STATE OF NORTH CAROLINA

Department of The Secretary of State

FILED JAN 19 2010

THE NORTH CAROLINA SECURITIES DIVISION,	)	
Petitioner,	)	**ADMINISTRATIVE PETITION**
vs.	)	
E*TRADE SECURITIES LLC 135 E. 57th Street, 14th Floor New York, New York 100221	)	**FILE NO. 08-SEC-0197**
Respondent	)	

The North Carolina Securities Division, by and through its undersigned attorneys, brings this Administrative Petition against the above-named Respondent to obtain administrative relief pursuant to the provisions of Chapter 78A, North Carolina General Statutes (the North Carolina Securities Act, hereinafter "the Act"). The Petitioner complains and alleges as follows:

JURISDICTION

(1) This Administrative Petition is filed and an action commenced against the above-named Respondent by the Petitioner, seeking relief under N.C.G.S. §78A-39.

(2) The Petitioner, the Securities Division of the Department of the Secretary of State, hereinafter the "Division," is authorized by N.C.G.S. §78A-39 to initiate an action seeking the issuance of a Final Order from the Securities Administrator, hereinafter "the Administrator," revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act .

(3) The Administrator has jurisdiction over the subject matter of this proceeding and over the person of the Respondent pursuant to the Act.

THE RESPONDENT

(4) At all times relevant herein, the Respondent, **E*TRADE SECURITIES LLC**, (hereinafter "Respondent E*Trade," "Respondent" or "E*Trade") a limited liability company organized under the laws of the State of Delaware, has been, and remains, a securities dealer registered with the Administrator under the provisions of the Act. In addition, Respondent E*Trade is a federally registered securities dealer offering brokerage and investment products and services to investors across the United States.

(5) Respondent E*Trade, at all times relevant herein, maintained and continues at present to maintain, an office in Charlotte, North Carolina. Respondent conducts much of its activities as a registered securities dealer with persons in North Carolina through telephone calls and use of the Internet. Respondent has failed to qualify to do business in North Carolina in violation of G.S. §55-15-01.

DEFINITIONS

AUCTION RATE SECURITIES

(6) "Auction rate securities" (hereinafter "ARS" or "auction rate securities") are long-term debt or equity instruments that include municipal auction rate bonds, auction rate

preferred shares ("ARPS") of "closed-end" mutual funds, and various asset-backed auction rate bonds. ARS are issued primarily by municipalities, investment companies (mutual funds), and corporations.

(7) While all ARS are either long-term debt instruments or equity interests without redemption rights, one significant feature of all ARS is that the variable interest rates reset through a bidding process known as a "Dutch auction" that occurs in varying intervals ranging from seven (7) to forty-two (42) days. These intervals are set by the issuer and described in the prospectus at the time a particular ARS product is first offered.

(8) In the Dutch auction, a bidder states the amount of ARS the bidder is willing to purchase and the minimum interest rate the bidder is willing to accept. Bids are then ranked, from lowest to highest, according to the minimum interest rate each bidder is willing to accept. The lowest interest rate required to sell all of a particular ARS product available at auction, is known as the "clearing rate." Setting a clearing rate serves two purposes: (a) identifying the successful bidders and (b) setting the interest rate that will be paid by the issuer of the ARS to the new owners until the next successful auction.

(9) Auctions for each ARS product are conducted at the incremental date set at the issuance of the product. Existing owners of an ARS product have three choices: (a) offer their ARS for sale at the auction; (b) elect to "hold" their existing position in the ARS regardless of the new interest rate to be determined at the auction; or, (c) elect to "hold at rate," meaning they will retain their ARS if the new clearing rate is at least as high as the prior rate. A hold at rate is essentially a "sell" order combined with a new "bid" at the prior rate. Bids to purchase ARS can be submitted by existing owners or any interested buyers.

(10) An auction is "successful" when there are sufficient bids to purchase the number of ARS shares offered for sale at that auction. In a successful auction, the winning bidders become the new owners of the ARS being sold by the selling investors.

(11) When there are insufficient orders to purchase all of the ARS being sold, a "failed" auction occurs. When an auction fails, investors are unable to sell any of their ARS until a successful auction occurs. If the auction market does not resume, the investors may end up holding illiquid ARS investments for lengthy terms, and in many cases, indefinitely. Those investors requiring liquidity can recover their investments only if: a) the auction market resumes, b) the issuer decides to redeem the ARS, or c) the investors decide to sell their ARS to others in the secondary market (often at a price significantly below par value).

(12) Beginning in February 2008, the ARS market experienced widespread and repeated failed auctions from which the market has not recovered. As a result, in excess of $330 billion of ARS products were rendered illiquid.

OTHER DEFINITIONS

(13) "Customer," "Client," or "Investor" means any natural person or other legal entity which purchased and/or held ARS from or through Respondent E*Trade.

(14) "Financial Advisor" or "FA" means an E*Trade agent who engaged in the offering, sale or purchase of securities. FAs are persons who are required to be registered with the Division as securities salesmen affiliated with and supervised by Respondent E*Trade: when dealing with customers in North Carolina or when an FA is present in North Carolina and engaged in the offering, sale or purchase of securities with a customer

no matter where the customer is located. E*Trade's internal management practices required that ARS transactions would be handled only through FAs.

(15) "FINRA" means the Financial Industries Regulatory Authority, a private entity authorized under federal law to act as the self-regulatory organization (SRO) to test, register and discipline firms and persons engaged in the business of federally registered securities dealers and salesmen. FINRA was formerly known as the National Association of Security Dealers (NASD) and has merged its functions as an SRO approved by the United States Securities and Exchange Commission with the enforcement operation of the New York Stock Exchange (NYSE). FINRA is still in the process of combining NASD, NYSE and new FINRA rules into one manual and thus certain of its rules are still cited by reference to NASD rules and others by reference to FINRA rules.

(16) "North American Securities Administrators Association" (hereinafter "NASAA") means the voluntary organization of state securities regulators in the United States, Canada, Mexico, District of Columbia, Puerto Rico and the Virgin Islands. The Division is a member of NASAA.

(17) "Underwriter" or "underwriting securities dealer" means a federally registered securities dealer that managed the auction process for an ARS product.

(18) "SEC" means the United States Securities and Exchange Commission, the federal agency charged with regulating and registering issuers of securities and those firms and persons that act as securities dealers or salesmen in the United States.

(19) "SIFMA" means the Securities Industry and Financial Markets Association, a private association of firms and persons active as dealers, brokers and salesmen in the United States securities industry.

