DEPARTMENT OF CONSUMER AND BUSINESS SERVICES
DIVISION OF FINANCE AND CORPORATE SECURITIES
SECURITIES SECTION
BEFORE THE DIRECTOR OF THE DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

In the Matter of: **CITIGROUP GLOBAL MARKETS INC.** (formerly known as Salomon Smith Barney Inc.) 388 Greenwich Street New York, New York 10013 **Respondents.**	**S-03-0035** **ADMINISTRATIVE ORDER ORDER IMPOSING MONETARY OBLIGATIONS AND CONSENT TO ENTRY OF ORDER**

WHEREAS, SSB now known as Citigroup Global is a broker-dealer registered in the state of **Oregon**; and

WHEREAS, an investigation into the practices, procedures and conduct of Salomon Smith Barney Inc. ("SSB")[1] respecting: (a) the preparation and issuance by SSB's U.S. equity research analysts ("Research Analysts") of research, analysis, ratings, recommendations and communications concerning common stocks of publicly traded companies covered by such analysts ("Research Coverage"), during the period 1999 through June 2002, including without limitation, commencement and discontinuance of Research Coverage, actual or potential conflicts of interests affecting Research Coverage, Research Analysts or termination of Research

[1] On or about April 7, 2003, SSB changed its name to Citigroup Global Markets Inc. ("Citigroup Global"). The U.S. Equity Research of SSB continues as part of Citigroup Global. Since the matters which were the subject of the Investigations occurred prior to the name change, the Findings of Fact herein generally refer to SSB.

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Labor and Industries Building
350 Winter Street NE, Suite 410
Salem, OR 97301-3881
Telephone: (503) 378-4387

Analysts, and misleading statements, opinions, representations or non-disclosure of material facts in Research Coverage; (b) the allocation by SSB and its predecessor Salomon Brothers, Inc. of stock from initial public offerings that traded at a premium in the secondary market when trading in the secondary market begins and spinning by SSB (i.e., allocating such offerings as preferential treatment to officers and directors of companies having or potentially having investment banking business with SSB), during the period 1996 through 2001 (“IPO Allocations”) and; (c) any other conduct referred to in the Findings of Fact set forth below in paragraphs 3 through 153 has been conducted by a multi-state task force of which **Oregon** was a part (the “Investigation”).

WHEREAS, the Investigation was conducted in connection with a joint task force of the U.S. Securities and Exchange Commission, the New York Stock Exchange, and the National Association of Securities Dealers (together, with the multi-state task force referred to above, the “regulators”); and

WHEREAS, The New York AG and Citigroup Global have previously entered into an Assurance of Discontinuance, dated April 24, 2003 (the "New York Assurance of Discontinuance"), a copy of which has been provided to the **Director of the Oregon Department of Consumer and Business Services (hereinafter the “Director”)** concerning the practices, policies and procedures of SSB which were the subject of the Investigation; and

WHEREAS, SSB has cooperated with regulators conducting the

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Telephone: (503) 378-4387

investigations by responding to inquiries, providing documentary evidence and other materials, and providing regulators with access to facts relating to the Investigation; and

WHEREAS, Citigroup Global has advised regulators of its agreement to resolve the Investigation; and

WHEREAS, Citigroup Global agrees to implement certain changes with respect to research and stock allocation practices, and to make certain payments; and

WHEREAS, Citigroup Global elects to permanently waive any right to a hearing and appeal under ORS Chapter 59 with respect to this Administrative Consent Order (the "Order");

NOW, THEREFORE, the **Director**, as administrator of the **ORS Chapter 59, the Oregon Securities Law**, hereby enters this Order:

FINDINGS OF FACT

A. Summary and Jurisdiction

1. Citigroup Global is, and under its former name SSB was, at all relevant times, a registered broker-dealer with its principal place of business located at 388 Greenwich Street, New York, New York 10013. SSB has engaged and Citigroup Global continues to be engaged, in a full-service securities business, including institutional and retail sales, investment banking services, trading and research.

