

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, : ORDER
Plaintiff, :
-against- : 03 Civ. 2937 (WHP)
BEAR, STEARNS & CO. INC., :
Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :
Plaintiff, :
-against- : 03 Civ. 2938 (WHP)
JACK BENJAMIN GRUBMAN, :
Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :
Plaintiff, :
-against- : 03 Civ. 2939 (WHP)
J.P. MORGAN SECURITIES INC., :
Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :
Plaintiff, :
-against- : 03 Civ. 2940 (WHP)
LEHMAN BROTHERS INC., :
Defendant. :

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- : 03 Civ. 2941 (WHP)

MERRILL LYNCH, PIERCE, FENNER & :
SMITH INCORPORATED :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- : 03 Civ. 2942 (WHP)

U.S. BANCORP PIPER JAFFRAY INC., :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- : 03 Civ. 2943 (WHP)

UBS WARBURG LLC, :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- : 03 Civ. 2944 (WHP)

GOLDMAN, SACHS & CO., :

Defendant. :

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- : 03 Civ. 2945 (WHP)

CITIGROUP GLOBAL MARKETS INC., :
f/k/a SALOMON SMITH BARNEY, :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- : 03 Civ. 2946 (WHP)

CREDIT SUISSE FIRST BOSTON LLC, :
f/k/a CREDIT SUISSE FIRST BOSTON :
CORPORATION, :

Defendant. :

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- : 03 Civ. 2947 (WHP)

HENRY McELVEY BLODGET, :

Defendant. :

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION, :

Plaintiff, :

-against- : 03 Civ. 2948 (WHP)

MORGAN STANLEY & CO. INCORPORATED, :

Defendant. :

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WILLIAM H. PAULEY III, District Judge:

On April 28, 2003, the Securities and Exchange Commission ("SEC") filed civil actions to redress violations of the Securities Act of 1933 and rules of NASD, Inc. and the New York Stock Exchange, Inc. against ten separate investment banks: Bear Stearns and Co. Inc.; Citigroup Global Markets Inc., f/k/a Salomon Smith Barney Inc.; Credit Suisse First Boston LLC f/k/a Credit Suisse First Boston Corporation; Goldman, Sachs and Co.; J.P. Morgan Securities Inc.; Lehman Brothers Inc.; Merrill Lynch Pierce Fenner & Smith, Incorporated; Morgan Stanley & Co. Incorporated; UBS Warburg LLC; and U.S. Bancorp Piper Jaffray, Inc. The SEC alleged that the investment banking groups at these banks exerted inappropriate influence over research analysts that compromised their objectivity and spawned conflicts of interest. Simultaneously, the SEC filed civil actions against two former research analysts: Jack Benjamin Grubman, formerly employed by

Citigroup Global Markets Inc.; and Henry McElvey Blodget, formerly employed by Merrill Lynch Pierce Fenner & Smith, Inc.

This Court has conducted a preliminary review of the proposed final judgments (collectively, the "consent judgments"). Initially, an administrative concern surfaced regarding the consent judgments' provision requiring payment to the Court Registry Investment System ("CRIS") and the creation of a CRIS Distribution Fund Account and a CRIS Investor Education Fund Account for each investment bank and defendant Blodget.¹ More specifically, the consent judgments prohibit the investment banks from deriving any direct or indirect benefit from the funds deposited in the CRIS accounts. In this regard, the consent judgments themselves create a potential conflict of interest since an affiliate of defendant J.P. Morgan Securities Inc. manages CRIS accounts for the United States Courts and derives certain fees for those activities. Accordingly, this Court contacted officials at the Federal Reserve Bank of New York ("FRB-NY") to explore the possibility of establishing accounts as an alternative to the CRIS system to facilitate implementation of the settlements. This Court suggests the establishment of accounts at the FRB-NY pursuant to § 15 of the Federal Reserve Act in place of the CRIS accounts contemplated by the consent

¹ Defendant Grubman's payments are to be deposited in the CRIS Distribution Fund Account for the Citigroup Global Markets action.

judgments.

Further, the consent judgments authorize the Clerk "to deduct from the income earned on the money in the Distribution Fund [and the Investor Education Fund] a fee equal to ten (10) percent of the income earned" on said funds. While this is the statutory charge for the Clerk's services, rigid economy of administration would be appropriate considering the total sum to be tendered and other relevant factors. This Court suggests that the SEC petition the Director of the Administrative Office of the United States Courts under 28 U.S.C. § 1914 to aggregate the deposits for purposes of calculating the statutory commissions. If authorized by the Director, aggregation would reduce the statutory commission and increase the funds available for distribution to victims of the securities fraud and for education of the investing public. Efforts to maximize the recovery for investors harmonize with the Congressional mandate of the Sarbanes-Oxley Act of 2002, Pub. L. 107-204.

Moreover, the Distribution Fund Administrator and Investor Education Fund Administrator indemnification provisions of the consent judgments seem too broad. Specifically, the consent judgments provide that:

The Distribution Fund Administrator [and the Investor Education Fund Administrator], his agents, attorneys, and all persons acting on his behalf, shall be held harmless against all liabilities, claims and demands, whether civil, criminal, administrative or

investigative arising from or relating to any act of omission to act in the course of performing his duties

While this Court appreciates the need to indemnify the "Administrators", it declines to approve any decree indemnifying or holding harmless any Administrator, agent, attorney or other person acting on his behalf, from criminal liability.

Turning to the substance of the consent judgments, further explication is required. The parties are therefore directed to respond to the Court by June 16, 2003, addressing the following issues:

1. The consent judgments are labeled "final", yet the plans to return moneys to investors, educate the investing public and fund independent research are seemingly inchoate. The consent judgments speak in abstractions and defer the formulation of specifics to unnamed "Administrators" or, in the case of independent research, to unnamed "Independent Consultants".
2. The consent judgments contemplate future, but not necessarily assured, acceptance by the fifty states, the District of Columbia and Puerto Rico. If one or more States reject the "State Settlement Offer" or challenge one or more of the consent judgments, what follows therefrom? Is there any time frame for acceptance by the states of the "State Settlement Offer"?
3. Who are the intended beneficiaries of the Distribution Fund? Are there categories of injured investors excluded by the consent judgments from claims against the Distribution Fund (for example, shareholders in mutual funds, investors in derivatives or purchasers of equity securities who relied on conflicted research but did not purchase the securities through any of the defendant investment banks)? If so, what are the reasons for such exclusions?

- 4. The consent judgments require the "Federal Payments" to be designated as a penalty and disgorgement in equal proportions. Will that allocation be affected by the states' acceptance of the "State Settlement Offer"? What are the tax ramifications of this arrangement?

This Court may raise additional matters as its review continues.

The Clerk is directed to file copies of this Order in all of the related actions bearing the following docket numbers: 03 Civ. 2937, 03 Civ. 2938, 03 Civ. 2939, 03 Civ. 2940, 03 Civ. 2941, 03 Civ. 2942, 03 Civ. 2943, 03 Civ. 2944, 03 Civ. 2945, 03 Civ. 2946, 03 Civ. 2947 and 03 Civ. 2948.

Dated: June 2, 2003
New York, New York

SO ORDERED:

15/ WHP 15/
 WILLIAM H. PAULEY III
 U.S.D.J.

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