07-5687-cv

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

JOE IBARZABAL, JENS CHRISTIAN SORENSEN, BILLY F. ADAMS, JUDY ADAMS, MACK D. YOAKUM, L. VERMELL YOAKUM, PATSY D. DEVEAU and ESTATE OF CHARLES DEVEAU, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

MORGAN STANLEY DW, INC.,

Defendant-Appellee.

On Appeal from the United States District Court for the Southern District of New York (White Plains)

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

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PRELIMINARY STATEMENT

For the reasons and authorities set forth below and in the Appellants' Brief, plaintiffs/appellants Joe Ibarzabal, Jens Christian Sorensen, Billy F. Adams, Judy Adams, Mack D. Yoakum, L. Vermell Yoakum, Patsy D. DeVeau, and Estate of Charles DeVeau (hereinafter "plaintiffs") respectfully request that this Court reverse the district court's dismissal of their complaint and denial of leave to file an amended complaint.

ARGUMENT

I. THIS COURT SHOULD REJECT MORGAN STANLEY'S GRATUITOUS AND SELF-SERVING REWRITE OF THE WELL-PLEADED ALLEGATIONS OF THE COMPLAINT

A. The district court improperly adopted and relied upon Morgan Stanley's self-serving rewrite of the facts pleaded in the complaint.

Faced with the damning facts in the complaint, as in the district court Morgan Stanley has decided to attempt to rewrite the facts to suit its ends. Thus, in contrast to plaintiffs' allegation that Morgan Stanley knew as of *as of October 2001* that it had a near-complete backup copy of its pre-October 2001 e-mails, and deliberately set about to conceal the existence of this data until it was sued by regulators in *December 2006* (JA A132, A162), Morgan Stanley weaves a version of events in which plaintiffs' complaint is a quibble that it did not move swiftly enough to recover and catalog its data in the hurly-burly aftermath of 9/11. See

Morgan Stanley Brief at 12. In Morgan Stanley's version of events, these archived e-mails were later "discovered" in or about March 2005, whereupon Morgan Stanley then advised arbitration claimants that there might be additional sources of e-mail discovery.

But Morgan Stanley's approach cannot withstand scrutiny, as the very same facts that form the basis of plaintiffs' claims were entered as *factual findings* with the consent of Morgan Stanley in FINRA Letter of Acceptance, Waiver and Consent No. 2005001449202 ("AWC") http://www.finra.org/web/groups/ enforcement/documents/enforcement/p037039.pdf.

Under the terms of the AWC, Morgan Stanley waived its rights to a FINRA disciplinary hearing concerning FINRA's allegations that it destroyed and concealed the existence of e-mails and other evidence that Morgan Stanley should have produced in arbitration proceedings and in response to regulatory inquiries. (AWC, pp. 2-3) Morgan Stanley has also consented, without admitting or denying the findings, to the entry of factual findings by FINRA as set forth in the AWC (among others):

a. Morgan Stanley destroyed millions of pre-September 2001 e-mails that were preserved on its backup tapes after the collapse of the World Trade Center by permitting the backup tapes to be overwritten with other data;

b. Morgan Stanley did not provide pre-October 2001 e-mail in numerous customer arbitration proceedings and in response to regulatory inquiries, stating falsely that it did not have any pre-October 2001 e-mails; and

c. Morgan Stanley's conduct violated NASD rules including NASD Procedural Rule 8210, NASD Conduct Rules 2110 and 3110, as well as NASD Code of Arbitration Procedure Rules 2110 and IM-10100. (AWC, pp. 5-6)

Of particular note, the AWC also contains the finding that Morgan Stanley destroyed *at least 7.8 million e-mails*, over a period of more than *three years* between October 9, 2001 and March 2005.

To settle these charges, Morgan Stanley agreed to a censure, a fine of $3 million, and to make a payment of $9.5 million to make restitution to arbitration claimants who were denied appropriate discovery in customer arbitrations. (AWC, p. 9) Morgan Stanley also agreed to have an independent consultant approved by

FINRA review its internal procedures for complying with discovery requests in arbitration proceedings relating to the firm's retail brokerage operations. (AWC, p. 10).

Thus, it is these facts, which have already been entered as findings of fact in the FINRA proceeding and are pleaded in the complaint, not Morgan Stanley's version of the facts, that this Court must consider in determining whether the district court erred in granting Morgan Stanley's motion to dismiss.

Nor should this Court accept Morgan Stanley's self-serving contention that the letters that it sent to certain of the plaintiffs stating that it had "recently come to appreciate" that additional e-mails were in its records constituted a corrective disclosure of its unlawful conduct. (JA A48, A87, A96, A109) Based on the well-pleaded allegations of the complaint the Morgan Stanley letters were at best a self-serving misleading partial disclosure, as Morgan Stanley had not in fact (as it claimed in the letters) "recently come to appreciate" that it had a near-complete backup copy of its pre-October 2001 e-mail. (See JA A35), c.f., Morgan Stanley Brief at 4. Rather, it had recently decided to send out the letters as a litigation tactic after having known for 3 ½ years that it had a near-complete backup of its e-mail that it was deliberately concealing. The true facts concerning Morgan Stanley's fraud only emerged when the NASD filed its case in December 2006,

whereupon plaintiffs (whose arbitration cases were by then over) promptly commenced this class action.