2. The **Director** has jurisdiction over this matter pursuant to the **provisions of ORS Chapter 59.**

3. In 1999, 2000, and 2001 (the "relevant period"), as

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described below, SSB issued research reports on two telecommunications ("telecom") companies that were fraudulent and issued research reports on several telecom companies that were misleading.

4. During the relevant period, SSB employed business practices that required research analysts to promote SSB's investment banking efforts. Research alone did not generate substantial profits for SSB; investment banking did, and it needed the services of research analysts to do so. Research analysts were expected to vet prospective investment banking deals, promote SSB's investment banking business to issuers during pitches, and market investment banking deals to SSB's customers. When SSB secured investment banking business, research analysts were expected to provide favorable coverage of SSB's investment banking clients. Important factors in evaluating an analyst's performance and determining an analyst's compensation at SSB were investment banker evaluations and investment banking revenues generated in an analyst's sector. These business practices created a culture in which investment bankers could and did pressure research analysts to maintain coverage or favorable ratings for investment banking clients and created the incentive for analysts to use research to obtain, retain and increase revenue from investment banking deals. SSB failed to manage the conflicts created by its practices.

5. Jack Grubman was the linchpin for SSB's investment banking efforts in the telecom sector. He was the preeminent

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telecom analyst in the industry, and telecom was of critical importance to SSB. His approval and favorable view were important for SSB to obtain investment banking business from telecom companies in his sector. In total, SSB earned more than $790 million in investment banking revenue during the relevant period from telecom companies Grubman covered. Given Grubman's key role in SSB's investment banking success in the telecom sector, SSB compensated him handsomely. During the relevant period, Grubman was one of the most highly paid research analysts at SSB and on Wall Street. Between 1999 and August 2002, when he left the firm, Grubman's total compensation exceeded $67.5 million, including his multi-million dollar severance package.

6. During the relevant period, SSB and Grubman published fraudulent research reports on Focal Communications and Metromedia Fiber Networks, as set forth below. These reports were contrary to the true views Grubman and another analyst on his team privately expressed, presented an optimistic picture that overlooked and minimized the risk of investing in these companies, predicted substantial growth in the companies' revenues and earnings without a reasonable basis, did not disclose material facts about these companies, and contained material misstatements about the companies.

7. Moreover, SSB and Grubman also published certain research reports that were misleading. In April 2001, Grubman expressed a need to downgrade six telecom companies (Level 3

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Communications, Williams Communications Group, XO Communications, Focal, Adelphia Business Solutions, and RCN Communications). Investment bankers pressured Grubman not to downgrade these companies and Grubman did not. He continued to advise investors to buy these stocks, and did not disclose the influence of investment bankers on his ratings. In addition, a research report on Williams Communications lacked a reasonable basis because it did not disclose the true views Grubman and others on his team privately expressed at the same time about the company and certain research reports on Focal failed to disclose facts as described below.

8. In November 1999, Grubman upgraded AT&T from a Neutral (3) - his longtime rating on the stock -- to a Buy (1). SSB and Grubman did not disclose in the report that Grubman had a conflict of interest relating to his evaluation of AT&T. Prior to the upgrade, Sanford I. Weill ("Weill"), the co-CEO and Chairman of Citigroup (and a member of the AT&T board of directors), had asked Grubman to take a "fresh look" at AT&T, and Grubman had asked Weill for assistance in gaining admission for his children to the selective 92nd Street Y preschool in New York City at the same time Grubman was conducting his "fresh look" at the company. Subsequently, Grubman stated privately that he had upgraded AT&T to help his children get into the 92nd Street Y preschool. After Grubman upgraded AT&T and his children were admitted to the preschool, Weill arranged a pledge of $1 million payable in equal amounts over five years from

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Citigroup to the 92nd Street Y.

