NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. CAF030017

TO: Department of Enforcement
NASD

RE: Henry McKelvey Blodget,
Respondent, CRD No. 2530161

Pursuant to Rule 9216 of the NASD Code of Procedure, Respondent Henry McKelvey Blodget ("Respondent" or "Blodget") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against Respondent alleging violations based on the same factual findings.

Respondent understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council ("NAC"), pursuant to NASD Rule 9216;

2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Respondent; and

3. If accepted:

   a. this AWC will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by NASD, or any other regulator, against Respondent;

   b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Respondent's disciplinary record;

   c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and

   d. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any allegation in this AWC or creating the impression that the AWC is without factual basis.

Nothing in this provision affects the testimonial obligations or right of Respondent to take factual or legal positions in litigation or other legal proceedings in which NASD is not a party.

Respondent also understands that his experience in the securities industry and his disciplinary history may be factors that will be considered in deciding whether to accept this AWC.

From February 24, 1999 to December 31, 2001, Respondent was a registered representative of Merrill Lynch, Pierce, Fenner & Smith Incorporated, a registered broker-dealer whose principal offices are located in New York City ("Merrill Lynch"), as a series 7 and series 63. Respondent was First Vice-President and Managing Director for Merrill Lynch and the senior research analyst for the Internet sector. Respondent has no prior, relevant, disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

Respondent specifically and voluntarily waives the following rights granted under NASD's Code of Procedure:

A. To have a Formal Complaint issued specifying the allegations against him;

B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;

C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and,

D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission ("Commission") and a U.S. Court of Appeals.

Further, Respondent specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Respondent further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

II.

ACCEPTANCE AND CONSENT

Respondent hereby accepts and consents, without admitting or denying the allegations or findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NASD:

A. Summary

During the period January 1, 1999 to December 31, 2001 (the "relevant period"), as enumerated below, Blodget issued research reports on one Internet company that violated antifraud provisions of the federal securities laws, and issued research reports on six other Internet companies that expressed views inconsistent with privately expressed negative views as discussed below in violation of NASD's advertising rules. Those rules require that, among other things, published research reports have a reasonable basis, present a fair picture of the investment risks and benefits, and not make exaggerated or unwarranted claims.

B. Overview of Internet Research at Merrill Lynch

During the relevant period, Merrill Lynch divided its research analysts into sectors that each covered a discrete industry, and published written research reports on selected companies within each sector. The three basic types of research reports issued by Merrill Lynch -- bulletins, comments, and in-depth reports – differed in length and level of detail. Bulletins did not include models, charts or other exhibits that would typically be included in a comment or in-depth report.

From February 1999 through December 2001, Merrill Lynch employed Blodget as a senior research analyst to cover the Internet sector and to head a group of analysts who issued, and who assisted him in issuing, research reports and ratings on Internet companies. The Internet research group covered Internet and similar technology stocks during this period. Blodget was First Vice-President and Managing Director for Merrill Lynch and the senior research analyst for the Internet sector. The analyst principally responsible for each research report published by Merrill Lynch on covered Internet companies was usually listed first on the report.

Merrill Lynch divided the Internet sector into the following three subsectors: (i) consumer Internet, e-commerce and new media; (ii) Internet infrastructure services; and (iii) business to business Internet companies. Blodget wrote, reviewed and/or consulted with other analysts regarding research generated by the Internet sector, and was the senior research analyst on all but a handful of the research reports discussed below.

Each Merrill Lynch research report included an investment rating that was intended to reflect the analyst's opinion on how the stock would perform. During 1999 to May 2001, Merrill Lynch stated that it used the following five-point rating system:

1 - Buy
2 - Accumulate
3 - Neutral
4 - Reduce
5 - Sell

Blodget did not rate any Internet stock a 4 or 5, during the relevant period. With respect to each of the research reports discussed below, the descriptive word(s) (e.g., "Buy", "Accumulate", etc.) representing the analyst's intermediate and long-term ratings appeared in the upper right corner of the research report in bold, capital letters, and in a font larger than in the text of the research report.

The descriptive words were to reflect the analyst's opinion of the stock's price appreciation potential over the intermediate term (0 to 12 months from the date of rating) and long term (more than 12 months from the date of rating): 1 – Buy (more than 20% appreciation), 2 – Accumulate (10-20% appreciation), 3 – Neutral (between 10% depreciation and 10% appreciation), 4 – Reduce (10-20% depreciation), and 5 – Sell (more than 20% depreciation). Although some of Merrill Lynch's research reports disclosed the stock appreciation percentages associated with the intermediate and long-term ratings, none of the research reports discussed below contained such disclosure.

During the relevant period, Merrill Lynch's published ratings had four elements: (i) a risk rating from "A" (low risk) through "D" (high risk); (ii) a rating for the intermediate term; (iii) a rating for the long term; and (iv) a dividend rating. With respect to each of the research reports discussed below, Merrill Lynch rated each company "D" (high risk).

Some of Merrill Lynch's research reports, including those issued by Blodget, also assigned to the stock a price target, which was intended to reflect the price at which the analyst believed the stock would trade within the next twelve months or, on occasion, within a longer period of time.

