

**Disciplinary Panel  
American Stock Exchange LLC**

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IN THE MATTER  
OF  
MORGAN STANLEY DW, INC.

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Case No. 02-49  
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Hearing Officer – DMF  
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**DECISION**  
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April 19, 2005  
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**In accordance with a Stipulation of Facts and Consent to Penalty, the Disciplinary Panel Chair determined that Respondent violated Exchange Rule 320(b), as stipulated, and as a penalty imposed a censure and a fine of \$30,000.**

**I. Introduction**

The American Stock Exchange, LLC (the “Exchange”) instituted a formal disciplinary proceeding against Morgan Stanley DW, Inc. (“Morgan Stanley”), a Regular Member organization of the Exchange. The Disciplinary Panel Chair, presiding without convening a full Disciplinary Panel, pursuant to Article V, Section 1(b) of the Exchange Constitution, held a hearing on March 24, 2005, pursuant to Article V, Section 2 of the Exchange Constitution, to review a Stipulation of Facts and Consent to Penalty (Stipulation), which is attached as Exhibit A. The Exchange and Morgan Stanley entered into that Stipulation for the purposes of settling this proceeding and concluding all disciplinary actions by the Exchange against Morgan Stanley based upon or arising out of the facts set forth in the Stipulation.

**II. Facts**

Morgan Stanley, without admitting or denying liability, stipulated to the facts set forth in the attached Stipulation. The Disciplinary Panel Chair has determined to accept those facts for purposes of this Decision, and they are incorporated herein.

### **III. Violation**

Based upon the stipulated facts, the Disciplinary Panel Chair concludes that Morgan Stanley violated Exchange Rule 320(b) by (1) failing to have reasonable policies or procedures in place on August 6 and 7, 2001 to detect or prevent an account or related accounts from entering multiple odd-lot orders, rather than larger round lot orders, into the firm's trading system, (2) failing to take steps in a reasonably timely manner to remind its employees of their continuing obligation to adhere to Exchange Rules 205 and 208 after becoming aware of the Exchange's investigation of odd-lot activity by one of the firm's employees, and (3) failing to develop systems and controls, apart from a detailed Compliance Notice issued to the firm's branch managers and financial advisors on July 10, 2003, designed to detect or prevent multiple entries of odd-lot orders.<sup>1</sup>

### **IV. Penalties and Publicity**

The Stipulation proposes that the Disciplinary Panel Chair impose a censure and a fine of \$30,000 on Morgan Stanley. After considering the Stipulation and the statements of the parties, as well as the decisions cited in the Exchange's precedent memorandum, the Chair finds that the proposed penalty is appropriate under the facts and circumstances of this case, and therefore it will be imposed. The Chair further finds that the results of this disciplinary proceeding should

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<sup>1</sup> At the hearing, counsel for Morgan Stanley advised that the firm is still in the process of establishing systems and controls to guard against future odd-lot violations. Enforcement nevertheless recommended that the Chair approve the Stipulation based upon the steps that Morgan Stanley has taken to date. The Chair, with some reluctance, agreed to approve the Stipulation, after noting that odd-lot violations such as those in this case are very serious and reminding the parties that the Chair's approval of the Stipulation will not preclude the Exchange from bringing additional disciplinary actions against Morgan Stanley in the future should it fail to adopt appropriate systems and controls to prevent odd-lot violations.

be publicly disclosed, as provided in Rule 12 of the Exchange Rules on Disciplinary Proceedings.<sup>2</sup>

**V. Conclusion**

The Disciplinary Panel Chair accepts the Stipulation of Facts and Consent to Penalty and hereby imposes upon Morgan Stanley DW, Inc. a censure and a fine of \$30,000.

**FOR THE DISCIPLINARY PANEL**

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David M. FitzGerald, Chair

Copies to: Philip A. Rothman, Esq. (*via facsimile and first class mail*)  
Anne Cooney, Esq. (*via facsimile and first class mail*)  
Jeffrey L. Brandt, Esq. (*electronically and via first class mail*)  
Arlene Collins-Day (*via facsimile and first class mail*)

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<sup>2</sup> Rule 12 exempts from publicity those cases in which the Panel finds that the offense “related solely to minor administrative requirements of the Exchange and does not materially affect the public interest or the interest of investors.” Those exemptions do not apply to the facts of this case.