9. Grubman's upgrade of AT&T also helped SSB gain investment banking business from AT&T. In late fall 1999, AT&T determined to make an initial public offering ("IPO") of a tracking stock for its wireless unit – the largest equity offering in the United States. In February 2000, AT&T named SSB as one of the lead underwriters and joint book-runners for the IPO, in large part because of Grubman's "strong buy" rating of, and "strong support" for, AT&T. SSB earned $63 million in investment banking fees from this engagement.

10. During the period 1996 through 2000, SSB engaged in improper spinning practices by allocating hot IPO shares[2] to executives of current or potential investment banking clients and providing special treatment for these executives. The executives profited significantly from selling IPO stock allocated to them. The investment banking business generated by the firms for which these executives worked represented a substantial portion of SSB's revenues during this period.

11. Additionally, SSB failed to maintain books and records sufficient to determine whether or not the distribution of IPO shares had been completed prior to the initiation of secondary market trading. Further, SSB failed to administer Issuer Directed Share Programs appropriately and failed to establish and maintain written supervisory procedures for the appropriate

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[2] A "hot IPO" is one that trades at a premium in the secondary market whenever trading in the secondary market begins.

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management of such programs.

B. SSB Failed to Manage Conflicts of Interest Between Research and Investment Banking

12. SSB's business practices intertwined research with investment banking, thus creating the vehicle for investment banking to exert inappropriate influence over research analysts. SSB failed to manage the resulting conflicts of interest in an adequate or appropriate manner.

1. SSB's Business Practices Required Research Analysts to Support Investment Bankers

13. Companies paid SSB's investment bankers to assist them with (a) capital raising activities such as IPOs, "follow on" offerings (subsequent offerings of stock to the public), and private placements of stock, and (b) other corporate transactions, such as mergers and acquisitions. During the relevant period, investment banking was an important source of revenue for SSB; revenues from investment banking grew from approximately $3.0 billion in 1999, to approximately $3.6 billion in 2000, and to approximately $3.9 billion in 2001. Investment banking fees comprised over 21% of SSB's revenue in 1999, over 22% in 2000, and over 25% in 2001.

14. SSB's equity research analysts provided SSB's investing clients and the public with research reports on certain public companies. SSB held out its research analysts as

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Salem, OR 97301-3881
Telephone: (503) 378-4387

providing independent, objective and unbiased information, reports, ratings, and recommendations upon which investors could rely in reaching investment decisions. SSB distributed its analysts' reports to its clients directly and by placing the reports on its website.

15. At SSB, research was a cost center. In contrast, investment banking generated substantial profits for SSB. To leverage its research, SSB required research analysts to serve, among others, investment banking. Accordingly,

- SSB expected research analysts to prepare business plans each year that, among other things, highlighted what the research analysts had done and would do to help SSB's investment bankers;
- SSB's research analysts were encouraged to develop investment banking business from issuers and private companies in their sectors;
- SSB's research analysts were expected to support investment banking by pitching business to prospective clients and marketing investment banking deals to institutional customers through road shows;
- Investment banking concerns sometimes affected research analysts' decisions to initiate coverage, rate companies, and drop coverage. SSB's research analysts were generally expected to initiate coverage of SSB's investment banking clients with favorable ratings;

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- Investment bankers reviewed the performance of the principal research analysts in their sector as part of the analysts' annual review; and
- Investment banking revenue generated in an analyst's sector and attributable to an analyst was an important factor SSB used to evaluate an analyst's performance and determine an analyst's compensation.

16. This integration of research analysts with investment banking was an SSB objective. In a January 1998 presentation to senior management at Travelers Corporation, then the parent of SSB, the head of SSB wrote: "There is a continuing shift in the realization that an analyst is the key element in banking success." Underscoring the same theme two years later, on December 8, 2000, the head of SSB's Global Equity Research wrote to the CEO of SSB that one of his goals since becoming global head of research was "to better integrate our research product with the business development plans of our constituencies, particularly investment banking . . . ."

