

II. Facts

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

III. Violations

Based upon the stipulated facts, the Chair concludes that Merrill Lynch:

(1) violated Exchange Rule 153A during the period from October 2003 through June 2005 by submitting erroneous blue sheet trade information to the Exchange in response to requests made in the context of ongoing Exchange investigations;

(2) violated Exchange Constitution Article V, Section 4(h) by engaging in conduct inconsistent with just and equitable principles of trade, in that during the period from October 2003 through June 2005, and in response to requests made in the context of ongoing Exchange investigations, the Firm submitted erroneous electronic blue sheet trade information to the Exchange; and

(3) violated Exchange Rule 320 during the period from October 2003 through June 2005 by (i) failing to establish and maintain appropriate policies, systems and procedures of supervision and control, including written supervisory procedures and (ii) failing to establish a separate system of follow-up and review to ensure compliance with the Exchange rule pertaining to the automated submission of accurate trade information to the Exchange.

IV. Penalties and Publicity

The Stipulation proposes that the Disciplinary Panel Chair impose on Merrill Lynch a censure, a \$500,000 fine to be paid jointly to the NYSE and the Exchange, and a requirement that the Firm conduct a validation of all required blue sheet data elements in accordance with ISG Regulatory Memorandum, ISG 2005-01. The Stipulation further states “Merrill Lynch

undertakes to submit a signed, dated letter to the COMPLIANCE ASSISTANT, NASD AMEX REGULATION DIVISION, ENFORCEMENT DEPARTMENT, ONE LIBERTY PLAZA, NEW YORK, NY 10006, providing the following information: (1) a reference to this matter; (2) a representation that the firm has completed its validation to address the deficiencies described in paragraphs 2.0 through 2.18; and (3) the date the validation was completed.”

At the hearing, the Parties urged the Disciplinary Panel Chair to approve the proposed penalty. After considering the Stipulation and the statements of the parties, as well as the decisions cited in the Exchange’s precedent memorandum and the fact that this is a joint settlement with the NYSE, the Chair finds that the proposed penalties are appropriate under the facts and circumstances of this case. Therefore, the Chair approves the Stipulation of Facts and Consent to Penalty. An NYSE Hearing Panel approved the NYSE settlement on January 3, 2006. 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 Merrill Lynch, Pierce, Fenner & Smith, Incorporated, a censure, a \$500,000 fine to be paid jointly to the NYSE and the Exchange, and a requirement that the Firm conduct a validation of all required blue sheet data elements in accordance with ISG Regulatory Memorandum, ISG 2005-01, as outlined above.

FOR THE DISCIPLINARY PANEL

Rochelle S. Hall, Chair

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.” That exemption does not apply to the facts of this case.

Copies to: Adrienne M. Ward, Esq. (*via facsimile and first class mail*)
Merrill Lynch, Pierce, Fenner & Smith, Inc. (*via overnight and first class mail*)
Jennifer D. Kim, Esq. (*electronically and via first class mail*)
Arlene Collins-Day (*electronically and via first class mail*)

Disciplinary Panel
American Stock Exchange LLC

.....X
X
IN THE MATTER X STIPULATION OF FACTS
OF X AND
MERRILL LYNCH, PIERCE X CONSENT TO PENALTY
FENNER & SMITH, INCORPORATED X
X
.....X

Case No. 05-95

This proceeding was instituted by the American Stock Exchange LLC (“AMEX” or the “Exchange”) against MERRILL LYNCH, PIERCE, FENNER & SMITH Incorporated (“Merrill Lynch” or “the Firm”) (CRD #7691), a Regular Member of the Exchange. This Stipulation of Facts and Consent to Penalty is entered into with Merrill Lynch pursuant to Article V, Section 2, of the Exchange Constitution in order to settle and conclude all disciplinary actions by the Exchange against Merrill Lynch based upon or arising out of the facts hereinafter stipulated. Merrill Lynch, without admitting or denying the facts, allegations and conclusions contained in this Stipulation of Facts and Consent to Penalty, hereby consents to the findings of violations of the Exchange Constitution and Rules and to the imposition of the penalties hereinafter provided. Merrill Lynch 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 that may not be appealed by the parties. Merrill Lynch 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 times, Merrill Lynch was a Delaware corporation with its principal place of business in New York, New York.
- 1.1 During all relevant periods herein, Merrill Lynch was a regular member organization of the Exchange and the New York Stock Exchange, Inc. (“the “NYSE”).
- 1.2 During all relevant periods herein, Merrill Lynch was a global investment banking and multi-service brokerage firm that, among other things, trades securities for institutional and individual customers.
- 1.3 During all relevant periods herein, Amex Rule 153A provided in relevant part:

A member or member organization shall submit such of the following trade data elements specified below in such automated format as may be prescribed by the Exchange from time to time, in regard to such transaction or transactions as may be subject of a particular request for information made by the Exchange:

(a) If the transaction was a proprietary transaction effected or caused to be effected by the member or member organization for any account in which such member or member organization, or any member, allied member, approved person, partner, officer, director, or employee thereof, is directly or indirectly interested, such member or member organization shall submit or cause to be submitted the following information:

(1) Clearing house number, or alpha symbol as used by the member or the member organization submitting the data;

(2) Clearing house number(s), or alpha symbol(s) as may be used from time to time, of the member(s) or member organization(s) on the opposite side of the transaction;

(3) Identifying symbol assigned to the security;

(4) Date transaction was executed;

(5) Number of shares, or quantity of bonds or options contracts for each specific transaction and whether each transaction was a purchase, sale, short

sale and if an options contract whether open long or short or close long or short;

(6) Transaction price;

(7) Account number; and

(8) Market center where transaction was executed.

(b) If the transaction was effected or caused to be effected by the member or member organization for any customer account, such member organization shall submit or cause to be submitted the following information:

(1) Data elements (1) through (8) as contained in paragraph (a) above; and

(2) Customer name, address(es), branch office number, registered representative number, whether order was solicited or unsolicited, date account opened and employer name and the tax identification number(s).

(3) If transaction was effected for a member broker-dealer customer, whether the broker-dealer was acting as principal or agent on the transaction or transactions that are the subject of the Exchange's request.

(c) In addition to the above trade data elements, a member or member organization shall submit such other information in such automated format as may be prescribed by the Exchange, as may from time to time be required.

(d) The Exchange may grant exceptions, in such cases and for such time periods as it deems appropriate, from the requirement that the data elements prescribed in paragraphs (a) and (b) above be submitted to the Exchange in an automated format.

1.4 During all times relevant herein, Exchange Rule 320 provided in relevant part:

(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.

1.5 During all relevant periods herein, Article V, Section 4(h) of the Exchange Constitution provided:

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 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.

Background of Merrill Lynch’s Electronic Blue Sheet Reporting Violations

2.0 This action concerns submissions by Merrill Lynch to the Exchange of inaccurate Electronic Blue Sheets (“EBS”) (“blue sheets”)¹ in violation of Exchange Rule 153A. Pursuant to NYSE Rule 410A, Merrill Lynch was also obligated to submit accurate trade information electronically to the NYSE in response to a NYSE request.

¹ Blue sheets are generated by member organizations at the request of regulators in connection with investigations of questionable trading. The blue sheets provide, *inter alia*, information identifying the account holder for whom specific trades were executed, indicating whether the transaction was a buy or a sell and long or short. The receipt and review of blue sheets are an essential component of Exchange investigations into matters such as potential insider trading or market manipulation, and potential violations of Rule 105 of Regulation M, under the Securities Exchange Act of 1934, which prohibits the covering of a short sale with securities obtained in a public offering, if the short sale occurred within five days of the date when the offering was priced.

- 2.1 These EBS reporting violations occurred from October 2003 through June 2005.
- 2.2 These EBS reporting violations pertain to Merrill Lynch's submission of trade information to the Exchange regarding trading in Lion's Gate Entertainment ("LGF"), Arrhythmia Research Technology ("HRT") and Nabor Industries, Inc. ("NBR") stock.