THE HISTORY OF THE ARS MARKET

(20) ARS, as a type of financial product, were designed to offer issuers an opportunity to sell long-term debt instruments that pay short-term interest rates. Because of the frequency of the auctions, ARS buyers were told ARS were short-term instruments that compete with true short-term financial products, such as money market mutual funds, as easily liquidated investments. At the same time, ARS paid a higher interest rate than true short-term investments, such as money market funds and U.S. Treasury bills. While ARS are offered and sold to investors at par value, the interest rate paid during the interval between auctions varies according to the clearing rate set at each auction.

(21) Each ARS product is initially offered and sold by a registered securities dealer acting as underwriter. The underwriter of an ARS product acts to manage the auction held on the incremental date specified in the particular ARS. An underwriting securities dealer is compensated for the initial offering and receives fees for managing the periodic auctions so long as the ARS product is in existence.

(22) Prior to 2005, it was industry practice that purchasers make a minimum investment of at least $100,000.00 in order to purchase an ARS product. The primary investors in these products were large institutional investors or large corporations engaged in the temporary investment of cash on hand. Many of the large publicly held or traded entities that invested in ARS treated their ownership of these products as "cash equivalent" for accounting purposes.

(23) In 1987, the U.S. Financial Accounting Standards Board (FASB) adopted FASB 95, outlining the accounting treatment of cash and "cash equivalents." Cash equivalents were defined as those investments that have short terms, are readily convertible

to cash, and are near maturity. FASB 95 was issued before the ARS market had grown very large.

(24) In 2005, certified public accounting firms in the United States recognized that FASB 95 applied to ARS and began advising their clients who filed public financial reports that ARS could not be treated as "cash equivalents" under generally accepted accounting principles and FASB 95. As the instruments were actually long-term or perpetual debt obligations, accounting firms required clients to move the accounting for ARS holdings on their balance sheets from cash equivalents to long-term debt.

(25) The consequence of implementing a change of the accounting classification for ARS was a substantial immediate reduction of "current assets" on ARS investor's balance sheets. Instead of valuing ARS at the investor's cost, the "par" or "face" value of the ARS product, ARS had to be valued by considering the length to time of redemption or, as with ARPS, the lack of any guarantee of redemption. As this accounting position became known in 2005 and early 2006, the large investors who previously comprised over 90% of the investors in ARS began liquidating their holdings.

(26) Due to the institutional investors' reduced demand for the purchase of new ARS and their dramatic increase in orders to sell their existing ARS, the underwriters (securities dealers) found it necessary to prevent failures of the ARS market by entering "support bids" using their own proprietary trading funds. These underwriters then resold these ARS to retail clients of the firms, to divest themselves of the inventory acquired in supporting ARS auctions.

(27) By May 2007, a substantial portion of the entire ARS in the United States market, as much as 80% by some estimates, had been resold to retail investors. These

investors had little or no actual knowledge of the complex nature of, or the accounting controversy surrounding, ARS.

(28) Some underwriting securities dealers generally supported the ARS market by systematically purchasing auction rate securities for their own inventories. These proprietary bids placed by the underwriter securities dealers for their own accounts were known as "support bids." Underwriters making support bids made up for shortfalls in market demand that would have, in the absence of such support, caused the supported auctions to fail. However, the underwriters were under no legal obligation to place support bids, and could refrain from doing so at any time in their sole discretion.

(29) In May 2006, the SEC settled several investigations it had conducted involving various underwriter securities dealers. These settlements were based on SEC findings that these various underwriting firms, prior to 2006, had not adequately disclosed their practices of making support bids in ARS auctions or the effect that support bids had on the clearing rate of a "successful" auction. The SEC sanctioned fifteen underwriters for various violations of securities laws. In its Order, the SEC noted that as a result of certain of these undisclosed practices, investors may not have been aware of certain liquidity risks. The Order required that the sanctioned underwriters provide all customers and all securities dealers purchasing ARS with a written description of the firms' material auction practices and procedures. The Order said that the practice of securities dealers submitting support bids to prevent failed auctions from occurring was a material auction practice and must be disclosed to investors.

(30) After the SEC sanctions, SIFMA developed guidance for its members that contains sample ARS disclosures that would assist securities dealers, such as Respondent E*Trade, and investors, such as the North Carolina customers of Respondent E*Trade, in properly understanding the ARS product offered.

(31) In the latter part of 2007, several of the underwriters of ARS offerings stopped submitting support bids in some types of ARS auctions. This resulted in a significant number of failed ARS auctions by November 2007.

(32) In February 2008 the entire market for ARS products in the United States collapsed when all underwriting securities dealers simultaneously stopped submitting support bids. This is known as the "freeze" of the ARS market. The ARS market continues to experience widespread failures, making many ARS holdings illiquid. Since the February 2008 "freeze" some ARS have been redeemed by their issuers. However, numerous investors, including Respondent's North Carolina customers, currently hold ARS that they have been unable to sell through the auction process and that have not yet been redeemed by the issuers.

RESPONSIBILITIES OF E*TRADE AS A SECURITIES DEALER

(33) Respondent E*Trade, as a registered securities dealer under the Act and as federally registered securities dealer, is required to observe various standards of conduct in its dealings with North Carolina customers. These standards are found in the Act, in the rules adopted by the Administrator pursuant to the Act, the Securities Exchange Act of 1934, and rules imposed on Respondent by the SEC itself and through the authority of the SEC as granted to FINRA.

(34) Respondent is obligated to deal fairly and honestly with its customers. This obligation is broad and includes, but is not limited to, the obligation to make truthful disclosures of all material facts, not to omit material facts, and not to provide even truthful information in a misleading or deceptive manner. These obligations are imposed by G.S. §78A-8(2); 18 NCAC 06A .1414(a) (formerly 18 NCAC 06 .1414(a)); 15 U.S.C. 78o(b)4(E) and (c)2(A); the standards set forth in G.S. §78A-39(a)(2)(b) and (g); and those rules enforced by FINRA: including the NASD Rule 2210 and FINRA Rules 2010 and 2020. Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

(35) Respondent is obligated to determine the suitability of any security before that security is offered to its customer. To determine suitability, a registered securities dealer such as Respondent, must assess both the security (its type or kind, the risks associated with investing in the security, and the market conditions affecting the issuer) and the customer (the customer's investment risk profile, the customer's present portfolio diversification, and the customer's investment goals). These obligations are imposed by 18 NCAC 06A .1414(b)(3) (formerly 18 NCAC 06 .1414(b)(3)); the standards set forth in G.S. §78A-39(a)(2); and NASD Rule 2310. Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

(36) Respondent is required to properly supervise those persons registered with the Division under the Act as securities salesmen to assure compliance with the standards

applicable to the business it conducts. These obligations are imposed by 18 NCAC 06A .1414(b)(14); 15 USC 78o(b)4(E); NASD Rule 3010; and the standards set forth in G.S. §78A-39(a1)(2). Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

(37) Respondent is required to maintain books and records of its transactions, of its supervision of salesmen, and of its dealings with its customers, see G.S. §78A-38, 18 NCAC 06A .1411 (formerly 18 NCAC 06 .1411), 15 U.S.C. 78o, and 17 C.F.R. 240.17a-3 and 240.17a-4.