Thus, the well pleaded facts before the district court and the findings of fact by FINRA demonstrate that Morgan Stanley engaged in a deliberate course of deception against arbitration claimants, litigants, and regulators to mitigate its exposure in post-"tech wreck" litigation, and sent the April 2005 letters to cover its tracks. This Court should not reward such a cynical, results-oriented approach based on the latent assumption that any penalty for discovery violations would be far smaller than Morgan Stanley's litigation losses if it produced its business records pursuant to its discovery obligations.

B. The district court misunderstood or misconstrued the facts in dismissing plaintiffs' case.

Plaintiffs have been defrauded by Morgan Stanley and have commenced litigation under, inter alia, the New York consumer fraud statute designed to provide redress for just such deceptive practices directed at the public. The district court's dismissal of the action was based in part on consideration of Morgan Stanley's own self-serving rewrite of the facts (see JA A189) and must be reversed.

Indeed, the district court appeared to misapprehend plaintiff's factual allegations entirely and to misunderstand the fact that Morgan Stanley's misconduct was not revealed until after the plaintiffs' arbitrations were over and done with:

> ...[T]he regulatory provisions are designed to provide protection to class action participants who decide to pursue legal remedies via a class action, rather than via arbitration. Coheleach v. Bear. Stegns & Co., 440 F. Supp. 2d 338, 341 (S.D.N.Y. 2006). Here, Defendant is not arguing that these claims should be dismissed because they must be arbitrated; indeed, the issue here is that Plaintiffs each already arbitrated their claims -they did not attempt to file a class action suit as a substitute for the arbitration proceedings required by their customer agreements. This analysis would be different if Plaintiffs had opted to file a class action suit instead of proceeding with their individual arbitrations -under that factual scenario, the NASD and NYSE rules would have protected Plaintiffs against an effort by Defendant to force the class to arbitration.

(JA A194)

Thus, the district court effectively held that in order to avail themselves of the rule that class actions are not subject to NASD arbitration (NASD Rule 10301), plaintiffs would have had to have filed their class action instead of an arbitration proceeding *before the violations complained of had even taken place.*

Such a "Catch 22" based on a more-than-strained reading of the facts alleged in the complaint[1] is grossly inconsistent with the standards that the district

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[1]As noted in Appellants' Brief, the district court has also effectively rewritten the complaint in order to fit its rationale that "the injuries alleged by

court was required to apply on a motion to dismiss, and shows that the district court did *not* accept plaintiffs' well-pleaded allegations as true when rendering its decision. "In considering a motion to dismiss for failure to state a claim pursuant to Rule 12(b)(6), a district court is limited to the facts stated in the complaint, documents attached to the complaint as exhibits, and documents incorporated by reference in the complaint." Abrahams v. Appellate Div. of Supreme Court, 473 F. Supp. 2d 550, 554 (S.D.N.Y. 2007), citing Hayden v. County of Nassau, 180 F.3d 42, 54 (2d Cir.1999). "The court must accept the factual allegations contained in the complaint as true, and view the pleadings in the light most favorable to the non-movant, drawing all reasonable inferences in its favor." Id., citing Sheppard v. Beerman, 18 F.3d 147, 150 (2d Cir.1994).[2]

Plaintiffs are predicated on the impact of MSDW's alleged conduct on the outcomes of their arbitration proceedings; accordingly, this Court must view the instant action as an attempt by those Plaintiffs who actually received final arbitration awards to collaterally attack those awards." (JA 192-193)

[2]This Court has observed that traditional Rule 12(b)(6) pleading standards under Fed. R. Civ. P. 8(a) may have been modified to some extent by the U.S. Supreme Court's decision in Bell Atlantic Corp. v. Twombly, 127 S.Ct. 1955, 1968 (2007), to require some level of factual plausibility. See Iqbal v. Hasty, 490 F.3d 143, 155 (2d Cir. 2007) (noting that U.S. Supreme Court has disavowed the literal interpretation of the "no set of facts" language in Conley v. Gibson, 355 U.S. 41 (1957)). There can be little doubt that plaintiffs' allegations herein are factually plausible in light of the fact that they are parallel to the factual findings made by FINRA in the AWC, to which Morgan Stanley itself consented.

This Court has stated that in reviewing a dismissal under Fed. R. Civ. P. 12(b)(6), "[W]e accept all of plaintiffs' factual allegations as true and will only affirm the district court's dismissal if we are satisfied that plaintiffs can prove no set of facts that would entitle them to relief on their claims." Holowecki v. Federal Exp. Corp. 440 F.3d 558, 565 (2d Cir. 2006), aff'd, 552 U.S. — , 128 S. Ct. 1147 (2008), citing Velez v. Levy, 401 F.3d 75, 84 (2d Cir. 2005).

Where a district court has so substantially deviated from the applicable legal standard on a motion to dismiss pursuant to Fed. R. 12(b)(6), the only proper disposition in this Court is reversal.