C. Blodget Assisted Investment Banking

1. Internet group research analysts assisted investment banking

Merrill Lynch's research department provided a service function within the firm and was not an independent profit center. Merrill Lynch funded its research department through firm revenues received from a number of businesses at the firm, including investment banking. Merrill Lynch's investment banking department generated substantial revenues for Merrill Lynch. Merrill Lynch encouraged Internet research group analysts to assist investment banking activities. Merrill Lynch expected its Internet research group analysts to vet initial public offerings, review and opine on other prospective investment banking deals, attend "pitch" sessions with investment bankers in which the bankers competed for the issuer's investment banking business, and talk with institutional investors about those issuers. When the Internet research group could not support favorable research ratings, it vetoed the investment banking deals.

Merrill Lynch's investment banking group used the Internet research group's ratings and coverage to support its business. In March 1999, within weeks of joining Merrill Lynch, Blodget circulated to research management and senior investment bankers an e-mail entitled "Managing the Banking Calendar for Internet Research." In that e-mail, Blodget stated,

> [w]e are now up to 11-12 Internet banking transactions in the pipeline . . . . The current schedule for this week . . . is 85% banking, 15% research . . . .

Blodget estimated that his team would devote the majority of its time that week to assisting in investment banking efforts, and cautioned that if he failed "to allocate at least 50% of [his] time and the overall research team's time" to performing research and institutional marketing, then his, and his team's, reputation among institutional investors might suffer.

If Merrill Lynch secured the mandate, the Internet research group analysts sometimes helped market investment banking deals to institutional investors by attending "roadshows." During roadshows, the issuer's management and Merrill Lynch investment bankers solicited interest in the offering from institutional investors. Internet group research analysts also attended "non-deal roadshows" for existing clients to promote interest in their company's stock. As a senior intermediate Internet group analyst stated to Blodget, among others, in a May 17, 2000 e-mail:

> We are taking InfoSpace . . . on a non-deal roadshow to introduce the new CEO. This company is very important to us from a banking perspective, in addition to our institutional franchise. . . . These non-deal roadshows are very important in my view in that they . . . have tremendous halo effect on our banking efforts.

During the relevant period, Merrill Lynch's Internet research group assigned consistently positive intermediate and long-term ratings on the Internet stocks it covered. During 1999 and 2000, virtually all the stocks covered by Blodget had a "1" (buy) or a "2" (accumulate) rating. Until late 2000, Blodget rarely used a "3" (neutral) rating. As a junior analyst in the Internet group explained to the management of an investment banking client in September 2000, Merrill Lynch's ratings

> range from 1-5, but we don't cover anything below a 3.

In a June 2000 e-mail, a senior intermediate analyst wrote to Blodget in connection with a company on which Merrill Lynch was then planning to but ultimately did not initiate coverage:

> I am personally afraid of the impact we will have on the stock if we do a 3-1 so am leaning towards a 2-2 which is still our lowest rating.

2. The existing or potential investment banking relationship factored into the decision to initiate research coverage

Whether Merrill Lynch had or wanted investment banking business from a company was a factor in the decision to initiate research coverage on that company, and in the instance described below, an important factor. During the relevant period, Merrill Lynch initiated coverage predominantly on existing or prospective investment banking clients. Blodget noted that the selection of a company for research coverage was

> based on the company's status in the industry, the number of shareholders, the long term prognosis, and/or a banking relationship.

In an April 2000 e-mail, a Merrill Lynch investment banker asked,

> Do you think we should aggressively link coverage with banking – that is what we did with Go2Net (Henry [Blodget] was involved) . . . .

In a July 2000 e-mail, a junior analyst in the Internet group observed:

> We listened to gotonet call last night – investors didn't like weakish traffic and ad growth. I don't understand what makes biz model tick. They beat estimates in part due to decreased share count, increased interest income and a low tax rate . . . . i imagine we will pick it up if there is some banking revenue attached.[1]

3. Blodget knew that certain prospective ratings and research reports with ratings were shared with investment bankers and issuers

Merrill Lynch did not prohibit all interaction between research and investment banking. Rather, its internal policies prohibited the dissemination of ratings and research reports with ratings to investment bankers and to issuers prior to publication. The Merrill Lynch Policies and Procedures Manual in effect during 1999 to 2001 imposed the following restrictions on pending research:

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[1] Merrill Lynch did not in fact initiate research coverage on Go2Net. In October 2000, Go2Net was sold to InfoSpace, a company on which Merrill Lynch provided research coverage, and Merrill Lynch provided advisory services to Go2Net between July and October 2000 in connection with the sale.

> Pending initial opinions, estimate or opinion changes, and decisions to issue research reports or comments may not be disclosed by any means to anyone, either inside or outside the Firm, until the information is disseminated in the appropriately prescribed manner. Exceptions are limited to [certain Merrill Lynch personnel] and, under limited circumstances, management of the subject company.[2] This prohibition is intended to avoid the misuse of market-sensitive information and the appearance of impropriety.

In the instances described below, Blodget knew that Internet research group analysts disseminated research reports with ratings to investment bankers and issuers prior to their publication.

a. Sharing unpublished ratings with investment bankers

In August 2000, a junior analyst in the Internet group sent the following e-mail to a Merrill Lynch research manager and Blodget:

> The following chart lays out Henry's [Henry Blodget's] universe and the ratings we would like to change. I have spoken to the [Merrill Lynch investment] banker . . . on this . . . as these are all B2C names—and he is fine with it.