LGF Stock

- 2.3 During the course of an investigation of certain trading activity conducted by the Market Surveillance Department ("MSD") of the Amex Regulation Division for possible violations of Rule 105 of Regulation M under the Securities Exchange Act of 1934² for the time period of October 2, 2003 through October 8, 2003, MSD obtained information identifying Merrill Lynch as the initial clearing broker on short sales in LGF prior to the pricing of a secondary offering of LGF shares.
- 2.4 In connection with MSD's investigation as set forth in paragraph 2.3 above, on or about December 1, 2003, MSD requested EBS submissions from Merrill Lynch with regard to the subject LGF trades under review by MSD.
- 2.5 On December 5, 2003, Merrill Lynch, in response to MSD's request, submitted blue sheet information on the trading activity in LGF to the Exchange. Merrill Lynch's blue sheet submission indicated that a number of *long sales* of LGF shares were effected for "ABC" Securities, LLC, on behalf of "DEF" firm.
- 2.6 MSD's review of the Amex Audit Trail for October 8, 2003 revealed that short sales of 90,000 shares of LGF had been identified as long sales for Merrill Lynch (Clearing Member ("CM") 161).

² This rule prohibits the covering of a short sale with securities obtained in a public offering if the short sale occurred within five days of the date when the offering was priced.

2.7 Merrill Lynch, in response to the Exchange's request made in connection with its ongoing investigation of LGF trading, reported incorrectly the short sales of 90,000 shares, identified in paragraph 2.6 above, as long sales in its blue sheet submission filed with the Exchange.

HRT Stock

2.8 MSD conducted an investigation regarding short sale violations in HRT during the period from December 5, 2003 through December 8, 2003. Specifically, MSD reviewed trading activity in HRT shares to ascertain short sales and confirmation of affirmative determination requirements prior to the execution of said short sales.

2.9 In connection with MSD's investigation as set forth in paragraph 2.8 above, on December 23, 2003, MSD requested EBS submissions from Merrill Lynch with regards to the subject HRT trades under review by MSD.

2.10 On or about January 9, 2004, Merrill Lynch, in response to MSD's request, submitted blue sheet information on the trading activity in HRT to the Exchange. Merrill Lynch's blue sheet submission indicated that long sales of 21,400 HRT shares were effected by "ABC" Securities, LLC for the account of "DEF" Partners with "GHI" Securities LLC.

2.11 MSD's review of the Amex PER Merged Order Log disclosed the "DEF" transactions in HRT under review by the Exchange, and reported by Merrill Lynch in its blue sheet submission as long sales, were in fact short sales.

2.12 Merrill Lynch, in response to the Exchange's request made in connection with its ongoing investigation of HRT trading, reported incorrectly the short sales of 21,400 shares,

identified in paragraph 2.10 above, as *long sales* in its blue sheet submission filed with the Exchange.

Exchange Request for Corrective Action by Merrill With Respect to its EBS Submissions:

- 2.13 Given Merrill Lynch's inaccuracies in connection with blue sheet information, as set forth in above paragraphs 2.3 to 2.12, on or about May 19, 2004, MSD requested that Merrill Lynch take corrective action necessary to remediate the problems which resulted in the Firm's inaccurate submission of EBS information to the Exchange. MSD requested that Merrill Lynch remediate its EBS problems no later than July 2, 2004.
- 2.14 On or about July 15, 2004, Merrill Lynch advised the Exchange that it had taken the necessary corrective action to ensure the accurate submission of EBS information by the Exchange's deadline.

NBR Stock

- 2.15 In verifying that Merrill Lynch had taken the corrective measures with respect to accuracy of its EBS submissions, on September 21, 2004, MSD initiated a review into the trading activity of NBR common stock by Merrill Lynch for the time period from August 30, 2004 through September 3, 2004. MSD reviewed the "5 Day Short Sale Concentration Report" in NBR for the period of August 8, 2004 through September 3, 2004, which disclosed that Merrill Lynch was the initial clearing broker for short sales of 21,000 shares of NBR.
- 2.16 In connection with MSD's review as set forth in paragraph 2.15 above, on or about September 23, 2004, MSD requested an EBS submission from Merrill Lynch with regard to the subject NBR trades under review by MSD.

- 2.17 On October 7, 2004, Merrill Lynch, in response to MSD's request, submitted blue sheet information on the trading activity in NBR to the Exchange. Merrill Lynch's blue sheet submission was based on inaccurate trade data. The trade file and resulting blue sheet indicated that "ABC" Securities, LLC, purportedly effected long sales OTC on September 1, 2004, for two accounts, "HIJ" Advisors and "KLM." Merrill Lynch did not have an exception report in place to compare the Amex PER Merged Order Log to possible inconsistent trade data submitted by its correspondent firms.
- 2.18 MSD's review of the Amex PER Merged Order Log disclosed the "ABC" transactions in NBR under review by the Exchange, and reported by Merrill Lynch in its blue sheet submission as *long* sales, were in fact short sales.

