

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2005003527001

TO: Department of Enforcement
NASD

RE: Morgan Stanley & Co. Incorporated, Respondent, CRD No. 8209

Pursuant to Rule 9216 of NASD Code of Procedure, Morgan Stanley & Co. Incorporated, ("Morgan Stanley," the "firm," or "Respondent") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against Respondent alleging violations based on the same factual findings.

Respondent understands that:

- 1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council ("NAC") Review Subcommittee or Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;**
- 2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and**
- 3. If accepted:**
 - a. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against it;**
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Respondent's disciplinary record;**
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and**

- d. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any allegation in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects Respondent's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

Respondent also understands that its experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

Morgan Stanley is a Delaware corporation with its principal place of business in New York, New York. Morgan Stanley is a registered broker dealer and has been a member of NASD since 1970. Morgan Stanley engages in a nationwide and international securities business and provides securities underwriting services, sales trading services, merger and acquisition advisory services, private banking services and equity research.

In December 2002, Morgan Stanley entered into a settlement with NASD, in which Morgan Stanley consented to a finding that it (a) failed to keep electronic communications for three years and/or failed to preserve electronic mail communications for the first two years in an accessible place in violation of Section 17(a) of the Exchange Act, Rule 17a-4 thereunder, and NASD Rule 3110, and (b) had inadequate supervisory systems and procedures that were not reasonably designed to achieve compliance with Section 17(a), Rule 17a-4 thereunder and NASD Rule 3110 in violation of NASD Rule 3010. Morgan Stanley was censured and fined \$1.65 million (\$1,650,000).

I.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against it;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a

hearing panel, to have a written record of the hearing made and to have a written decision issued; and

- D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

II.

ACCEPTANCE AND CONSENT

- A. Morgan Stanley hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NASD:

Overview

This action relates to Morgan Stanley's failure to produce electronic communications in response to requests for information and documents made by the NASD in connection with certain regulatory investigations described below.

From April 2002 to at least September 2005 (the "relevant period"), the firm failed to produce tens of thousands of e-mails sought by NASD during certain NASD investigations. Morgan Stanley did not search diligently for back-up tapes containing responsive e-mails until 2005, well after being served with requests in the investigations described herein. As a result, Morgan Stanley failed to timely produce e-mails contained on thousands of back-up tapes. These back-up tapes were readily accessible to Morgan Stanley in its offices and the facilities of its off-site storage providers ("Storage Facilities"). To date, these tapes have yielded 14.3 million e-mails that Morgan Stanley had not previously searched in responding to the investigations. The firm also made misstatements

regarding the status and completeness of its productions and the unavailability of certain documents.

Morgan Stanley also did not timely produce e-mails sought in certain of these investigations because it delayed loading millions of e-mails into its searchable e-mail archive database ("the E-Mail Archive") and searching them for responsive e-mails. In addition, Morgan Stanley failed to produce responsive e-mails by over-writing back-up tapes after receiving NASD requests. Morgan Stanley's over-writing destroyed thousands of e-mails, including some e-mails that likely were responsive to NASD requests.

These repeated violations of the production obligations compromised NASD's ability to effectively investigate and determine whether Morgan Stanley had complied with NASD rules and the federal securities laws. Morgan Stanley's conduct delayed and prejudiced certain investigations by depriving NASD of evidence and potential sources of information relevant to those investigations for years, and in some cases, permanently.

Accordingly, Morgan Stanley violated NASD Rule 8210 and NASD Rule 2110.

Facts

I. NASD Issued Document Requests To Morgan Stanley For Its E-Mails And Back-Up Tapes Containing E-Mail

Beginning in April 2002, NASD issued requests for information pursuant to NASD Rule 8210 in its Research Analyst Investigation and certain other NASD investigations. Prior to 2003, e-mail sent or received by Morgan Stanley employees was backed-up on magnetic tapes. In early 2003, Morgan Stanley began using the E-Mail Archive, which preserved e-mails sent or received by Morgan Stanley employees on a going-forward basis in a database that was more readily searchable. The E-Mail Archive allowed Morgan Stanley to discontinue its use of tapes, which Morgan Stanley had used to back-up and search for e-mail sent prior to January 2003. Later in 2003, Morgan Stanley began loading its pre-2003 e-mails stored on back-up tapes into the E-Mail Archive so that its pre-2003 e-mails would be more accessible and more readily searchable ("the Migration Project").

A. The Research Analyst Investigation

In April 2002, the Securities and Exchange Commission ("SEC"), the NASD and the NYSE each commenced Research Analyst Investigations, which focused on whether certain broker-dealers, including Morgan Stanley, engaged in practices that created conflicts of interest for their research analysts' coverage of investment banking clients. On April 29, 2002, NASD sent a request to Morgan Stanley seeking e-mail for certain Morgan Stanley employees for the

period July 1, 1999 to June 30, 2001 ("the April 2002 Request"). In April 2003, NASD settled with Morgan Stanley. The investigations continued thereafter, focusing on the conduct of supervisors at Morgan Stanley.

