BEFORE THE NATIONAL ADJUDICATORY COUNCIL
NASD REGULATION, INC.

In the Matter of Market Regulation Committee, Complainant, v. Morgan Stanley & Co., Inc. New York, NY, Thomas Anthony Crocamo Allendale, NJ, Carl DeFelice Massapequa, NY, Joseph Louis Ferrarese Old Tappan, NJ, Peter William Ferriso, Jr. Basking Ridge, NJ, Robert Scott Ranzman Armonk, NY, Charles McMichael Simonds Fairfield, CT, and David Robert Slaine New York, NY, Respondents	DECISION Complaint No. CMS960235 Dated: January 18, 2000

TABLE OF CONTENTS

I. INTRODUCTION 1

II. PROCEDURAL BACKGROUND 2

The Respondents 2
The Complaint 2
The Answer 3
The MRC Hearing and Decision 3
NAC Proceedings 3

III. DISCUSSION 4

A. The Manipulation 4

1. Overview of the MRC's Findings of Manipulation 4

2. Details of the Bidding Activity in the 10 Securities 7

a. Cause One - Crocamo (Linear) 8
b. Cause Two - DeFelice (TCOMA and U.S. Heathcare) 8
c. Cause Three - Ferrarese (Dell and Willamette) 11
d. Cause Four - Ferriso (Bruno) 12
e. Cause Five - Ranzman (Novell) 13
f. Cause Six - Simonds (Molex and Vanguard) 14
g. Cause Seven - Slaine (Sybase) 16

3. Analysis of the Record Evidence Regarding the Manipulative Activity. 16

a. The Size of the Short Positions 16
b. Market-Making Activity in the 10 Securities 17
c. Morgan Stanley's Upticks Before the Market Opening 17
d. The Nature of the Market During the Pre-Opening Period 18
e. Morgan Stanley's Claimed Other Efforts to Purchase the Securities 19
f. The Effect of Morgan Stanley's Opening Bids on Opening Print Prices. 19
g. Morgan Stanley's Downticking 21
h. Morgan Stanley's Purchases of Stock 21
i. Profitability 22
j. The Traders' Testimony About the Bidding Activity 23

4. MRC Findings on Manipulation 24

TABLE OF CONTENTS

5. NAC Findings on Manipulation....................27

a. Applicable Legal Standards....................27
b. NAC Findings on Manipulation Allegations Against Respondents Morgan Stanley, Crocamo, DeFelice, Ferrarese, Ferriso, Simonds, and Slaine....................29
c. NAC Findings as to Respondent Ranzman....................33
d. NAC Findings re Due Process and Fairness....................34

B. The Locked and Crossed Markets....................35

1. The Allegations....................35
2. Marketplace Rule 4613(e)....................35
3. The Locked and Crossed Markets....................36
4. The Lack of "Extraordinary Circumstances"....................37
5. The Lack of "Reasonable Efforts"....................38

IV. SANCTIONS....................39

Market-making firm and its stock traders appealed findings that they had engaged in market manipulation by "marking the open" in 10 Nasdaq National Market securities, and firm appealed finding that it had violated the rule prohibiting locked and crossed markets. Held, findings of manipulation reversed as to respondent Ranzman and affirmed as to other respondents, findings of violations of the locked and crossed markets rule affirmed, and sanctions modified.

I. INTRODUCTION

Morgan Stanley & Co., Inc. ("Morgan Stanley" or "the Firm") and seven of its current and former over-the-counter ("OTC") traders, Thomas Anthony Crocamo ("Crocamo"), Carl DeFelice ("DeFelice"), Joseph Louis Ferrarese ("Ferrarese"), Peter William Ferriso, Jr. ("Ferriso"), Robert Scott Ranzman ("Ranzman"), Charles McMichael Simonds ("Simonds"), and David Robert Slaine ("Slaine") (collectively, the "Respondent Traders"), have appealed an April 13, 1998 decision of the Market Regulation Committee ("MRC") (formerly known as the "Market Surveillance Committee"). The MRC found that the Firm, by and through the Respondent Traders, had engaged in improper manipulation of the opening print prices of 10 securities, in violation of NASD Conduct Rules 2110 and 2120. The MRC also found that Morgan Stanley had violated Marketplace Rule 4613(e) and Conduct Rule 2110 by causing and maintaining locked and crossed markets during normal market hours.[1]

We reverse the findings as to respondent Ranzman and dismiss the allegations as to him. We affirm the findings of manipulation as to the other six individual respondents and the Firm, affirm the finding that the Firm violated Marketplace Rule 4613, and modify the sanctions. We order that Morgan Stanley be censured, fined $495,000, and assessed MRC hearing costs, and we order that respondents Crocamo, DeFelice, Ferrarese, Ferriso, Simonds, and Slaine each be fined $2,500.

II. PROCEDURAL BACKGROUND

The Respondents. In 1995, Crocamo, Ferrarese, Ferriso, Ranzman, Simonds, and Slaine were traders on Morgan Stanley's OTC Desk, and DeFelice was an assistant trader.[2] Slaine, in addition to trading, had supervisory duties on the OTC Desk.

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[1]The MRC dismissed the complaint's allegations that Morgan Stanley had violated Conduct Rules 3010 (the supervision rule) and 2110 by failing to maintain and enforce adequate written supervisory procedures to detect and deter locked and crossed market activity. We affirm the dismissal of these allegations.

[2]Crocamo, who has been employed by Morgan Stanley since 1980, has been registered as a general securities representative since 1983. DeFelice, who has been employed by the Firm since 1987, has been registered as a general securities representative since 1991. Ferrarese, who has been employed by the Firm since 1988, has been registered as a general securities representative

The Complaint. The MRC filed the 10-cause complaint on October 25, 1996.[3] The first seven causes contained allegations about the activities of particular traders and the quotations that they entered for 10 stocks, alleging (as described in more detail below) violations of Conduct Rules 2110 and 2120. The eighth cause alleged that Morgan Stanley, by and through the actions of the Respondent Traders, engaged in fraudulent, deceptive and manipulative activity whereby it intentionally or recklessly influenced the opening prices of the 10 securities, in violation of NASD Conduct Rules 2120 and 2110.

The ninth cause alleged that the Firm (but not the traders) violated Marketplace Rule 4613(e) and Conduct Rule 2110 by causing locked markets in eight of the securities and a crossed market in one of them at the market's open. The tenth cause, which the MRC dismissed, alleged that Morgan Stanley had failed to establish, maintain, and enforce adequate written supervisory procedures.

The Answer. The respondents denied any manipulation. Morgan Stanley admitted that it had initiated locked and crossed quotations before the market opening and that it had maintained these locking or crossing quotations "briefly" after the market's opening. Morgan Stanley asserted, however, both that "extraordinary circumstances" had justified the locking or crossing quotations and that its OTC traders had made reasonable efforts to avoid entering locking or crossing quotations.

The MRC Hearing and Decision. A five-day hearing was held in June and July of 1997 before an MRC hearing panel. The MRC heard testimony from the respondents, from other

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since 1991. Ferriso entered the securities industry in 1986 when he became registered as a general securities representative with another firm. He has been registered with Morgan Stanley as a general securities representative since 1992.

Ranzman entered the securities industry in 1980 as a general securities representative, and he was registered with other firms until 1994. Between 1994 and 1996, Ranzman was associated with Morgan Stanley as a general securities representative. Since 1996, he has been associated with other firms, and he currently is associated with First New York Securities L.L.C.

Simonds entered the securities industry as a general securities representative in 1986. He was associated with Morgan Stanley as a general securities representative between 1992 and 1996. He has been associated with Jefferies & Company, Inc. since 1996.

Slaine entered the industry in 1984 as a general securities representative. He was associated with Morgan Stanley as a general securities representative between 1986 and 1998 and as a general securities principal between 1994 and 1998. He has not been employed in the industry since January 1998.

[3]This disciplinary action arose out of an investigation conducted by the staff of the Market Regulation Department of NASD Regulation, Inc. ("NASD Regulation") after at least one market-making firm complained that Morgan Stanley was locking and crossing markets during the pre-opening period on the days when Nasdaq 100 Index options expired.

Morgan Stanley personnel, and from two members of the NASD Regulation staff. The respondents called as an expert witness Charles Cox ("Cox"), who presently is with a consulting firm and who has served as Chief Economist and as a Commissioner of the Securities and Exchange Commission ("SEC"). The MRC decision was issued on April 13, 1998.

NAC Proceedings. All eight respondents appealed, and the matter was docketed for our consideration. The parties requested and received permission to file briefs in excess of the usual page number limitations. An appeal hearing before a NAC Subcommittee was scheduled for October 8, 1998, but the parties jointly sought a lengthy continuance of the appeal hearing based on the retirement of respondents' lead counsel from the private practice of law and the schedules of Market Regulation Department staff. An appeal hearing was held before a NAC Subcommittee on February 25, 1999 in Washington, D.C. The respondents were jointly represented by one law firm and, in addition, two of the respondents also were represented by separate counsel.

Upon reviewing the NAC Subcommittee's confidential recommendation, we determined that it would be helpful for us to be able to hear the parties' arguments and pose questions to counsel. Accordingly, we invited the parties to present oral argument before the full NAC and to submit additional briefs addressing questions that had been raised by certain of our members.[4] After reviewing the additional written submissions, we heard argument en banc on this matter on November 12, 1999.[5]

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[4]Shortly before the en banc hearing, Market Regulation Department staff wrote to us noting announcements of a business venture between Morgan Stanley and several securities firms, including one firm with which a member of the NAC Subcommittee is associated. Based on information provided to us by the Subcommittee member regarding the timing of the negotiations leading to the venture, however, we have not identified any conflict of interest in this regard. Our decision to schedule en banc argument was based on our own interest in exploring the substantive issues presented by this case.

[5]On March 24, 1999, after the NAC Subcommittee appeal hearing in this matter, the respondents submitted a copy of a March 18, 1999 Wall Street Journal article entitled "Nasdaq's Continued Battle with 'Crossed' or 'Locked' Markets Frustrates Traders." The respondents asked that we take official notice under Procedural Rule 9145(a) of the article's assertions about locked and crossed markets, in particular: (1) that locked and crossed markets may result from traders' efforts to communicate demand; (2) that locked and crossed markets may arise in part from traders' reduced ability to conduct price discovery by telephone in the wake of governmental investigations of alleged collusion; and (3) that Nasdaq lacks special procedures to deal with volatility. Market Regulation Department staff opposed the motion, arguing that the "facts" in the article did not meet Rule 9145's standard of being "such matters as might be judicially noted by a court" because they were subject to reasonable dispute. Staff also noted that the article was irrelevant, since it concerned market conditions in 1998-99, rather than 1995.

The respondents replied, arguing that we should take notice of the document under the second prong of Rule 9145, which permits notice to be taken of "other matters within the specialized knowledge of the Association as an expert body." Although we, as a body with industry expertise, are well aware of current market conditions and press reports, we deny this

III. DISCUSSION

A. The Manipulation

1. Overview of the MRC's Findings of Manipulation. The MRC's findings of manipulation were consistent with the allegations of the complaint, i.e., that on March 17, 1995 and October 20, 1995, the respondents engaged in a scheme to manipulate the opening print prices of 10 stocks (five on each day) in which Morgan Stanley made markets.

Each of the 10 securities was a component of the Nasdaq 100 Index ("NDX"). The NDX is a capitalization-weighted index, which, in 1995, was composed of the 100 largest non-financial domestic issuers listed on the Nasdaq National Market. Morgan Stanley, through its Program Trading Desk, participated in the market for NDX options, primarily to facilitate customer transactions. Morgan Stanley typically hedged its NDX options positions. Thus, whenever it entered into a derivatives transaction, it would offset that position by purchasing or selling the component NDX securities. When the options expired, the corresponding hedge positions had to be unwound.

In 1995, NDX options expired on a cash settlement basis on the third Friday of each month (the "Expiration Friday") at the market opening, i.e., 9:30 a.m. The cash settlement value of NDX options was determined by the opening "print," the first reported trade, in each of the component stocks.[6] In order to unwind the hedges in an economically neutral manner, the Program Trading Desk sought to trade at the opening print prices, thereby unwinding the hedges at the same prices as determined the cash-settlement price of the options that were hedged.

There was an arrangement between Morgan Stanley's Program Trading Desk and its OTC Desk, pursuant to which the Program Trading Desk was allowed to unwind the stock hedges associated with expiring NDX options positions in an economically neutral fashion. At some

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request because the article, which consists of quotations from industry participants about current market conditions, contains no undisputed information that is probative in this matter.

The respondents also have asked that we take notice of Nasdaq's recent proposal to impose certain specific obligations -- including an obligation to send SelectNet messages signaling willingness to trade up to 5,000 shares -- on firms that lock and cross quotations between 9:20 and 9:30 a.m. We are aware of the proposal, but we find it irrelevant to the merits in this matter, since it was designed to address market conditions in 1999, not those of the time period relevant to this action. See SR-NASD-99-23, at 4, 9-10 (Apr. 30, 1999); see also SR-NASD-98-01, Amendment No. 1, at 11 (June 5, 1998). We also reject the respondents' request that we give them copies of NASD documents discussing the 1999 proposal and any structural problems it was designed to address. We note that, aside from the fact that such documents would be irrelevant, the respondents have no discovery rights to such materials.