II. THIS COURT SHOULD REJECT MORGAN STANLEY'S ARTIFICIAL ARGUMENT THAT THIS CLASS ACTION CASE CONSTITUTES A CHALLENGE TO AN ARBITRATION AWARD

The centerpiece of Morgan Stanley's argument herein and before the district court, and of the district court's dismissal order, is that this class action constitutes a challenge to an arbitration award under 9 U.S.C. § 10. But nowhere in the complaint do plaintiffs' ask for *vacatur* of their arbitration awards, or request a "do-over" of their arbitrations. 9 U.S.C. § 10, by its terms, sets forth the grounds for seeking "an order vacating the [arbitration] award upon the application of any party to the arbitration... ." Thus, the very foundation of Morgan Stanley's argument cracks: This case is not a challenge to an arbitration award, but is a

class action that happens to involve a fraudulent course of conduct directed at arbitration claimants.[3]

Even if this case were a challenge to an arbitration award, the authorities relied upon by Morgan Stanley for the proposition that plaintiffs' claims are barred by the Federal Arbitration Act are distinguishable, and none provided the district court with a proper basis for dismissing plaintiffs' claims.

In Pisciotta, Decker, and Hornsby,[4] the plaintiffs asserted only individual claims, and complained of conduct that was limited in scope to their own respective arbitration proceedings. In Pisciotta, the plaintiffs alleged that the firm and its broker withheld information about the circumstances surrounding the broker's termination from the firm, and that the broker lied to the arbitration panel about her past criminal conduct. Pisciotta, 629 A.2d at 521. In Decker, the plaintiffs alleged that the brokerage firm interfered with the arbitration proceedings by hiring the chairperson of the arbitration panel as a closing agent

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[3]As this action does not seek to vacate an arbitration award, the FAA statute of limitations relied upon by Morgan Stanley (See Morgan Stanley Brief at 53-54) is irrelevant.

[4]Pisciotta v. Shearson Lehman Bros., Inc., 629 A.2d 520 (D.C. 1993) ("Pisciotta"); Decker v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 205 F.3d 906 (6th Cir. 2000) ("Decker"); Prudential Securities Inc. v. Hornsby, 865 F.Supp. 447 (N.D. Ill. 1994) ("Hornsby"); and Quintana v. Morgan Stanley DW, Inc., 05-cv-21401 (S.D. Fla. 2005) ("Quintana").

for various real estate transactions, resulting in a biased award. Decker, 205 F.3d at 907. In Hornsby, the plaintiffs alleged a conspiracy between the brokerage firm and its broker to fraudulently conceal documents regarding the broker's improper sales practices. Hornsby, 865 F. Supp. at 448. Thus, in each of these cases, plaintiffs sought damages to compensate them for deficiencies in their individual arbitration awards for arbitrable claims.

Plaintiffs in the instant case, by contrast, have pleaded causes of action relating to fraud and misconduct that was not limited to any single arbitration proceeding, but rather, was perpetrated on the public at large as well as government and industry regulators, and inhibited class members' abilities to receive disclosure of documents to which they were lawfully entitled. (See JA A34-36) This conduct is estimated to affect at least 1000 persons. (See JA A163)

Unlike the plaintiffs in Morgan Stanley's cases, the instant class plaintiffs have alleged a statutory violation of GBL § 349. Plaintiffs do not seek damages predicated upon a deficiency in their individual arbitration awards under the FAA, but instead seek statutory and other damages to compensate for Morgan Stanley's violations of law. Morgan Stanley in effect argues that plaintiffs' injury can be measured only by the impact of Morgan Stanley's alleged conduct and omissions on the outcome of plaintiffs' arbitrations (see Morgan Stanley brief at p.12), but

the complaint does not thus limit itself to or specify such a measure of relief.

While the Quintana case was a class action, plaintiffs in Quintana did not even raise the issue of Rule 10301 in opposition to the motion to dismiss. See Quintana opposition brief, (JA A137). Plaintiffs in Quintana also did not call to the court's attention the language in Morgan Stanley's standardized account agreement prohibiting arbitration of class actions, relying instead principally on the argument that the Sixth Circuit Corey case was not a controlling legal authority in the Southern District of Florida and was wrongly decided. See id. and discussion of Corey immediately below. Thus, the controlling legal authority on which (plaintiffs maintain) this Court should base its reversal of the district court was quite simply not before the Quintana court.

Quintana, Pisciotta, Decker, and Hornsby all cite Corey v. New York Stock Exchange, 691 F.2d 1205 (6th Cir. 1982) as authority prohibiting collateral attacks on arbitration awards.[5] But Corey has been distinguished by this Court in a case

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[5]In addition to Quintana, Pisciotta, Decker and Hornsby, Morgan Stanley cites to several other cases that follow the Corey line of reasoning. See Morgan Stanley brief at 21, fn. 8. In those cases, none of which are binding upon this Court, the courts held that the plaintiff attempted to use a subsequent lawsuit, in effect, to change the result in an arbitration proceeding, on grounds which could have been raised in the arbitration proceeding under 9 U.S.C § 10. Plaintiffs' claim here, however, is not an attempt to challenge the award to the parties recovering in the arbitration, but rather a totally separate and distinct claim which is not subject to arbitration and therefore not within the FAA's coverage.