(38) Respondent is required to produce its books and records to the Division, see G.S. §78A-38, G.S. §78A-46 (a) and (b), and 18 NCAC 06A .1411 (formerly 18 NCAC 06 .1411).

E*TRADE'S INVOLVEMENT IN THE ARS MARKET

(39) The Division, in addition to conducting its own investigation of Respondent E*Trade's marketing and sales practices for ARS products, has participated in coordinated investigations of these activities of Respondent E*Trade conducted by a multi-state task force composed of members of NASAA.

(40) Respondent E*Trade has held itself out to its customers as a lower-cost alternative to the "full service" securities dealers with whom it competes for business. Respondent solicited its North Carolina customers to invest in ARS products. Respondent offered and sold numerous ARS products to its North Carolina customers,

and was compensated for these sales. This compensation was by either an initial sales commission, an on-going "trailing" sales commission, or by both methods.

(41) Unlike E*Trade's advertised equity trading business model, where customers process their own orders in a self-directed manner, E*Trade's actual internal policies, procedures and systems required the involvement of an E*Trade Financial Advisor authorized to sell ARS products.

(42) A sale of ARS products to a customer was accomplished by an authorized E*Trade Financial Advisor submitting a customer's order to the E*Trade fixed income desk where the order was reviewed and transmitted to the E*Trade ARS distributor for execution. In addition, Respondent E*Trade frequently held an inventory of ARS in its proprietary accounts and offered new issue sales to its customers on behalf of underwriters of those new issues.

(43) E*Trade's registered securities salespersons routinely reviewed accounts, identified those accounts with large cash balances and referred those customers to E*Trade's FAs for investment advice, including the offer and sale of ARS.

NORTH CAROLINA INVESTORS

CLIENT A

(44) Client A, a North Carolina resident and senior citizen, maintains a non-discretionary brokerage account with Respondent E-Trade for the purposes of personal investment. Client A was first introduced to ARS by Respondent E-Trade in late 2007 when Client A requested a recommendation on where he might invest extra cash that could provide a good rate of return but still be safe and liquid.

(45) Respondent E*Trade referred Client A's inquiry to an FA authorized to sell ARS products. The FA recommended to Client A the purchase of Blackrock Preferred and Equity F7 (an ARPS product with no maturity date or mandatory re-purchase obligation) as a suitable investment. Client A was assured by the FA that the investment was safe and could be cashed every 7 days. In reliance on these representations, Client A purchased $450,000 of this ARS product on December 26, 2007.

(46) Client A was not informed that the future liquidity of the investment was dependent on and provided by the continuation of successful auctions. Client A was never informed that in the event of an auction failure the security would only pay interest based on a formulaic fail rate that is set forth in the ARS offering documents. Disclosure of the fail rate was not provided to Client A. Client A was not informed by Respondent E*Trade that underwriting securities dealers conducting auctions were permitted to, but were under no obligation to place supporting bids in order to assure a successful auction.

(47) Respondent E*Trade's sale of ARS to Client A was not a suitable transaction for Client A and was made on the basis of material misrepresentations and omissions by Respondent E*Trade.

(48) Since the February 2008 ARS market "freeze," Client A has had $225,000 of his ARS redeemed by Blackrock (the issuer). Client A has not been able to liquidate the remaining $225,000 of his ARS investment.

CLIENT B

(49) Client B is a North Carolina resident who maintains a non-discretionary brokerage account with Respondent E*Trade for purposes of personal investment. Client B was first introduced to ARS products by an E*Trade FA in September 2005.

(50) Client B requested a recommendation for ideas on where she could invest for a good rate of interest while keeping her funds safe and liquid. Client B was informed by her E*Trade FA that ARS products could be sold anytime without penalty. Her FA recommended Van Kampen Merritt Trust and on the basis of that recommendation, Client B purchased $25,000.00 of that ARS product in September 2005. In July 2006, Client B, after consulting with her FA, purchased $75,000.00 of an ARS product, Dreyfus Strategic Municipal Securities.

(51) Client B was not informed that the future liquidity of the investment was dependent on and provided by the continuation of successful auctions. Client B was never informed that in the event of an auction failure the security would only pay interest based on a formulaic fail rate that is specified in the ARS offering documents. Disclosure of the fail rate was not provided to Client B. Client B was not informed by the E*Trade FA that certain underwriters involved in conducting auctions were permitted to, but under no obligation to, place supporting bids in order to assure a successful auction.

(52) Respondent E*Trade's sales of ARS to Client B were not suitable transactions for Client B and were made on the basis of material misrepresentations and omissions by Respondent E*Trade.

(53) On or about February 12, 2008, as the ARS market "freeze" was almost complete, Client B was contacted by a different E*Trade FA. This FA recommended to Client B the purchase of two Unit Investment Trust securities (UITs) for a total price of $100,000.00. The FA advised Client B to pay for the UIT purchase by selling her ARS products. Client B followed this E*Trade recommendation and gave permission for the sale and purchase orders to be placed.

(54) When Client B reviewed her February 2008 E*Trade statement in March 2008, she was surprised to find that although the purchase of the UITs had been completed, the ARS she held had not been sold. The failure of Respondent E*Trade to liquidate her ARS products had not been previously communicated to her. Respondent E*Trade treated her UIT investment as a margin purchase and charged her interest on the new UIT purchase.

(55) When Client B contacted Respondent E*Trade after viewing her February 2008 account statement she was informed for the first time that ARS auctions had failed and her ARS products were not liquid.

(56) Client B has not been able to liquidate any of her $100,000.00 investment in ARS and has been forced to sell other assets to pay for the UIT purchase so that she would not continue to be charged margin interest.

CLIENT C

(57) Client C is a North Carolina resident who had an account with Respondent E*Trade for the purpose of exercising stock options received from her employer.

(58) Client C exercised some of her stock options on or about August 8, 2007. As a result of the exercise of her options, Client C had a cash balance of approximately $150,000.00 in her E*Trade account.

(59) Several days after her exercise of these stock options and while the $150,000.00 proceeds were still in her account with Respondent, Client C was solicited by an E*Trade FA. Client C informed the FA that her goal for this money was to have a safe investment option, such as a CD, that would pay interest, but be available for her to pay her taxes. The FA recommended the Pimco Corporate Opportunity Fund and told Client C that this product would pay higher interest than a CD but that she could sell it at a weekly auction by calling him prior to her tax deadline. This product was an ARS.