In an e-mail dated November 12, 2000, Blodget gave the following advance notice to a Merrill Lynch investment banker:

> based on what I'm hearing, we will probably be taking CMGI to at least a 2-2 after they report guidance Monday night.

Two days later, on November 14, 2000, Merrill Lynch, through Blodget, in fact downgraded CMGI from a 2-1 to a 3-2.

b. Sharing unpublished reports and ratings with covered companies

Prior to initiating research coverage on GoTo.com, Inc. ("GoTo") (discussed in greater detail below), a research analyst shared the prospective rating with both investment bankers and the company. On November 21, prior to initiating coverage of GoTo, a junior Internet research analyst e-mailed Blodget to report,

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2 Certain of these exceptions allowed investment bankers and company management to review unpublished research reports to verify factual accuracy, or after the market closed but before publication of the research. None of the instances cited herein, however, qualified for any of the exceptions listed in Merrill Lynch's Policies and Procedures Manual.

> GoTo has gotten back to me and says they are 'comfortable' with the discussions we had with them, and with coming out with a 3-1 [rating], etc. given that we would be downgrading LOOK at the same time so the ratings are the same.[3]

As the date for initiating coverage of GoTo drew closer, the same junior analyst e-mailed the investment bankers,

> Research mgmnt [ ] wants to go with a 3-2 on GoTo.

4. Internet group research analysts' contributions to investment banking factored into their performance evaluations and compensation and Blodget knew that Internet group analysts were subject to pressure from investment bankers

Investment banking revenues generated in the Internet sector were a factor in evaluating Internet analysts' performance and, consequently, in determining their compensation. In November 2000, Merrill Lynch's research management requested that all equity analysts submit a report detailing their contributions to investment banking during the year and highlighting instances where their research coverage played a role in originating and securing an underwriting mandate or advisory work on mergers and acquisitions. Blodget's e-mail response highlighted his Internet group's involvement in over 52 completed or potential investment banking transactions and included among his team's activities: pitching the client, marketing the offering, and providing research "coverage for future banking." Blodget estimated that from December 1999 to November 2000, the Internet research group was involved in activities relating to investment banking deals that produced approximately $115 million of revenue for Merrill Lynch. During this period, Blodget knew that Internet group analysts were subject to pressure from investment bankers.

D. Blodget issued research on GoTo that violated anti-fraud provisions of the federal securities laws

As described below, certain of Blodget's research reports for GoTo.com, Inc. ("GoTo") expressed views that were contrary to the analysts' privately expressed negative views and did not disclose those negative views, thereby making those reports fraudulent.

GoTo, now known as Overture Services Inc., is an Internet advertising services company that introduces consumers and businesses that search the Internet to advertisers

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[3] In an e-mail dated July 28, 2001 from Blodget to the junior analyst, Blodget stated: "Some of the communication with the GoTo people and the bankers prior to the initiation may have been a technical violation of the firm's written policies and procedures (which, I have now learned, say the company/bankers should not be told what the proposed rating is or will be, even if the company isn't currently under coverage) . . . ."

who provide products, services and information. In September 2000, Merrill Lynch pursued and secured a mandate for a private placement for GoTo's European subsidiary. In connection with that mandate, Merrill Lynch initiated research coverage on GoTo.

Initiation of coverage on GoTo

The initial research report on GoTo was published in January 2001 and expressed views contrary to the privately expressed negative views of Blodget and his fellow analysts during the period November 2000 to January 2001. On November 15, 2000, a junior analyst e-mailed Blodget and stated,

> [another firm] initiated on GoTo.com with a buy . . . i guess they are angling for the M&A [mergers and acquisitions] business too!

The next day, while working on the initiation of coverage report, Blodget e-mailed a junior analyst and queried,

> What is your honest take on the stock? No reason to own it . . . or going a lot lower[?] [In my humble opinion], I think the first [rating] should be a 2[-]2 . . . the second a 3…

Later that day, the junior analyst responded:

> . . . I think both – no reason to own now. . . . totally could go lower. who are we trying to please by doing a 2-2 ? I don't want to be a whore for f-ing mgmnt. if 2-2 means that we are putting half of merrill retail into this stock because they are out accumulating it, then I don't think that's the right thing to do. we are losing people money and I don't like it. [hypothetical retail clients] john and mary smith are losing their retirement because we don't want [GoTo's CFO] to be mad at us. [Merrill Lynch's investment banking relationship manager for GoTo] said he is fine with a 3-2 (I said to him the whole idea that we are independent from banking is a big lie – without banking this would be a 3-2 and he said "no—you guys are independent you can do what you want – I'm fine with that["] –I would put it back to the company to convince you that there is a reason you should own this at 54x [year 2002 earnings per share]. . . so that's my feeling. . . .

On January 4, 2001 the junior analyst e-mailed the investment bankers,

> Research mgmnt [] wants to go with a 3-2 on GoTo.[4]

One of the bankers responded to Blodget and the junior analyst:

> Briefly, in talking to [Research Compliance] yesterday, I thought the strategy was to go out with the 3-1 as soon as the stock hit $10; if it doesn't, I don't think anybody has an interest in seeing initiation at a 3-2.

