



### **III. Violation**

Based upon the stipulated facts, the Disciplinary Panel concludes that:

- 1.) Merrill Lynch violated Exchange Rule 208 and Article V, Section 4(h) of the Exchange Constitution in that the Firm did not aggregate multiple odd-lot orders entered by a customer through the Firm's PER connection to the Exchange Floor, as set forth in paragraphs 3.0 through 3.4.
- 2.) Merrill Lynch violated Exchange Rule 320(b) in that the Firm did not have reasonable policies or procedures in place designed to detect or prevent an account or related accounts from entering multiple odd-lot orders, rather than larger round lot orders, into the Firm's PER system, as set forth in paragraph 4.0.

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

The Stipulation proposes that the Disciplinary Panel impose a censure and a \$30,000 fine for the above misconduct. At the hearing, the Parties urged the Disciplinary Panel to accept the proposed penalty as being appropriate to the facts and circumstances of this case. After consideration of the Stipulation and the agreed-upon penalty, the Disciplinary Panel finds the proposed penalty is at the appropriate level to be imposed in this proceeding and therefore accepts the penalty proposed in the Stipulation.

The Disciplinary Panel 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.<sup>1</sup>

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<sup>1</sup> Rule 12 exempts from publicity those cases where 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.

**V. Conclusion**

Based on the foregoing, the Disciplinary Panel, by unanimous vote, accepts the Stipulation of Facts and Consent to Penalty and hereby imposes a censure and a fine of \$30,000 upon Merrill Lynch.

**FOR THE DISCIPLINARY PANEL**

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Jerome Nelson, Chair

Dated: November 4, 2003

Copies to: Michael D. Solomon, Esq. (*via facsimile and first class mail*)  
Justin Kletter, Esq. (*via facsimile and first class mail*)

Disciplinary Panel  
American Stock Exchange LLC

.....X	X	
	X	
IN THE MATTER	X	STIPULATION OF FACTS
OF	X	AND
MERRILL LYNCH, PIERCE,	X	CONSENT TO PENALTY
FENNER & SMITH,	X	Case No. 02-02
INCORPORATED	X	
	X	
.....X	X	

This proceeding was instituted by the American Stock Exchange LLC (the “Exchange”), against MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED (“Merrill” or the “Firm”) (CRD No. 7691), a Regular Member Organization of the Exchange. This Stipulation of Facts and Consent to Penalty is entered into with Merrill pursuant to Article V, Section 2 of the Exchange Constitution in order to settle and conclude all disciplinary actions by the Exchange against Merrill based upon or arising out of the facts hereinafter stipulated. Merrill, 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. Merrill 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. Merrill 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, Merrill was a Regular Member Organization of the Exchange.

1.1 During all relevant periods herein, Public Customer A ("Customer A") was an institutional client of Merrill. Customer A is not a member of the Exchange and, accordingly, is neither subject to the Exchange's jurisdiction nor a party to this Stipulation.

1.2 During all relevant periods herein, customers of Merrill, including Customer A, submitted orders through Merrill's electronic proprietary order entry system. Merrill's electronic proprietary order entry system directed orders to a second proprietary computer system at Merrill's portfolio trading desk, the Aspen system. The Aspen system employed a mathematical formula to determine the amount of an order to complete at a specific time in order to receive an average price without the intervention of a broker. The program utilized by the Aspen system was Merrill's Volume Weighted Average Price Program (the "VWAP program"). The VWAP program split a large order into smaller orders, including odd-lot orders, and routed them to the Amex via Merrill's Post Execution Reporting system ("PER")<sup>1</sup> connection for execution of the orders on the Floor of the Exchange.