(60) On the basis of the recommendation by Respondent E*Trade, Client C invested $75,000.00 in the Pimco Corporate Opportunity Fund on August 15, 2007. Client C received by email an "Oppenheimer Brochure" containing a generic description of ARS products. Client C believed that the brochure was sent by mistake because she had authorized purchase of a Pimco product, not an Oppenheimer product. Client C did not receive any prospectus for a Pimco ARS product.

(61) Client C was not informed that the future liquidity of the investment was dependent on and provided by the continuation of successful auctions. Client C was never informed that in the event of an auction failure the security would only pay interest based on a formulaic fail rate that is specified in the ARS offering documents. Disclosure of the fail rate was not provided to Client C. Client C was not informed by the E*Trade FA that

certain underwriters involved in conducting auctions were permitted to, but under no obligation to, place supporting bids in order to assure a successful auction.

(62) Respondent E*Trade's sale of ARS to Client C was not a suitable transaction for Client C and was made on the basis of material misrepresentations and omissions by Respondent E*Trade.

(63) In March of 2008 Client C contacted Respondent E*Trade to liquidate her ARS products so that she could pay her taxes. Client C was then first informed by Respondent E*Trade that auctions had been failing and that she could not sell her ARS products. Client C has not been able to liquidate any of her $75,000.00 investment in ARS and had to take a home equity loan in order to meet her tax obligation.

CLIENT D

(64) Client D is a North Carolina resident and senior citizen that maintains a non discretionary brokerage account with respondent E-trade for purposes of personal investment and future expansion of his small business.

(65) Client D was first introduced to ARS by E-Trade when the E-Trade Financial Advisor that had been assigned to Client D, recommended "Resets" to Client D for monies that had previously been invested in short term Certificate of Deposits. Client D had made it clear to the Financial Advisor that Client D was planning on using these monies to expand his small business so that he required a liquid investment. Client D was told by the Financial Advisor that the "Resets" were safe, liquid, paid a good interest rate and could be sold weekly.

(66) Client D had never heard of "Resets" before but on the basis of the Financial Advisor's' recommendation did purchase a total of $275,000 worth of two different Nuveen ARPS.

(67) Client D was not informed that the future liquidity of the investment was dependent on and provided by the continuation of successful auctions. Furthermore, Client D was never informed that in the event of an auction failure the security would only pay interest based on a formulaic fail rate that is specified in the ARS offering documents. Disclosure of the fail rate was not provided to Client D. Client D was not informed by the E-Trade Financial Advisor that certain underwriters involved in conducting auctions were permitted to, but under no obligation to, place supporting bids in order to insure a successful auction.

(68) Respondent E*Trade's sale of ARS to Client D was not a suitable transaction for Client D and was made on the basis of material misrepresentations and omissions by Respondent E*Trade.

(69) Since the February 2008 ARS market "freeze" Client D has not been able to liquidate any of the $275,000 investment in ARS.

CLIENT E

(70) Client E is a North Carolina resident that maintains a non discretionary brokerage account with respondent E-trade for purposes of personal investment. Client E was first introduced to ARS when an E-Trade Financial Advisor contacted Client E and recommended a short term investment alternative to a money market.

(71) The investment was described to Client E as risk free and providing above money market rates of interest with weekly liquidity. On the basis of this recommendation, Client E did purchase a total of $300,000 of Cohen and Steers ARPS.

(72) Client E was not informed that the future liquidity of the investment was dependent on and provided by the continuation of successful auctions. Furthermore, Client E was never informed that in the event of an auction failure the security would only pay interest based on a formulaic fail rate that is specified in the ARS offering documents. Disclosure of the fail rate was not provided to Client E. Client E was not informed by the E-Trade Financial Advisor that certain underwriters involved in conducting auctions were permitted to, but under no obligation to, place supporting bids in order to insure a successful auction. Client E was not contacted by E-Trade to inform him of the auction failures nor had he been provided with any ongoing information regarding his ARS investment.

(73) Respondent E*Trade's sale of ARS to Client E was not a suitable transaction for Client E and was made on the basis of material misrepresentations and omissions by Respondent E*Trade.

(74) The issuer of Client E's ARS (Cohen and Steers) undertook a rolling redemption of the ARS and has recently repurchased the entire $300,000 of ARS from Client E.

CLIENT F

(75) Client F is a North Carolina resident and senior citizen that maintains a non discretionary brokerage account with respondent E-Trade for purposes of personal

investment. Client F was introduced to ARS when he had asked his E-Trade Financial Advisor for recommendations for alternatives to money markets.

(76) The Financial Advisor recommended ARS to Client F as a suitable investment but described them as short term bonds. On the basis of the recommendation, Client F did purchase $50,000 of Nicholas Applegate ARPS and $50,000 of John Hancock ARPS in early January 2008.

(77) In early February 2008, Client F requested that his E-Trade Financial Advisor sell both of the ARPS because Client F wished to receive his money. Only the John Hancock ARPS were successfully liquidated at auction so that Client F was able to obtain only $50,000 of his desired $100,000.

(78) Client F was not informed that the future liquidity of the investment was dependent on and provided by the continuation of successful auctions. Furthermore, Client F was never informed that in the event of an auction failure the security would only pay interest based on a formulaic fail rate that is specified in the ARS offering documents. Disclosure of the fail rate was not provided to Client F. Client F was not informed by the E-Trade Financial Advisor that certain underwriters involved in conducting auctions were permitted to, but under no obligation to, place supporting bids in order to insure a successful auction.

(79) Respondent E*Trade's sale of ARS to Client F was not a suitable transaction for Client F and was made on the basis of material misrepresentations and omissions by Respondent E*Trade.

(80) Since the February 2008 ARS market "freeze," Client F has not been able to liquidate any of the remaining $50,000 investment in ARS.

CLIENT G

(81) Client G is a North Carolina resident that maintains a non discretionary brokerage account with respondent E-trade for purposes of personal investment. Client G was introduced to ARS when an E-Trade Financial Advisor contacted Client G and recommended ARS as a suitable alternative for the money market balance that Client G maintained with E-Trade.

(82) The Financial Advisor told Client G that auctions take place every week so that Client G's money would only be tied up for the week. In return Client G would earn higher rates of interest than he otherwise would in a money market. In reliance on these representations, Client G did purchase various issues of ARPS including Dreyfus Strategic Municipal and Federated Premier Intermediate.

(83) Client G was not informed that the future liquidity of the investment was dependent on and provided by the continuation of successful auctions. Furthermore, Client G was never informed that in the event of an auction failure the security would only pay interest based on a formulaic fail rate that is specified in the ARS offering documents. Disclosure of the fail rate was not provided to Client G. Client G was not informed by the E-Trade Financial Advisor that certain underwriters involved in conducting auctions were permitted to, but under no obligation to, place supporting bids in order to insure a successful auction.