[6] In April 1996, the method of calculating the exercise-settlement value of NDX options changed. Since then, the exercise-settlement value has been based on a volume-weighted average of the prices for the component securities as reported during the first five minutes of trading. See Exchange Act Rel. No. 37089 (Apr. 9, 1996).

time before March 1995, Morgan Stanley's senior management, together with Ralph Reynolds ("Reynolds"), the head of the Firm's domestic equity derivative trading division (which included the Program Trading Desk) and Slaine (on behalf of the OTC area), decided to conduct the "basket" trading internally through the Firm's OTC Desk. Under the arrangement, on "Expiration Fridays," the OTC Desk was required to sell to the Program Trading Desk, via internal journal entries, huge "baskets" of the securities underlying the NDX in which Morgan Stanley made markets (about 75 of the 100 component securities) at whatever the opening print prices for those securities were on the day in question. Morgan Stanley treated the transactions between the Program Trading Desk and the OTC Desk as internal journal entries that occurred "as of" 9:30 a.m. at the opening print prices. Because these transactions were internal within the Firm, they were not reported to other participants in The Nasdaq Stock Market ("Nasdaq").

The Firm decided to conduct the basket trading internally because the OTC Desk had appropriate expertise. Under this arrangement, the Firm was able to avoid the transaction costs it would have had to pay to execute the transactions outside the Firm. Thus, the OTC Traders "inherited" the risk that the Firm assumed when it carried the NDX options positions into expiration.

On the evenings before Expiration Fridays, the Program Trading Desk often told the OTC Desk its approximate need for various securities in the baskets. On such Thursday evenings, David Baker ("Baker"), who, along with Reynolds, headed the Program Trading Desk, would begin calculating the size of the Expiration Friday orders by netting the Firm's and its customers' expiring options positions. Based on these calculations, a "basket" was created consisting of specific quantities of certain NDX component securities that the Program Trading Desk needed to purchase to unwind its hedges. The Program Trading Desk's order, however, remained subject to change until late in the Friday morning pre-opening period. Sometime between 9:00 a.m. and 9:30 a.m. on Expiration Fridays, the OTC Desk received a final list of the securities and share amounts that it would have to sell to the Program Trading Desk.

On March 17 and October 20, 1995, which were Expiration Fridays, the Respondent Traders knew, before the market opening, that the OTC Desk would have to take on short positions in the 10 securities named in the complaint by selling those securities to the Program Trading Desk at the opening print prices. The gravamen of the complaint was that in order to improve the odds of being able to cover the short positions at a profit, the Respondent Traders engaged in a manipulative scheme to inflate artificially the opening prices of the securities by upticking the Firm's bids during the pre-opening period. More specifically, the complaint alleged that during the pre-opening periods on the two Expiration Fridays, the Respondent Traders fraudulently upticked the Firm's bids in the 10 securities in order to cause the opening bids for each of the securities to equal or exceed the previous day's closing offering prices, and thereby increase the chances that the opening print prices for each of the securities would be equal to or greater than the previous day's closing offering prices.

The complaint alleged that as a result of the respondents' bidding, eight of the 10 securities opened "locked" and one of the securities opened "crossed."[7] The complaint also alleged that, in furtherance of the manipulative scheme, within minutes of the market opening, the Respondent Traders downticked in each of the securities. The Respondent Traders allegedly then attempted to cover their short positions at a profit by buying the securities below the opening prices.

The first seven causes of the complaint concerned the individual Respondent Traders. The complaint's specific allegations were virtually identical for each trader. For example, the complaint alleged that Crocamo:

> "intentionally and/or recklessly through his bidding activity attempted to and did in fact cause the opening price of [a stock] to reflect the previous day's closing offering price";
>
> that he upticked "prior to the opening of the market with the intent to cause [the stock] to open at the previous day's closing offering side of the market or higher";
>
> that by doing so, he "increased the chance that the opening print price of [the stock] would be at the previous day's closing offering price or higher";
>
> that as a result of his bidding activity, the stock opened locked at a level equal to the previous day's closing offer;
>
> that "[i]n furtherance of this manipulative scheme," he decreased his quotations shortly after the opening of the market;
>
> that he "attempted to cover his short position [in the stock] throughout the remainder of the day by buying back the securities below the opening print price"; and
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> that "[b]y reason of the foregoing," he "engaged in fraudulent, deceptive and manipulative activity whereby he intentionally and/or recklessly influenced the opening print price" of the stock.[8]

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[7]A "locked" market occurs when the inside bid quotation for a security equals the inside ask quotation for that security. A "crossed" market occurs when the inside bid exceeds the inside ask.

[8] The first seven causes of the complaint contained allegations about the following seven traders and 10 stocks:

> Crocamo's trading in Linear Technology Corp. ("Linear") on October 20, 1995;
>
> DeFelice's trading in Class A shares of Tele-Communications, Inc. ("TCOMA") and common stock of U.S. Healthcare, Inc. ("U.S. Healthcare") on March 17, 1995;

The eighth cause of the complaint alleged that Morgan Stanley, by and through the actions of the Respondent Traders, engaged in fraudulent, deceptive and manipulative activity whereby it intentionally or recklessly influenced the opening prices of the 10 securities.

The MRC found that, as the complaint alleged, the respondents had violated NASD Conduct Rules 2120 (the antifraud rule) and 2110 (the requirement of adherence to high standards of commercial honor and just and equitable principles of trade).

2. Details of the Bidding Activity in the 10 Securities. It is undisputed that the respondents engaged in the following bidding activity (None of the respondents bought any of the securities prior to the market openings.):[9]

a. Cause One - Crocamo (Linear). On October 20, 1995, Crocamo had to sell 58,300 shares of Linear to the Program Trading Desk at the opening print price. Because Crocamo had been "long" in Linear the previous day, at the opening of the market on October 20, after the shares were journaled to the Program Trading Desk, Crocamo faced a short position of 36,407 shares.

Ferrarese's trading in Dell Computer Corp. ("Dell") and Willamette Industries, Inc. ("Willamette") on October 20, 1995;

Ferriso's trading in Bruno's, Inc. ("Bruno"), on March 17, 1995;

Ranzman's trading in Novell, Inc. ("Novell") on March 17, 1995;

Simonds' trading in Molex, Inc. ("Molex") on March 17, 1995 and Class A shares of Vanguard Cellular Systems, Inc. ("Vanguard") on October 20, 1995; and

Slaine's trading in Sybase, Inc. ("Sybase") on October 20, 1995.

Each set of allegations was the same as those concerning Crocamo quoted above, except that in some cases the traders were alleged to have succeeded at making stocks open above, rather than at, the previous day's close, and the complaint noted that eight of the stocks opened locked, one (U.S. Healthcare) opened crossed, and one (Molex) opened normally.

[9]These descriptions are based on the MRC's detailed description, which was undisputed, of the respondents' bidding and trading activity.

We note that the MRC repeatedly cited to stipulations. Although the record contains draft stipulations circulated among the parties, it contains no executed stipulations. We affirm the findings that were based on the stipulations, nonetheless, because the parties did not challenge any of those findings on appeal.

The previous day, Linear had closed at 44 1/4 bid and 44 1/2 offer, with Morgan Stanley at the exclusive inside bid.

Prior to the opening, Crocamo upticked his bid twice for a total increase of one-fourth of a point:

First, at 7:59.38 a.m., when already at the exclusive inside bid, Crocamo upticked his bid by one-eighth of a point, causing Morgan Stanley to become the exclusive inside bid at 44 3/8.

Second, at 9:21.06 a.m., while still the exclusive inside bid, Crocamo again upticked his bid by one-eighth of a point, causing Morgan Stanley to become the exclusive inside bid at 44 1/2 and initiating a locked quote condition.

Of the 21 active market makers in Linear, Morgan Stanley was the only market maker to affect the inside bid in Linear prior to 9:30 a.m. Prior to the opening of the market, there were a total of 26 upticks by other market makers, as well as three downticks, but all of the upticks followed Crocamo's.

Linear opened locked at 44 1/2 -- the previous day's closing offer -- with Morgan Stanley at the exclusive inside bid. The opening print price in Linear was established by a 275-share Small Order Execution System ("SOES") trade at 44 1/2 between Morgan Stanley's OTC Desk and John G. Kinnard & Co., Inc.

After the market opened, at 9:31.29 a.m., Crocamo downticked Morgan Stanley's bid by one-fourth of a point -- the sum of his pre-open upticks -- and thereby unlocked the market. Morgan Stanley was the first market maker to affect the inside bid in Linear after the opening of the market. Prior to downticking, Crocamo purchased, via SOES, 375 shares of Linear, i.e., he executed the 275-share trade that established the opening print price and made an additional 100-share purchase.

b. Cause Two - DeFelice (TCOMA and U.S. Healthcare). On March 17, 1995, DeFelice had to sell 162,600 shares of TCOMA to the Program Trading Desk at the opening print price. At the opening of the market, after the shares were journaled from the OTC Desk to the Program Trading Desk, DeFelice, who had been "long" the day before, faced a short position of 157,780 shares in TCOMA.

The previous day, TCOMA had closed at 22 1/4 bid and 22 3/8 offer. Morgan Stanley's bid was 22 1/8.

On March 17, 1995, prior to the opening of the market, DeFelice upticked the bid four times for a total increase of one-half of a point:

First, at 7:52.32 a.m., DeFelice first upticked by one-eighth of a point to join the inside bid.

Second, at 8:48.52 a.m., after two other market makers updated their quotations to join the inside bid, DeFelice upticked by one-eighth of a point, giving Morgan Stanley the exclusive inside bid at 22 3/8 and initiating a locked quote condition. (The quotations for TCOMA were unlocked when another market maker updated its market at 8:56.51 a.m.)

Third, at 9:00.29 a.m., after six other market makers had updated their quotes to join Morgan Stanley at the inside bid, DeFelice upticked his bid by one-eighth of a point, restoring the exclusive inside bid to Morgan Stanley, and thereby re-initiated a locked quote condition.

Fourth, at 9:03.47 a.m., although he already had the exclusive inside bid at 22 1/2, DeFelice upticked his bid again by one-eighth of a point, increasing Morgan Stanley's bid to 22 5/8, and thereby initiated a crossed quote condition. (Although another market maker had upticked to join Morgan Stanley at the inside bid of 22 1/2, that market maker downticked its bid by one-eighth of a point at 9:02.19 a.m., before Morgan Stanley again upticked its bid. Later, the quotations for TCOMA were uncrossed and became locked when another market maker updated its market at 9:22.04 a.m.)

Of the 61 active market makers in TCOMA, Morgan Stanley was the only firm that affected the inside bid prior to the open. Prior to the opening of the market, there were 118 upticks and 10 downticks by other market makers. All of the upticks followed DeFelice's upticks.

TCOMA opened locked at 22 5/8, which was one-fourth of a point higher than the previous day's closing offer, with Morgan Stanley sharing the inside bid with four other market makers. The opening print was a 250-share SOES trade between two firms at 22 5/8.

At 9:33.12 a.m., DeFelice downticked the bid by three-eighths of a point and thereby unlocked the market. Although 12 other market makers had decreased their bids before Morgan Stanley did so in the post-opening period (one market maker decreased its bid twice), Morgan Stanley was first market maker to affect the inside bid in TCOMA after the market opened. DeFelice did not purchase any shares of TCOMA prior to downticking Morgan Stanley's bid for the stock.

On March 17, 1995, DeFelice also was responsible for trading U.S. Healthcare. DeFelice had to sell 43,000 shares to the Program Trading Desk at the opening print price. At the opening of the market, after the shares were journaled from the OTC Desk to the Program Trading Desk, DeFelice had a short position of 42,502 shares in U.S. Healthcare.

The previous day, U.S. Healthcare had closed at 44 1/4 bid and 44 3/4 offer, and Morgan Stanley had shared the inside bid with 12 other market makers.

On March 17, 1995, prior to the opening of the market, DeFelice upticked Morgan Stanley's bid four times for a total increase of one point:

First, at 7:53.00 a.m., after another market maker who had shared the inside bid upticked one-fourth of a point to become the exclusive inside bid at 44 1/2, DeFelice increased Morgan Stanley's bid by one-fourth, joining the new inside bid of 44 1/2.

Second, at 9:04.41 a.m., after eight other market makers had joined the inside bid, DeFelice upticked his bid by one-fourth of a point, giving Morgan Stanley the exclusive inside bid at 44 3/4 and initiating a locked quote condition. (The quotations were unlocked when another firm updated its market at 9:21.46 a.m.)

Third, at 9:26.58 a.m., after another market maker had upticked one-eighth of a point to become the exclusive inside bid at 44 7/8 and 20 other market makers had joined Morgan Stanley's bid at 44 3/4, DeFelice upticked by a fourth, giving Morgan Stanley the exclusive inside bid at 45, and re-initiated a locked quote condition.