where the plaintiff (as here) alleged the violation of a statute that occurred during the pendency of arbitration proceedings.[6] In Mian v. Donaldson, Lufkin & Jenrette Securities Corp., 7 F.3d 1085 (2d Cir. 1993), this Court held that when a brokerage firm engaged in conduct during the course of an arbitration proceeding that violated a federal discrimination statute, the injured party was free to bring an independent action within the applicable limitations period. Mian, 7 F.3d at 1086-87. In Mian, this Court refused to extend the "collateral attack" doctrine established by the Corey court, and found that the plaintiff's failure to move to vacate the arbitration award did not prevent him from seeking damages for misconduct that took place "during the arbitration proceeding itself." Id. at 1087.

The Mian court stated:

> The fact that a major component of the damages sought would consist of the amount of the arbitration award-if the plaintiff can prove that but for the [statutory violations], the arbitrators would have ruled in his favor-does not mean that [the plaintiff's] suit is one to challenge the award within the meaning of § 10 of the Federal Arbitration Act.

Id.

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[6]Contrary to Morgan Stanley's argument, plaintiffs do not concede that their claims would be barred by the FAA if brought individually. To the extent that this Court applies Mian to mean that a claim alleging a statutory violation that occurs in the course of an arbitration proceeding is not barred by the FAA, Mian would provide an alternative basis for reversal of the district court.

In light of Mian, at the pleading stage the district court should not have stretched to characterize a class action complaint as an action to challenge an arbitration award under the FAA.[7] Based on the allegations of the complaint, plaintiffs in the instant case are not attempting to challenge arbitration awards under the FAA, and the district court's dismissal must be reversed.

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[7]Nor does Morgan Stanley's red herring argument about the Rules Enabling Act carry any weight. It is well established that "[a]rbitration is entirely a creature of contract." Sole Resort, S.A. de C.V. v. Allure Resorts Management, LLC, 450 F.3d 100, 104 (2d Cir. 2006). The question of "which disputes are subject to arbitration," if any, is "determined entirely by an agreement between the parties .... Without the contract, the arbitration ... never could exist." Id.; see also Volt Info. Sciences v. Bd. of Trustees, 489 U.S. 468, 478, 109 S.Ct. 1384, 103 L.Ed.2d 685 (1989) ("[The Federal Arbitration Act] simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms."). Here, the very contract relied upon by Morgan Stanley makes it clear that plaintiffs' class action claims are not subject to arbitration (and therefore not subject to the FAA). Thus, Morgan Stanley's argument has it exactly backwards: Plaintiffs are not attempting to assert rights under Rule 23 that they would not otherwise have as individual litigants, but rather are exercising their right to litigate claims that were never the subject of an arbitration agreement. Cf., Gulf Petro. Trading Co., Inc. v. Nigerian Nat. Petro. Co., 512 F.3d 742 (5th Cir. 2008) (not addressing the argument that claims asserted in action challenging conduct that occurred during arbitration proceeding were not arbitrable under the subject arbitration agreement).

III. WHETHER CERTAIN PLAINTIFFS' CLAIMS ARE BARRED BY RELEASE IS AN ISSUE PROPERLY RAISED BY AN AFFIRMATIVE DEFENSE THAT WAS NOT PROPERLY RAISED IN THE DISTRICT COURT

As argued in plaintiffs' opening brief, an "affirmative defense is normally asserted in an answer," but it may be raised on a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) where "the complaint itself establish[es] the circumstances required as a predicate to a finding" that the affirmative defense applies. McKenna v. Wright, 386 F.3d 432, 435 (2d Cir. 2004).

Here, Morgan Stanley relies upon, and the district court relied upon, releases appended to its affidavits (JA A66, A88, A92), which were not part of the complaint, appended to the complaint, or even referenced in the complaint. The district court should not have considered such materials on a motion to dismiss. This Court has summarized the proper rule governing a district court's reliance on a document that is not part of or incorporated by reference in the complaint as follows:

> [W]hen a plaintiff chooses not to attach to the complaint or incorporate by reference a [document] upon which it solely relies and which is integral to the complaint, the court may nevertheless take the document into consideration in deciding the defendant's motion to dismiss, without converting the proceeding to one for summary judgment.

Holowecki, supra, 440 F.3d at565-66, quoting Int'l Audiotext Network, Inc. v. Am. Tel. & Tel. Co., 62 F.3d 69, 72 (2d Cir.1995) [internal quotation marks omitted].

Here, plaintiffs did not “solely rely” upon the releases relied upon by Morgan Stanley (or even allude to them), nor are such documents integral to the complaint. Instead, they are integral to an affirmative defense of release that must be pleaded and proven by Morgan Stanley.

Further, even if the district court had been within the rules to consider the releases, this is not a circumstance in which "the complaint itself establish[es] the circumstances required as a predicate to a finding" that the affirmative defense applies. McKenna, 386 F.3d at 435. To the extent that the district court believed that the affirmative defense of release might be applicable, it erred by refusing to grant plaintiffs leave to amend to further explain their claim that they were fraudulently induced into settling their cases in the absence of material information concerning Morgan Stanley’s fraud and destruction of evidence. The district court went well beyond the four corners of the complaint, and in effect granted Morgan Stanley summary judgment on an affirmative defense at the pleading stage. This overreach mandates reversal.

