

# **\$700,000 high-tech nest egg now \$404; Microsoft colleagues blame broker for losses**

**By Gretchen Morgenson**

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It took John Teeples 6½ years as a software salesman at Microsoft to amass the stock options and other assets he felt he needed to take a break from work and spend more time with his wife, Sharon, and their two young sons.

"I wanted to park the bus," Teeples, 45, said from his home in Reston, Va. "So I pulled the bus over to the side of the road, I took my stock options and said, 'I can reacquaint myself with my 9-year-old, who thought Daddy wasn't there for him.' "

As Teeples was about to exit the fast track of 80-hour weeks in late 1999, he encountered two Morgan Stanley Dean Witter brokers: Arun Sardana, 36, and Michael Moriarty, 46. The brokers persuaded Teeples, who had never traded in the market, to entrust them with retirement accounts and stock options worth roughly \$700,000.

Within 16 months, Teeples said, what had taken him years to build was gone. By April, all that was left of his portfolio was \$403.95 and a \$40,000 tax bill due next April. Now he's fighting back.

With the stock market in the doldrums, and the practices of brokerage firms under the microscope, executives at Wall Street firms are clearly worried that investors have lost faith in the industry. If Teeples' account of how his money was managed is any indication of what passed for investment advice and brokerage services in the market mania of the late 1990s, Wall Street should be worried indeed.

Unfortunately for the industry and investors alike, Teeples' story is just one of many tales beginning to emerge as investors realize their decimated portfolios may never come back, and that for novices, investing is not as easy as it looks.

## **Others lost savings, too**

But perhaps the most troubling aspect of Teeples' story is that he is not the only current or former Microsoft employee to say he has lost his life savings under the guidance of Sardana and Moriarty. In several arbitration claims filed recently against the brokers and Morgan Stanley — most investor claims cannot go to court — 13 customers on the East and West coasts accuse the two men of a widespread pattern of sales-practice violations. These include recommendations of highly speculative stock trades and excessive use of margin borrowing. In about a year, these people lost \$20 million, according to the complaints.

"Morgan Stanley Dean Witter's brokers were out of control," said Jacob Zamansky, a lawyer at Zamansky & Associates in New York, who represents the Microsoft workers. "Young, inexperienced brokers preyed on hard-working people with little or no investment experience. They lost my clients' retirement and life savings."

## **Wall Street on the defensive**

Across the country, many workers at technology companies have been hurt by stocks that have fallen below their options' prices. Even worse, some have exercised options at high levels and watched the underlying stock collapse. But the Teeples case is particularly compelling because it brings together all the elements of the speculative frenzy of the late 1990s. Now that the bubble has burst, brokerage-firm practices like the ones Teeples encountered are coming under scrutiny. All of Wall Street is on the defensive.

As was the case at many technology companies, Teeples and his fellow plaintiffs had amassed sizable nest eggs through stock-option grants earned at Microsoft. The other plaintiffs wish to remain anonymous because most of them still work at Microsoft. But their naiveté in the ways of Wall Street made them easy pickings for aggressive brokers looking to make fortunes of their own. And these brokers, encouraged by the fee structure at Morgan Stanley, subjected their customers to high-risk strategies involving the heavy use of borrowed funds. Furthermore, by following the recommendations of the firm's research department, the brokers submitted their customers to what their lawyer calls biased analysts peddling overvalued stocks.

Bret Gallaway, a Morgan Stanley spokesman, said, "We are very comfortable leaving the disposition of Mr. Teeples' claims to the arbitration process he initiated." Sardana and Moriarty, who are still employed there, did not respond to several calls seeking comment.

According to the complaint, the money lost by the customers of Sardana and Moriarty is considerable. Seven of the 13 Microsoft workers lost a total of \$1.3 million in JDS Uniphase, \$555,000 in Cisco Systems and \$366,000 in America Online. Numbers like these put into perspective exactly who lost the \$5 trillion in stock-market value since the Nasdaq crashed last year.

But perhaps even more astonishing is the amount that Morgan Stanley earned on this performance. According to a securities and accounting expert who has examined all of the trades made for the plaintiffs and who plans to testify on their behalf in the arbitration, Morgan Stanley earned at least 5 percent, on average, of the net assets in these customers' accounts. This amount, more than five times what an institution might pay, was made up of margin interest and aggressive money-management fees. It is unclear how much of this went to the brokers involved, but the usual level is 35 percent to 50 percent of fees.