Fourth, at 9:29.05 a.m., after another market maker had upticked one-fourth to become the exclusive inside bid at 45 1/8 and eight other market makers had joined Morgan Stanley's bid, DeFelice again upticked by one-fourth of a point, giving Morgan Stanley the exclusive inside bid (at 45 1/4) and further crossing the quotations for U.S. Healthcare.

Of the 40 active market makers in U.S. Healthcare, Morgan Stanley was one of only three to affect the inside bid in U.S. Healthcare prior to 9:30 a.m.; Morgan Stanley initiated three of the six upticks that affected the inside bid; and Morgan Stanley's fourth uptick was the last to affect the inside bid prior to the opening of the market. Prior to the opening of the market, other market makers entered 95 upticks and one downtick in U.S. Healthcare. All but one of the upticks followed DeFelice's.

U.S. Healthcare opened crossed at 45 1/4 bid and 45 offer, with Morgan Stanley at the exclusive inside bid, which was one-half of a point higher than the previous day's closing offer. The opening print was a 500-share SOES trade at 45 between two firms.

After the market opened, at 9:30.46 a.m., DeFelice downticked Morgan Stanley's bid by one-half of a point and thereby uncrossed the market. Morgan Stanley was first market maker to affect the inside bid in U.S. Healthcare, although before it downticked, three other market makers had upticked their bids post-open. Prior to downticking Morgan Stanley's bid, DeFelice bought 500 shares of U.S. Healthcare via SOES.

c. Cause Three - Ferrarese (Dell and Willamette). On October 20, 1995, Ferrarese had to sell 27,200 shares of Dell to the Program Trading Desk at the opening print price. At the opening, after the shares were journaled from the OTC Desk to the Program Trading Desk, Ferrarese (who had been "long" Dell the night before) faced a short position of 7,243 shares in Dell.

The previous day, Dell had closed at 89 7/8 bid and 90 offer. Morgan Stanley's bid was 89 3/4.

On October 20, 1995, prior to the opening of the market, Ferrarese upticked Morgan Stanley's bid twice for a total increase of one-fourth of a point:

> First, at 8:30.12 a.m., Ferrarese increased Morgan Stanley's bid by one-eighth of a point to join the inside bid.
>
> Second, at 9:20.23 a.m., after three other market makers had joined the inside bid, Ferrarese upticked Morgan Stanley's bid by one-eighth, giving Morgan Stanley the exclusive inside bid at 90, and thereby initiated a locked quote condition.

Of the 23 market makers with active quotes in Dell as of the open, Morgan Stanley was the only market maker to affect the inside bid in Dell prior to 9:30 a.m. Prior to the opening of the market, there were 20 upticks and three downticks by other market makers. All of the upticks followed Ferrarese's upticks.

Dell opened locked at 90 -- the previous day's closing inside offer -- with Morgan Stanley at the exclusive inside bid. The opening print price in Dell was established by a 200-share SOES trade between two firms at 90.

After the market opened, at 9:31.28 a.m., Ferrarese downticked Morgan Stanley's bid by one-fourth of a point -- an amount equal to the sum of Morgan Stanley's pre-open upticks -- and thereby unlocked the market. Morgan Stanley was the first market maker to affect the inside bid in Dell after the market opened. Prior to the opening of the market, Ferrarese did not purchase any Dell shares. Prior to downticking his bid, Ferrarese purchased 1,200 shares of Dell in two transactions executed via SOES.

On October 20, 1995, Ferrarese also had to sell 34,200 shares of Willamette to the Program Trading Desk. At the opening of the market, after the shares were journaled to the Program Trading Desk, Ferrarese had a short position of 17,185 shares in Willamette after netting out shares he had held over from the previous day.

The previous day, Willamette had closed at 65 3/4 bid and 66 1/4 offer, with Morgan Stanley sharing the inside bid with eight other market makers.

Prior to the opening of the market, Ferrarese upticked Morgan Stanley's bid twice for a total increase of one-half of a point:

> First, at 8:28.13 a.m., Ferrarese upticked the bid by one-fourth of a point, giving Morgan Stanley the exclusive inside bid at 66.
>
> Second, at 9:21.38 a.m., after another market maker joined Morgan Stanley at the inside bid, Ferrarese again upticked the bid by one-fourth, which restored the exclusive inside bid to Morgan Stanley at 66 1/4, and thereby initiated a locked quotation condition.

Of the 20 active market makers in Willamette, Morgan Stanley was the only market maker to affect the inside bid prior to 9:30 a.m. Prior to the opening of the market, there were a total of 10 upticks and two downticks by other market makers. All of the upticks followed Ferrarese's upticks.

Willamette opened locked at 66 1/4 -- the previous day's closing offer -- with Morgan Stanley at the exclusive inside bid. The opening print price of 66 1/4 was established by a 423-share Advanced Computer Execution System ("ACES") trade.

At 9:31.42 a.m., Ferrarese downticked Morgan Stanley's bid by one-half -- the sum of Morgan Stanley's pre-open upticks -- and thereby unlocked the market. Morgan Stanley was the first market maker to affect the inside bid in Willamette after the opening of the market. Prior to downticking, Ferrarese purchased 1,000 shares via SOES.

d. Cause Four - Ferriso (Bruno). On March 17, 1995, Ferriso had to sell 19,600 shares of Bruno to the Program Trading Desk at the opening print price. At the opening of the market, after the shares were journaled from the OTC Desk to the Program Trading Desk, Ferriso had a short position of 19,663 shares in Bruno.

The previous day, Bruno had closed at 9 3/8 bid and 9 1/2 offer. Morgan Stanley's bid was 9 1/4.

On March 17, 1995, prior to the opening of the market, Ferriso upticked Morgan Stanley's bid twice for a total increase of one-fourth of a point:

> First, at 7:49.04 a.m., Ferriso upticked Morgan Stanley's bid by one-eighth of a point to join the inside bid.
>
> Second, at 8:50.25 a.m., Ferriso upticked Morgan Stanley's bid by one-eighth of a point, giving Morgan Stanley the exclusive inside bid at 9 1/2 and initiating a locked quote condition.

Morgan Stanley was the only market maker -- of the 38 market makers with active quotes in Bruno as of the open -- to affect the inside bid in Bruno prior to 9:30 a.m. Prior to the opening, there were a total of 20 upticks and one downtick by other market makers; all of the upticks followed Ferriso's upticks.

The market opened locked at 9 1/2 -- the previous day's closing offer -- with Morgan Stanley at the exclusive inside bid. The opening print was a 600-share purchase by another firm from a customer at 9 1/2.

At 9:37.17 a.m., Ferriso downticked Morgan Stanley's bid by three-eighths of a point -- one-eighth of a point more than the sum of Morgan Stanley's pre-open upticks -- and unlocked the market. Although one other market maker decreased its bid before Morgan Stanley did so in the post-opening period, Morgan Stanley was the first market maker to affect the inside bid in Bruno after the market opened. Seconds later, at 9:37.23 a.m., Ferriso downticked Morgan Stanley's bid by an additional one-eighth of a point, which together with the first downtick

represented a three-eighths of a point decrease from the previous day's closing inside bid and a one-half of a point decrease from Morgan Stanley's opening bid. Ferriso did not purchase any Bruno stock prior to either downtick.

e. Cause Five - Ranzman (Novell). On March 17, 1995, Ranzman had to sell 82,100 shares of Novell to the Program Trading Desk at the opening print price. At the opening of the market, after the shares were journaled from the OTC Desk to the Program Trading Desk, Ranzman had a short position of 36,952 shares in Novell.

The previous day, March 16, 1995, Novell had closed at 18 7/8 bid and 19 offer, and Morgan Stanley had shared the inside bid with eight other market makers.

On March 17, 1995, prior to the open, Ranzman upticked Morgan Stanley's bid twice for a total increase of three-eighths of a point.

> First, at 9:15.00 a.m., Ranzman upticked by one-fourth, giving Morgan Stanley the exclusive inside bid at 19 1/8, and thereby initiated a crossed quote condition at 19 1/8 bid and 19 ask. (The quotations for Novell were uncrossed and became locked when another market maker updated its market at 9:15.44 a.m.)
>
> Second, at 9:25.38 a.m., after eight other market makers had joined Morgan Stanley at the inside bid, Ranzman upticked his bid by one-eighth of a point, which gave Morgan Stanley the exclusive inside bid at 19 1/4, and thereby re-initiated a crossed quote condition. (Two other market makers had also upticked to join Morgan Stanley at the inside bid of 19 1/8, but they downticked their bids by one-eighth of a point before Ranzman upticked at 9:25.38 a.m. The quotations for Novell were uncrossed and became locked when another market maker updated its market at 9:26.02 a.m.)

Of the 70 active market makers in Novell, Morgan Stanley was one of only two to affect the inside bid in Novell prior to 9:30 a.m.; Morgan Stanley initiated two of the three upticks that affected the inside bid; and Morgan Stanley's second uptick was the last uptick to affect the inside bid in Novell prior to the opening of the market. Prior to the opening, there were 135 upticks and seven downticks by other market makers. Thirty of the upticks followed Ranzman's.

Novell opened locked at 19 1/4, with Morgan Stanley at the exclusive inside bid, which was one-fourth of a point higher than the previous day's closing offer. The opening print was Ranzman's 20,000-share purchase from Troster Singer Steven Rothchild Corp. ("Troster Singer") at 19 1/4. Ranzman was unable to recall how this transaction was initiated.

At 9:32.02 a.m., Ranzman downticked the bid by one-fourth of a point and thereby unlocked the market. Although two other market makers lowered their bids in the post-opening period before Morgan Stanley did so, Morgan Stanley was the first market maker to affect the inside bid in Novell after the market opened.

f. Cause Six - Simonds (Molex and Vanguard). On March 17, 1995, Simonds had to sell 14,300 shares of Molex to the Program Trading Desk at the opening print price. At the opening of the market, after the shares were journaled from the OTC Desk to the Program Trading Desk, Simonds had a short position of 14,870 shares in Molex.

The previous day, March 16, 1995, Molex had closed at 35 bid and 35 1/2 offer, and Morgan Stanley shared the inside bid with 15 other market makers.

On March 17, prior to the open, Simonds upticked Morgan Stanley's bid six times for a total increase of 3/4 of a point:

> First, at 8:16.44 a.m., Simonds upticked by one-fourth of a point, giving Morgan Stanley the exclusive inside bid at 35 1/4.
>
> Second, after another market maker joined Morgan Stanley at the inside bid, Simonds upticked by one-eighth, giving Morgan Stanley the exclusive inside bid at 35 3/8.
>
> Third, while still at the exclusive inside bid, Simonds upticked by one-eighth of a point and thereby initiated a locked quote condition at 35 1/2. (The quotations for Molex were unlocked when another market maker updated its market at 9:15.48 a.m.)
>
> Fourth and fifth, while still the exclusive inside bid, Simonds upticked his bid twice, by one-eighth of a point each time, increasing Morgan Stanley's bid to 35 3/4, and thereby re-initiated a locked quote condition. Simonds subsequently downticked one-eighth of a point to unlock the quotations in Molex.
>
> Sixth, while Morgan Stanley was still the exclusive inside bid at 35 5/8, Simonds again upticked by one-eighth of a point before the open.

Of the 19 active market makers in Molex, Morgan Stanley was the only one that affected the inside bid in Molex prior to 9:30 a.m. (and did so six times). Prior to the opening of the market, there were a total of 29 bid upticks and two downticks by other market makers; all of the upticks followed Simonds' upticking.

The Molex market opened in a normal condition at 35 3/4 bid and 36 offer, with Morgan Stanley at the exclusive inside bid, which was one-fourth of a point higher than the previous day's closing offer. The opening print was a 5,800-share transaction at 35 3/4 between two market-making firms.

At 9:34.11 a.m., Simonds downticked Morgan Stanley's bid by one-fourth of a point. Although one other market maker decreased its bid before Morgan Stanley did so in the post-opening period, Morgan Stanley was the first market maker to affect the inside bid in Molex after the market opened. Prior to downticking, Simonds purchased 2,006 shares of Molex from Nash, Weiss & Co.

In addition, on October 20, 1995, Simonds had to sell 31,900 shares of Vanguard to the Program Trading Desk at the opening print price. At the opening of the market, after the shares were journaled from the OTC Desk to the Program Trading Desk, Simonds had a short position of 22,856 shares in Vanguard.

The previous day, Vanguard had closed at 25 1/2 bid and 25 3/4 offer, with Morgan Stanley at the exclusive inside bid.

On October 20, prior to the opening, even though Morgan Stanley already had the exclusive inside bid, Simonds upticked Morgan Stanley's bid twice for a total increase of one-fourth of a point:

> First, at 8:19.32 a.m., Simonds upticked by one-eighth of a point, giving Morgan Stanley the exclusive inside bid at 25 5/8.
>
> Second, at 9:21.12 a.m., while Morgan Stanley still had the exclusive inside bid, Simonds upticked the bid by one-eighth of a point, giving Morgan Stanley the exclusive inside bid at 25 3/4, and thereby initiated a locked quotation condition.