(84) Respondent E*Trade's sale of ARS to Client G was not a suitable transaction for Client G and was made on the basis of material misrepresentations and omissions by Respondent E*Trade.

(85) Since the February 2008 ARS market "freeze," Client G has had approximately one third of his ARS investments redeemed by issuers. However, Client G has not been able to liquidate any of the remaining ARS positions and therefore continues to be forced into holding over $800,000 in "frozen" ARS.

CLIENT H

(86) Client H is a North Carolina resident that maintains a non discretionary brokerage account with respondent E-Trade for purposes of personal investment. Client H originally made his investment in ARS as a result of having received a telephone call from an E-Trade Financial Advisor. The Financial Advisor told Client H that he noticed that Client H had a large cash balance in his brokerage account.

(87) The E-Trade Financial Advisor recommended that Client H purchase ARS with his cash balance because ARS would pay higher yields, offer tax advantages and were absolutely safe. The Financial Advisor told Client H that liquidity was provided weekly via an auction but did not explain what an auction process entailed. In reliance on these representations, Client H authorized the purchase of $50,000 of Nuveen Premium Income ARPS.

(88) Client H was not informed that the future liquidity of the investment was dependent on and provided by the continuation of successful auctions. Furthermore, Client H was never informed that in the event of an auction failure the security would

only pay interest based on a formulaic fail rate that is specified in the ARS offering documents. Disclosure of the fail rate was not provided to Client H. Client H was not informed by the E-Trade Financial Advisor that certain underwriters involved in conducting auctions were permitted to, but under no obligation to, place supporting bids in order to insure a successful auction.

(89) Respondent E*Trade's sale of ARS to Client H was not a suitable transaction for Client H and was made on the basis of material misrepresentations and omissions by Respondent E*Trade.

(90) Since the February 2008 ARS market freeze, Client H has had $25,000 of his Nuveen ARPS redeemed by the issuer. He has not been able to liquidate his remaining $25,000 ARS position.

NORTH CAROLINA CLIENTS IN GENERAL

(91) At the time of the February 2008 "freeze" of the national ARS market, there were forty-seven (47) North Carolina customers that had acquired ARS from Respondent E*Trade and were still holding those ARS in their respective accounts. North Carolina customer accounts administered by Respondent held at least $8,375,000.00 in "frozen" ARS assets in February 2008. Most of these customers had invested in ARPS products.

(92) Since certain ARS products contained penalty rates that imposed interest charges above financing costs available to the issuers elsewhere, certain issuers redeemed the ARS they had sold. As a result of various issuer redemptions since February 2008, the Division is informed and does believe that the current balance of all "frozen" ARS

products held by Respondent E*Trade for its' North Carolina customers is, at the time of the issuance of this Administrative Petition, approximately $2,000,000.00.

(93) The Division's investigation of the conduct of Respondent E*Trade demonstrates that the North Carolina customers of Respondent, when solicited to purchase ARS products or when inquiring on their own about ARS products, did not receive truthful, accurate or complete information from Respondent.

(94) Nearly all North Carolina customers interviewed by the Division report that they were not informed that:

(a) The future liquidity of the customer's investment depended on a complicated Dutch auction mechanism;

(b) There was a possibility the auctions could fail;

(c) The underwriting securities dealers were permitted to support, and in some cases did support, the auctions with proprietary bids;

(d) The underwriting securities dealers were under no obligation to support auctions to assure liquidity for customers; or

(e) The customer's money was not being invested in short term securities but was actually being invested in long term and/ or perpetual securities with no final maturity date.

(95) Respondent E*Trade, by the practices described above with respect to its North Carolina customers, in each ARS transaction with its North Carolina customers, violated G.S. §78A-8(2); 18 NCAC 06A .1414(a) (formerly 18 NCAC 06 .1414(a)); 18 NCAC 06A .1414(b)(3) (formerly 18 NCAC 06 .1414(b)(3)); 15 U.S.C. 78o(b)4(E) and (c)2(A); the standards set forth in G.S. §78A-39(a)(2)(b) and (g); and rules enforced by FINRA: NASD Rules 2210 and 2310, as well as FINRA Rules 2010 and 2020.

Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

E*TRADE'S MOTIVE IN ARS SALES

(96) During the national economic crisis of 2007 the financial market deteriorated. The financial health of the parent company of Respondent E*Trade deteriorated with loss of customer accounts and a decline in share prices. Respondent E*Trade instructed its securities salespersons to identify customers with large cash balances or who were considering moving their accounts to other securities dealers. Management directed the securities salesmen to refer such customers to an FA authorized to sell ARS products in order to retain customer accounts and funds.

(97) Throughout the fall and winter of 2007, the financial and economic stability of Respondent E*Trade continued to erode precipitously. By the end of November 2007, an increasing number of customers were asking questions to E*Trade FAs and registered securities salespersons about the viability of E*Trade and the security of their investments with the firm. Respondent E*Trade intensified its efforts to have its registered securities salespersons refer customers to the FAs authorized to sell ARS in order to retain customer assets with the firm and immediately halt the outflow of cash positions from the firm's accounts.

(98) Respondent E*Trade, with respect to customers in North Carolina and its customers in other states adopted a policy of identifying customers with ready cash or in the process of removing funds from E*Trade accounts and targeted those customers with

solicitations to purchase ARS products. These solicitations were made through false or misleading representations by its FAs.

(99) On several occasions in an attempt to retain firm customers and assets, E*Trade FAs encouraged customers concerned about the safety and security of their funds invested with E*Trade to move their money out of FDIC insured accounts into ARS.

(100) Respondent E*Trade, by intentionally acting to retain customers through its violations of law and rules as described herein failed in its duty to observe a high standard of commercial honor and engage in fair and equitable dealings while noting any conflicts of interest, thereby violating 18 NCAC 06A .1414(a) (formerly 18 NCAC 06 .1414(a)); and the standards set forth in G.S. §78A-39(a)(2)(b) and (g). Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

MISREPRESENTATIONS AND OMISSIONS BY E*TRADE

(101) In connection with the sale of ARS, some North Carolina investors were told by Respondent E*Trade that ARS products were: "just like treasuries but liquid every seven days;" "safe and offer weekly liquidity;" "7 day paper;" "just like a CD but with a higher yield;" "absolutely safe;" and "short term notes."

