but let stand Maass' sanctions. The case has been appealed to the Florida Supreme Court.

Blum and fellow plaintiff attorneys said the discovery violations in Perelman's case illustrate a pattern of misconduct.

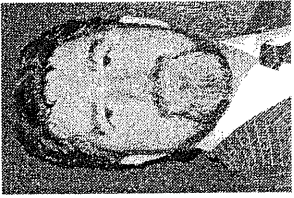
"The jury had awarded \$850 million in punitive damages in the case," Blum said. "That gives us a guidance of how much we're seeking in each individual case."

Sonn said the missing e-mails could be critical in a number of cases because of their content.

Favorable presumption

Attorney Jack Scarola, a partner at Searcy Denney Scarola Barnhart & Shipley in West Palm Beach who represented Perelman, said his firm also is evaluating individual cases to consider moving forward against Morgan Stanley.

The destruction of e-mails and the denial of their existence create a presumption that evidence favorable to claimants existed.



Sonn

"The mere destruction of evidence generally will give rise to adverse inference that what was destroyed was relevant to these claims," Scarola said. "I don't think it's necessary to say that on Oct. 23, 2003, an e-mail was sent and it related to the transaction that I am now basing a claim on."

Although Morgan Stanley clients have an opportunity to recover the e-mails in a new round of discovery, some were erased by Morgan Stanley, removing a potential smoking gun.

But defense attorneys insist plaintiffs must pursue the e-mail record if they want to receive more money on these claims.

"Not all e-mails hurt a defense case. Many e-mails help it," said Miami securities defense attorney Lawrence Kellogg. "Just because e-mails were missing doesn't follow that they were harmful to Morgan Stanley."

To him, the more disturbing part of the settlement was Morgan Stanley's failure to update its supervisory manuals. That combined with the "lost" e-mails and discovery violations in the Perelman case could be problematic.

But Klock said Morgan Stanley is the big-

ger "victim" in this case.

"Businesses and broker-dealers are frequently the subject of lawsuits because they have deep pockets," she said. "The fact that there were settlements does not mean there is any widespread issue at Morgan Stanley. It is often more economical to settle than endure ongoing litigation."

So far, Blum has filed one case on the basis of spoliation of evidence based on the investigations by Spitzer and the SEC.

The suit filed last fall claimed septuagenarian Helen Weiss lost about \$1.2 million because misleading Morgan Stanley research reports. Weiss settled for an undisclosed amount following the Sept. 24 settlement between Morgan Stanley and FINRA. She had previously won money in arbitration against Morgan Stanley.

Blum contends Morgan Stanley consented to an egregious spoliation of evidence, and its conduct will open the door to other cases.

In a tire liability case, "you preserve the tire," Blum said. "You can't go and burn the tire and say 'Ha-ha, you can't prove it's the tire because we burnt it and destroyed it.' In this case not only did Morgan Stanley spoil the evidence, but they hid the spoliation and lied about it." ■

Jordana Mishory can be reached at (954) 468-2616.