On May 30, 2003, NASD issued a request under Rule 8210 to Morgan Stanley seeking all e-mails for certain members of the firm's senior management, including certain investment banking and research supervisors, for the period July 1, 1999 through June 30, 2002.

B. Other NASD Investigations

NASD conducted a number of other investigations of activities at Morgan Stanley in which it requested e-mail. In one investigation, NASD requested in December 2004 and January 2005, pursuant to NASD Rule 8210, that Morgan Stanley produce e-mails from July 2003 through August 2004. In the first quarter of 2005, Morgan Stanley produced some, but not all, e-mail responsive to this request because it did not conduct a wholly effective search of its E-mail Archive. Morgan Stanley thereafter produced thousands of responsive e-mails not previously provided to NASD, and recently informed NASD that it may continue to produce newly located e-mails through June 2006. In another investigation, NASD made numerous requests that Morgan Stanley produce e-mails for the period October 18, 1999 to March 17, 2000.

II. Morgan Stanley's Production Failures

A. Morgan Stanley Failed for Years to Produce E-Mail

Starting in or around May 2004 through July 2005, Morgan Stanley located over 10,000 back-up tapes, many of which contained e-mails for time periods covered by requests in the Research Analyst Investigation and at least one other NASD investigation. The newly found tapes included numerous 1999 e-mail back-up tapes. Morgan Stanley found most of these back-up tapes in locations where tapes that backed-up e-mail customarily were stored.

The 10,000 tapes included approximately 1,400 tapes found in one of Morgan Stanley's offices in Brooklyn, New York ("the Brooklyn Tapes") in May 2004. On July 16, 2004, the firm's tape restoration vendor informed Morgan Stanley's Information Technology ("IT") group that 112 of the Brooklyn Tapes contained a total of 2,183,331 "unique e-mails" (that is, e-mails that were not duplicates of other e-mails in Morgan Stanley's E-Mail Archive).

After its discovery of the Brooklyn Tapes, Morgan Stanley continued to find 1999 and 2000 back-up tapes that had not been searched previously. For example, in January 2005, one of Morgan Stanley's Storage Facilities informed the firm that it had located 169 back-up tapes. Those tapes contained e-mails for the period May 1999 through December 2000.

By July 2005, Morgan Stanley's tape restoration vendor had extracted 14.3 million unique e-mails from newly found tapes that included time periods covered by the NASD requests. The newly-located tapes have yielded thousands of responsive e-mails for the period from 1999 through 2002.

B. Morgan Stanley Failed For Months to Produce E-Mail Because It Delayed Loading E-Mails into Its E-Mail Archive System

Morgan Stanley failed for months to produce e-mail that it had located because it delayed loading e-mails into its E-Mail Archive. Morgan Stanley also made representations that its productions of e-mails were complete, when that was inaccurate. In about September 2003, Morgan Stanley began the Migration Project by directing its tape restoration vendor to harvest e-mails from pre-2003 back-up tapes and send the harvested e-mail to Morgan Stanley to be uploaded into the E-Mail Archive.

Morgan Stanley did not complete the Migration Project in April 2004. In fact, by August 2004, there was a large backlog of e-mail that had been extracted from pre-2003 back-up tapes, including the Brooklyn Tapes, at Morgan Stanley waiting to be loaded into the E-Mail Archive. Morgan Stanley treated the loading of e-mails into the E-Mail Archive as a low priority until mid-October 2004.

Morgan Stanley did not disclose until November 23, 2004 that potentially responsive e-mail had not been loaded into the E-Mail Archive. It was not until April 1, 2005 -- almost a year after Morgan Stanley had located the Brooklyn Tapes -- that Morgan Stanley began producing e-mails extracted from the Brooklyn Tapes and from other newly-located tapes.

C. Morgan Stanley Failed To Produce E-Mail by Recycling Back-Up Tapes Containing E-Mail

Testing by Morgan Stanley revealed that 341 of the 501 backup tapes selected by the SEC for testing from a total of 19,000 tapes could have contained e-mail requested by NASD Requests. Of these 341 tapes, twelve (12) had been over written after Morgan Stanley received NASD's April 29, 2002 request in the Research Analyst Investigation. The recycling of these 12 tapes destroyed thousands of e-mails, including some e-mails that likely were responsive to NASD requests. The recycling continued through at least December 2002.