### **Conflict of interest?**

Some of the plaintiffs' stock-market loss may be a result of conflicts of interest between Morgan Stanley's retail business and its investment-banking business — the very conflicts, so pervasive on Wall Street, that have caught the attention of securities regulators and members of Congress.

Last week, Merrill Lynch settled a case in which a customer had accused Henry Blodget, the firm's Internet analyst, of maintaining a positive rating on Bellevue-based Infospace stock without disclosing a conflict. Merrill Lynch was simultaneously brokering a \$4 billion deal for Infospace to buy Seattle-based Go2Net. The brokerage paid \$400,000, or half of what the customer had sought in investment losses. Zamansky was the customer's lawyer in that case, too.

Of the 23 stocks that the brokers bought for Teeple and his wife, 12 were companies that Morgan Stanley had brought public or provided with other investment-banking services. Ten were rated buys by Morgan Stanley analysts when they were bought. Three of these rose slightly, but seven fell, generating \$85,000 in losses. By the time Teeple sold all his shares in those seven, they had lost, on average, half their value.

Teeple and his wife have taken out a second mortgage on their home to pay their bills, and he went back to work in November at a wireless-data company in Baltimore that he would not identify. But he is remarkably philosophical about it all. Teeple says he should never have trusted Sardana and Moriarty. But they seemed like nice guys, he said, and investing was something he knew nothing about.

"I was working hard on understanding Microsoft technology and how to solve my customers' problems," he said. "I had never had an investment account. My mother taught school and my father taught college. Money was foreign to me."

### **Party leads to advice**

At a pool party given by mutual friends in the summer of 1999, Teeple recalled, he met Sardana, who struck up a conversation with him. He told him he managed money for many of Teeple's colleagues in Washington and Seattle. "He said he had gotten permission to do a series of seminars at the Microsoft office in D.C.," Teeple said. Sardana also told him later that he often flew to Seattle to work with Microsoft employees based at company headquarters.

Teeple attended the next seminar sponsored by Morgan Stanley.

At the seminar, the brokers handed out some pages describing their investment management strategies. "As Morgan Stanley Dean Witter Financial Advisors," the document stated, "Arun Sardana and Michael Moriarty provide affluent individuals with customized professional money-management services. Each portfolio is individually managed to meet the personal goals and risk tolerance of the client."

Teeple said the brokers also explained that they would earn a flat fee of 1 percent to 2.5 percent of assets to manage the money. Other prospects said they were told that paying a flat fee would be cheaper than paying commissions on each trade.

When he met Sardana, Teeple was weeks away from quitting his job at Microsoft. He knew that when he left, he would have only three months to exercise his options. And because of the brokers' connections to other Microsoft employees, he felt no need to investigate them further. So in January 2000, he turned to Sardana for help.

### **Options made the difference**

In his years at Microsoft, Teeple reckoned that his annual cash compensation, beginning at \$75,000 in 1992 and rising to \$100,000 when he left, was 37 percent below what was paid in comparable jobs elsewhere. "The bet I made was that the options were going to make up for the difference," he said.

That bet seemed to be paying off as Teeples rose through the organization. When he left Microsoft, he had options for 12,000 shares, worth just over \$500,000. He said he told Sardana that he wanted to achieve a reasonable growth rate on his money but added that he was interested in a conservative investment strategy. "He said that Microsoft was not going to grow at a fast-enough rate, and we needed to diversify into other stocks," Teeples recalled. "He gave me a last-quarter performance on his picks that clearly showed he was brilliant."

According to the complaint, the list supplied by Sardana showed 10 stocks that had returned an average of 70.62 percent annually for the past 10 years. They were Clear Channel Communications, EMC, Tellabs, Cisco Systems, Dell Computer, Solectron, America Online, Microsoft, Amgen and MCI Worldcom.

All carried strong "buy" recommendations from Morgan Stanley analysts. The list did not disclose whether Morgan Stanley had relationships with the companies on it, as the National Association of Securities Dealers requires of any sales materials. In fact, half were clients of the investment-banking department at Morgan Stanley.

### **Exercising options**

Teeples said he was impressed with the stocks' performances. So when Sardana recommended that he exercise all his Microsoft options immediately and put the proceeds in a Morgan Stanley account, he agreed. The broker also advised Teeples to take out a margin loan to pay part of the taxes due on the transaction and to help buy the stock. By Jan. 31, Teeples' account at Morgan Stanley held Microsoft stock worth \$1.17 million. The margin loan stood at \$620,524, leaving him with a net asset value of \$551,000.