Blodget replied to the bankers:

> my concern is that waiting for $10 is waiting for godot[5]…

During the following week, GoTo traded intraday above $10 and, on January 11, 2001, Blodget initiated coverage on GoTo at a 3-1 (neutral-buy), the same rating reflected in the e-mail from investment banking. Blodget's initiation piece reported that

> GoTo has a pay-for-performance model, which should help it gain share in the current environment. . . . It is growing quickly and probably has enough cash to make it to break-even (estimated in 1Q02). . . . Given the current weak environment for online advertising, we do not see any near term catalysts. We expect the market to improve in 2H 2001, however, and we believe that GoTo will be a survivor.

On the same day coverage was initiated, an institutional client e-mailed Blodget to ask,

> What's so interesting about Goto except banking fees????

Blodget replied,

> nothin.

The initial research report on GoTo expressed views contrary to privately expressed negative views as described above, and did not disclose those contrary views, including Blodget's belief that GoTo was "interesting" only for the banking fees it could generate. As a result, the January 11th research report was fraudulent.

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4 Ratings on initiation of coverage were approved by Research Management and Research Compliance.

5 The reference here was to the Samuel Beckett play *Waiting for Godot*. In that play, the central story line involves two characters who continuously wait for the arrival of an individual named Godot. He never comes.

Subsequent research on GoTo

On April 25, 2001, Blodget upgraded GoTo from 3-1 to 2-1 (accumulate-buy), based on GoTo's very strong first quarter results and the observation that GoTo had "execut[ed] extremely well in a tough environment." The upgrade set a price objective of $18-19 from GoTo's then current trading price of $11.57.

On May 4, 2001, GoTo closed at $21.92. In a May 6, 2001 e-mail, an institutional client asked Blodget for buy recommendations that were "compelling currently"; Blodget responded:

> I would have said GoTo and HOMS but both have had very strong runs and are overdone, in my opinion.

On May 22 and 23, 2001, when GoTo closed at $23.90 and $23.43, respectively, Merrill Lynch issued additional research reports that reiterated GoTo's 2-1 rating and stated,

> We believe a few stocks are attractive. . . . we are recommending . . . GoTo. . . .

These research reports expressed views contrary to the views privately expressed by Blodget in his May 6th e-mail, and did not disclose Blodget's view that the stock price was overdone.

In mid-May 2001, Merrill Lynch's investment bankers pitched to GoTo the idea of doing a secondary equity offering, underwritten by Merrill Lynch, and set a May 31 meeting date to discuss this possibility. However, on May 25, GoTo's CEO and CFO advised a Merrill Lynch investment banker that GoTo was leaning toward selecting a firm other than Merrill Lynch to do the underwriting work. That same day, in an internal e-mail, a Merrill Lynch investment banker remarked:

> I was very dismayed to learn that [GoTo was] leaning toward [another firm] as the lead bookrunning manager, particularly given the tremendous effort we have put forth on the Company's behalf. Not only did Henry Blodget initiate on the stock when it was flirting with penny stock status but he recently upgraded it and sponsored a set of meetings for management in New York which dramatically moved the stock price. . . . we have the #1 ranked Internet research analyst in Henry Blodget . . . .

A few hours later, a research analyst e-mailed to Blodget draft downgrade bullets for GoTo:

> H, I don't think I've downgraded a stock on valuation since the mid-90's. Anyway, I threw together these bullets in a note on my hard drive so that we are ready to pull the trigger quickly. Do you think we need more than bullets? I didn't think so since this downgrade would be based solely on valuation? Let me know.

The downgrade bullets explained that,

> GoTo has doubled since our upgrade about a month ago. We are downgrading the stock due to valuation . . . . we believe it is prudent to take some money off the table.

Blodget's immediate e-mail response was,

> beautiful
> fuk *[sic]* em

While the May 22nd and May 23rd research reports maintained GoTo's 2-1 rating and recommended GoTo as "attractive", the May 25th e-mail stated an intention to downgrade GoTo based on valuation concerns – meaning that they viewed the stock as expensive. GoTo's stock price, however, remained relatively constant from May 21 to May 31, 2001. In fact, on May 22nd and May 23rd, when Merrill Lynch issued research reports recommending the stock, GoTo closed at $23.90 and $23.43, respectively and on May 25th, the date of the e-mail, GoTo closed at $22.75. Accordingly, the May 22nd and May 23rd research reports also expressed views that were contrary to the views privately expressed in the May 25th e-mail, and did not disclose those contrary views. As a result, the May 22nd and 23rd research reports were fraudulent.

Blodget did not publish the GoTo downgrade on May 25. On the morning of June 6th, GoTo issued a press release announcing its follow-on offering and naming its underwriters, which did not include Merrill Lynch. Blodget and his fellow analyst believed that news of GoTo's secondary offering would have a near term negative impact on GoTo's stock price. That same morning, Blodget issued his report downgrading GoTo from 2-1 to 3-1 in substantially the same form as the draft bullets in the May 25th e-mail.[6] The June 6th research report did not disclose the analysts' belief that news of GoTo's secondary offering would have a near term negative impact on GoTo's stock price.