(102) Respondent E*Trade engaged in widespread fraudulent and deceptive conduct in the sale of millions of dollars of ARS products to North Carolina investors as part of its nation-wide marketing practices. Respondent E*Trade regularly

misrepresented ARS products to its clients as safe, liquid investments that were suitable for their short-term, cash management purposes. Respondent E*Trade persistently failed to disclose or made misrepresentations that concealed the risk that clients would not be able to sell their auction rate securities and could thus lose liquidity should auctions fail.

(103) Because of Respondent E*Trade's misleading sales practices, many E*Trade customers invested in ARS based upon false assurances of liquidity and without being provided the fundamental information needed to properly assess the risks of investing in ARS.

(104) Respondent E*Trade made practically no effort to inform or educate its customers about the risks of ARS identified in the 2006 SEC actions. Most investors were not provided with a prospectus before they purchased ARS from Respondent E*Trade. Respondent E*Trade did not provide the disclosures recommended in the SIFMA "Best Practices" Manual for ARS products.

(105) The conduct of Respondent E*Trade in generally misrepresenting the liquidity of, and risks associated with, ARS to North Carolina customers was consistent with E*Trade's nationwide sales practices. These practices violated G.S. §78A-8(2); 18 NCAC 06A .1414(a) and (b)(3) (formerly 18 NCAC 06 .1414(a) and (b)(3)); and the standards set forth in G.S. §78A-39(a)(2)(b) and (g). Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

E*TRADE'S FAILURE TO TRAIN AND SUPERVISE

(106) Respondent E*Trade failed to reasonably supervise its employees in violation of the standards set forth in G.S. §78A-39(a1)(2)(a) with regard to the marketing and sale of ARS products by:

(a) failing to provide timely and comprehensive sales and marketing literature regarding ARS and the mechanics of the auction process to FAs and customers;

(b) failing to provide to its customers pertinent material information concerning the complexity of the ARS products;

(c) failing to ensure that its FAs were selling ARS to individual investors for whom such products were suitable;

(d) failing to review ARS transactions in accounts of clients who needed liquidity; and,

(e) failing to implement SIFMA "best practices" recommendations concerning ARS product sales.

(107) Respondent E*Trade maintained a "Policies and Procedures Manual" addressing how its FAs would meet their obligations as registered persons with the Division, FINRA and other states' securities regulators. That manual merely stated the following regarding ARS: "...It is imperative that you fully explain the differences between an ARP and a Money Market...." This guidance was insufficient and inadequate as Respondent did not provide any information to its FAs by which such persons could even know what the differences were between "an ARP and a Money Market."

(108) Because E*Trade maintained completely inadequate internal standards governing ARS sales, acquisition of knowledge about ARS was left substantially to the

discretion of individual FAs authorized to sell ARS. Respondent E*Trade's failure to educate and supervise its FAs in ARS sales resulted in no consistency in how its FAs presented ARS to clients.

(109) Respondent E*Trade compounded its failures by a pattern or practice of providing certain customers immediate liquidity outside of the auction process. For an example, in select cases, Respondent E*Trade would provide liquidity to a customer between auctions by purchasing the customer's ARS and moving the ARS into E*Trade's own error account. Likewise, Respondent E*Trade would also arrange for internal cross trades with another E*Trade account, with another securities dealer, or another non-E*Trade buyer before the scheduled auction. This activity caused a false impression with customers and E*Trade FAs about the actual availability of liquidity and the function of the ARS auction process.

(110) Respondent E*Trade did not instruct its FAs to disclose the 2006 SEC actions against ARS underwriters.

(111) In August 2007, the credit crisis and other deteriorating market conditions strained the ARS market. Several disruptions and auction failures occurred in the market for these complex products in the summer and fall of 2007. Although, the potential for auction failures was, or should have been, evident, E*Trade largely ignored or downplayed their significance. In fact, even after Respondent was put on notice that auctions could fail and had failed, Respondent did little if anything to determine the likelihood of failure or its implications for their customers.

(112) Respondent E*Trade did not instruct its FAs to inform customers of the recent history and known risks of auction failure in the ARS market. Respondent E*Trade continued to market ARS products as cash equivalent investments appropriate for the same purposes that money markets and certificates of deposits.

(113) Respondent E*Trade failed to instruct its FAs to notify their customers who had already purchased ARS investments about the increasing amount of auction failures.

(114) Respondent E*Trade, by its constantly repeated failures to supervise the registered salesmen associated with it, in each ARS transaction with its North Carolina customers, violated 18 NCAC 06A .1414(a) and (b)(14) (formerly 18 NCAC 06 .1414(a) and (b)(14)); 15 U.S.C. 78o(b)4(E) and (c)2(A); the standards set forth in G.S. §78A-39(a)(2)(b) and (g); the standards set forth in G.S. §78A-39(a1)(2)(a); and rules enforced by FINRA: NASD Rules 2210 and 2310, as well as FINRA Rules 2010 and 2020. Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

E*TRADE'S FAILURE TO CREATE AND PRESERVE RECORDS

(115) Respondent E*Trade established, documented and maintained various policies and procedures that specified it would collect and verify account holders' account suitability. Based upon a review of the documents received by the Division, it appears that from at least January 1, 2005 through July 6, 2009, E*Trade failed to conduct many

mandatory account review and approvals. Consequently, E*Trade's documented procedures differed materially from its actual operational procedures.

(116) Between January 1, 2005 and March 1, 2009, Respondent E*Trade failed to follow the suitability documentation procedures set forth in its policies. E*Trade did not consistently complete, maintain and update account opening documents and "Know Your Customer" ("KYC") reports for newly opened and existing accounts. In addition, Respondent failed to document and maintain customer interaction and sales logs. E*Trade's four (4) year failure to accurately document its customer information constitutes and demonstrates the lack of adequate management supervision of the firm's regulated activities.

(117) By failing to document accurately its customer suitability procedures, Respondent E*Trade willfully violated G.S. §78A-38; 18 NCAC 06A .1411(a), (b)(3) and (b)(14) (formerly 18 NCAC 06 .1414(a), (b)(3) and (b)(14)); and the standards set forth in G.S. §78A-39(a)(2)(b). Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

E*TRADE'S FAILURE TO PROVIDE RECORDS TO THE DIVISION

(118) During its investigation, the Division requested that Respondent E*Trade produce emails and other records relating to its involvement in the ARS market. Prior to the issuance of this Administrative Petition, Respondent E*Trade has made only a partial production of documents that are subject to the Division's requests.

(119) On April 30, 2009, the Division served on E*Trade a *Subpoena Duces Tecum and Interrogatories* that required the production of documents and information pertaining to E*Trade's sale of ARS. However, to date, Respondent has failed to provide complete and adequate responses for basic information relating to North Carolina investors who purchased, sold or held ARS with E*Trade. For example, E*Trade has failed to provide complete responses relating to the following:

(a) Account opening documents; customer account statements; brokerage account statements; screen shots and/or associated content of any and all E*Trade databases used to capture, document and manage customer/investor personal/financial information; and transfer records.