The next month, according to the complaint, Sardana sold 9,000 Microsoft shares for \$820,000. Despite instruction from Teeples to preserve his capital so he could rest easily about his family's future, the broker bought 23 highflying technology stocks — including Amgen, America Online, Cisco Systems, EMC, Dell Computer, JDS Uniphase and Tellabs. All were bought using the margin loan.

Two months later, Moriarty persuaded Teeples to move his Individual Retirement Account, then in Fidelity mutual funds and a 401(k) at Microsoft, to Morgan Stanley. "Moriarty said, 'You should bring it over here; you'll have more control over it,'" Teeples recalled.

So he cashed in his funds and 401(k) and deposited an additional \$147,000 with Morgan Stanley.

"They said retirement is a long way off for you; you can afford to be more aggressive," Teeples said. So Sardana bought shares in Ariba, JDS Uniphase, Intel, PMC-Sierra, Exodus Communications, Texas Instruments and Microsoft for Teeples' retirement account.

### **The dangers of margin trading**

March 2000 dawned. Technology stocks had risen to stupefying levels and were about to collapse.

Teeples' account, laden with speculative technology shares bought with borrowed funds, was ground zero for the earthquake that shattered investors' dreams.

How did the Morgan Stanley brokers react when prices started slipping? Reassuringly, at first. "They started putting out statements with these great graphs," Teeples said. "They'd say, 'Our analysts say it's going to be all right.' Or, 'The technicals look great.'" Then, with the exception of abrupt calls for more cash to shore up the margin loan, the communications from Morgan Stanley ceased.

Later last year, as the stocks kept falling, Teeples called the brokers several times in alarm. He said they told him "to hang in there."

Teeples learned the hard way how treacherous margin borrowing can be. When borrowing to buy stocks, the shares serve as collateral. When the shares fall in price, the investor must put up additional funds to shore up the loan. A margin call is typically set off when a stock has declined by about 40 percent from the purchase price.

Teeples said he was stunned by the speed at which his money vanished. That shares in free fall create calls for more money had never been mentioned by either Morgan Stanley broker, he said. "They did not explain to me the downside of margin," Teeples said. "I had no idea."

It was not until late fall, he said, that he got some advice from Moriarty. "He said it looked like it wasn't going to come back and he said we should go to cash," the investor recalled — in other words, sell all the stock to cut the losses.

By December, Teeples' account value was down to \$33,000 and he had \$72 cash in his retirement account. The regular account kept dwindling: Only \$403.95 was left in it April 30.

At the same time, Teeple had to pay \$98,000 in taxes on the options he had exercised. Unable to pay it all, he appealed to the IRS to construct a payment plan for part of it. He figures that next April he will owe at least \$40,000 more for withdrawals from an early retirement account that he made to pay bills.

### **No money, but plenty of fees**

When Teeple turned over his account statements to an accountant, he learned that he had paid \$10,000 in fees on his account and \$26,000 in margin interest. It is customary at Wall Street firms to pay brokers a portion of the margin interest earned in their accounts. A Morgan Stanley spokesman said that some brokers share in the margin interest generated by their clients, but that the rules vary. Brokers who receive such remuneration have an incentive to put their customers into risky margin-trading strategies.

The Morgan Stanley brokers had another incentive to put customers on margin. The money-management fees the firm charged to customers in its Morgan Stanley Dean Witter Choice Account — 1 to 2.5 percent annually — were based on total assets, including margin loans. Other firms calculate money-management fees based on net-asset values, the market value in an account after margin-loan balances have been subtracted.

"The Morgan Stanley Dean Witter fee arrangement encouraged and rewarded brokers for putting clients on heavy margin," Zamansky said. "And the firm encouraged their brokers to generate huge fees by pushing stocks of companies with whom the firm had investment banking relationships."

Morgan Stanley made \$36,000 on Teeple in fees and margin interest, or 4.25 percent of his assets on an annualized basis.

"I could have taken this money myself, put it in an Etrade account and done better," he said.

For Teeple, life goes on. "I'm going to have to work three times as hard to recover from this series of lapses in judgment," he said. "I have my beautiful wife and two beautiful children. I've had a very, very lucky life. But it doesn't mean that this wasn't wrong."