E. Blodget Issued Research That Violated NASD's Advertising Rules

Under NASD's advertising rules, Blodget must have a reasonable basis for his recommendations, and his communications must present a fair and balanced picture of

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[6] From May 25th to June 6th, GoTo's stock price closed at $22.75 (May 25th), $22.96 (May 29th), $21.05 (May 30th), $22.36 (May 31st), $23.43 (June 1st), $25.99 (June 4th), $26.64 (June 5th) and $23.78 (June 6th).

the risks and benefits of investing in the covered companies, and must not make exaggerated or unwarranted claims. As discussed below, Blodget published research reports on InfoSpace, Inc., 24/7 Media, Inc., Lifeminders, Inc., Homestore.com, Inc., Excite@Home, and Internet Capital Group, Inc. that violated NASD's advertising rules, as well as the NASD rule that requires members to observe high standards of commercial honor and just and equitable principles of trade.

1. InfoSpace (INSP)

InfoSpace, Inc. ("InfoSpace") is an Internet information infrastructure services company that provides technologies to Web sites, merchants and wireless devices. Merrill Lynch maintained a 1-1 (buy-buy) rating on InfoSpace from January through December 2000, when it was downgraded to a 2-1 (accumulate-buy). From March 2000 to December 2000, Merrill Lynch included InfoSpace on its monthly "Favored 15" list. The Favored 15 list is a list of 15 stocks covered by Merrill Lynch that are each rated 1-1 and that satisfy certain other technical and quantitative criteria. InfoSpace's stock price declined throughout 2000 and into early 2001, from $140 on January 27, 2000, to $40.56 on September 15, 2000, to $21.94 on October 9, 2000, to $13.81 on December 11, 2000 and to $8.59 on January 9, 2001.

On June 15, 2000, while Blodget maintained a 1-1 rating on InfoSpace, Merrill Lynch's Internet research analysts raised questions about the stock. Specifically, an analyst e-mailed an article entitled, "Why One Short-Seller is Attracted to InfoSpace" to Blodget and a second senior intermediate analyst who covered InfoSpace with Blodget. The second analyst replied,

> thanks . . . a lot of people have been calling me on inside selling . . . i checked it out – its not that bad . . . [InfoSpace's Chairman] owns 29% of company and has sold three times over past year . . . i don't think that's a big deal . . . i would sell.

That same day, Blodget responded to the second analyst as follows:

> . . . enormous skepticism about this one now. . . . got questions yesterday about the exact extent of svces/content that [InfoSpace] provides to "50% of global and 80% of US carriers." AT&T apparently saying "they give us maps and directories, not a 'platform' – whooptedo. In three yrs, the $1/sub will be $0.10/sub." stock obviously caught in backlash of [the InfoSpace Chairman's] hyperbole, unfortunately. just like ICGE . . . .

On July 10, 2000, Go2Net asked Merrill Lynch to serve as its financial advisor in connection with a proposed sale of Go2Net to InfoSpace, and Merrill Lynch agreed. On

July 11, 2000, Blodget issued an "update report" on InfoSpace, reiterating the 1-1 buy rating, but not disclosing the concerns raised in the June 15th e-mail.

That same day, apparently in response to the newly issued report, a Merrill Lynch financial consultant sent Blodget the following e-mail:

> it seems that InfoSpace is your favorite stock. Should we worry that the chairman has sold over 1MM shares before their quarterly earnings? Are we planning a secondary for the stock?

Later that day, Blodget forwarded the e-mail to a senior intermediate InfoSpace analyst complaining,

> ugh. i'm getting killed on this thing.

Two days later, on July 13, 2000, Blodget e-mailed the same analyst and stated,

> I don't mean to be a pain on this one, but this stock is a powder keg, given how aggressive we were on it earlier this year and given the "bad smell" comments that so many institutions are bringing up. . . .

Later that day, the analyst replied,

> Fair point. But here's how I look at it. I still believe in the story long-term and secondly, we addressed the issues without crushing the stock which we would have done and angered everyone. Also, it is not as smelly as the hedgies say – they're just looking for a short.

The following day, July 14, 2000, InfoSpace's Chairman e-mailed the same research analyst to confide that InfoSpace was contemplating an investment in the company "U.S. Search." The research analyst advised him as follows,

> We need to talk about this. . . . I am concerned the market will not react favorably to any news that [InfoSpace] funds US Search. My BEST advice to you is to let [your competitors] win this one – there will be plenty of deals for you to do and [InfoSpace] cannot afford this kind of scrutiny right now – the stock is under a lot of pressure.

On or about October 2000, another senior analyst assumed coverage of InfoSpace, but Blodget continued to participate in the research process and his name continued to appear on the research reports beneath the name of the senior analyst. On the morning of October 20, 2000, Blodget received an e-mail from a Merrill Lynch financial consultant asking about the buy rating and a $100 price target on InfoSpace (at a time it was trading in the $20 price range), and a Dow Jones News Service article stating that InfoSpace had published a handwritten annual report in a "high school exam format." Blodget immediately forwarded the e-mail to the senior analyst for InfoSpace and said,

> I am so tired of getting these. Can we please reset this [InfoSpace] stupid price target and rip this piece of junk off whatever list it's on. If you have to downgrade it, downgrade it.

That same morning, the financial consultant sent another e-mail to Blodget explaining that he had read InfoSpace's 1999 annual report and that he believed it was not as bad as the newspaper article had indicated. Again, that same morning, Blodget forwarded the e-mail to the senior analyst for InfoSpace and remarked,

> Phew. Still would love to reset the price target to $30 or something. . .

At the time of the October 20th e-mail exchanges, InfoSpace was still rated 1-1.