(b) Emails, correspondence, notes, memoranda, and other documentation related to North Carolina investors, including all marketing material, sales material, prospectuses, disclosure documents and other information actually provided to each specific E*Trade customer.

(c) Order tickets; order confirmations; commission runs; all trade blotters (i.e., purchases and sales journal) listing transactions (including all trade errors, cancellations, re-bills, and reallocations) in ARS for current and former North Carolina clients.

(d) All compliance records/reports; internal audit reports; all Self Regulating Organization ("SRO") audit reports; exception reports; surveillance reports, complaints and other documentation relating or referring to North Carolina ARS purchases and sales.

(e) Policies and procedures implemented in order to track or ensure that clients received information referenced in any disclosure documents including those made available to investors on-line.

(f) Commission or other remuneration earned by E*Trade or any E*Trade personnel relating to all purchases and sales of ARS by E*Trade to clients in North Carolina.

(g) Communications made by E*Trade personnel to the clients concerning the suitability, advantages and risks of ARS.

(h) Organizational/hierarchal chart for E*Trade's ARS business, its management and staff, and their respective duties and responsibilities.

(i) P olicies, procedures, guidelines, records or reports developed by or used by E*Trade relating to the research and analysis of ARS markets, auctions or individual securities.

(j) Em ails to or from E*Trade salesmen requesting or providing guidance and information on the sale of ARS.

(k) Documents and information relating to any training programs and/or training materials created or used by E*Trade relating to the sale of ARS.

(l) I nformation relating to E*Trade's Information Technology or Information Services departments.

(120) On October 28, 2009, the Division served an additional *Subpoena Duces Tecum* that requires the production of documents and records pertaining to E*Trade's sale of ARS. The Division's subpoena contained several specifically tailored demands which included emails and all other documents from eight (8) key participants involved in E*Trade's ARS business.

(121) In response to the additional subpoena, the Division was provided with allegedly responsive emails for only four (4) individuals for an extremely limited period of time. Although the Division is still in the process of reviewing these emails, it is clear that this response is wholly inadequate.

(122) On January 7, 2010, the Division provided Respondent with a draft of this Administrative Petition together with a demand for settlement. After receipt of the Division's letter and draft, E*Trade provided additional information to the Division. On January 13, 2010 the Division received a further response to the *Subpoena Duces Tecum*

and Interrogatories dated April 30, 2009. In addition, E*Trade represented to the Division that it will provide further limited information during the week of January 18, 2010.

(123) On January 14, 2010, the Division informed Respondent that the recently provided and promised information represented only a small part of the outstanding information required by the Division's subpoena. Respondent was again notified of the deficiencies of their responses and that the Division immediately required a full and complete response to all outstanding demands.

(124) The failure of Respondent E*Trade to produce records pursuant to the subpoenas issued to and served upon it violated N.C.G.S. §78A-38(d); and the standards set forth in G.S. §78A-39(a)(2)(b). Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

VIOLATIONS OF LAWS AND RULES

(125) Respondent E*Trade, as a federally registered securities dealer, was and is required by Section 15A of the Securities Exchange Act of 1934 (the 1934 Act) to employ or affiliate only individuals holding a federally approved license through a national securities association recognized by the SEC. FINRA is recognized by the SEC under the 1934 Act as a self-regulatory organization authorized to examine, license and discipline firms and persons engaged in the business of securities dealers, brokers or salesmen. In addition, Chapter 78A, N.C.G.S., requires federally registered securities dealers, including

Respondent E*Trade, to register as securities salesmen those persons located in North Carolina and/or acting on its behalf with respect to persons located in North Carolina. Under the rules of FINRA applicable to the times relevant herein, Respondent E*Trade was and is required to supervise its employees, officers, affiliated persons and salesmen to assure compliance with the rules of FINRA, the various states, including North Carolina, and the SEC.

(126) Respondent E*Trade, by willfully failing to supervise its officers, employees and registered salesmen under the Act, with respect to the communication of information to North Carolina investors by registered salesmen and by materials prepared and distributed by its employees, all of whom were under its supervision, as required by the 1934 Act and FINRA rules adopted pursuant to the 1934 Act, violated 18 NCAC 06A .1414 (a), (b)(3) and (b)(14) (formerly 18 NCAC 06 .1414(a), (b)(3) and (b)(14)); and the standards set forth in N.C.G.S. §§78A-39(a)(2)(b), 78A-39(a)(2)(g) and 78A-39(a1)(2)(a). The repeated failures of Respondent E*Trade to comply with its obligations under FINRA and NASD rules are egregious violations of the rules of a national securities organization under 18 NCAC 06A .1414(b)(14) (formerly 18 NCAC 06 .1414(b)(14)). Moreover, the Division is authorized by N.C.G.S. §78A-39 to initiate an action revoking, suspending or censuring the registration of a securities dealer upon grounds stated in the Act.

(127) It is in the public interest of the citizens of North Carolina and for the protection of investors that the securities dealer registration, and any right to a new registration, transfer of registration or renewal of any registration of Respondent E*Trade, be revoked or suspended.

STATUTORY PROVISIONS

(128) N.C.G.S. §78A-2(2) states:

"Dealer" means any person engaged in the business of effecting transactions in securities for the account of others or for his own account...

(129) N.C.G.S. §78A-2(9) states:

"Salesman" means any individual other than a dealer who represents a dealer in effecting or attempting to effect purchases or sales of securities.

(130) N.C.G.S. §78A-8 states:

It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

(131) N.C.G.S. §78A-38 states:

(a) Every registered dealer shall make and keep such accounts, correspondence, memoranda, papers and books, and other records as the Administrator by rule prescribes...

(b) Every registered dealer shall file such financial reports as the Administrator by rule prescribes...

(d) All the records referred to in subsection (a) of this section are subject at any time or from time to time to such reasonable periodic, special or other examinations by representatives of the Administrator...as the Administrator deems necessary or appropriate in the public interest or for the protection of investors...

(132) N.C.G.S. §78A-39(a) states:

The Administrator may by order deny, suspend, or revoke any registration in whole or in part or restrict or limit as to any person, office, function, or activity or censure the registrant if he finds

(1) That the order is in the public interest and

(2) That the applicant or registrant...

b. Has willfully violated or willfully failed to comply with any provision of this Chapter or a predecessor law or any rule or order under this Chapter or a predecessor law or any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisors Act of 1940, or the Commodity Exchange Act ...

g. Has engaged in dishonest or unethical practices in the securities business...

