

**Disciplinary Panel
American Stock Exchange LLC**

IN THE MATTER
OF
LEHMAN BROTHERS, INC.

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:
: Case No. 04-217
: Hearing Officer – DMF
:
: **DECISION**
: May 23, 2005
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In accordance with a Stipulation of Facts and Consent to Penalty, the Disciplinary Panel Chair determined that Respondent violated Article V, Section 4(h), Exchange Rule 16 and Exchange Rule 320(b) and (c), as stipulated, and as a penalty imposed a censure and a fine of \$10,000.

I. Introduction

The American Stock Exchange, LLC (the “Exchange”) instituted a formal disciplinary proceeding against Lehman Brothers, Inc., a Regular Member Organization of the Exchange. The Disciplinary Panel Chair, presiding without convening a full Disciplinary Panel, pursuant to Article V, Section 1(b) of the Exchange Constitution, held a hearing on April 11, 2005, pursuant to Article V, Section 2 of the Exchange Constitution, to review a Stipulation of Facts and Consent to Penalty (Stipulation). The Exchange and Lehman Brothers entered into that Stipulation for the purposes of settling this proceeding and concluding all disciplinary actions by the Exchange against Lehman Brothers based upon or arising out of the facts set forth in the Stipulation.

II. Stipulated Facts

Lehman Brothers, without admitting or denying liability, stipulated to the facts, set forth in the Stipulation of Facts and Consent to Penalty. The Disciplinary Panel Chair has determined to accept the facts for purposes of this Decision, and they are incorporated herein, as follows:

1.0 During all relevant periods herein, Lehman was a Regular Member Organization of the Exchange.

2.0 During all relevant periods herein, Lehman was subject to Exchange Constitution Article V, Section 4(h), which provided:

Violation of Constitution, Rules or Resolution --Inequitable Conduct (h) A member, member organization or approved person who or which shall be adjudged guilty in a proceeding under this Article of a violation of the Constitution of the Exchange, of a violation of a rule adopted pursuant to the Constitution, of a violation of a resolution of the Board of Governors regulating the conduct or business of members or member organizations, or of conduct or proceeding inconsistent with just and equitable principles of trade, may, if a member or member organization, be suspended or expelled from membership or, if an approved person have his approval withdrawn, unless the offense is the violation of a provision, rule or resolution for which a different penalty has been provided, in which case such other penalty may be imposed.

2.1 During all relevant periods herein, Lehman was subject to Exchange Rule 16, which provided “[e]very member and member organization shall at all times adhere to the principles of good business practice in the conduct of his business affairs.”

2.2 During all relevant periods herein, Lehman was subject to Exchange Rule 320(b) and (c), which provided:

(b) Each office, department or business activity of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility.

The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer including compliance with securities laws and regulations.

(c) The general partners, directors, trustees of each member organization shall provide for appropriate supervisory control and shall designate a general partner, principal executive officer,

trustee to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. This person shall:

(1) delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control; and

(2) establish a separate system of follow-up and review to verify that the delegated authority and responsibility is being properly exercised.

Testing of Order Routing System

- 3.0 During all relevant periods herein, ABC Corporation (“ABC”) stock was listed for trading on the Exchange. On trade date June 11, 2003, ABC opened at \$18.49 and closed at \$19.40. The low of the day was \$18.23 and the high was \$19.40. The trading volume on June 11, 2003 was 1,493,600 shares.
- 3.1 During all relevant periods herein, DEF (“DEF”) stock was listed for trading on the Exchange. On trade date June 11, 2003, DEF opened at \$48.50 and closed at \$49.35. The low of the day was \$48.01 and the high was \$49.35. The trading volume on June 11, 2003 was 78,800 shares.
- 3.2 During all relevant periods herein, GHI Company (“GHI”) stock was listed for trading on the Exchange. On trade date June 11, 2003, GHI opened at \$25.92 and closed at \$26.61. The low of the day was \$25.87 and the high was \$26.71. The trading volume on June 11, 2003 was 85,600 shares.
- 3.3 During all relevant periods herein, JKL Corporation (“JKL”) stock was listed for trading on the Exchange. On trade date June 11, 2003, JKL opened at \$53.30 and closed at

\$55.95. The low of the day was \$53.25 and the high was \$56.20. The trading volume on June 11, 2003 was 2,402,900 shares.

3.4 During all relevant periods herein, MNO, Incorporation (“MNO”) stock was listed for trading on the Exchange. On trade date June 11, 2003, MNO opened at \$415.00 and closed at \$419.05. The low of the day was \$410.25 and the high was \$421.40. The trading volume on June 11, 2003 was 56,800 shares.

3.5 During all relevant periods herein, PQR Corporation (“PQR”) stock was listed for trading on the Exchange. On trade date June 11, 2003, PQR opened at \$111.76 and closed at \$112.15. The low of the day was \$111.75 and the high was \$112.30. The trading volume on June 11, 2003 was 5,600 shares.