Of the 23 active market makers in Vanguard, Morgan Stanley was the only market maker to affect the inside bid in Vanguard prior to 9:30 a.m. Prior to the opening of the market, there were a total of 13 upticks and one downtick by other market makers; they all followed Simonds' upticks.

Vanguard opened locked at 25 3/4 -- the previous day's closing inside offer -- with Morgan Stanley at the exclusive inside bid. The opening print was a 300-share ACES purchase executed at 25 3/4 by Morgan Stanley, through a proprietary account maintained by the Firm's Program Trading Desk, from a market-making firm.

At 9:31.55 a.m., Simonds downticked Morgan Stanley's bid by one-fourth of a point -- which equaled the sum of Morgan Stanley's pre-open upticks in Vanguard -- and thereby unlocked the market. Morgan Stanley was the first market maker to affect the inside bid in Vanguard after the opening of the market. Less than two minutes later, at 9:33.36 a.m., Simonds downticked the bid by an additional one-half point -- which together with the first downtick represented a half-point decrease from the previous day's closing inside bid. Simonds did not purchase any Vanguard stock prior to either of his downticks.

g. Cause Seven - Slaine (Sybase). On October 20, 1995, Slaine had to sell 42,500 shares of Sybase to the Program Trading Desk at the opening print price. At the opening of the market, after the shares were journaled from the OTC Desk to the Program Trading Desk, Slaine had a short position of 34,026 shares in Sybase.

The previous day, Sybase had closed at 36 3/8 bid and 36 1/2 offer, with Morgan Stanley sharing the inside bid with two other market makers.

Slaine upticked his bid for Sybase once:

> At 9:28.25 a.m., Slaine upticked his bid by one-eighth, giving Morgan Stanley the exclusive inside bid at 36 1/2 and initiating a locked condition.

Of the 38 market makers with active quotes in Sybase as of the open, Morgan Stanley was the only market maker to affect the inside bid in Sybase prior to 9:30 a.m. Prior to the opening of the market, there were a total of 32 upticks by other market makers, as well as four downticks. Twenty-one of the upticks preceded Slaine's uptick.

Sybase opened locked at 36 1/2 -- which reflected the previous day's closing offer -- with Morgan Stanley at the exclusive inside bid. The opening print price was a 100-share sale by another firm to a customer at 36 1/2.

After the market opened, at 9:32.04 a.m., Slaine downticked by one-eighth of a point -- the same amount as his pre-open uptick -- and thereby unlocked the market. Morgan Stanley was the first market maker to affect the inside bid in Sybase after the opening of the market, and it did so after two other market makers had upticked their bids after the opening of the market. Prior to downticking, Slaine purchased 200 shares of Sybase via SOES.

3. Analysis of the Record Evidence Regarding the Manipulative Activity.

a. The Size of the Short Positions. The orders for the 10 securities that the OTC Desk had to fill for the Program Trading Desk were amounted to one to 21 percent of the stocks' average daily trading volumes. The Respondent Traders were left with substantial short positions in each of the 10 securities after journaling shares to the Program Trading Desk:

Date	Security	Order Size (number of shares)	% of Avg Daily Trading Volume in this Stock Rep'd by Order	Morgan Stanley's Short Position at Market Opening (# shares)
3/17/95	Bruno	19,600	9%	19,663
"	Molex	14,300	16%	14,870
"	Novell	82,100	3%	36,952
"	TCOMA	162,600	7%	157,780
"	U.S. Healthcare	43,000	2%	42,502
10/20/95	Dell	27,200	1%	7,243
"	Willamette	34,200	10%	17,185
"	Linear	58,300	7%	36,407
"	Sybase	42,500	1%	34,026
"	Vanguard	31,900	21%	22,856

b. Market-Making Activity in the 10 Securities. The 10 securities were well-capitalized, and numerous firms made markets in them. Morgan Stanley did not hold a dominant market-share position in any of them, but it did have significant market shares of more than 10 percent in three of the stocks and of more than five percent in four more stocks:

Date	Security	Market Capitalization	Number of Market Makers	Morgan Stanley's Market Share in the Stock during the Expiration Month
3/17/95	Bruno	$736,279,000	37	17%
"	Molex	1,429,071,000	18	4%
"	Novell	7,037,338,000	69	8%
"	TCOMA	11,107,721,000	60	13%
"	U.S. Healthcare	7,198,380,000	40	7%
10/20/95	Dell	4,118,490,000	23	7%
"	Willamette	3,661,704,000	20	11%
"	Linear	3,261,316,000	21	6%
"	Sybase	2,633,001,000	38	3%
"	Vanguard	1,062,754,000	23	2%

c. Morgan Stanley's Upticks Before the Market Opening. During the pre-opening period, Morgan Stanley increased its bids in the 10 securities. Although other firms also increased their quotations, Morgan Stanley upticked more aggressively than did other market makers in the same securities. Morgan Stanley upticked between one and six times in each security during the pre-opening period. In eight of the 10 securities (Bruno, Molex, TCOMA, Dell, Linear, Sybase, Vanguard, and Willamette), Morgan Stanley was the only firm that upticked the inside bid during the pre-opening period. In the other two securities (Novell and U.S. Healthcare), although other firms also upticked the inside bid before the opening, Morgan Stanley entered most of the upticks that moved the inside bid during the pre-opening period and entered the last uptick before the opening. In four securities -- Molex, TCOMA, Linear, and Vanguard -- Morgan Stanley upticked its bid while it already had the exclusive inside bid. In nine stocks (all but TCOMA), Morgan Stanley had the exclusive inside bid at the opening of the market.

The quotations and opening print prices for the 10 securities were as follows:

Security	*Previous Day's Closing Bid/Ask*	*Sum of Morgan Stanley Upticks*	*Number of Morgan Stanley Upticks*	*Open'g Bid/Ask*	*Open'g Print Price*	*Open'g Price vs. Previous Day's Closing Ask*	*Extent to Which Open'g Price Exceeded Previous Day's Closing Bid*
Bruno	9 3/8 - 9 1/2	1/4	2	9 1/2 - 9 1/2	9 1/2	Equal	1/8
Molex	35 - 35 1/2	3/4	6	35 3/4 - 36	35 3/4	Above	3/4
Novell	18 7/8 - 19	3/8	2	19 1/4 - 19 1/4	19 1/4	Above	1 3/8
TCOMA	22 1/4 - 22 3/8	1/2	4	22 5/8 - 22 5/8	22 5/8	Above	3/8
U.S. Healthcare	44 1/4 - 44 3/4	1	4	45 1/4 - 45	45	Above	3/4

Dell	89 7/8 - 90	1/4	2	90 - 90	90	Equal	1/8
Linear	44 1/4 - 44 1/2	1/4	2	44 1/2 - 44 1/2	44 1/2	Equal	1/4
Sybase	36 3/8 - 36 1/2	1/8	1	36 1/2 - 36 1/2	36 1/2	Equal	1/8
Vanguard	25 1/2 - 25 3/4	1/4	2	25 3/4 - 25 3/4	25 3/4	Equal	1/4
Willamette	65 3/4 - 66 1/4	1/2	2	66 1/4 - 66 1/4	66 1/4	Equal	1/2

Morgan Stanley, however, was not alone in upticking in the 10 securities. Other market-making firms entered numerous upticks during the pre-opening period, and in each of the 10 securities, the number of pre-opening bid increases by other market makers exceeded the number of pre-opening bid decreases. During the pre-opening period, no trades were executed by third parties at prices below Morgan Stanley's bids, and a few third-party trades (in Novell and U.S. Healthcare) were executed via Instinet at prices above Morgan Stanley's bids.

During the pre-opening period, Morgan Stanley initiated locked quotations -- which persisted until the market opening -- in eight of the securities and a crossed quotation in one of the securities.

d. The Nature of the Market During the Pre-Opening Period. No sellers appeared before the two market openings offering to sell any of the 10 securities to Morgan Stanley, with the apparent exception of Novell. Based on our industry expertise, we agree with the testimony of the respondents' expert witness, as well as the industry-expertise-based conclusions of the MRC, that Morgan Stanley was unlikely to be deluged by orders from sellers during the pre-opening period regardless of its upticking. The expert witness, Cox, testified that market participants are generally reluctant to trade in the pre-opening period, especially on Expiration Fridays. Thus, the volatility and uncertainty of Expiration Friday pre-openings created, in essence, a "vacuum," leaving "a bigger gap that prices could move in before one would be flooded with orders." The MRC agreed, noting that "because of the volatility and uncertainty surrounding Expiration Fridays," bids posted during the pre-opening period would be unlikely to attract interest and that "market participants tend[ed] to 'sit on the sidelines' on Expiration Fridays."

e. Morgan Stanley's Claimed Other Efforts to Purchase the Securities. The Respondent Traders claimed to have upticked in response to their impending demand for the 10 securities, and they also asserted that they had made certain other efforts during the pre-opening period to obtain the securities. For example, Slaine testified that he would have "advertised" his demand on the Autex system.[10] Two of the traders (Crocamo and DeFelice) posted offers to buy on Instinet at their then-prevailing bids.[11] Matthew DeSalvo ("DeSalvo"), who was the co-head

[10]Autex Trading Information System is an electronic bulletin board on which broker/dealers can post indications of interest in securities. See Exchange Act Rel. No. 39884 (Apr. 28, 1998).

[11]At 9:25 a.m. on March 17, 1995, Crocamo, who had upticked to lock the quotations for Linear at 44 1/2 at 9:21, entered an Instinet offer to buy 10,000 shares at the same price. The offer

with Slaine of the OTC Desk and was responsible for supervising the OTC Desk's day-to-day activities and sales activities, and Reynolds, the head of the domestic equity derivative trading division, testified that DeSalvo and the OTC sales traders would have made numerous phone calls to institutional clients.

The respondents further argued that certain other techniques for finding sellers either were impermissible or would have been futile. The Respondent Traders testified that in 1995, in light of the then-pending investigation of Nasdaq market maker behavior, they did not use telephone calls to solicit trades. They also testified that they did not use SelectNet because in 1995, they were unfamiliar with that system and did not use it very much.

f. The Effect of Morgan Stanley's Opening Bids on Opening Print Prices. In nine of the 10 securities (all but TCOMA), Morgan Stanley's bid was the exclusive inside bid at the opening.[12] In the eight securities that opened locked, the opening prints were all executed at the locked price (Morgan Stanley's bid). In the crossed stock (U.S. Healthcare), the opening print was executed at the offer (which was below Morgan Stanley's bid). In the "normal" stock (Molex), the opening print was executed at Morgan Stanley's bid.

As the MRC noted, stocks generally open at or within the inside bid and ask, and when the quotations for a security are locked, there is a substantial likelihood that the stock will open at the locked quotation. SOES orders, which are executed automatically at the inside bid or ask, established the opening print prices for four of the securities, and the opening print prices for two of the securities were established through ACES, an automated order execution system which, like SOES, executes trades at the prevailing inside bid or ask. The other four opening prints were executed at Morgan Stanley's bid.

The opening prints were as follows:

Security	Quotations at Market Opening	Price of Open'g Print	Description of Opening Print Trade
Bruno	locked at 9 1/2	9 1/2	600-share purchase by a firm from a customer
Molex	35 3/4 to 36	35 3/4	5,800-share purchase by a firm from another firm
Novell	locked at 19 1/4	19 1/4	20,000-share purchase by Morgan Stanley OTC desk from Troster Singer
TCOMA	locked at 22 5/8	22 5/8	250-share SOES purchase by a firm from another firm
U.S. Healthcare	crossed at 45 1/4 (bid) to 45 (offer)	45	500-Share SOES purchase by a firm from another firm
Dell	locked at 90	90	200-share SOES purchase by a firm from another firm

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expired at 9:28. At 9:07 a.m. on October 20, 1995, DeFelice, who had crossed the quotations in TCOMA at 9:03, entered an Instinet offer to buy 25,000 shares of the stock at his bid. That offer expired at 9:10.

[12]In TCOMA, Morgan Stanley shared the inside bid with four other firms at the opening.