On December 5, 2000, the senior analyst advised him,

> happy day -- insp off the favored 15,

to which Blodget replied,

> oh my god. I can't believe it took until now.

On December 11, 2000, Merrill Lynch downgraded InfoSpace to 2-1 (accumulate-buy).

On December 19, 2000, the senior analyst forwarded to Blodget a news article entitled, "InfoSpace VP Sues Chairman Over Stock Option Promise," and added,

> not that this is any news . . . but thank god we downgraded while in the doubledigits [sic].

Blodget responded

> My god. What a sleazebag.

Seven minutes later, Blodget sent the following e-mail:

> I think you can go ahead and downgrade on this [if] you feel like taking to neutral. I've seen enough of [the InfoSpace Chairman's] alleged sleazery [sic] that I'm officially not comfortable with him still involved with co. .

> . . I would actually forward this to [Merrill Lynch research management] – they may insist that you cut it.

The InfoSpace research reports dated July 11, August 7, September 15, October 9, October 23, October 25, October 26, October 31, November 6, November 7, and December 20, 2000, and January 8 and January 9, 2001, were contrary to the privately expressed negative views as described above.

2. 24/7 Media, Inc. (TFSM)

24/7 Media, Inc. ("24/7") is an Internet company that provides marketing services to Internet advertisers. After Merrill Lynch closed a secondary offering for 24/7 on May 3, 1999, Blodget published a May 12, 1999 research report rating 24/7 a 2-1, when 24/7 traded at $45.00. On August 12, 1999, Blodget upgraded the stock to 1-1. As of December 31, 1999, 24/7 was trading at $56.25. On January 26 2000, 24/7 reached a high of $64.62. During the course of 2000, 24/7's stock price plummeted. On August 7, 2000, Blodget downgraded the rating to a 2-2 "accumulate", and on November 9, he changed the rating to a "neutral" 3-3. On December 29, 2000, the stock closed at $0.53.

On March 6, 2000, a junior analyst e-mailed Blodget a draft research report on 24/7 that, among other things, referred to the launch of 24/7's "Connect" proprietary advertising software. The analyst stated,

> Try these on for size – trying to be oblique to help stock in anticipation of downgrade on wed – so we can say we were expecting great Q4 – w/ 20 mm names they should be making tons on email – we'd take opportunity to lighten position until co. brings all of assets onto one platform, go to accumulate. also would be surprised if EPS comes in much better than [$]0.46 . . . . if worse, another excuse to downgrade.

The following day, March 7, 2000, Blodget issued the report in substantially identical form as the previous day's e-mail draft and maintained a 1-1 on 24/7. The March 7th report was inconsistent with the privately expressed negative view in the above-noted March 6th e-mail and did not disclose the junior analyst's appraisal that 24/7 would report lower than expected 4th quarter results, that the analyst expected to downgrade 24/7 on that news, or that the analyst then believed that investors should "lighten position" or sell the stock. Two days later, 24/7 reported its fourth quarter results, which exceeded the Internet group's expectations. Blodget maintained his 1-1 rating on 24/7 until August 7, 2000, when he downgraded 24/7 to 2-2.

On October 10, 2000, Blodget privately expressed a negative view about a 24/7 key product -- its "Connect" proprietary advertising software. That day, another analyst e-mailed to Blodget a news article entitled "24/7 Media working to repair technology glitch." The article highlighted glitches in 24/7's "Connect" advertising software, resulting in the reporting of inaccurate results to 24/7's clients. The analyst remarked,

> Don't know if you saw this, nothing revolutionary – but it probably confirms what you and [another fellow analyst] have talked about for some time.

That same day, Blodget responded,

> That it's a pos [piece of shit]? yes.

On August 11, 2000, Blodget published a research report rating 24/7 a 2-2. In that report, Blodget's only mention of Connect was to explain that 24/7 had yet to complete its full rollout, but that 24/7 was then serving over 80% of its U.S. network ads through Connect. Blodget's November 8, 2000 report maintained the 2-2 rating and noted,

> We hope to hear more about traction at Connect, including any new business from competitors based on Connect's capabilities as opposed to those won on price.

Blodget's August 11 and November 8, 2000 research reports were inconsistent with Blodget's privately expressed negative view of a key product of the company in his October 10, 2000 e-mail.

3. Lifeminders, Inc. (LFMN)

LifeMinders, Inc. ("LFMN") is an online direct marketing company specializing in outbound messaging, both e-mail and wireless. Blodget initiated coverage of LFMN on September 28, 2000 with a 2-1, when LFMN traded at $22.69. At that time, Merrill Lynch was pursuing an investment banking relationship with LFMN. Blodget described his team's contribution to the investment banking effort on LFMN as "coverage for future banking."

After Merrill Lynch initiated research coverage, LFMN's price declined to the $10 range in October and the $3-5 range in December. On December 4, 2000, Blodget e-mailed a fellow analyst,

> LFMN at $4. I can't believe what a POS [piece of shit] that thing is. Shame on me/us for giving them any benefit of doubt.

Blodget's research report on LFMN dated December 21, 2000, which reiterated a 2-1 rating, was inconsistent with Blodget's privately expressed negative view of LFMN in his December 4th e-mail.