Failure to Supervise

- 3.0 During the period October 2003 through June 2005, Merrill Lynch failed to develop, maintain and enforce reasonable written supervisory procedures with regards to ensuring the accuracy of its EBS submissions to the Exchange so as to prevent violation of the Exchange rule pertaining to the automated submission of accurate trading information to the Exchange.
- 3.1 During the period October 2003 through June 2005, Merrill Lynch failed to establish a separate system of follow-up and review sufficient to reasonably ensure that supervisory authority and responsibility in connection with the automated submission of accurate trading information to the Exchange was being properly exercised.
- 3.2 During the period October 2003 through June 2005, Merrill Lynch failed to establish adequate policies or procedures, or a system to implement such policies or procedures,

which would reasonably be expected to detect violations of the Exchange rule pertaining to the automated submission of accurate trading information to the Exchange.

- 3.3 During the period October 2003 through July 2004, the Firm's systems failed to transfer certain information regarding proprietary trades to another of its systems. Specifically, the Firm's system coded certain of its correspondent firms as market makers, which caused an automatic and erroneous conversion of their transactions coded as short sales to long sales. During the period October 2003 through June 2005, Merrill Lynch did not detect that certain of its correspondent firms failed to provide it with accurate and/or complete information.
- 3.4 As part of an ongoing process to enhance its policies and procedures pertaining to EBS submissions, Merrill Lynch implemented an exception report in June 2005 and written supervisory procedures in August 2005.

CONCLUSIONS:

By reasons of the above, a Disciplinary Panel may conclude that:

- 4.0 Merrill Lynch violated Exchange Rule 153A in that during the period from October 2003 through June 2005, and in response to requests made in the context of ongoing Exchange investigations, the Firm submitted erroneous electronic blue sheet trade information to the Exchange, as set forth in paragraphs 2.0 through 2.18.
- 4.1 Merrill Lynch violated Article V, Section 4(h) of the Exchange Constitution, engaging in conduct or proceeding inconsistent with just and equitable principles of trade, in that during the period from October 2003 through June 2005, and in response to requests made in the context of ongoing Exchange investigations, the Firm submitted erroneous

electronic blue sheet trade information to the Exchange, as set forth in paragraphs 2.0 through 2.18.

- 4.2 Merrill Lynch violated Exchange Rule 320 in that during the period from October 2003 through June 2005, the firm failed to establish and maintain appropriate policies, systems and procedures of supervision and control, including written supervisory procedures and failed to establish a separate system of follow up and review to ensure compliance with the Exchange rule pertaining to the automated submission of accurate trade information to the Exchange, as set forth in above paragraphs 3.0 through 3.4.

DISCIPLINARY ACTION:

By reason of the foregoing Stipulated Facts, a Disciplinary Panel may impose the following penalties upon the Firm:

- (a) a censure;
- (b) a total fine of \$500,000 to be paid jointly to the Exchange and the NYSE; and
- (c) a requirement that the Firm will conduct a validation of all required blue sheet data elements in accordance with ISG Regulatory Memorandum, ISG 2005-01. Merrill Lynch undertakes to submit a signed, dated letter to the COMPLIANCE ASSISTANT, NASD AMEX REGULATION DIVISION, ENFORCEMENT DEPARTMENT, ONE LIBERTY PLAZA, NEW YORK, NY 10006, providing the following information: (1) a reference to this matter; (2) a representation that the firm has completed its validation to address the deficiencies described in paragraphs 2.0 through 2.18; and (3) the date the validation was completed.

Merrill Lynch hereby acknowledges that it has read carefully this Stipulation and understands all of the provisions contained herein; that it has agreed to its provisions voluntarily; and that no offer, promise, threat or inducement of any kind has been tendered to Merrill Lynch by the Exchange, its staff or representatives to induce Merrill Lynch to enter into this Stipulation, aside from the prospect of settling this disciplinary proceeding based on the terms and conditions set forth in this Stipulation rather than adjudicating this matter by way of a hearing on a Charge Memorandum as provided by Exchange rules.

ON BEHALF OF:
AMERICAN STOCK EXCHANGE LLC

By: _____

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

Agreed to this _____ day of _____, 2005.

On behalf of Merrill Lynch, Pierce
Fenner & Smith, Incorporated