Willamette	locked at 66 1/4	66 1/4	423-share ACES purchase by a firm from another firm
Linear	locked at 44 1/2	44 1/2	275-share SOES purchase by Morgan Stanley's OTC desk from John G. Kinnard
Sybase	locked at 36 1/2	36 1/2	100-share sale by a firm to a customer
Vanguard	locked at 25 3/4	25 3/4	300-share ACES purchase by Morgan Stanley from Herzog Heine Geduld

The record contains no evidence regarding general market conditions on the days in question. The respondents submitted evidence showing that during 1995, Nasdaq stocks opened at or above the prior days' closing offer prices half of the time.

g. Morgan Stanley's Downticking. In each of the nine securities that opened locked or crossed,[13] Morgan Stanley was the market maker that "unlocked" or "uncrossed" the markets by downticking the inside bid after the opening. After the market opened, Morgan Stanley maintained the locked and crossed quotations for up to seven minutes, 17 seconds before downticking:

Security	Period that Market Locked or Crossed With Morgan Stanley at Inside Bid	Time Elapsed Until Market Unlocked/Uncrossed after Opening
Bruno	8:50 - 9:37	7:17
Dell	9:20 - 9:31	1:28
Linear	9:21 - 9:31	1:29
Novell	9:25 - 9:32	2:02
Sybase	9:28 - 9:32	2:04
TCOMA	9:03 - 9:33	3:12
U.S. Healthcare	9:29 - 9:30	0:46
Vanguard	9:21 - 9:31	1:55
Willamette	9:21 - 9:31	1:42

h. Morgan Stanley's Purchases of Stock. Morgan Stanley did not buy any of the 10 securities before the market openings on the days in question.

At the opening on March 17, respondent Ranzman bought a large block (20,000 shares) of Novell from another market-making firm, and this trade was reported as the opening print for that security. Morgan Stanley's OTC Desk executed no other significant purchases of the 10 securities at or shortly after the market opening; in six of the securities, the Respondent Traders purchased small quantities of stock before downticking:

[13]Molex did not open locked or crossed.

Date	Security	# Shares Bought by OTC Desk Before Downticking	
3/17/98	Bruno	0	
"	Molex	2,006	(in one trade)
"	Novell	20,000	(in one trade)
"	TCOMA	0	
"	U.S. Healthcare	500	(in one SOES trade)
10/20/95	Dell	1,200	(in two SOES trades)
"	Willamette	1,000	(in one SOES trade)
"	Linear	375	(in two SOES trades)
"	Sybase	200	(in one SOES trade)
"	Vanguard	0	

Morgan Stanley covered its short positions in each of the 10 securities during the remainder of each of the two trading days in question.

i. Profitability. The allegedly manipulative bidding generated relatively small profits, given the size of the transactions. According to the staff's profit and loss calculations, which the respondents adopted, the Respondent Traders realized, in the aggregate, profits of approximately $137,294.50. The profits and losses, which were calculated by comparing the opening print prices at which the OTC Desk sold stocks to the Program Trading Desk to the prices at which the OTC Desk covered its positions over the course of the trading day, were as follows:

Date	Security	Profit/Loss	Trade Size
3/17/98	Bruno	$862.50	$186,200.00
"	Molex	75.75	511,225.00
"	Novell	17,037.50	1,580,425.00
"	TCOMA	60,975.00	3,678,825.00
"	U.S. Healthcare	14,000.00	1,935,000.00
10/20/95	Dell	12,000.00	2,448,000.00
"	Willamette	8,500.00	2,265,750.00
"	Linear	31,175.00	2,594,350.00
"	Sybase	(16,418.75)	1,551,250.00
"	Vanguard	9,087.50	821,425.00

The respondents, however, appear to have successfully limited the Firm's risk. On the Expiration Fridays involved in this proceeding, substantial capital was at risk because the Firm needed to unwind its hedges in numerous Nasdaq 100 stocks.[14] The orders that the OTC desk had to fill in the 10 securities, standing alone, amounted to $17,572,450.

[14]The MRC observed that on March 17, 1995, more than $70 million of the Firm's capital was at stake, and that on October 20, 1995, more than $245 million of capital was at stake. The MRC did not, however, accept into the record the exhibit that it cited in support of this assertion. That exhibit, the respondents' "Wells" submission, is not evidence in this matter, and we have not reviewed it. We accept the MRC's findings regarding the total amount of capital at stake, given the lack of dispute on this point.

j. The Traders' Testimony About the Bidding Activity. Although several of the traders[15] candidly admitted that they preferred for the stocks they traded to open high on the days in question, all but one of the Respondent Traders testified that they had raised their bids during the pre-opening period in order to advertise demand, locate sellers, and engage in price discovery.[16] For example, Slaine testified that he was:

> showing . . . that Morgan Stanley is a buyer of the stock and we would like any type of offerings . . . using [Nasdaq] as a way of advertisement, to let the community know that we're a buyer.

Crocamo testified that he raised his bid for Linear because he was:

> trying to attract a natural institutional seller, or any kind of seller. Somebody who would hit . . . [his] bid or [engage in] some type of price discovery where . . . [he] could find out where some stock was available.

DeFelice testified that "if [he] was going to buy stock, the most logical thing to do would be to move [his] bid higher, because [he] wanted to find stock for sale." Ranzman testified that he raised the bid for Novell "[t]o find stock for sale and try to attract a seller in." Simonds testified that he upticked for price discovery. Ferriso testified that "the best way for [him] to signal to the marketplace that [he was] a buyer [was] to go best bid," "signaling an order imbalance." He asserted that "the [Nasdaq] machine is as much an advertisement machine . . . as it is anything else" and that "being best bid with your name next to it . . . tells everybody who looks at it who the buyer is."

Several of the respondents acknowledged that buying stock before the opening on the days in question would have created a risk of locking in losses. All but two of the respondents acknowledged that they were not especially anxious to execute trades prior to the opening and that they were not seeking to eliminate their short positions prior to the opening at their bid prices, although most of them testified that they would have been willing to buy some quantities of stock prior to the opening in order to engage in price discovery.[17] Most of the respondents also testified, however, that they would have accepted any proposals that would have permitted them to eliminate their entire risk positions by "pairing off" with another party, i.e., contracting, prior to the opening, to trade at the eventual opening print price.[18]

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[15]DeFelice, Simonds, Slaine, and Ranzman.

[16]Ferrarese did not testify as to his reasons for upticking.

[17]Crocamo and Ranzman did not testify in this regard.

[18]There was no testimony from Ferrarese in this regard. Ranzman indicated that he would have accepted an offer to "pair off" to some extent, but that he might not have eliminated his entire risk that way.

As for the downticking, Crocamo testified that he lowered his bid after the opening because "[once he knew] the price of the stock . . . [he] wasn't blindly selling something . . . [he] could now trade it." DeFelice stated that after the opening, he downticked because he was "working [his] position"; he acknowledged that the only thing that had changed was that he knew the price at which the sale had occurred. Simonds testified that he downticked because he knew the price at which he had sold the stock and in order to unlock the market. Ferriso testified that he downticked in order to unlock the market (although that goal could have been accomplished by a smaller downtick than he effected). Slaine testified that he downticked after the market opened because he knew his price and position, and he acknowledged that the 200-share purchase of Sybase he made prior to downticking did not significantly change his risk. Ferrarese testified that he might have downticked because of his small purchases.

None of the Respondent Traders gave any testimony indicating why they did not act affirmatively to execute any trades when the markets opened before they downticked. Ferriso speculated that he might have been too busy trading other stocks to do so.

Slaine and the other Respondent Traders denied that there was ever any discussion or instruction about moving markets. Slaine acknowledged, however, that during morning meetings on Expiration Fridays, he and the OTC traders discussed strategies to "handle" and mitigate the risk inherited from the Program Trading Desk.

4. <u>MRC Findings on Manipulation.</u> The MRC found that the respondents had engaged in a pattern of bidding during the pre-opening period that caused the 10 securities to have opening print prices at or above the previous day's closing offering prices. The MRC then inquired: (1) whether the respondents, through their pre-opening bidding activity, had interfered with free forces of supply and demand; and (2) if so, whether the respondents had acted with the requisite degree of scienter. The MRC made affirmative findings in both regards, concluding that the respondents had "intentionally or recklessly conveyed false information to the market as to their demand for the relevant securities and their price levels . . . ."

The respondents argued that they did not interfere with the forces of supply and demand. They argued that their conduct was consistent with supply and demand because their large short positions in the 10 stocks constituted "demand" that, under the laws of supply and demand, explained the upticking activity. Cox testified that the pattern of upticking was reflective of Morgan Stanley's demand for the stock and that, in the absence of a mechanism to disseminate information about order imbalances, such as exists for exchange-listed stocks, upticking was the only means available to communicate the demand. Cox also testified that, given Morgan Stanley's demand for the securities, if the Respondent Traders had not upticked, their bids would have been less informative. The respondents contended, specifically, that they had upticked for two reasons: (1) in the hopes of finding a "natural seller" with which to "pair off" in a transaction to be executed at the opening; and (2) as a means of "advertising" to the investing community, through Nasdaq, that Morgan Stanley would be a buyer at the opening.

The MRC found, however, that the respondents did interfere with the free forces of supply and demand. The MRC rejected the respondents' claim that their upticking was based on real demand. The MRC found that this theory would have been plausible only if the Respondent Traders had had a genuine interest in satisfying their demand for the securities during the pre-

opening period, at their posted bids. The MRC found that they did not, because the Respondent Traders were not interested in covering their entire short positions at their posted bids prior to the opening of the market, and Cox had acknowledged that it would have been economically irrational for them to do so.

The MRC also found that upticking was not likely to accomplish the goal of finding a contra party with which to "pair off" because of the nature of the markets on Expiration Fridays, when market participants tended to "sit on the sidelines." The MRC also found that the respondents had not established that they had used other methods that might have been more effective in finding buyers in the pre-opening period. The MRC found that the lack of evidence of serious attempts to use Instinet or make telephone calls to potential buyers cast serious doubt on the claim that the bidding activity was intended to attract selling interest.[19]

The MRC also rejected the respondents' argument that they had used the upticks to advertise the fact that Morgan Stanley would be a buyer at the opening. The MRC found that this argument was undermined by the downticking after the opening. The MRC found that the downticking indicated that the respondents believed that their pre-opening bids were at levels higher than appropriate to reflect their demand for the securities or the prices that they were willing to pay. The MRC also noted that under the theory that upticking indicated an interest in buying, the downticking would have signaled a lack of buying interest to the market.

The MRC also found it relevant, in two respects, that the respondents had been able to uptick free from normal market constraints. First, the MRC found that the respondents were able to uptick in the pre-opening period without provoking a deluge of sale orders because market participants typically are reluctant to trade during the pre-opening period, especially on Expiration Fridays. Second, the MRC found that there had been no "client discipline" because the "client" was price insensitive, i.e., the Program Trading Desk did not care what prices it paid for the NDX component securities so long as it obtained the opening print prices.

The MRC concluded that the respondents had interfered with free forces of supply and demand by "marking the open." The MRC also found that the respondents had acted with scienter in misleading the marketplace as to the genuine price levels for the 10 securities. The MRC found that the Respondent Traders knew or were reckless in not knowing that:

> their bidding activity would affect opening print prices;
>
> by locking markets they were substantially ensuring or significantly increasing the likelihood that the opening print prices would equal the locked quotations;
>
> by crossing markets they were substantially enhancing the chance that opening prints would be executed at prices above a certain level;
>
> their pre-open bids did not need to reflect their actual demand for the stock because the Program Trading Desk was price-insensitive; and

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[19]We note that Instinet was used to an extent. The respondents also offered testimony that they made phone calls attempting to locate sellers and used Autex.

> they could uptick without fear of attracting sellers because of the general reluctance to trade in the pre-opening period.

The MRC also found that the respondents had motives to engage in the manipulative conduct. The MRC noted that the Respondent Traders had inherited substantial short positions from the Program Trading Desk. In the face of what the MRC called this "untenable" position, the MRC reasoned, the Respondent Traders sought to sell the securities to the Program Trading Desk at the previous day's closing offering prices or higher.[20]

The MRC rejected the argument that the Respondents had little motive to participate in a manipulative scheme because the activity in which they engaged generated small profits. The MRC found that the respondents were motivated by their desire to avoid substantial losses and that it typically is hard to make large block purchases without paying a premium. The MRC also noted that in manipulation cases, profit-making need not be established because it "'is not talismanic'" and "[t]he manipulator simply may not be clever or lucky enough to profit from his or her misdeed.'" In re Brooklyn Capital & Securities Trading, Inc., 52 S.E.C. 1286, 1293 (1997) (quoting In re R.B. Webster Investments, Inc., 51 S.E.C. 1269, 1274 (1994)).

Although the Respondent Traders testified that they had never discussed their upticking strategy with each other, the MRC found that the pattern of conduct and common sense "indicate[d]" that discussions of the bidding occurred and that given the magnitude of the risk involved, it was "highly likely" that there were discussions about how to handle that risk.

5. NAC Findings on Manipulation.

a. Applicable Legal Standards. The respondents are alleged to have manipulated the opening prices of 10 securities in violation of Conduct Rule 2120, which prohibits the use of manipulative, deceptive and/or fraudulent devices and contrivances.[21] The United States Supreme Court has held that "manipulation" is a "term of art . . . connot[ing] intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976). The SEC has reasoned that:

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[20]The MRC noted that the OTC Desk had been placed in a difficult position by the fact that in 1995, the settlement value of NDX option contracts was based on opening print prices, leaving entities like Morgan Stanley unable to unwind their hedges at the prices used to determine the closing settlement value. The MRC found, however, that the structure of the options contract did not mitigate the respondents' manipulative conduct because when Morgan Stanley established its options positions, it assumed this risk.