4. Homestore.com, Inc. (HOMS)

Homestore.com, Inc. ("HOMS") is a collection of Internet websites that focus on the home and real estate-related information and advertising products and services. Shortly after Merrill Lynch closed a follow-on offering for HOMS, Blodget initiated coverage on HOMS on September 8, 1999 with a 2-1 rating, when HOMS traded at $47.50. By February 1, 2000, the date Merrill Lynch closed a second equity offering for HOMS, the stock price had risen to $97. On March 6, 2000, Blodget upgraded HOMS to 1-1, when the stock price had fallen to $67. Blodget maintained his 1-1 rating until July 9, 2001 when he downgraded HOMS to 2-1 and the stock price was $35.29.

On April 26, 2001, Blodget issued a research report reiterating the 1-1 rating on HOMS and setting a price objective of $35 (from its current price of $28.73). On May 4, 2001, HOMS closed at $34.70. On May 6, 2001, when an institutional client asked Blodget for recommendations that were "compelling currently", Blodget responded:

> I would have said GoTo and HOMS but both have had very strong runs and are overdone, in my opinion.

On May 10, 2001 Blodget issued a research report reiterating the 1-1 rating on HOMS, then trading at $32.56. Both the April 26th and May 10th reports were inconsistent with the views expressed in Blodget's May 6, 2001 e-mail.

5. Excite@Home (ATHM)

Excite@Home ("ATHM") is a broadband network services company that provides high-speed Internet, data and content services to consumers. In June 1999, At Home Corporation acquired Excite and became Excite@Home. Blodget assumed coverage of ATHM from another analyst in April 1999 with a 2-1 rating, and continued coverage after At Home's acquisition of Excite in June 1999, when the stock price was $97. Merrill Lynch acted as a financial advisor to At Home in connection with the acquisition of Excite. On July 20, 2000, when the stock price was $29, Blodget downgraded ATHM to 2-2.

By December 21, 2000, ATHM's stock price had fallen to $4. On January 29, 2001, while Blodget still had a 2-2 rating on ATHM, Blodget expressed a view to a financial consultant that he did not think there was any reason to buy more shares of ATHM. Specifically, when a Merrill Lynch financial consultant e-mailed Blodget and asked if he would recommend buying more shares of ATHM at its then-current level (approximately $8), Blodget responded,

> I don't think it goes much lower, but I also don't think there's any reason to buy more of it… as a standalone business, it's falling apart.

On January 26, 2001, Blodget published a research report on ATHM that maintained a 2-2 rating and noted

> [ATHM] 3Q had a weak quarter, as expected, and gave a dismal outlook for 2001. However, the company believes it can hit double digit EBITDA margins in 2H. . . . [ATHM] might be on the right track , but never-ending state of flux makes forecasting (and investing) difficult. Pieces of the company remain attractive for acquisition, but we believe the value as a consolidated operating business continues to decline. If indeed the company is able to turn EBITDA positive and hit the double-digit margin targets in the back half of the year, the stock should act favorably. However, at this point, we have neither the visibility nor confidence in this happening, and maintain our "wait and see stance."

On March 8, 2001, Blodget published a research report on ATHM that reiterated the 2-2 rating and noted that the "[t]one was very upbeat" at ATHM's latest conference. Both the January 26th and March 8th reports were inconsistent with Blodget's privately expressed negative views in his January 29, 2001 e-mail.

6. Internet Capital Group, Inc. (ICGE)

Internet Capital Group, Inc. ("ICG") is a holding company, an "incubator" with owner positions in numerous partner companies, most of which are focused on Business to Business ("B2B") e-commerce. ICG allocates capital to promising B2B opportunities, then provides partner companies with strategic and operational guidance with the aim of building market leaders. ICG was designed to facilitate strategic relationships and share best practices, advantages not enjoyed by stand-alone B2B start-ups.

Blodget initiated coverage of ICG on August 30, 1999 with a 2-1 rating, when ICG traded at $53.50. By the end of 1999, ICG was trading at $164. In early 2000, ICG reached a high of $212, but then fell sharply to $23.13 on September 25, 2000 and $11 on November 10, 2000. Blodget maintained a 2-1 rating on ICG during that time period.

On October 5, 2000, when ICG was trading in the $12 –15 range, Blodget made the following statement about the direction of ICG's stock price in an internal e-mail to the research analyst covering ICG with Blodget:

> Going to 5.

During that same e-mail exchange, Blodget also remarked,

> Sure hope [the co-founders of ICG] taking some dough off table.

The next day, on October 6, 2000, a Merrill Lynch financial consultant e-mailed Blodget for advice on ICG. Blodget replied,

> No hopeful news to relate, I'm afraid. This has been a disaster… There really are no 'operations' here to fall back on, so there really is no 'floor' to the stock… We see nothing that will turn this around near-term. The company needs to restructure its operations and raise additional cash, and until it does that, there is nothing positive to say.

Blodget's September 25, 2000 research report reiterated a 2-1 rating and expressed concern that current market conditions, the need for financing, ICG's vertical market maker focus and potential year-end tax-loss selling could keep pressure on the stock. Although this report stated that ICG needed cash and that its then current investments were not optimal, it also expressed strong approval of ICG's new CFO and stated that a successful financing and the sale of non-strategic assets could be potential positive catalysts for the stock.