IV. THE COMPLAINT STATES A CLAIM FOR VIOLATION OF GBL § 349

New York's General Business Law ("GBL") § 349 is a broad, remedial statute directed at wrongs against the consuming public. See, e.g., Oswego Laborers' Local 214 Pension Fund v. Marine Midland Bank, 85 N.Y.2d 20 (1995). Section 349(a) declares as unlawful "[d]eceptive acts and practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state." The elements of a claim for violation of GBL § 349 are "merely (1) that the act or practice was misleading in a material respect, and 2) that the plaintiff was injured." McDonald v. North Shore Yacht Sales, Inc., 134 Misc. 2d 910, 914, 513 N.Y.S.2d 590 (Sup. Ct. Nassau Cty. 1987); see also Anonymous v. CVS Corp., 188 Misc.2d 616, 624 (N.Y. Sup. Ct. Mar. 1, 2001), *grant of class certification affirmed*, 293 A.D.2d 285 (1st Dept. 2002). Plaintiffs have alleged facts sufficient to state a claim under GBL § 349.

A. Morgan Stanley's Acts Are Consumer Oriented Under GBL § 349

Consumer-oriented conduct does not require a repetition or pattern of deceptive behavior. Oswego, 85 N.Y.2d at 25. A plaintiff must demonstrate only that the acts or practices complained of have a broader impact on consumers at large. Id. In Oswego, the Court of Appeals reasoned that a bank's acts fell within the "consumer-oriented" ambit of GBL § 349 because the Bank, inter alia,

furnished the plaintiffs with standard documents presented to customers upon the opening of accounts and because the transactions in question were not unique to the parties. 85 N.Y.2d. at 26. Accordingly, the Court held that the plaintiffs "satisfied the threshold test in that the acts they complain of are consumer-oriented in the sense that they potentially affect similarly situated consumers." Id. at 26-27. Like the bank in Oswego, Morgan Stanley furnished each plaintiff with standardized forms, including the standard customer agreement, and made standardized misrepresentations to its customers at large, including the misrepresentation quoted at page 25 infra, (see, also, JA A123-24) *and* the false and misleading partial disclosure contained in its form letter to customers in April 2005. (See, e.g., JA A48, A87, A96, A109). The transactions complained of herein are "consumer-oriented" under of GBL § 349. See Dunn v. Northgate Ford, Inc., Index Nos. 2003-0179, 2003-0180, 2004 WL 189780 (N.Y. Sup. Ct. Jan. 7, 2004); Hart v. Moore, 155 Misc.2d 203 (N.Y. Sup. Ct., July 6, 1992).[8]

Morgan Stanley mischaracterizes the holding in Goldman v. Geico Gen. Ins. Co., 292 A.D.2d 162, 163, 739 N.Y.S.2d 360, 362 (1st Dep't 2002). The court did not issue a sweeping declaration that deceptive conduct occurring during an

[8]That defendant's acts are "consumer-oriented" is further evidenced by the acts of various securities regulators whose mission it is to protect investors and ensure vigorous, fair and effective enforcement of securities law and regulations. See JA A130, A132.

arbitration is not within the ambit of Section 349. Rather, the court's decision turned on a very specific fact peculiar to the case-- the insurer's act of submitting a single incorrect declarations page to an arbitrator-- which the court held did not constitute consumer-oriented conduct. The conduct in Genesco, which unlike in the case at bar was directed at a single person, was a classic "one shot" wrongful act that the courts have held is not directed at the public for purposes of GBL § 349. See Genesco, 593 F. Supp. at 752; Cf. Hart, supra.[9]

B. Morgan Stanley Engaged in Deceptive Practices

A prima facie case under GBL § 349 requires a showing that a defendant is engaging in an act or practice that is deceptive or misleading in a material way. Oswego, 85 N.Y.2d at 25. The Court of Appeals has adopted an objective

[9]The cases cited by Morgan Stanley in support of its argument that § 349 is inapplicable in cases involving the sale of securities and disputes pertaining to insurance coverage are easily distinguishable. In Cyber Media Grp., Inc. v. Island Mortg. Network, Inc., 183 F.Supp.2d 559 (E.D.N.Y. 2001), the court found that because the action was based upon a fraudulent sale of securities, plaintiffs failed to state a claim for relief pursuant to § 349. Here, plaintiffs have made no such a claim. The court dismissed the plaintiff's § 349 claim in Polidoro v. Chubb Corp., 386 F. Supp. 2d 334 (S.D.N.Y. 2005) because she failed to provide *any* argument as to how defendant's denial of disability benefits was consumer oriented. The court suggested that plaintiff's claim might have survived had she pled facts sufficient to establish a "national policy" or an "extensive" scheme having "a broad impact on consumers at large". See id. To the contrary, Plaintiffs in this case have presented ample argument to the Court to demonstrate how their allegations satisfy each requirement of § 349.

definition of deceptive acts and practices, holding that the misrepresentations or omissions actionable under GBL § 349 are limited to those likely to mislead a reasonable consumer acting reasonably under the circumstances. Id. at 26. In the case of omissions, where as here the defendant alone possesses material information and fails to provide this information to the consumer, the omission is actionable. Id.