4.0 On trade date June 11, 2003, Lehman entered 106 odd lot orders at a limit price of \$0.01 in six different Exchange-listed securities: ABC, DEF, GHI, JKL, MNO, and PQR, identified in paragraphs 3.0 through 3.5 above. All orders were entered between approximately 2:11 p.m. and 2:44 p.m. None of the orders were executed because the market in each of the securities was considerably above the limit price at the time the orders were entered. Each order was cancelled shortly after having been entered.

4.1 These six securities, as identified in paragraphs 3.0 through 3.5 above, were part of a larger basket of stocks formulated by Lehman and intended to replicate trading in listed and NASDAQ securities during the re-balance of the Russell 2000 Index scheduled for June 30, 2003. Lehman used these baskets to perform tests to determine whether its systems could handle the volume of trading expected on June 30, 2003. The test was undertaken because of the Firm’s concerns about volume capacity problems which it had

encountered using a different system during a NASDAQ re-balancing which occurred on December 20, 2002.

4.2 The Securities Industry Automation Corporation (“SIAC”) provides a means through which firms may test their order-routing systems without having to enter orders in a “live” environment.

Supervision

5.0 During the relevant period herein, Lehman did not have written supervisory procedures or controls in place to prevent the entry of orders in a “live” environment as a means of testing the capacity of an order-routing system.

III. Violations

Based upon the stipulated facts, the Disciplinary Panel Chair concludes that Lehman Brothers:

(1) violated Article V, Section 4(h) of the Exchange Constitution, and Exchange Rule 16, on June 11, 2003, by allowing its trading desk to enter 106 odd lot orders through the Exchange’s electronic order entry system as a test of the capacity of the firm’s own order entry system in a “live” environment;

(2) violated Exchange Rule 320(b) and (c) by failing to have in place written supervisory procedures, or a system of controls, designed to detect and prevent the entry of multiple odd lot orders through the Exchange’s electronic order entry system when conducting a test of the capacity of the firm’s own order entry system in a “live” environment.

IV. Penalties and Publicity

The Stipulation proposes that the Disciplinary Panel Chair impose a censure and a fine of \$10,000 on Lehman Brothers. After considering the stipulated facts and the statements of the

parties, as well as the decisions cited in the Exchange's precedent memorandum, the Chair finds that the proposed penalty is appropriate under the facts and circumstances of this case, and therefore it will be imposed. The Chair further finds that the results of this disciplinary proceeding should be publicly disclosed, as provided in Rule 12 of the Exchange Rules on Disciplinary Proceedings.¹

V. Conclusion

The Disciplinary Panel Chair accepts the Stipulation of Facts and Consent to Penalty and hereby imposes upon Lehman Brothers, Inc. a censure and a fine of \$10,000.

FOR THE DISCIPLINARY PANEL

David M. FitzGerald, Chair

Copies to: Lynne Johnston, Esq. (*via facsimile and first class mail*)
Alison H. Mijares, Esq. (*electronically and via first class mail*)
Arlene Collins-Day (*electronically and via first class mail*)

¹ Rule 12 exempts from publicity those cases in which the Panel finds that the offense "related solely to minor administrative requirements of the Exchange and does not materially affect the public interest or the interest of investors." Those exemptions do not apply to the facts of this case.

Disciplinary Panel
American Stock Exchange LLC

.....X	X	
	X	
IN THE MATTER	X	STIPULATION OF FACTS
OF	X	AND
LEHMAN BROTHERS, INC.	X	CONSENT TO PENALTY
	X	Case No. 04-217
	X	
.....X		

This proceeding was instituted by the American Stock Exchange LLC (the “Exchange”) against LEHMAN BROTHERS, INC. (“Lehman” or the “Firm”) (CRD# 7506), a Regular Member Organization of the Exchange. This Stipulation of Facts and Consent to Penalty is entered into pursuant to Article V, Section 2 of the Exchange Constitution in order to settle and conclude all disciplinary actions by the Exchange against Lehman based upon or arising out of the facts hereinafter stipulated. Lehman, without admitting or denying the facts, allegations and conclusions contained in this Stipulation of Facts and Consent to Penalty, hereby consents to the entry of findings of violations of the Exchange Constitution and Rules and the imposition of the penalties hereinafter provided. Lehman understands that this settlement is subject to approval by an Exchange Disciplinary Panel and by the Amex Adjudicatory Council and that, if so approved, shall constitute a final decision, which may not be appealed by the parties. Lehman understands and acknowledges that the Disciplinary Panel’s decision in this matter will become part of its disciplinary record and may be considered in any future proceeding brought by the Exchange.