Disciplinary Panel  
American Stock Exchange LLC

.....	X	
	X	
IN THE MATTER	X	
OF	X	STIPULATION OF FACTS
MORGAN STANLEY DW, INC.	X	AND
	X	CONSENT TO PENALTY
	X	Case No. 02-49
.....	X	

This proceeding was instituted by the American Stock Exchange LLC (“the Exchange” or “Amex”) against MORGAN STANLEY DW, INC. (“Morgan Stanley” or the “Firm”) (CRD # 7556), a Regular Member organization of the Exchange. This Stipulation of Facts and Consent to Penalty is entered into with Morgan Stanley pursuant to Article V, Section 2 of the Exchange Constitution in order to settle and conclude all disciplinary actions by the Exchange against Morgan Stanley based upon or arising out of the facts hereinafter stipulated. Morgan Stanley, without admitting or denying the facts, allegations and conclusions contained in this Stipulation of Facts and Consent to Penalty, hereby consents to the findings of violations of the Exchange Rules and to the imposition of the penalties hereinafter provided. Morgan Stanley understands that this settlement is subject to approval by an Exchange Disciplinary Panel and by the Amex Adjudicatory Council and that, if so approved, shall constitute a final decision, which may not be appealed by the parties. Morgan Stanley understands and acknowledges that the Disciplinary Panel’s decision in this matter will become part of its disciplinary record and may be considered in any future proceeding brought by the Exchange.

**STIPULATED FACTS:**

- 1.1 At all times relevant herein, Morgan Stanley was Regular Member Organization of the Exchange.
- 1.2 During all relevant periods herein, Morgan Stanley maintained a retail branch office in Columbus, Ohio to service public customer accounts.
- 1.3 During all relevant periods herein, NE (“NE”) was a registered representative at Morgan Stanley. NE was employed in the Firm’s Columbus, Ohio branch office and was authorized to service public customer accounts. NE also maintained personal and family-related accounts with the Firm.
- 1.4 During all relevant periods herein, TR (“TR”) was a Branch Office Manager at the Firm’s Columbus, Ohio branch office. TR’s responsibilities included directly supervising the trading by accounts serviced by NE.
- 2.0 During all relevant periods herein, Morgan Stanley was subject to Exchange Rule 208, which provided in pertinent part:

“When a person gives, either for his own account, for various accounts in which he has an actual monetary interest, or for accounts over which such person is exercising investment discretion, buy or sell odd-lot orders which aggregate one or more round lots, a member or member organization shall not accept such orders for execution unless they are, as far as possible, consolidated into round lots, except that selling orders marked “long” need not be so consolidated with selling orders marked “short.”
- 2.1 Pursuant to Exchange Rule 205, Specialists on the Exchange are required to execute an odd-lot market order at the prevailing offer (in the case of an order to buy) or bid (in the case of an order to sell). Pursuant to Exchange Rule 205, Specialists on the Exchange are required to execute an odd-lot limit order at the price of the first round lot transaction which is at or below the specified limit (in

the case of an order to buy), or at the price of the first round transaction which is at or above the specified limit (in the case of an order to sell).

- 2.2 During all relevant periods herein, Morgan Stanley was subject to Exchange Rule 320(b), which provided that:

“Each office, department or business activity of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility. The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer including compliance with securities laws and regulations.”

- 2.3 During all relevant periods herein, The ABC Co. (“ABC”) stock was listed for trading on the Exchange.
- 2.4 During all relevant periods herein, The DEF Co. (“DEF”) stock was listed for trading on the Exchange.

### **Odd-Lot Transactions by NE**

- 3.0 On August 6 and 7, 2001, NE entered approximately 137 odd-lot limit orders and eight (8) odd-lot market orders for ABC and DEF in both personal and family accounts in which he exercised investment discretion. The odd-lot orders consisted of both buy and sell orders. Approximately 108 of the odd-lot limit orders were executed on these two trade dates. Each of the odd-lot trades entered had a volume of 90 shares.

- 3.1 The division of round-lot orders into odd-lot orders, and NE's subsequent entry of multiple odd-lot buy orders in ABC and DEF stock replaced the execution of a round-lot order that would have appeared on the Exchange tape. As a result, actual market interest in ABC and DEF stock was not publicly reflected. Additionally, the entry of multiple odd-lot orders, rather than larger round lot orders, prevented their exposure to the trading crowd, which in turn prevented any opportunity for price improvement in the auction market for ABC and DEF stock.
- 3.2 Exchange rules and systems compel the Specialist, as the only contra-party to odd-lot trades, to execute the multiple odd-lot buy orders entered by NE at the prevailing bid or offer.
- 3.3 In entering a total of 145 odd-lot orders over the course of August 6 and 7, 2001, NE entered multiple odd-lot orders within short periods of time on the same side of the market (e.g. six odd-lot buy limit orders entered all within approximately two minutes). To trigger the execution of these odd-lot trades, NE then entered multiple small round lot market orders (e.g. sell 100 shares at market) on the opposite side of the market shortly following his entry of the odd-lot orders. The execution of this round lot market sell order would be at or below the limit of NE's odd-lot buy orders, thereby triggering the execution of NE's odd-lot buy orders. The following chart illustrates these transactions:

Buy/Sell	Qty.	Limit/ Mkt.	Exec. Price	Entry Time	Exec. Time	Bid/Offer size prior to order entry	Bid/Offer size after order entry
Buy	90	11.10	11.00	10:07.31	10:17	11-11.50 25x2	11-11.50 25x2
Buy	90	11.10	11.00	10:08.01	10:17	11-11.50 25x2	11-11.50 25x2
Buy	90	11.10	11.00	10:08.26	10:17	11-11.50 25x2	11-11.50 25x2
Buy	90	11.15	11.00	10:09.31	10:17	11-11.50 25x2	11-11.50 25x2
Buy	90	11.15	11.00	10:09.50	10:17	11-11.50 25x2	11-11.50 25x2
Buy	90	11.15	11.00	10:09.58	10:17	11-11.50 25x2	11-11.50 25x2
Sell	100	Mkt.	11.00	10:11.37	10:17	11-11.50 25x2	11-11.35 25x2

- 3.4 Between August 8, 2001, and August 31, 2001, Morgan Stanley's Compliance Department was told by the Exchange it was opening an investigation into NE's odd-lot activity.
- 3.5 On April 22, 2002, the Exchange conducted a telephone interview with NE as part of its investigation into NE's odd-lot activity.<sup>1</sup>
- 3.6 On May 9, 2002, the Exchange conducted a telephone interview with TR as part of its investigation into Morgan Stanley's supervision of NE's entry of multiple odd-lot orders on August 6 and 7, 2001.<sup>2</sup>

### **Supervision**

- 4.0 Between August 7, 2001 and June 6, 2002, despite the Exchange's notification to Morgan Stanley of its investigation into activity by NE, Morgan Stanley took no affirmative measures to remind its Branch Managers or Financial Advisors, other than NE or TR, of the requirements of Exchange Rules 205 and 208. During this time the Firm did not implement additional policies, procedures, or systems and controls concerning the detection, monitoring and supervision of odd-lot orders entered through the Firm.
- 4.1 On June 6, 2002, TR issued an inter-office memorandum directly to NE. The memorandum acknowledged that Morgan Stanley was aware of the Exchange's investigation into NE's odd-lot activity and possible violation of Rule 208. The memorandum also included a copy of Rule 208 and a reminder to NE not to enter odd-lot orders in violation of Exchange Rules. Morgan Stanley, however, did not

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<sup>1</sup> NE has been represented by outside counsel since the time of his interview with the Exchange, but Morgan Stanley has been aware of the nature of the investigation and the allegations against NE since August 2001.

<sup>2</sup> Morgan Stanley has represented TR throughout the duration of the Exchange's investigation.

issue a memorandum to other employees at the Firm reminding them of their obligation to comply with Exchange odd-lot rule. Furthermore, Morgan Stanley did not, at that time, develop, maintain, or enforce supervisory procedures reasonably designed to detect or prevent multiple entry of odd-lot orders entered through the Firm.

- 4.2 On July 10, 2003, Morgan Stanley issued a Compliance Notice (“The Notice”) to the Firm’s Branch Managers and Financial Advisors regarding the Firm’s obligation to comply with Rule 208. The Notice reiterated the Firm’s policy to comply with the odd-lot rules and notify the Firm’s Compliance Department if and when a violation of odd-lot provisions was detected. Although the Firm has issued this detailed Notice, the Firm has not, to date, developed systems and controls designed to detect or prevent multiple entry of odd-lot orders through the Firm.

## **CONCLUSION**

By reason of the foregoing Stipulated Facts, a Disciplinary Panel may conclude that:

- 5.0 Morgan Stanley violated Exchange Rule 320(b) in that the Firm: (a) did not have reasonable policies or procedures in place on August 6<sup>th</sup> and 7<sup>th</sup>, 2001 designed to detect or prevent an account or related accounts from entering multiple odd-lot orders, rather than larger round lot orders, into the Firm’s PER system, as set forth in paragraphs 3.0 through 3.3; (b) did not take steps in a reasonably timely manner to remind its employees of their continuing obligation to adhere to Exchange

Rules 205 and 208, as set forth in paragraphs 3.4 through 4.2; and (c) The Firm has not, to date, developed systems and controls, beyond the detailed Notice, designed to detect or prevent multiple entry of odd-lot orders through the Firm., as set forth in paragraphs 4.0 through 4.2.

**DISCIPLINARY ACTION:**

A Disciplinary Panel may impose the following penalty upon Morgan Stanley

Dean Witter, Inc.:

- (a) A censure; and
- (b) \$30,000 fine.

ON BEHALF OF:  
AMERICAN STOCK EXCHANGE LLC

By: \_\_\_\_\_

David Rosenstein  
Vice-President and Chief Counsel  
Enforcement Department  
NASD Amex Regulation Division

Agreed to this \_\_\_\_\_ day of \_\_\_\_\_, 2005.

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