2.0 During all relevant periods herein, Merrill was subject to Exchange Rule 208, which provided in pertinent part:

"When a person gives, either for his own account, for various accounts in which he has an actual monetary interest, or for accounts over which such person is exercising investment discretion, buy or sell odd-lot orders which aggregate one or more round lots, a member or member organization shall not accept such

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<sup>1</sup> The "PER System" is the Exchange's Post Execution Reporting System. It is an electronic system whereby customer orders are routed directly to the specialist's electronic book.

orders for execution unless they are, as far as possible, consolidated into round lots, except that selling orders marked “long” need not be so consolidated with selling orders marked “short.”

2.1 Pursuant to Exchange Rule 205, Specialists on the Exchange are required to execute an odd-lot market order at the prevailing offer (in the case of an order to buy) or bid (in the case of an order to sell).

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

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

2.3 During all relevant periods herein, Merrill was subject to Article V, Section 4(h) of the Exchange Constitution, which provided, in pertinent part, that a member organization shall not engage in conduct inconsistent with just and equitable principals of trade.

### **Odd-Lot Transactions**

3.0 During all relevant periods herein, stock ABC was listed for trading on the Exchange.

3.1 On April 25, 2001, Customer A entered a 10,000 share buy order in ABC through Merrill’s electronic proprietary order entry system. The order was routed to Merrill’s Aspen system, as described in paragraph 1.2 above, which divided the 10,000 share order in ABC into a total of 36 odd-lot orders and 48 round-lot

- orders. Each order was then entered on the Floor of the Exchange through Merrill's PER connection. The aggregate volume of Customer A's odd-lot activity on April 25, 2001 was 2,592 shares, and all 36 odd-lot orders were for the same proprietary account of Customer A.
- 3.2 The division of round-lot orders into odd-lot orders, and the subsequent entry of multiple odd-lot buy orders in ABC stock by Merrill's VWAP program, replaced the execution of a round-lot order that would have appeared on the Exchange tape. As a result, actual market interest in ABC stock was not publicly reflected. Additionally, the entry of multiple odd-lot orders, rather than larger round lot orders, prevented their exposure to the trading crowd, which in turn prevented any opportunity for price improvement in the auction market for ABC stock.
- 3.3 Exchange rules and systems compel the Specialist, as the only contra-party to odd-lot trades, to execute the multiple odd-lot buy orders entered by Merrill on behalf of Customer A at the prevailing offer.
- 3.4 During the period between the implementation of the VWAP program in October 1999 and February 2002, Merrill's Aspen system entered multiple odd-lot orders in listed securities for customers, including Customer A, on the Floor of the Exchange via Merrill's PER connection. For example, between March 1, 2001 and April 30, 2001, Merrill's Aspen system entered over 1,800 odd-lot orders that were executed on the Floor of the Exchange via Merrill's PER connection.

## **Supervision**

4.0 During the period between October 1999 and April 2002, Merrill had not developed, maintained or enforced supervisory procedures reasonably designed to detect or prevent the multiple entry of odd-lot orders through the Firm's PER system.

## **CONCLUSION**

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

- 5.0 Merrill violated Exchange Rule 208 and Article V, Section 4(h) of the Exchange Constitution in that the Firm did not aggregate multiple odd-lot orders entered by a customer through the Firm's PER connection to the Exchange Floor, as set forth in paragraphs 3.0 through 3.4.
- 5.1 Merrill violated Exchange Rule 320(b) in that the Firm did not have reasonable policies or procedures in place designed to detect or prevent an account or related accounts from entering multiple odd-lot orders, rather than larger round lot orders, into the Firm's PER system, as set forth in paragraph 4.0.

**DISCIPLINARY ACTION:**

A Disciplinary Panel may impose the following penalty upon Merrill Lynch,  
Pierce, Fenner & Smith, Incorporated:

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

AMERICAN STOCK EXCHANGE LLC

By: \_\_\_\_\_  
Glen Barrentine  
Senior Vice President

Agreed to this \_\_\_\_\_ day of \_\_\_\_\_, 2003.

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on behalf of Merrill Lynch, Pierce, Fenner & Smith, Inc.