17. In reviewing his performance for 2000, the head of SSB's Global Equity Research stated:

> We have become much more closely linked to investment banking this year as a result of participating in their much-improved franchise review process this year. There has been a yearend [sic] cross review of senior analysts and bankers particularly in the U.S. and Europe

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> and with the development of the Platinum Program in the investment bank, the analyst's understanding of the relative importance of clients for IB [investment banking] and GRB [global relationship bank] is much improved.

18. In January 2000, SSB held a "Best Practices Seminar" for research analysts that was hosted by the head of U.S. Equity Research Management. At that seminar, a senior member of Research Management stated:

> [W]hen you look at the market share gap between us and the three competitors who are trying to close. When I just eyeballed it, it looked like to me there is something like roughly a billion dollars of, maybe not Equity Capital Markets but Investment Banking revenues, on the table for this firm. And that's a lot of money.
> And its clear...that Research is driving a lot of this increasingly. And therefore, as a [research] department our goal has to be, to be a really effective partner in terms of helping drive initiation, execution and everything else. Because there is a lot of money on the table for this company. And we'll all benefit from it.

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2. SSB Analysts Helped Investment Bankers Identify and Obtain Business

19. Research analysts at SSB helped investment banking by identifying prospective clients and mandates and by participating in sales "pitches" for investment banking business. SSB bankers would not pitch for investment banking business unless they knew the SSB analyst who would cover the company was going to support the proposed deal.

20. SSB's pitchbooks to potential investment banking clients routinely highlighted the experience and qualifications of the lead analyst in the company's sector and how the analyst would help market the proposed deal. During the "pitch" process, SSB conveyed that its research analysts would cover the company if the company gave it investment banking business, and analysts frequently attended the "pitch" sessions. Once a company selected SSB as the underwriter, SSB analysts worked together with investment bankers to (among other things) perform due diligence on the deal and take the company executives out on "road shows" to market the potential transaction to institutional investors.

21. During the relevant period, all parties involved – the analyst, the firm, and the issuer – understood that the analyst would initiate coverage of the company if SSB was given investment banking business and would initially rate the company favorably.

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3. SSB's Research Analysts Supported Investment Banking Through Their Ratings and Coverage

22. SSB encouraged analysts to support SSB's investment banking business through their ratings. Each research report SSB issued included an investment rating that purportedly reflected the analyst's objective opinion of the relative attractiveness of the company to the investors.

23. During the relevant time period, SSB advised its customers that it utilized the following five-point investment rating system:

1 – Buy
2 – Outperform
3 – Neutral
4 – Underperform
5 – Sell

24. In addition, SSB during the relevant period included in each research report a risk rating of L (low risk), M (moderate risk), H (high risk), S (Speculative), or V (Venture). Each of the research reports and call notes discussed below, other than those on AT&T, rated the company S (Speculative).

25. In practice during the relevant period, SSB's research analysts rarely rated companies a 4 (Underperform) and never a 5 (Sell) in part to avoid antagonizing issuers in a way that would harm SSB's investment banking business. As a Director who provided Research Management Support stated in a March 30, 2001

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Labor and Industries Building
350 Winter Street NE, Suite 410
Salem, OR 97301-3881
Telephone: (503) 378-4387

e-mail:

> [W]e in U.S. Research currently have no “4” (Underperform) or “5” (Sell) ratings. We use neutral rating as a statement that we are not at all enthusiastic about a stock. That effectively conveys the message that customers should not be in the stock. If we were to use 4 or 5 ratings that approach would be perceived as highly antagonistic to buy side accounts . . . [and] company management teams.

26. In a later e-mail, the same person suggested that the common terms SSB used to rate stocks did not mean what they said: “various people in research and media relations are very easy targets for irate phone calls from clients, reporters, etc. who make a very literal reading of the rating . . . . [I]f someone wants to read the ratings system for exactly what it says they have a perfect right to do that.”