D. Morgan Stanley's E-Mail Production Failures Prejudiced the NASD's Investigations

Morgan Stanley's production failures prejudiced the Research Analyst Investigation and other NASD investigations. By failing for years to find back-up tapes containing e-mail, including 1999 back-up tapes, by over-writing back-up tapes containing e-mail, and in at least one NASD matter described above in Section I.B. by conducting an ineffective search, Morgan Stanley deprived the

NASD of potential sources of evidence for years, and in some instances, permanently.

Violations and Sanctions

I. Violations

Failure to produce documents in NASD investigations (NASD Rule 8210). NASD Rule 8210 requires member firms such as Morgan Stanley to produce documents and information as requested by NASD staff. Each of the NASD requests described herein was issued pursuant to NASD Rule 8210. By virtue of the conduct described above, Morgan Stanley violated NASD Rule 8210.

Failure to Supervise (NASD Rule 3010). NASD Rule 3010 requires that a member firm reasonably supervise and control the activities of its employees and establish an adequate system of follow-up and review to ensure compliance with NASD rules and the federal securities laws relating to the production of e-mail. By virtue of the foregoing, Morgan Stanley violated NASD Rule 3010.

II. Sanctions

Morgan Stanley consents to the imposition of the following sanctions:

- a. A censure, and
- b. A fine in the amount of \$2,500,000.¹

Morgan Stanley further consents to undertake the following:

- a. Adopt and implement policies and procedures reasonably designed to ensure compliance with NASD Rule 8210 concerning the preservation and prompt production of electronic communications and inform the NASD staff in writing no later than ninety (90) days after Notice of Acceptance of this AWC that it has adopted and implemented such policies and procedures. Upon written request showing good cause, the NASD staff may extend the procedural date in this paragraph.

¹ Morgan Stanley has been ordered to pay a civil penalty in the amount of \$15 million in a proceeding brought by the SEC, provided, however that the SEC payment obligation is reduced by amounts paid pursuant to this AWC and any agreement with the NYSE. See final judgment entered in United States Securities and Exchange Commission v. Morgan Stanley & Co. Incorporated, Civil Action No. ___ CV ___ (___) (D.D.C.), Securities Exchange Act Release No. ___ -- (date).

- b. Provide annual training to its employees responsible for preserving or producing electronic communications requested by NASD. The first annual training shall commence no later than one hundred and fifty (150) days after Notice of Acceptance of this AWC, and the first annual training shall be completed no later than two hundred and forty (240) days after Notice of Acceptance of this AWC. Morgan Stanley agrees to videotape any live training sessions conducted during the first annual training. Upon written request showing good cause, the NASD staff may extend the procedural dates in this paragraph.
- c. Retain an Independent Consultant to conduct a review of the implementation and effectiveness of such policies, procedures and training referred to in (a) and (b) above, and such Independent Consultant shall provide written recommendations identifying improvements necessary to ensure the proper implementation and efficacy of those policies, procedures and training. The Independent Consultant shall submit written reports to the NASD.²

The sanctions imposed herein shall be effective on a date set by NASD staff.

III.

OTHER MATTERS

- A. Respondent understands that it may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.
- B. Respondent agrees to pay any monetary sanctions imposed on it upon notice that this AWC has been accepted and that such payments are due and payable and have attached an Election of Payment form showing the method by which it proposes to pay any fine imposed.

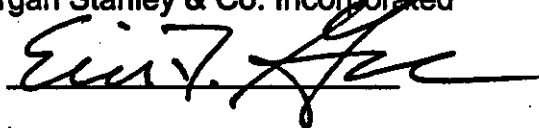
² Pursuant to this undertaking, Respondent agrees that it will retain the Independent Consultant, implement and adopt procedures pursuant to the procedures set forth in the final judgment entered in United States Securities and Exchange Commission v. Morgan Stanley & Co. Incorporated, Civil Action No. ____ CV ____ () (D.D.C.), Securities Exchange Act Release No. ____ (date).

- C. Respondent specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

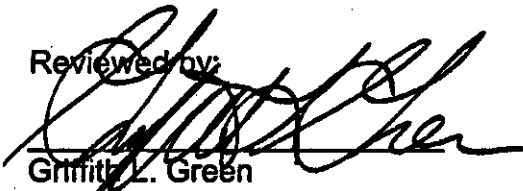
Respondent certifies that it has read and understand all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce Respondent to submit this AWC.

Date: May 2, 2006

Morgan Stanley & Co. Incorporated

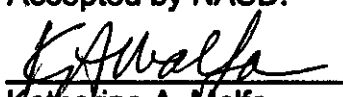
By: 

Eric F. Grossman
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Accepted by NASD:



Katherine A. Malfa
Vice-President, Department
of Enforcement

Signed on behalf of the Director of ODA,
by delegated authority