Morgan Stanley falsely represented that its pre-October 2001 email had been destroyed in numerous arbitration proceedings brought against the firm and destroyed evidence. (JA A34, A35-36) Numerous arbitration claimants were therefore deprived of potentially valuable evidence that Morgan Stanley possessed but falsely denied having. (JA A34) Clearly, plaintiffs neither possessed nor could reasonably have obtained the e-mails stored on Morgan Stanley's e-mail servers. Thus, Morgan Stanley alone possessed material information relevant to plaintiffs, which it failed to provide in order to gain a strategic advantage. Clearly such conduct deceived plaintiffs and other class members.

C. Morgan Stanley's Deceptive Practices Injured Plaintiffs

A plaintiff is not required to allege injury under GBL § 349 with great specificity. See Meyerson v. Prime Realty Services, LLC, 7 Misc.3d 911, 796 N.Y.S.2d 848, 856 (Sup. Ct. N.Y., Feb. 28, 2005). Although an actual injury is

required by GBL § 349, it need not involve a pecuniary loss. Oswego, 85 N.Y.2d at *26. "[A] clear distinction exists between the deception *being the injury* and a real right being lost." Anonymous, 188 Misc.2d at 625 [emphasis supplied] (plaintiff's claim that defendant deprived him of the right to take action to prevent disclosure of his private medical information sufficient to allege actual injury under GBL § 349); Meyerson, 796 N.Y.S.2d at 856("[I]t cannot be doubted that a privacy invasion claim and an accompanying request for attorney's fees may be stated under GBL § 349 based on non-pecuniary injury....").[10]

Here, plaintiffs have pleaded that they were deprived of material information,[11] and were also injured due to defendant's deceptive business practice

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[10]See also Remsburg v. Docusearch, Inc., 149 N.H. 148, 816 A.2d 101 (2003)(similar result under New Hampshire law); Bio-Vita, Ltd. v. Rausch, 759 F.Supp. 33 (D. Mass. 1991)(under Massachusetts law).

[11]Morgan Stanley's argument that plaintiffs lack standing to seek an injunction under GBL § 349 lacks merit. The mootness doctrine derives from the "case or controversy" requirement in Article III of the U.S. Constitution, and "the question of standing is related only to whether the dispute sought to be adjudicated will be presented in an adversary context and in a form historically viewed as capable of judicial resolution." See U.S. Parole Comm'n v. Geraghty, 445 U.S. 388, 395, 100 S.Ct. 1202 (1980). "It is for that reason that the emphasis in standing problems is on whether the party invoking federal court jurisdiction has a personal stake in the outcome of the controversy, and whether the dispute touches upon the legal relations of parties having adverse legal interests."Id. at 396-97. There can be no doubt that plaintiffs herein are adverse to Morgan Stanley and have an interest in obtaining relief against Morgan Stanley sufficient to satisfy Article III. Further, New York GBL § 349(b) expressly provides a statutory right to seek an injunction to "any person who *has* been injured by reason of any

of destroying evidence. (See JA 35-36) GBL § 349 claims are subject to the pleading standard set forth in Fed. R. Civ. P. 8(a). Pelman v. McDonald's Corp., 396 F.3d 508, 512 (2d Cir. 2005). Clearly plaintiffs have alleged injury and all of the other elements of a claim under GBL § 349.

V. THE COMPLAINT STATES A CLAIM FOR BREACH OF CONTRACT

Contrary to defendant's mischaracterization, plaintiffs do not seek to assert a claim for an implied cause of action for violation of NASD and NYSE rules. Rather, plaintiffs allege that defendants violated their standardized customer agreement with members of the Class, which provided that the subject accounts "are subject to... the rules, regulations and customs of... the NYSE, the NASD, other self-regulatory organizations, and exchanges." (See JA A133)

The U.S. District Court for the Southern District of New York and other courts have distinguished between such a claim and an implied cause of action under SRO rules, and have permitted the former. See Komanoff v. Mabon, Nugent & Co., 884 F. Supp. 848, 859-60 (S.D.N.Y. 1995) (valid claim for breach of contract based on, inter alia violation of NYSE Rule 405, where contract required defendant to follow such rules); Hofmayer v. Dean Witter & Co., 459 F. Supp.

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violation of this section... ." Unless this statute is unconstitutional— and plaintiffs' research finds no case law so holding-- plaintiffs clearly have standing under its plain language to seek an injunction.

733, 739 (N.D. Cal.1978); see also Miley v. Oppenheimer & Co., Inc. 637 F.2d 318, 333 (5th Cir. 1981); Mihara v. Dean Witter & Co., Inc., 619 F.2d 814, 824 (9th Cir. 1980) Lange v. H. Hentz & Co., 418 F. Supp. 1376, 1383-84 (N.D. Tex. 1976) (violations of SRO rules relevant to whether a broker breached a legal duty owed to plaintiff).[12]

Plaintiffs have pleaded a breach of contract claim, not an SRO rule violation claim. Morgan Stanley has blatantly violated the SRO arbitration rules and other rules that it contracted to follow and should be held liable.