27. The head of SSB’s Global Equity Research raised the issue of research integrity directly with the head of SSB in a memorandum entitled “2000 Performance Review,” when he expressed a “legitimate concern about the objectivity of our analysts which we must allay in 2001.” The head of Global Equity Research also addressed the nature of the research ratings at an SSB equities management meeting. He made a presentation regarding the SSB “Stock Recommendations as of 1/29/01,” which showed that, out of a total of 1179 stock ratings, there were no Sell

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ratings and only one Underperform rating. In handwritten notes attached to this presentation, he described these ratings in the U.S. as the "worst" and "ridiculous on face." He observed that there was a "rising issue of research integrity" and a "basic inherent conflict between IB [investment banking], equities and retail." In a February 22, 2001 memo, the head of Global Equity Research told the managing directors in the U.S. equity research division that the global head of SSB's private client (i.e., retail) division said SSB's "research was basically worthless" and threatened to terminate his division's contribution to the research budget.

28. SSB did not change its rating system, however, and the de facto three-category rating system remained in place throughout 2001. As of the end of 2001, SSB covered over 1000 U.S. stocks but had no Sell ratings and only 15 Underperform ratings (1.4%).

4. Investment Banking Influenced SSB's Evaluation and Compensation of Research Analysts

29. SSB established a compensation structure that linked research analysts with investment banking. Research analysts were requested to draft business plans that discussed, among other things, their steps to support investment banking business in the past year and their plans to support investment banking in the upcoming year.

30. In addition, investment bankers among others evaluated

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the performance of research analysts. Bonuses for research analysts – comprising most of their compensation – were tied to several factors, one of the most important of which was the investment banking revenue SSB attributed to the research analyst.

C. Grubman Supported SSB's Investment Banking Business in the Telecom Sector

31. During the relevant period, Grubman was one of the most prominent analysts on Wall Street. He was a Managing Director of SSB, and the preeminent research analyst at SSB. He managed a team of analysts who issued research reports ("Reports") and call notes ("Notes) on telecom companies. Grubman was principally responsible for each Report and Note SSB issued on these companies.

1. Grubman Helped Obtain Investment Banking Clients for SSB

32. Grubman helped to obtain and maintain business for SSB's investment bankers from telecom companies in his sector. Grubman also vetted proposed transactions involving telecom companies and vetoed those he could not view favorably. Once he determined he could support a proposed transaction, he and other telecom analysts who reported to him often participated in pitching the potential client to award SSB investment banking business and in road shows that marketed offerings to investors.

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2. Grubman's Ratings Assisted SSB's Investment Banking Business

33. During the relevant period, SSB was the lead underwriter on 6 IPOs for telecom companies. For each company, Grubman initiated coverage with a 1 (Buy) recommendation. In virtually every instance, Grubman also issued favorable research reports on telecom companies for which SSB acted as lead or co-manager of a secondary offering of equity stock offering. In fact, Grubman and his group, with only one exception, did not rate a stock a 4 during the relevant period and never rated a stock a 5. Rather, he and the research personnel who reported to him would drop coverage altogether rather than rate a stock at less than a Neutral.

3. Grubman Helped Generate Substantial Revenue for SSB's Investment Banking Department and Was Highly Compensated

34. Grubman's efforts contributed to the telecom sector generating substantial investment banking revenue for SSB. During the relevant period, as reflected in documents prepared in connection with Grubman's evaluation and compensation, SSB earned more than $790 million in total gross investment banking fees from telecom companies covered by Grubman: approximately $359 million in 1999, $331 million in 2000, and $101 million in 2001.

35. Grubman was well paid for his efforts. During the relevant period, he was one of the most highly compensated research analysts at SSB. His total compensation (including

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deferred compensation) from 1999-2001 exceeded $48 million: over $22 million in 1999, over $20.2 million in 2000, and over $6.5 million in 2001. In light of the importance investment banking played in SSB's annual evaluations, Grubman and two of his assistants in their 2001 performance evaluation highlighted the investment banking deals for which they had been responsible.