On November 9, 2000, Blodget downgraded ICG from 2-1 to 2-2, following ICG's announcement of its third quarter results and its plans to downsize its operations, reduce cash burn and intensify its focus on the execution of a core set of 15 "developed" partner companies. On November 10, 2000, Blodget issued a report reiterating the 2-2 rating. Although Blodget's October 6, 2000 e-mail expressed concerns about ICG in the "near term" and Blodget's November 10 report stated that ICG could remain under pressure "over the intermediate term," the November 9, 2000 downgrade did not adjust the intermediate term rating, but only the long-term rating for ICG.

Blodget's September 25th, November 9th and November 10th research reports on ICG were inconsistent with Blodget's privately expressed negative views in his October 5th and 6th e-mails.

F. Violations of Federal Securities Laws and NASD Rules

<u>Fraud: Violations of 15(c) of the Securities Exchange Act of 1934, Rule 15c1-2 thereunder and NASD Conduct Rules 2210(d)(1) and (d)(2) and 2110</u>. On the occasions described above, Blodget issued research reports on GoTo that were materially misleading because they were contrary to privately expressed negative views noted above. As a result, Blodget aided and abetted Merrill Lynch in effecting transactions in, or inducing the purchase or sale of, securities by means of acts deemed to be manipulative, deceptive or otherwise fraudulent devices or contrivances in violation of Sections 15(c)(1) and 15(c)(2) of the Securities Exchange Act of 1934 and Rule 15c1-2 thereunder, and violated NASD Conduct Rules 2210(d)(1) and (d)(2)[7] and 2110.[8]

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7 NASD Conduct Rule 2210(d)(1) provides in part: "(A) All member communications with the public shall be based on principles of fair dealing and good faith and should provide a sound basis for

Advertising: Violations of NASD Conduct Rules 2210(d)(1) and (d)(2) and 2110. As described above, Blodget issued research reports on InfoSpace, Inc., 24/7 Media, Inc., Lifeminders, Inc., Homestore.com, Inc., Excite@Home, and Internet Capital Group, Inc. that were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts, contained exaggerated or unwarranted claims about these companies, and/or contained opinions for which there was no reasonable basis. As a result, Blodget violated NASD Conduct Rules 2210(d)(1) and (d)(2) and 2110.

G. Sanctions

Respondent also consents to the imposition, at a maximum, of the following sanctions:

1. a permanent bar from association with any NASD member in any capacity.

2. A total payment in the amount of $4,000,000 as specified in the Final Judgment ordered in a related action filed by the Securities and Exchange Commission ("Final Judgment") as follows:

   (a) $2,000,000 as a fine; and

   (b) $2,000,000 as disgorgement.

   The monetary sanctions imposed by NASD shall be reduced by the amounts paid by Respondent pursuant to the Final Judgment. The payment provisions of the Final Judgment are incorporated by reference herein.

3. Respondent agrees that he shall not seek or accept, directly or indirectly, reimbursement or indemnification, including but not limited to payment made pursuant to any insurance policy, with regard to all penalty/fine amounts that Respondent shall pay pursuant to Section II of the Final

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evaluating the facts in regard to any particular security or securities or type of security, industry discussed, or service offered. No material fact or qualification may be omitted if the omission, in the light of the context of the material presented, would cause the communication to be misleading. (B) Exaggerated, unwarranted, or misleading statements or claims are prohibited in all public communications of members. In preparing such communications, members must bear in mind that inherent in investment are risks of fluctuating prices and the uncertainty of dividends, rates of return and yield, and no member shall, directly or indirectly, publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement or a material fact or is otherwise false or misleading."

NASD Conduct Rule 2210(d)(2) provides in pertinent part that "[i]n making a recommendation in advertisements and sales literature, whether or not labeled as such, a member must have a reasonable basis for the recommendation." The rule also contains numerous other specific standards that apply to the advertisements and sales literature, which are defined to include research reports.

[8] NASD Conduct Rule 2110 provides that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."

Judgment, regardless of whether such amounts or any part thereof are added to the Distribution Fund Account provided for in the Final Judgment ("Distribution Fund Account") or otherwise used for the benefit of investors. Respondent further agrees that he shall not claim, assert or apply for a tax deduction or tax credit with regard to any federal, state, or local tax for any penalty/fine amounts that he shall pay pursuant to Section II of the Final Judgment, regardless of whether such penalty/fine amounts or any part thereof are added to the Distribution Fund Account or otherwise used for the benefit of investors. Respondent understands and acknowledges that these provisions are not intended to imply that NASD would agree that any other amounts Respondent shall pay pursuant to the Final Judgment may be the basis for any tax deduction or tax credit with regard to any federal, state, or local tax.

The sanctions imposed herein shall be effective on a date set by NASD staff.

III.

OTHER MATTERS

Respondent understands that he may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondent understands that he may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.

Respondent certifies that he has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce Respondent to submit it.

[SIGNATURES APPEAR ON FOLLOWING PAGE]

Henry McKelvey Blodget

Date: 4/22/03

By: ____________________
Henry McKelvey Blodget, individually

Reviewed by:

Samuel J. Winer, Esq.
Foley & Lardner
3000 K Street, N.W.
Washington, D.C. 20007
Counsel for Respondent

Accepted by NASD:

On behalf of the Director of the Office of Disciplinary Affairs, through delegated authority,

4/24/03
Date

Barry R. Goldsmith
Executive Vice President
Department of Enforcement
NASD
1801 K St. NW
Washington, DC 20006