[21]Conduct Rule 2120 provides, in its entirety:

> No member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.

The respondents were not alleged to have violated any of the federal antifraud laws or rules.

> Investors and prospective investors . . . are . . . entitled to assume the prices they pay and receive are determined by the unimpeded interaction of real supply and real demand so that those prices are the collective marketplace judgments that they purport to be. Manipulations frustrate those expectations. They substitute fiction for fact . . . . The vice is that the market has been distorted and made into a "stage-managed performance."

In re Edward J. Mawod & Co., 46 S.E.C. 865, 871-872 (1977), aff'd, 591 F.2d 588 (10th Cir. 1979). Manipulation, therefore, has also been defined as the deceptive movement of a security's price accomplished by an intentional interference with the forces of supply and demand. In re Patten Securities Corp., 51 S.E.C. 568, 572 (1993).

The Supreme Court and the SEC have observed that in the absence of manipulation, prices are set by the free forces of supply and demand. The Commission, thus, has noted that investors are entitled to assume that prices are set by "the unimpeded interaction of real supply and real demand so that those prices are ... collective marketplace judgments" and that manipulation is defined as the frustration of those assumptions. Mawod, 46 S.E.C. at 871-72. The Commission has also noted that manipulation is accomplished by "interference with the forces of supply and demand." In re Pagel, Inc., 48 S.E.C. 223, 226 (1985), aff'd, 803 F.2d 942 (5th Cir. 1986). "Proof of a manipulation almost always depends on inferences drawn from a mass of factual detail." Pagel, supra, at 226.

"There is no single set of factors that identify a manipulation, which encompasses 'diverse devices that ingenious minds have conceived to manipulate securities prices.'" R.B. Webster, supra, 51 S.E.C. at 1271 (quoting United States v. Regan, 937 F.2d 823, 829 (2d Cir. 1991), cert. denied, 112 S.Ct. 2273 (1992)). Most of the manipulations described in published decisions have involved facts unlike those present in the instant matter. Typically, the reported cases have involved manipulation of relatively thinly-traded securities, where the following elements were present: a rapid price surge dictated by the firm that controls the security's market, little investor interest, an abundant supply available to the manipulator, and the absence of any known prospects for the issuer or favorable developments affecting it. Patten Securities, supra, 51 S.E.C. at 573. In some cases, manipulators have used nominee accounts to hide the true ownership of stock and to control and regulate trading volume. SEC v. Kimmes, 799 F. Supp. 852, 859 (N.D. Ill. 1992), aff'd, 997 F.2d 287 (7th Cir. 1993). Typically, the markets for such securities collapse when the manipulators cease their activities. SEC v. Resch-Cassin & Co., Inc., 362 F. Supp. 964, 970 (1984).

The trading practice known as "marking the close" is, however, a well-recognized form of manipulation. Marking the close is the practice of "attempting to influence the closing price of a stock by executing purchase or sale orders at or near the close of the market." E.g., In re Thomas C. Kocherhans, 52 S.E.C. 528, 530 (1995). Marking the close conveys false information to the market as to a stock's real price level and the demand for it. Id. at 530-31. In such cases, orders are found to have been manipulative if they were placed for the purpose of affecting a stock's closing print price, to, for example, cause the stock to close on the ask (rather than the bid) and thereby assist a manipulator in avoiding a margin call. Thus, in the marking-the-close context,

otherwise legitimate activity, such as placing a trade, is impermissible if is motivated by intent to manipulate.

For there to be a violation of Conduct Rule 2120, the respondent must have acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud," Hochfelder, 425 U.S. at 193 n.12, sometimes established through a showing of recklessness amounting to an extreme departure from the standards of ordinary care, e.g., Hollinger v. Titan Capital Corp. 914 F.2d 1564, 1568-69 (9th Cir. 1990) (en banc), cert. denied, 499 U.S. 976 (1991). The word "manipulative" is "virtually a term of art when used in connection with securities markets . . . . It connotes ***intentional or willful conduct designed to deceive or defraud*** investors by controlling or artificially affecting the price of securities." Hochfelder, 425 U.S. at 199 (emphasis added). "The hallmark of manipulation is an ***intentional*** interference with the free forces of supply and demand." In re R.B. Webster Investments, Inc. et al., 51 S.E.C. 1269, 1273-74 (1994) (emphasis added). Thus, it must be established that the respondents in a manipulation case "acted with the requisite manipulative intent." Patten Securities, supra, 51 S.E.C. at 574.[22]

b. NAC Findings on Manipulation Allegations Against Respondents Morgan Stanley, Crocamo, DeFelice, Ferrarese, Ferriso, Simonds, and Slaine. Excepting respondent Ranzman -- who is discussed separately below and who is not included in our references to "the respondents" in the remainder of this subsection -- we find that the preponderance of the evidence establishes that the respondents upticked their bids and locked and crossed markets not for the purpose of attracting sellers, but for the purpose of affecting the opening print prices, in order to price their impending short positions as high as possible so as to minimize losses and/or maximize profits in closing out the short positions. Thus, we affirm the MRC's findings that the respondents interfered with the forces of supply and demand (as required by the Supreme Court's

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[22]We note parenthetically that we are not adopting the MRC's statement that in cases brought under Section 10(b) of the Exchange Act or Conduct Rule 2120, "a showing of manipulative purpose is not required." See MRC Decision at 53. The so-called "manipulative purpose" test is one established in cases under Exchange Act Section 9(a). Section 9(a), which applies to transactions on national securities exchanges, prohibits wash and matched trades executed "for the purpose of creating a false or misleading appearance" (§ 9(a)(1)) and series of transactions executed "for the purpose of inducing" trades by others (§ 9(a)(2)). Thus, for a violation to be established under Section 9(a), there must be a specific showing of "manipulative purpose" in line with the statutory language.

It is indisputable that the specific requirements of Exchange Act Section 9(a) are inapplicable here, but we do not find these circumstances relevant to our analysis of the evidence. We note that for findings of violations to be made under Conduct Rule 2120, there must be proof of scienter. When a manipulation is alleged under Conduct Rule 2120, scienter must be established through proof of manipulative intent. In other words, in manipulation cases brought under Conduct Rule 2120, ***a*** manipulative purpose requirement exists, although it is not ***the*** manipulative purpose requirement of Exchange Act Section 9(a). Cf. IM-3310, Manipulative and Deceptive Quotations ("[I]t would be inconsistent with [Rule 2110, Rule 3310, and Rule 2120] for a member . . . to publish . . . any quotation for any security without having reasonable cause to believe that such quotation . . . is not published . . . for any fraudulent, deceptive or manipulative purpose.").

and the SEC's manipulation cases) and, more specifically, that the six traders and the Firm used bids to convey false information about their demand for the securities and the "real" price levels of the securities that would have existed in the absence of manipulative influences (the MRC's specific finding of violation).

Throughout these proceedings, Market Regulation staff has argued that the respondents had both motive and an opportunity to peg the opening print prices of these securities. We find that there is relatively little dispute on these first points. We note that ***motive*** clearly was present in the form of the huge risks that the OTC Desk faced based on its agreement to sell $17 million worth of securities to the Program Trading Desk at the opening print prices. The respondents knew that they would have to establish large short positions at the securities' opening print prices and then cover those short positions. Therefore, the respondents wanted for the securities to open as high as possible. As the respondents were well aware, if these securities had opened with normal bid/asked spreads, it was not unlikely, with respect to each security, that the opening print might be executed at the bid -- causing the OTC Desk to "sell" to the Program Trading Desk at the (lower) bid price, forcing the OTC Desk to attempt to cover its resulting short position based on the (higher) offer price (the price typically paid by a buyer who initiates a transaction), and thereby potentially costing the OTC Desk the spread on each of the stocks. We note that (for the nine securities other than Novell), if the OTC Desk had had to pay the previous day's closing spread for the stocks, it would have lost about $100,000 on the nine securities. We also note that if the OTC Desk had lost money on the basket trading, it would have had to absorb those losses because the Program Trading Desk did not reimburse the OTC Desk for such losses. In these circumstances, the respondents clearly had a motive to attempt to bring the stocks' opening prices up to floor prices at which the OTC Desk would be more comfortable establishing short positions.

In addition, we note certain traders' admissions that they would have preferred for the stocks to open high on the days in question, although we recognize that these admissions of preference for profit-making did not, standing alone, amount to admissions of misconduct. Finally, although profit-making is not "talismanic" to a finding of manipulation, see Brooklyn Capital, 52 S.E.C. at 1293, we note that the respondents earned approximately $120,257 on the nine securities (excepting Novell from the list of 10 securities).

We also find that the respondents had an ***opportunity*** to peg the securities' opening prices. Morgan Stanley, as a registered market maker in the securities, was able to enter quotations during the pre-opening and was required to enter such quotations after the opening. Moreover, the unique circumstances applicable in this case made it particularly easy for the traders to manipulate the securities. First, as the traders would have known, other market-making firms, oblivious to Morgan Stanley's internal trades, were likely to view Morgan Stanley's quotations as genuine indications of large demand and adjust their own bids accordingly, perhaps by joining in the upticking. Second, because the Program Trading Desk was price-insensitive, the traders were not constrained by the normal price discipline mechanisms that, as several of them admitted, would have prevented their upticking if they were making a sale at the opening price to an outside client who was watching their bids; instead, they could uptick free from fear of any client

reprisals.[23] Third, the traders knew that their upticks would not expose them unduly to the risk of large purchases at inflated prices. It was highly unlikely that any sellers would even attempt to transact during the pre-opening period, because: (1) as the respondents' expert testified, market participants are hesitant during the pre-opening period on Expiration Fridays; (2) there was no automatic execution facility in operation during the pre-opening; and (3) in any event, pre-opening quotations were non-binding. Even after the opening, the traders would have been forced only to honor the relatively small then-applicable Nasdaq "size" requirements of 1,000 shares per stock quoted before they could downtick.

Finally, we find that the respondents not only had motives and opportunities to manipulate, but also actually engaged in manipulative misconduct, i.e., that they engaged in "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." See Ernst & Ernst v. Hochfelder, 425 U.S. at 199. First, we find that the upticks, which were the first upticks that day in seven of the nine stocks (all but U.S. Healthcare and Sybase), which were the only upticks that affected the inside bid during the pre-opening period in eight of the nine stocks (all but U.S. Healthcare), and which caused the stocks to open locked or crossed in the cases of eight of the stocks (all but Molex),[24] did affect the securities' opening prices. Second, we reject the respondents' claims that the upticks were intended to attract sellers or otherwise engage in price discovery. Instead, we find, for the following three reasons, that the respondents upticked for the purpose of pegging the opening print prices in order to price their impending short positions, rather than to attract sellers:

First, we find that it is undisputed that the traders did not uptick because they wanted to buy any significant amount of stock -- i.e., to satisfy their impending "demand" -- prior to the market openings. Most of the traders admitted that if any sellers had called to propose large transactions with them prior to the open, they would have bought only small quantities. In addition, some of the traders, as well as their expert witness, admitted the obvious fact that it would have been irrational for them to have bought significant quantities of stock prior to the openings, since such transactions might have locked in losses vis-a-vis the eventual opening print prices. Thus, the upticks could not have been motivated by desire to trade prior to the openings.

Second, we reject the traders' somewhat half-hearted claims (there was little testimony in this regard) that they upticked because they sought to advertise their demand in order to locate a natural counter-party who would agree, prior to the opening, to "pair off" in a transaction that would be executed at the opening print price. The respondents argued that the basket transactions were so large and so risky that they sought to eliminate their risk by "pairing off,"

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[23]Several of the traders were asked how they would have reacted if, during the pre-opening period, a good institutional customer had asked to buy a large amount of stock from Morgan Stanley at the opening print price. Ferriso and Crocamo indicated that if they had received such an order from a customer, they would not have upticked and locked the markets during the pre-opening period. Slaine testified that in such a situation, he might uptick, but only after discussing doing so with the customer and determining that the customer was not price-sensitive.

[24]In U.S. Healthcare, after Morgan Stanley had locked the quotations for the second time, another market maker crossed them (at 9:27). At 9:29, DeFelice upticked, making the quotations even more crossed.

rather than to trade in an attempt to earn profits. Like the MRC, however, we discredit the traders' claims in this regard because we find that, given the uncertain nature of the pre-opening period on Expiration Fridays and the traders' own lack of experience in "pairing off," they must have known that it was highly unlikely that upticking would generate such a response.[25] In addition, in connection with our rejection of this defense, we find it extremely telling that the traders executed very few or no pro-active purchases of the stocks ***after*** the openings,[26] even though there was ample time (due to the locked/crossed markets that they themselves caused) for them to pro-actively execute trades to fill at least a portion of the short positions at the prices at which the securities had opened -- the neutral prices at which the traders sought to trade, if one credits their claim that they upticked because they wanted to eliminate the risk on their desks.[27] In addition, we note, as to Simonds, DeFelice, and Crocamo, that their credibility is further undermined by the fact that they upticked from the exclusive inside bid (Simonds did so in Molex and Vanguard; DeFelice did so in TCOMA; and Crocamo did so in Linear). We reject any claim that these upticks were motivated by genuine desire to communicate demand. Any potential seller trying to identify a likely source of demand would have been fully aware of Morgan Stanley's claimed demand based on its position as the high bidder; further upticking, which might even have conveyed desperation to buy, could only have been manipulative.