36. As was true of other research analysts, Grubman was evaluated by investment bankers, institutional sales, and retail sales. Grubman received high scores and evaluations from investment bankers in 2000 and 2001 that reflected his importance to investment banking. Investment bankers rated analysts on a scale from 1 (lowest) to 5 (highest). For 2000, Grubman received a 5 rating overall from investment bankers, who ranked him first among all analysts. His ratings and rankings in specific investment banking categories, such as pre-marketing, marketing, and follow-up were also at the top levels. For 2001, Grubman's average score (the only score presented that year) from investment bankers was 4.382, ranking him 23rd among the 98 analysts reviewed.

37. SSB's institutional sales force rated Grubman 16th out of 113 analysts in 2000 and 46th out of 115 analysts in 2001.

38. Retail brokers ranked analysts on a scale from -1 (lowest) to 2 (highest). For 1999, the retail sales force gave Grubman an average score of 1.59, ranking him 4th out of 159 analysts evaluated. In contrast, for 2000 and 2001, Grubman's evaluations from retail were dramatically lower and well below

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his scores from investment bankers and the institutional sales force in both years. In 2000, retail ranked Grubman last among all analysts with a score of –0.64. The same was true for 2001 -- the retail force ranked Grubman last among all analysts reviewed, and his score fell to –0.906.

39. Moreover, Grubman received scathing written evaluations from the retail sales force in 2000 and 2001. Hundreds of retail sales people sent negative written evaluations of Grubman in both years.

- Many claimed Grubman had a conflict of interest between his role as an analyst and his role assisting investment banking:
    - "poster child for conspicuous conflicts of interest";
    - "I hope Smith Barney enjoyed the investment banking fees he generated, because they come at the expense of the retail clients";
    - "Let him be a banker, not a research analyst";
    - "His opinions are completely tainted by 'investment banking' relationships (padding his business)";
    - "Investment banker, or research analyst? He should be fired";
    - "Grubman has made a fortune for himself personally and for the investment banking division. However, his investment recommendations have impoverished the portfolio of my clients and I have had to spend

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endless hours with my clients discussing the losses Grubman has caused them."

- Many criticized his support of companies that were SSB investment banking clients:
  - "Grubman's analysis and recommendations to buy (1 Ranking) WCOM [Worldcom], GX [Global Crossing], Q [Qwest] is/was careless";
  - "His ridiculously bullish calls on WCOM and GX cost our clients a lot of money";
  - "How can an analyst be so wrong and still keep his job? RTHM [Rhythm NetConnections], WCOM, etc., etc.";
  - "Downgrading a stock at $1/sh is useless to us.";
  - "How many bombs do we tolerate before we totally lose credibility with clients?"

40. The evaluations and comments from retail did not appear to affect Grubman. In a January 2001 e-mail, he stated:

> I never much worry about review. For example, this year I was rated last by retail (actually had a negative score) thanks to T [AT&T] and carnage in new names. As the global head of research was haranguing me about this I asked him if he thought Sandy [Weill] liked $300 million in trading commission and $400 million (only my direct credit not counting things like NTT

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> [Nippon Telecom] or KPN [KPN Qwest] our total telecom was over $600 million) in banking revenues. So, grin and bear it....

41. When Grubman left SSB in August 2002, he signed a separation agreement that included compensation worth approximately $19.5 million plus approximately $13 million in deferred compensation previously accrued in 1999, 2000, and 2001.

D. Investment Bankers Successfully Pressured Grubman to Maintain Positive Ratings on Stocks

42. Investment bankers pressured Grubman to maintain positive ratings on companies in part to avoid angering the covered companies and causing them to take their investment banking business elsewhere.