(133) N.C.G.S. §78A-39(a1) states:

The Administrator may by order deny, suspend, or revoke any registration in whole or in part or restrict or limit as to any person, office, function, or activity or censure the registrant if he finds

(1) That the order is in the public interest and

(2) That the applicant or registrant:

a. Has failed reasonably to supervise his salesmen if he is a dealer...

(134) N.C.G.S. §78A-46 states:

(a) The Administrator in his discretion

(1) May make any investigation within or outside of this State as the Administrator deems necessary to determine whether any person has violated or is about to violate any provision...or to aid in the enforcement...

(b) For the purpose of any investigation or proceeding…the Administrator or any officer designated by him may…take evidence and require the production of any books, papers, correspondence, memoranda, agreements, or other documents or records which the Administrator deems relevant or material to the inquiry.

PRAYER FOR RELIEF

WHEREFORE, the Petitioner requests that the Secretary of State find that it is in the public interest to:

(1) After notice of and an opportunity for a hearing, issue a Final Order revoking the securities dealer registration of Respondent E*Trade;

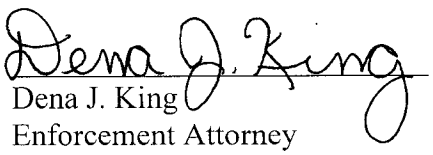
(2) As an alternative, should the Administrator deem it appropriate, suspend the securities dealer registration of Respondent E*Trade until all North Carolina investors are made whole for their investments in ARS sold to them by Respondent, then staying a period of suspension and placing E*Trade on probation for a period of at least three (3) years, conditioned upon its demonstrating compliance with its obligations to keep records and supervise its salesmen; and,

(3) Grant such other and further relief as the Secretary of State may deem appropriate under the circumstances.

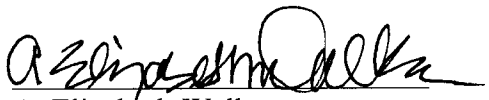
This the 19th day of January, 2010.

Blackwell Brogden
Enforcement Attorney

Kevin Harrington
Enforcement Attorney



Dena J. King
Enforcement Attorney



A. Elizabeth Walker
Enforcement Attorney

Department of the Secretary of State
Securities Division
Post Office Box 29622
Raleigh, North Carolina 27626-0622
(919) 733-3924

FILED JAN 19 2010

THE NORTH CAROLINA SECURITIES DIVISION, Petitioner, **vs.** **E*TRADE SECURITIES LLC** 135 E. 57th Street, 14th Floor New York, New York 100221 Respondent	**AFFIDAVIT OF STEVEN C. BUTZ** **FILE NO. 08-SEC-0197**

THE UNDERSIGNED, Steven C. Butz, being first duly sworn, deposes and says as follows:

(1) I am employed as a Securities Investigator with the Securities Division of the Department of the North Carolina Secretary of State.

(2) In the course and scope of my duties, I have conducted an investigation of the business activities of the Respondent named in the Administrative Petition in this matter. I have read the Administrative Petition in this matter. Based upon my review of the records of the Department concerning registration of securities dealers, salesmen, and investment offerings; my examination of the records of the Corporations Division of the Department; my examination of certain books and records maintained by Respondent; my review of NASAA ARS Task Force member investigative files; my interviews with persons who have invested funds with Respondent; and upon copies of documents provided to me by the investors I interviewed, the

factual allegations contained in Paragraphs (4) through (6), inclusive; Paragraph (12); Paragraphs (39) through (46), inclusive; Paragraphs (48) through (51), inclusive; Paragraphs (53) through (61), inclusive; Paragraphs (63) through (67), inclusive; Paragraphs (69) through (72), inclusive; Paragraphs (74) through (78), inclusive; Paragraphs (80) through (83), inclusive; Paragraphs (85) through (88), inclusive; Paragraphs (90) through (94), inclusive; Paragraph (107); Paragraph (112); Paragraph (115); Paragraphs (118) through (123), inclusive; of the Administrative Petition in this matter are true and correct.

Steven C. Butz, Affiant
Securities Investigator
Department of the Secretary of State

STATE OF NORTH CAROLINA
SAMPSON COUNTY

Duly Sworn and Subscribed Before Me, by Steven C. Butz,

This the 19th day of January 2010

NOTARY PUBLIC (SEAL)

Notary Printed Name: Dorothy D. Bennett

My Commission Expires: July 19, 2011

STATE OF NORTH CAROLINA

Department of The Secretary of State

FILED JAN 19 2010

THE NORTH CAROLINA SECURITIES DIVISION, Petitioner,	**NOTICE OF RIGHTS AND OPPORTUNITY FOR A HEARING**
vs.	
E*TRADE SECURITIES LLC 135 E. 57th Street, 14th Floor New York, New York 100221	
Respondent	**FILE NO. 08-SEC-0197**

THE RESPONDENT named above is hereby notified that, pursuant to the provisions of N.C.G.S. §78A-39(c), it is entitled to a hearing upon the matters set forth in the attached Administrative Petition.

You may transmit a written request for such hearing to David S. Massey, Deputy Securities Administrator, Securities Division, Post Office Box 29622, Raleigh, North Carolina 27626-0622. A copy of any such request should be transmitted to the undersigned at the address shown below.

The matter shall be scheduled for an administrative hearing in accordance with Chapter 150B of the North Carolina General Statutes before an officer designated by the Administrator within twenty (20) days of the receipt by said Administrator of a request for a hearing to determine whether or not the Administrative Petition shall become permanent and final.

At any hearing you have the right to be represented by counsel, to give testimony, and to call and cross-examine witnesses. You may have subpoenas ad testificandum and duces tecum

issued on your behalf prior to any hearing by requesting the same, in writing, including with such request the name and address of all witnesses to be subpoenaed, together with a description of any document or object requested to be produced by a witness at the hearing.

FURTHER TAKE NOTICE that, in the event no request for a hearing, no answer, responsive pleading or other submission contesting the allegations made in the Administrative Petition is received within the time allowed after service thereof, the undersigned may apply to the Deputy Securities Administrator for a Final Order granting the full relief sought in said Petition, to-wit: there being no request for a hearing after notice of and an opportunity for a hearing were provided, issue a Final Order revoking the securities dealer registration of Respondent E*Trade or as an alternative, suspend the securities dealer registration of Respondent E*Trade until all North Carolina investors are made whole for their investments in ARS sold to them by Respondent, then staying a period of suspension and placing E*Trade on probation for a period of at least three (3) years, conditioned upon its demonstrating compliance with its obligations to keep records and supervise its salesmen; and grant such other and further relief as the administrator may deem appropriate in the circumstances.

This the 19th day of January, 2010.

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Enforcement Attorney

Kevin Harrington
Enforcement Attorney

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A. Elizabeth Walker
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