

Merrill Lynch Faces Cuomo Suit on Auction-Rate Debt (Update4)

By Karen Freifeld and Bradley Keoun

Aug. 15 (Bloomberg) – Merrill Lynch & Co. may face a lawsuit by New York Attorney General Andrew Cuomo, who called the firm's offer to buy back \$10 billion of auction-rate debt an inadequate response to claims the firm misled investors.

“We have not been able to reach satisfactory terms” to settle allegations the firm falsely marketed the securities as safe, liquid investments, Cuomo said today. “I want them to do it my way.”

Merrill said Aug. 7 it would buy back about \$10 billion in frozen auction-rate securities at face value, starting in January. The firm was “surprised” by possible legal action, according to an e-mailed statement from spokesman Mark Herr. “We thought we were making progress,” the statement said.

Merrill has drawn Cuomo's ire for refusing to reach settlements such as the ones he's negotiated with Wachovia, Citigroup Inc. and three other banks. Earlier this week, he criticized a similar voluntary plan by Morgan Stanley before announcing a settlement with that firm.

“They clearly want to get past this,” Robert Ray, a former federal prosecutor who is now a partner at Pryor Cashman LLP in New York, referring to Merrill. “But sometimes you've got to fight a bit in order to work out a settlement that's one you can live with.”

Five Days

Merrill has five days to make a case that the attorney general shouldn't take action, according to a letter released to the media from David Markowitz, the head of Cuomo's Investor Protection Bureau.

“Some institutions have ‘voluntarily’ announced plans,” Cuomo said. “I don't think voluntary is the appropriate word when customers were clamoring for this.”

Regulators have been investigating how banks and Wall Street firms sold auction-rate securities before the \$330 billion market collapsed in February. The investments have been frozen in customer accounts since firms backed away from the market, leading to complaints by customers and investigations by the U.S. Securities and Exchange Commission, the states of New York and Massachusetts, and a nationwide task force of state securities regulators.

Wachovia Corp., the fourth-largest U.S. bank, agreed today to buy back \$9 billion of frozen auction-rate securities and pay a \$50 million fine to settle state and federal claims that arose from the probe.

`Significant' Penalties

Citigroup, based in New York, last week agreed to buy back about \$7.5 billion of auction-rate securities and pay a fine of \$100 million. Zurich-based UBS on Aug. 11 announced an agreement to buy back \$18.6 billion of securities and pay a \$150 million fine. Morgan Stanley and JPMorgan, both based in New York, agreed to buy back a combined more than \$7 billion of securities and pay fines totaling \$60 million.

Cuomo says he wants banks to buy back auction-rate securities frozen in retail customers' accounts, pay for damages, help institutional investors liquidate their investments and pay ``significant" penalties

The attorney general's office has subpoenaed about 25 firms, including the five that have settled, Cuomo said.

``With the Wachovia settlement, Merrill seems to be on the front burner," he said.

Merrill shares rose 28 cents to \$26.26 at 3:37 p.m. in New York Stock Exchange composite trading. Wachovia fell 27 cents to \$15.53.

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