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[12]The cases relied upon by defendant are distinguishable. See Davantzis v. Painewebber Inc., No. 20032/2000, 2001 WL 1423519 at * (Sup. Ct. N.Y. Nassau Cty. July 23, 2001) (plaintiff relied on implied contractual duty, rather than, as here, an express contractual duty, to follow SRO rules); Lantz v. Private Satellite Television, Inc., 813 F. Supp. 554, 556 (E.D. Mich. 1993) ((NASD rules did not give rise to a legal duty, the breach of which would constitute negligence); Prodex, Inc. v. Legg Mason Wood Walker, Inc., Civ. A. No. 86-1950, 1987 WL 6329 at *2 (E.D. Pa. Feb. 6, 1987 (no indication that contract between customer and brokerage house contained express agreement to abide by NASD rules or incorporation by reference of such rules); Bloch v. Prudential-Bache Secs., 707 F. Supp. 189, 195 (D. N.J. 1989) (plaintiffs urged theory that they were third-party beneficiary of defendant's contractual agreement to abide by NYSE and NASD rules, and see cases cited in opinion at p. 195 for proposition that courts in Second Circuit have recognized implied cause of action for violation of regulatory rules); Frota v. Prudential-Bache Securities, Inc., 639 F. Supp. 1186, 1190 (S.D.N.Y. 1986) (plaintiffs attempted to state federal claim for violation of SRO rules, not breach of contract claim).

VI. THE COMPLAINT STATES A CLAIM FOR FRAUD

To sustain a claim based upon common law fraud in New York, plaintiffs must plead that Morgan Stanley made "a representation of fact, which [was] either untrue and known to be untrue or recklessly made, and which [was] offered to deceive the other party and to induce them to act upon it, and which cause[d] injury." Jo Ann Homes at Bellmore, Inc. v. Dworetz, 25 N.Y.2d 112, 119, 302 N.Y.S.2d 799, 250 N.E.2d 214 (1969); see also Citibank, N.A. v. K-H Corp., 968 F.2d 1489, 1496 (2d Cir. 1992). The claim also requires a showing of proximate causation, such that the injury "is the natural and probable consequence of the defrauder's misrepresentation or the defrauder ought reasonably to have foreseen that the injury was a probably consequence of his fraud." Cumberland Oil Corp. v. Thropp, 791 F.2d 1037, 1044 (2d Cir. 1986). Furthermore, in New York "[t]he rule is clear that where one party to a transaction has superior knowledge, or means of knowledge not open to both parties alike, he is under a legal obligation to speak and his silence constitutes fraud." Lefkowitz v. ITM, Inc., 52 Misc.2d 39, 48 (Sup. Ct. N.Y. Sept. 29, 1966).

Plaintiffs allege that despite the fact that it had a near-complete backup of the pre-October 2001 e-mails, Morgan Stanley routinely told claimants in arbitration proceedings and regulators that its pre-September 11, 2001 e-mails

were destroyed in the collapse of the World Trade Center. (JA A33) More specifically, plaintiffs allege that Morgan Stanley routinely responded to requests for e-mails (from arbitration claimants and regulators alike) 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 email] were destroyed," or similar language. (JA A35-36)

Morgan Stanley had actual knowledge of the falsity of its statements, as Morgan Stanley's Messaging Team within its Technology Department 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. (JA A33) Plaintiffs have pleaded that a senior member of the Messaging Team 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 with at least one high ranking Morgan Stanley Compliance official. (JA A33)

These inherent characteristics of plaintiffs' particularized allegations give rise to a strong inference of scienter that the defendant knew or were reckless in not knowing the facts that contradicted the statements alleged herein. See Novak, v. Kasaks, 216 F. 3d 300, 311 2d Cir. 2000)) ("defendants knew or, more

importantly, should have known that they were misrepresenting material facts related to the corporation"); In re Carter-Wallace Inc. Sec. Litig., 220 F.3d 36, 40 (2d Cir. 2000) (it is sufficient for a strong inference of scienter for plaintiffs to allege defendants' knowledge of facts *or access to information* contradicting their public statements).[13]

Morgan Stanley intended that plaintiffs rely upon its false and fraudulent representations.[14] Plaintiffs allege that Morgan Stanley well knew that e-mails, the

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[13]As with federal securities fraud claims under Rule 10b-5, knowledge or recklessness is sufficient to satisfy the scienter element for common law fraud. Fraternity Fund Ltd. v. Beacon Hill Asset Management LLC, 376 F. Supp. 2d 385, 407 (S.D.N.Y. 2005, citing Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87, 104-05 (2d Cir. 2001). To plead scienter, plaintiffs must plead "with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." Novak, 216 F.3d at 311-12 (Rule 10b-5 case); In re Scholastic Corp., 252 F.3d 63, 74 (2d Cir. 2001). In determining whether plaintiffs' allegations suffice, reference must be made to the totality of the circumstances pleaded the Complaint "as a whole." Cosmos v. Hassett, 886 F.2d 8, 11 (2d Cir. 1989); Yoder v. Orthomolecular Nutrition Institute, Inc., 751 F.2d 555, 562 (2d Cir. 1985).