STIPULATED FACTS

1.0 During all relevant periods herein, Lehman was a Regular Member Organization of the Exchange.

2.0 During all relevant periods herein, Lehman was subject to Exchange Constitution Article V, Section 4(h), which provided:

Violation of Constitution, Rules or Resolution --Inequitable Conduct

(h) A member, member organization or approved person who or which shall be adjudged guilty in a proceeding under this Article of a violation of the Constitution of the Exchange, of a violation of a rule adopted pursuant to the Constitution, of a violation of a resolution of the Board of Governors regulating the conduct or business of members or member organizations, or of conduct or proceeding inconsistent with just and equitable principles of trade, may, if a member or member organization, be suspended or expelled from membership or, if an approved person have his approval withdrawn, unless the offense is the violation of a provision, rule or resolution for which a different penalty has been provided, in which case such other penalty may be imposed.

2.1 During all relevant periods herein, Lehman was subject to Exchange Rule 16, which provided “[e]very member and member organization shall at all times adhere to the principles of good business practice in the conduct of his business affairs.”

2.2 During all relevant periods herein, Lehman was subject to Exchange Rule 320(b) and (c), which provided:

(b) Each office, department or business activity of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility.

The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer including compliance with securities laws and regulations.

(c) The general partners, directors, trustees of each member organization shall provide for appropriate supervisory control and shall designate a general partner, principal executive officer, trustee to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. This person shall:

(1) delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control; and

(2) establish a separate system of follow-up and review to verify that the delegated authority and responsibility is being properly exercised.

Testing of Order Routing System

- 3.0 During all relevant periods herein, ABC Corporation (“ABC”) stock was listed for trading on the Exchange. On trade date June 11, 2003, ABC opened at \$18.49 and closed at \$19.40. The low of the day was \$18.23 and the high was \$19.40. The trading volume on June 11, 2003 was 1,493,600 shares.
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- 3.5 During all relevant periods herein, PQR Corporation (“PQR”) stock was listed for trading on the Exchange. On trade date June 11, 2003, PQR opened at \$111.76 and closed at \$112.15. The low of the day was \$111.75 and the high was \$112.30. The trading volume on June 11, 2003 was 5,600 shares.
- 4.0 On trade date June 11, 2003, Lehman entered 106 odd lot orders at a limit price of \$0.01 in six different Exchange-listed securities: ABC, DEF, GHI, JKL, MNO, and PQR, identified in paragraphs 3.0 through 3.5 above. All orders were entered between approximately 2:11 p.m. and 2:44 p.m. None of the orders were executed because the market in each of the securities was considerably above the limit price at the time the orders were entered. Each order was cancelled shortly after having been entered.
- 4.1 These six securities, as identified in paragraphs 3.0 through 3.5 above, were part of a larger basket of stocks formulated by Lehman and intended to replicate trading in listed and NASDAQ securities during the re-balance of the Russell 2000 Index scheduled for June 30, 2003. Lehman used these baskets to perform tests to determine whether its systems could handle the volume of trading expected on June 30, 2003. The test was undertaken because of the Firm’s

concerns about volume capacity problems which it had encountered using a different system during a NASDAQ re-balancing which occurred on December 20, 2002.

- 4.2 The Securities Industry Automation Corporation (“SIAC”) provides a means through which firms may test their order-routing systems without having to enter orders in a “live” environment.

Supervision

- 5.0 During the relevant period herein, Lehman did not develop, maintain and enforce written supervisory procedures, or a system of controls, designed to detect and prevent the entry of orders in a “live” environment as a means of testing the capacity of an order-routing system.

CONCLUSION

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

- 6.0 Lehman violated Article V, Section 4(h) of the Exchange Constitution, which prohibits engaging in conduct inconsistent with just and equitable principles of trade, and Exchange Rule 16, which requires members and member organizations adhere to the principles of good business practice, when the firm allowed its trading desk to enter multiple odd lot orders through the Exchange's electronic order entry system as a test of the capacity of the firm's own order entry system in a "live" environment, as set forth in paragraphs 3.0 through 4.2.
- 6.1 Lehman violated Exchange Rule 320(b) and (c) by failing to have in place written supervisory procedures, or a system of controls, designed to detect and prevent the entry of multiple odd lot orders through the Exchange's electronic order entry system when conducting a test of the capacity of the firm's own order entry system in a "live" environment, as set forth in paragraph 5.0.

DISCIPLINARY ACTION:

By reason of the foregoing stipulated facts, a Disciplinary Panel may impose the following penalty upon Lehman Brothers, Inc.:

- (a) a censure; and
- (b) a \$10,000 fine.

On Behalf of the: AMERICAN STOCK EXCHANGE LLC

David Rosenstein
Vice President and Chief Counsel
NASD Amex Regulation Division

Agreed to this _____ day of _____, 2005.

On Behalf of Lehman Brothers, Inc.