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[25]Slaine testified that his strategy had been to try to find customers who were on the other side, to "get the risk right off the desk," and Ferriso argued that he was "attempting to find the other side of the trade, get rid of the risk." Although the MRC did not explicitly discredit the traders' testimony in this regard, the MRC, in making its findings of illegal manipulation, implicitly discredited all of the traders' claimed explanations for the upticking. The MRC's entire opinion bespeaks a credibility determination to the detriment of the respondents, and we defer to the credibility judgments rendered by the MRC as the initial trier of fact.

Several of the respondents admitted that a "pairing off" transaction with another market maker was exceptionally unlikely. DeFelice stated that he would have agreed to "pair off" only for a good customer. Ferriso stated that he had never "paired off" with another market maker or with a customer. Crocamo indicated that he conceivably would "pair off" with a "legitimate customer," but he did not indicate that he would do so with another market-making firm. Simonds indicated that he had never "paired off" with anyone, and that he hypothetically would do so for some customers, but not for a competitor. Slaine indicated that if "pairing off" had been proposed to him at 9:29, he would have done so for a good customer such as Fidelity Investments, but not for anybody else.

[26]In three of the stocks, the traders executed no purchases before downticking. In each the other six stocks, they bought only 200 to 2,006 shares (in a grand total of eight transactions) before downticking. All but one of these pre-downticking transactions were executed via SOES with Morgan Stanley acting in a principal capacity, and given the restrictions on the use of SOES by firms acting in a proprietary capacity, the Morgan Stanley traders could not have initiated these SOES trades. The record does not indicate who initiated the trade that was not executed via SOES (Simonds' 2,006-share purchase of Molex).

[27]Given the respondents' claims that these transactions were highly significant, we reject any claim that they might have too preoccupied by other matters to try to eliminate their risk on the basis that they claim to have been seeking, i.e., buying at the opening print prices.

Third, we reject any argument that the traders upticked in order to indicate that they would be buyers of the stock after the openings. We note that the traders engaged in downticking after the openings without having satisfied their demand to any real extent. To the extent that the pre-opening upticking could be construed as a message that Morgan Stanley had significant demand for the relevant securities (as respondents argue), the downticking would have sent the opposite message. Thus, we discredit the claim that the upticking could have been intended to signal post-opening demand.

Finally, we reject any claim that the traders were entitled, by virtue of the lack of a single-price opening system on Nasdaq, to set opening prices to correct what they perceived to be imbalances in supply and demand. Morgan Stanley was neither entitled nor obliged to work as a "specialist" in the Nasdaq system; it lacked sufficient information about other parties' orders to determine an objectively "correct" price, and it was not required to honor the prices that it set to any significant degree. Morgan Stanley made a business decision to internalize its own trading, and its only proper role was to convey its own quotations. It had no privilege to set opening prices for the marketplace.

In sum, we find that the evidence establishes that Crocamo, DeFelice, Ferrarese, Ferriso, Simonds and Slaine engaged in the upticking activity because they sought to peg the opening prices of the relevant securities. As such, we necessarily also find that those respondents and the Firm, which was alleged in the complaint to have engaged in manipulation by and through their activities and which has never sought to distance itself from their misconduct, acted with the requisite scienter for a finding of manipulation. For there to be a violation of Conduct Rule 2120, the respondent must have acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud," Hochfelder, 425 U.S. at 193 n.12. We find that scienter was present here because the respondents purposefully upticked in order to peg the securities' opening prices, i.e., acted intentionally to manipulate. Given our findings of violations of Conduct Rule 2120, we also find that Crocamo, DeFelice, Ferrarese, Ferriso, Simonds, Slaine, and the Firm violated Conduct Rule 2110 by violating just and equitable principles of trade.

c. NAC Findings as to Respondent Ranzman. We find that the preponderance of the evidence does not establish that Ranzman upticked in order to peg the opening price of the stock he was trading.

Novell had closed at 18 7/8 bid to 19 ask the previous day. At 9:14.38, another firm upticked the inside bid to 19, locking the quotations. Immediately (at 9:15.00), Ranzman upticked his bid by a quarter to 19 1/8, crossing the quotations. At 9:15.44, a third firm upticked the inside ask to 19 1/8, leaving the quotations locked at 19 1/8. Instinet trades were reported at 9:17, 9:18, and 9:25 (at $19.125, $19.188, and $19.25). At 9:25.38, Ranzman upticked the inside bid by an eighth, leaving the quotations crossed at 19 1/4 to 19 1/8. At 9:26, a fourth firm upticked the inside offer, leaving the quotations locked at 19 1/4. Seven Instinet trades were executed between 9:26 and 9:30 at 19 1/4. The market opened locked at 19 1/4, and at the opening, Ranzman bought 20,000 shares of stock from Troster at 19 1/4. (Ranzman testified that he could not recall how this trade was negotiated.)

When Ranzman first upticked in Novell, there had already been 30 upticks in the stock, including one uptick of the upside bid that had locked the market. By contrast, in most of the other securities (Linear, TCOMA, Dell, Willamette, Bruno, Molex, and Vanguard), no other upticks preceded Morgan Stanley's upticks.

Moreover, Ranzman was not the only market maker to uptick the inside bid in Novell during the pre-opening period; another firm also entered -- prior to Ranzman's first uptick -- an uptick that locked the quotations. By contrast, in all but one of the other stocks (Linear, TCOMA, Dell, Willamette, Bruno, Molex, Vanguard, and Sybase), Morgan Stanley was the only firm that upticked the inside bid during the pre-opening. (In U.S. Healthcare, Morgan Stanley was one of three firms that affected the inside bid during the pre-opening.)[28] Most importantly, we note that Ranzman bought Novell at the opening, covering more than half of his short position, in a large transaction with another market-making firm at his posted bid price. We find, in applying the preponderance-of-the-evidence standard to these facts, that the weight of the evidence does not support a finding that Ranzman was motivated by intent to peg the opening.

d. NAC Findings re Due Process and Fairness. We reject most of the respondents' various claims of procedural unfairness. First, the respondents argue that the NASD's failure to set up a better system for market openings (in combination with the structure of the Nasdaq 100 Index option product, which -- in 1995 -- settled based on opening print prices of the component Nasdaq 100 securities) served market participants poorly and made it very difficult for them to unwind hedges for stock index option investments in a price-neutral fashion. This argument fails because no marketplace or competitive challenges can justify manipulative

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[28]Novell, U.S. Healthcare, and Sybase were the only stocks in which firms other than Morgan Stanley had entered any upticks prior to Morgan Stanley's, and U.S. HeathCare and Novell were the only stocks in which other firms entered ***any*** quotations affecting the inside bid during the pre-opening period. Although the bidding activities in U.S. Healthcare and Sybase may appear, based on these observations, to have been similar to Ranzman's bidding in Novell, we find that they were not similar.

Although DeFelice's bidding in U.S. Healthcare followed an uptick to the inside bid by another firm (as did Ranzman's bidding in Novell), DeFelice entered four upticks totaling a full point, while Ranzman's bidding in Novell involved only two upticks totaling three-eighths of a point. Moreover, U.S. Healthcare was the only stock to open crossed, rather than simply locked. In addition, although Ranzman entered his last uptick in Novell at 9:25, DeFelice entered his last uptick in U.S. Healthcare at 9:29, causing an already-crossed market to become more crossed at a time so close to the market's opening that his final uptick could not have been intended to attract supply. DeFelice himself admitted that at 9:29, he would not have agreed to pair off with any party other than a good customer.

Slaine's trading in Sybase is distinguishable from Ranzman's because, even though other quotation adjustments preceded Slaine's uptick, his uptick was the only uptick during the pre-opening period that affected the inside bid. This uptick, which was not entered until 9:28.25 and which was withdrawn two minutes after the opening, could not have been intended to signal demand. We note that Slaine himself testified that at 9:29 a.m., he would not have agreed to "pair off" with anyone other than a very good customer.

misconduct. The respondents cannot be permitted to shift to the NASD responsibility for the Firm's decision to engage in the hedging transactions, regardless of the complexities involved in such transactions, or to shift to the NASD responsibility for their manipulative misconduct.

Second, the respondents argue that NASD Market Regulation Department staff, which investigated their bidding practices throughout the Summer and Fall of 1995, should have advised them that their bidding practices were impermissible. This argument, too, fails. Even if responsibility could ever be shifted to regulatory authorities, it could not be shifted here. During the early stages of the investigation, staff was unaware of the precise nature of the misconduct, which had come to staff's attention in the form of a complaint about locked and crossed markets. The attempt to shift responsibility to NASD Regulation staff is particularly inappropriate because scienter usually cannot be observed, and staff's mere presence on-site, which gave staff the ability to witness individual, potentially benign acts, did not enable staff to detect the manipulation as a whole. Under these circumstances, we find it no defense that the staff was unable to infer from the sweep of detail, some capable and some incapable of observation, the existence of the manipulation.

Third, the respondents argue that they did not have fair notice, via any rule or reported decision, that their bidding conduct would be viewed as impermissible. This argument fails, however, because respondents cannot be heard to argue, as a substantive defense, that they did not know that intentional manipulation is impermissible. (We have, however, taken this argument into account in assessing remedial sanctions against the respondents.)

Finally, the respondents challenge the fairness of the MRC's finding that Morgan Stanley engaged in a "pattern" of pre-open bidding activity in other securities that were included in the basket transactions between the Firm's Program Trading Desk and the OTC Desk on the two Expiration Fridays in question. The MRC found this so-called "pattern" to be probative of manipulative conduct. We find, however, that the claimed "pattern" evidence is not relevant to our review or to the assessment of sanctions because no pattern was alleged in the complaint, and we have not considered the "pattern" evidence.

B. The Locked and Crossed Markets

1. The Allegations. The ninth cause of the complaint alleged that Morgan Stanley -- but not the Respondent Traders -- violated Marketplace Rule 4613(e) and Conduct Rule 2110. The complaint alleged that Morgan Stanley caused locked markets in eight of the securities and a crossed market in one of them at the market's open; that the locked and crossed markets occurred during normal business hours; that no extraordinary circumstances existed; and that before entering the quotations that initiated the locked or crossed markets, the Respondent Traders did not make reasonable efforts to transact with the firms whose quotations would be locked or crossed.

When Morgan Stanley answered the complaint, it admitted that it had initiated locked and crossed quotations before the market opening and that it had maintained these locking or crossing quotations "briefly" after the market's opening. Morgan Stanley asserted, however, both: (1) that "extraordinary circumstances" had justified the entry of locking or crossing quotations; and (2)

that its OTC traders had made reasonable efforts to avoid entering locking or crossing quotations by transacting with the market makers whose quotations would be locked or crossed.

2. Marketplace Rule 4613(e). Marketplace Rule 4613 is entitled "Character of Quotations." Its first four subsections require that market makers enter two-sided quotations, that quotations be firm, and that quotations be reasonably related to the prevailing market and reasonably competitive. Subsection (e), entitled "Locked and Crossed Markets," prohibits market makers from entering or maintaining locking or crossing quotations on Nasdaq. During the relevant period, subsection (e) provided:

> (1) A market maker shall not, except under extraordinary circumstances, enter or maintain quotations in The Nasdaq Stock Market during normal business hours if:
>
> > (A) the bid quotation is equal to or greater than the asked quotation of another market maker entering quotations in the same security; or
> >
> > (B) the asked quotation is equal to or less than the bid quotation of another market maker entering quotations in the same security.
>
> (2) A market maker shall, prior to entering a quotation that locks or crosses another quotation, make reasonable efforts to avoid such locked or crossed market by executing transactions with all market makers whose quotation would be locked or crossed.

Rule 4613(e) (emphasis added).[29] Thus, the version of the rule that existed in 1995, which only applied during "normal business hours" (when quotations are binding), generally prohibited locked and crossed markets. The rule recognized exceptions for "extraordinary circumstances" and for market makers who made "reasonable efforts" to transact before entering locking or crossing quotations.[30]

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[29]When the NASD Manual was revised, Part V, Section 2 of Schedule D to the NASD By-Laws, which formerly contained the relevant rule ("Character of Quotations"), was renumbered as Rule 4613. More recently, in 1998, language was added specifically addressing quotations entered during the five minutes before the market's opening.