[14]While reliance is a key element of common law fraud, reliance has been presumed in certain cases involving material omissions. The New York Appellate Division, First Department has recognized the application of a presumption of reliance. See Ackerman v. Price Waterhouse, 252 A.D.2d 179, 197-98, 683 N.Y.S.2d 179 (1st Dept 1998); see also In re Sumitomo Copper Litigation v. Credit Lyonnais Rouse, Ltd. 262 F.3d 134, 142-43 (2d Cir. 2001) (surveying New York case law concerning presumption of reliance in omission and market manipulation cases alleging common law fraud). Contrary to Morgan Stanley's argument, plaintiffs' allegations of uniform omissions will strengthen, not weaken, their arguments for class certification because reliance will be presumed as to all class members. See Fisher v. Plessy Co. Ltd., 103 F.R.D. 150, 156 (S.D.N.Y.

existence of which it denied, and which it destroyed, were routinely subject to production to claimants in NASD and NYSE arbitration proceedings. (JA A36) In fact, such e-mail communications are (and were at relevant times) presumptively discoverable under the NASD Discovery Guide which is contained in NASD Notice to Members 99-90. Id. Plaintiffs' knowledge or ability to discover the true status of Morgan Stanley's e-mail servers was nonexistent, a handicap Morgan Stanley fully intended to exploit. Plaintiffs were left with no option but to take Morgan Stanley at its word.

As a result, many Class members were left to prosecute (or settle) their arbitration cases without the benefit of potentially valuable evidence that Morgan Stanley did indeed possess. (JA 34) Plaintiffs were also injured by having evidence destroyed. (JA A26, A36)

Based on the foregoing, plaintiffs have adequately pleaded common law fraud.

1984) (presumption of reliance applicable to all class members upon showing of materiality and nondisclosure of a fact).

VII. PLAINTIFF IBARZABAL'S CLAIM IS NOT BARRED BY THE DOCTRINE OF RES JUDICATA

Under the doctrine of res judicata, a judgment on the merits in a prior suit bars a second suit involving the same parties or their privies based on the same cause of action. See Parklane Hosiery Co., Inc. v. Shore, 439 U.S. 322, 326 n. 5, 99 S.Ct. 645, 649 n. 5, 58 L.Ed.2d 552 (1979). Because res judicata bars relitigation of the same cause of action, the rule binds the parties not only to matters that actually were raised in the prior action, but also to matters that could have been raised. Allen v. McCurry, 449 U.S. 90, 94, 101 S.Ct. 411, 414, 66L.Ed.2d 308 (1980).

Whether particular issues or claims shall be precluded "depends in part on whether the same transaction or connected series of transactions is at issue, whether the same evidence is needed to support both claims, and whether the facts essential to the second were present in the first." N.L.R.B. v. United Technologies Corp., 706 F.2d 1254, 1260 (2d Cir. 1983), cert. denied, 61 U.S.L.W. 3478 (1993); see also Restatement (Second) of Judgments § 24(b).

Here, plaintiff Ibarzabal's claims and legal contentions at issue in his arbitration case are not the same as those underlying this class action, and the facts

essential to this action were not at issue or (as Morgan Stanley emphasizes) actually litigated in Ibarzabal's arbitration proceeding.

Further, res judicata does not dispose of claims that were unknown at the time of the first adjudication. See Porn v. National Grange Mut. Ins. Co., 93 F.3d 31, 34 (1st Cir. 1996). Morgan Stanley's misconduct herein was not fully disclosed until the regulatory case against Morgan Stanley was announced in December 2006– a year after Ibarzabal's arbitration case was over and also a year after his petition to vacate the award were filed.[15]

In these circumstances, the doctrine of res judicata is inapplicable to plaintiff Ibarzabal.

CONCLUSION

For the foregoing reasons and authorities and the reasons and authorities set forth in the Appellants' Brief, plaintiffs respectfully request that the Court reverse the district court's December 3, 2007 Decision and Order to the extent that it dismissed plaintiffs' complaint and denied plaintiffs leave to replead,

[15]Morgan Stanley's form letter stating that it had "recently come to appreciate that there are additional sources that might contain additional responsive email" does not avail it because, accepting the well-pleaded allegations of the complaint, this was a false and misleading partial disclosure, as in fact defendant had not "recently come to appreciate" these facts, but rather had known since October 2001 that it had a backup copy of its pre-September 11 e-mails. See JA A32-34.

and remand this action to the district court for proceedings not inconsistent with this Court's disposition of this appeal.

Dated: New York, New York
May 15, 2008

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), I hereby certify that this brief was produced in Times New Roman (a proportionally-spaced typeface), 14-point type and contains 6,985 words (based on the WordPerfect word count function).

Dated: New York, New York
May 15, 2008

_____
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ANTI-VIRUS CERTIFICATION FORM

See Second Circuit Local Rule 32(a)(1)(E)

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