[30]We believe that neither "extraordinary circumstances" nor "reasonable efforts" were present in this matter. Thus, it is unnecessary to determine whether the rule requires that both be present for locked or crossed quotations to be permitted, or whether one of them can provide an excuse single-handedly. No interpretive materials specifically address this question, but various materials suggest that either, standing alone, will suffice. See NASD Regulatory & Compliance Alert, at 6 (Vol. 10, No. 2, July 1996) (the NASD will determine whether a firm that initiated a locked/crossed market complied with Rule 4613's requirement to take reasonable steps to avoid the situation by executing a transaction with the market maker whose quotation is being locked); NASD Regulatory & Compliance Alert, at 24 (Vol. 11, No. 3, Sept. 1997) ("Market makers are obligated to use reasonable means not to lock or cross the market.").

3. The Locked and Crossed Markets. It is undisputed that before the market openings on March 17 and October 20, 1995, Morgan Stanley, through the Respondent Traders, initiated locked quotation conditions in eight of the securities and a crossed quotation condition in one of the securities, and that the quotations for these securities were locked and crossed when the market opened. It is also undisputed that after the market opened, Morgan Stanley maintained these locked and crossed markets during normal business hours.

Morgan Stanley maintained the locked and crossed markets for an average of two minutes, 26 seconds after the open. The locked and crossed markets were as follows:

Security	Time Elapsed After Market Open Until Unlocked/Uncrossed
Bruno	7:17
Dell	1:28
Linear	1:29
Novell	2:02
Sybase	2:04
TCOMA	3:12
USHC	0:46 (crossed, not locked)
Vanguard	1:55
WMTT	1:42

We find that Morgan Stanley "maintained" locked and crossed markets, and we reject Morgan Stanley's claim to have engaged in "rapid responses" to the locked and crossed markets. There is no evidence that the Respondent Traders made any effort to correct the locked and crossed markets -- either by transacting with contra-side market makers or by downticking -- as soon as possible after the opening. Instead, Morgan Stanley proceeded in an extremely leisurely manner, and in a fashion interfering with the functioning of the Nasdaq market. We find, based on our industry expertise, that the time periods that passed before the conditions were corrected were extremely long. We also find that the locked and crossed markets were pervasive and intentional.

4. The Lack of "Extraordinary Circumstances." For the reasons stated by the MRC, we affirm the MRC's finding that no extraordinary circumstances justified the locked and crossed markets. First, as the MRC noted, there were no trading halts and no significant news about the issuers was released during the relevant periods. Second, the MRC properly rejected Morgan Stanley's claim that Expiration Fridays and "triple witch" Expiration Fridays[31] are "extraordinary circumstances." As the MRC found, even if Expiration Fridays were highly unusual in the early days of stock index options trading, by 1995 they had become predictable. We concur, and we note that we are unwilling to give market participants carte blanche to lock markets on Expiration Fridays.

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[31] A "triple witch" Expiration Friday occurs on the third Friday of each calendar quarter when stock index futures, stock index options, and individual stock options all expire. March 17, 1995 was a "triple-witch" Expiration Friday.

Third, the MRC properly rejected the respondents' argument that the SEC implicitly recognized that extraordinary circumstances exist on Expiration Fridays when it permitted the New York Stock Exchange ("NYSE") and other exchanges to adopt special procedures to deal with order imbalances and enhanced volatility on Expiration Fridays. (The MRC found that the SEC orders cited by the respondents actually indicated that the SEC had permitted the exchanges to change their methods of calculating the settlement values of various index products -- from a closing to an opening price settlement method -- in order to alleviate the stock market volatility and order imbalances that might otherwise be experienced on Expiration Fridays.[32]) We find that nothing in the cited releases is directly relevant to a determination of whether the "extraordinary circumstances" exception to Rule 4613(e) is applicable here.

Finally, we find that the MRC properly rejected the argument that the period surrounding the opening of the Nasdaq market always presents extraordinary circumstances.[33] As the MRC noted, the respondents' reasoning would allow market makers to initiate locked and crossed market conditions at the opening with impunity. In sum, we reject each of the respondents' arguments that extraordinary circumstances were present.[34]

5. <u>The Lack of "Reasonable Efforts."</u> We also find that Morgan Stanley failed to make "reasonable efforts" to avoid locking or crossing the markets. Morgan Stanley argued that the Rule requires a market maker to contact the contra side and try to transact ***at any time*** before entering a quotation that would create a locked or crossed condition, whether or not during normal business hours. Morgan Stanley asserted that the Respondent Traders had complied with the Rule because they had attempted (unsuccessfully) to contact contra-side market makers during the pre-opening period, when they initiated locked and crossed quotation conditions. The MRC found, however -- and we concur -- that Morgan Stanley's interpretation of the Rule is illogical, because market makers have no obligation to trade before the opening. We hold that any "reasonable efforts" to transact must be made during business hours.

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[32]<u>See</u> Exchange Act Rel. No. 37894 (Oct. 30, 1996) (NYSE auxiliary closing procedures); Exchange Act Rel. No. 36236 (Sept. 14, 1995) (Pacific Stock Exchange calculation of the settlement price of Technology Index Options); Exchange Act Rel. No. 30944 (July 21, 1992) (Chicago Board Options Exchange ("CBOE") calculation of the settlement price of SPX Options); Exchange Act Rel. No. 25804 (June 15, 1988) (NYSE calculation of the settlement value of NYSE Composite Index Options).

[33]The respondents cited a statement that the SEC made about the Limit Order Display Rule, which requires market makers to display customer limit orders within 30 seconds of receipt. Recognizing the increased activity at the opening, the SEC stated that during the opening a market maker must display the limit order as soon as practicable, instead of within 30 seconds. Nothing in this SEC statement, however, indicated that unusual, much less "extraordinary," circumstances exist at the opening of the market in a fashion relieving market makers of their obligation to avoid locking and crossing markets.

[34]We also note that at oral argument before the NAC Subcommittee, counsel for the respondents acknowledged that once the market had opened, "extraordinary circumstances" did not exist, other than in the subjective sense.

The record is clear that, although the Respondent Traders might have attempted to transact with contra-side market makers before initiating locked or crossed quotations during the pre-opening period, they did not make any reasonable attempts to transact ***at the time of the market opening***. The Respondent Traders uniformly testified that, before locking or crossing any quotations during the pre-opening period, they would have attempted to contact and transact with contra-side market makers. DeSalvo testified that he specifically recalled that the Respondent Traders had attempted to contact other market makers before locking or crossing quotations on the Expiration Fridays in question. However, the Respondent Traders did not even claim to have attempted -- ***at the opening*** of the market -- to contact and transact with the contra-side market makers whose quotes they had locked or crossed. The Respondent Traders also did not attempt to use SelectNet to transact with other market makers at 9:30 a.m.[35]

Thus, we find that Morgan Stanley was responsible for maintaining locked and crossed market conditions during normal business hours in violation of Marketplace Rule 4613(e) and, hence, Conduct Rule 2110.

IV. SANCTIONS

The MRC ordered that all respondents be censured; Morgan Stanley be fined $1 million individually; Slaine be fined $100,000 jointly and severally with the Firm and suspended in all capacities for 90 calendar days; each of the other Respondent Traders be fined $25,000, jointly and severally with the Firm, and suspended in all capacities for a period of 30 business days; and all respondents be assessed hearing costs. The MRC imposed sanctions on the Firm for manipulation, but not for the violation of Marketplace Rule 4613(e); the MRC treated the Rule 4613(e) violation as an aggravating factor with respect to the manipulation.

For the manipulations, we order that Crocamo, DeFelice, Ferrarese, Ferriso, Simonds, and Slaine each be fined $2,500.[36] We find that the NASD Sanction Guideline for marking the close should be applied to this matter.[37] We recognize that the guideline suggests that higher fines and

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[35]In 1997, the NASD noted that "reasonable means" to avoid locking and crossing a market include placing "a SelectNet order preferenced to the firm(s) at the bid or offer." NASD Notice to Members 97-49 (August 1997). However, the testimony of the Respondent Traders, which the MRC credited, was that it was not their practice in 1995 to use SelectNet to transact with other market makers.

[36]We note that the MRC imposed substantially higher sanctions on Slaine than on the other individual respondents. We find, however, that because the complaint did not allege that Slaine had engaged in supervisory misconduct, the sanctions imposed on him should be comparable to those imposed on the other respondents.

[37]See NASD Sanction Guidelines (1996 ed.) at 32 (Marking the Close). There is no general guideline for manipulation, and prior to 1998, there was no guideline specifically applicable to marking the open. Thus, although we find the 1996 version of the marking-the-close guideline instructive, we have considerable discretion in this matter.

We note that when the Sanction Guidelines were revised in 1998, the marking-the-close guideline was reissued as a guideline specifically applicable both to marking the close and

suspensions be imposed than we impose here, and we also recognize that market manipulations typically require the imposition of much more severe sanctions, but we find that the unusual circumstances that the respondents faced and the somewhat novel nature of their violations justify the imposition of individual sanctions below the range suggested by the marking-the-close guideline.

The evidence establishes that the individuals engaged in impermissible manipulative activity by upticking with the intention of affecting the opening print prices of the relevant securities; i.e., that the respondents' bids were both deceptive and artificial. We find, however, that although the individuals were fully aware of the artificial nature of their conduct, they were not necessarily aware that it would be viewed as illegal manipulative activity. A respondent's awareness of the illegality of his or her misconduct need not be established for a finding of violation, SEC v. Falstaff Brewing Corp., 629 F.2d 62, 77 (D.C. Cir.), cert. denied., 449 U.S. 1012 (1980), but we find that in the unique and novel circumstances of this case, the respondents' apparent lack of such awareness -- given their consistent behavior both before and after the NASD began investigating them, and while being watched closely by the Firm's compliance officials -- can properly be considered in this unusual case.

For the manipulation, we order that the Firm be censured and fined $450,000. This fine includes an assessment of $50,000 per manipulated security, i.e., a fine at the midpoint of the range suggested by the marking-the-close guideline. We believe that the MRC properly found, under the guideline, that the following aggravating factors are relevant to determining the appropriate remedial sanctions: (1) the misconduct involved nine securities that were components of the NDX; (2) the manipulative activities allowed the Firm to avoid potentially substantial losses; (3) the conduct was intentional; (4) the damage to the integrity of the market was significant; and (5) locked and crossed quotations were initiated and maintained as a means to influence the opening print prices of the relevant securities.

We note that the introduction to the 1996 Sanction Guidelines suggested that the sanctions recommended therein be imposed "in the aggregate rather than per individual violation," but that the introduction also specified that numerous violations should be viewed as aggravating. We find it appropriately remedial to impose on the Firm a fine of $50,000 per manipulated stock, rather than a single fine for all manipulations, because we do find it aggravating that this misconduct occurred on the part of six traders and in nine securities. On the other hand, given the changed circumstances since 1995 (i.e., the new method for calculating the settlement price of NDX options), we do not find that it would be appropriately remedial to suspend the Firm from market-making (as also suggested by the guideline).

Although the Firm's liability is derivatively based on the traders' conduct, we do not find the considerations applicable to the traders to be applicable to the Firm. First, we note that the Firm, not the individual traders, was the designated market maker in the relevant securities and had the primary responsibility for ensuring that they were traded in accordance with our rules. Second, we have considered that the Firm was the creator and the beneficiary of the situation that led to the traders' misconduct. The Firm: (1) entered into the transactions that created the need

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marking the open. Thus, it is clear that in any future marking-the-open cases, the sanctions imposed will be comparable to those that would be imposed for marking the close.

for the hedges whose unwinding necessitated the basket trading; (2) ordered the OTC Desk traders to handle the basket trading; (3) was aware that the individual securities' opening prices would affect not only the Nasdaq market but also the NDX option prices; and (4) was capable of discerning that the traders were engaging in misconduct and that markets were being locked and crossed. Given these circumstances, we find that serious sanctions must be imposed to ensure that other employers take care to prevent similar circumstances from arising.

In connection with the Firm's nine violations of the Locked and Crossed Markets Rule, Marketplace Rule 4613(e), we order that the Firm be censured and fined $45,000. The NASD Sanction Guideline[38] for violations of Marketplace Rule 4613(e) recommends a Letter of Caution for a first violation, a fine of up to $1,000 for a second violation, and fines of $1,000 to $10,000 for subsequent violations, with the possibility of higher fines in egregious cases. Against the background of the Firm's previous sanctions for locked and crossed markets, and given the pervasive and intentional nature of the misconduct here, we find that a fine of $5,000 per locked or crossed market is appropriately remedial in this action. We find that these serious sanctions are necessary because Morgan Stanley did not attempt to correct the crossed and locked markets as soon as possible after the opening.

Finally, we order that the Firm be assessed the MRC hearing costs of $11,589.55.

Accordingly, we order that Morgan Stanley be censured, fined $495,000, and assessed MRC hearing costs in the amount of $11,589.55 and that respondents Crocamo, DeFelice, Ferrarese, Ferriso, Simonds, and Slaine each be fined $2,500.[39]

On Behalf of the National Adjudicatory Council,

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Joan C. Conley, Senior Vice President and Corporate Secretary

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[38]See Sanction Guidelines (1996 ed.) at 31 (Locked/Cross Market: Schedule D, Part V, Section 2(e) to the NASD By-Laws).

[39]We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Pursuant to NASD Procedural Rule 8320, any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.