43. On April 18, 2001, one of the companies Grubman covered, Winstar Communications, Inc. (a Competitive Local Exchange Carrier or CLEC), declared bankruptcy. In the aftermath of the Winstar bankruptcy, an SSB investment banker suggested that SSB's telecom investment bankers and research analysts have a conference call followed by a meeting to consider the prospects of other CLECs and similar telecom companies. Grubman agreed, but made clear that the Winstar bankruptcy had convinced him of the need to downgrade other CLECs and telecom companies, all of which he rated a Buy (1) at the time:

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Telephone: (503) 378-4387

> Also to be blunt we in research have to downgrade stocks lest our retail force (which Sandy cares about a lot which I know to [sic] well) end up having buy rated stocks that go under. So part of this call will be our view that LVLT [Level 3], WCG [Williams Communication Group], XOXO [XO Communications], FCOM [Focal], ABIZ [Adelphia Business Solutions], RCN [RCN Communications] must not remain buys.

44. Thereafter, the then-head of investment banking for SSB and the head of telecom investment banking called Grubman separately. The head of investment banking told him not to downgrade the stocks because doing so would anger these companies and hurt SSB's investment banking business. The head of telecom investment banking told him that they should discuss his proposed downgrades because some of the names were more sensitive than others. SSB and Grubman did not downgrade these stocks until months thereafter, continued to advise investors to buy these stocks and, in the weeks and months following, merely lowered the target prices for each of these companies.

45. Grubman acknowledged that investment banking influenced his publicly expressed views about the companies he covered. He stated in a May 2001 e-mail to an analyst who reported to him:

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> . . . If anything the record shows we support our banking clients too well and for too long.

46. The analyst agreed and stated that Grubman had helped SSB's investment banking business by using his influence to sell securities for questionable companies:

> . . . I told [an investment banker] that you get the good and the bad with you [Grubman] and to look at all the bad deals we sold for them in the past. He agreed.

47. On May 31, 2001, Merrill Lynch downgraded XO, one of the stocks Grubman had wanted to downgrade in April. Merrill's actions caused Grubman to consider again whether he should have downgraded XO:

> Another one. *I hope we were not wrong in not downgrading*. Try to talk to folks to see what they think of these downgrades. *Maybe we should have done like I wanted to. Now it's too late.* (Emphasis added.)

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48. A research analyst who reported to Grubman responded to this e-mail by reiterating a negative view of XO and Level 3:

> . . . XOXO is a lost cause, its [sic] never too late to do the call, we could downgrade XO, LVLT, etc.

49. Later the same day, the same analyst e-mailed Grubman, warning him that an institutional investor thought downgrading

XO would:

> definitely get the Lame-O award on CNBC & wouldn't help anyone out, it would just call attention to our negligence on not downgrading sooner.

50. A few weeks later, Grubman was invited to a dinner with the head of U.S. Equity Research and two senior investment bankers. Grubman anticipated discussing banking's displeasure with his commentary on telecom stocks. Grubman e-mailed one of his research colleagues:

> . . . I have dinner with [a senior investment banker and the head of U.S. Equity Research] I bet to discuss banking's displeasure with our commentary on some names. *Screw [the investment bankers]. We should have put a Sell on everything a year ago.* (Emphasis added.)

51. The next day, Grubman e-mailed the head of U.S. Equity Research, stating that the pressure from investment banking had caused him not to downgrade stocks he covered:

> See you at dinner. If [a senior investment banker] starts up I will lace into him. . . . most of our banking clients are going to zero and you know I wanted to downgrade them months ago but got huge pushback from banking.

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52. SSB and Grubman maintained Buy ratings on Level 3, WCG, XO, RCN, Adelphia, and Focal for months after April 2001. SSB and Grubman did not downgrade Level 3 until June 18, 2001; RCN until August 2, 2001; Focal and Adelphia until August 13, 2001; and WCG and XO until November 1, 2001. In each instance, SSB downgraded these stocks to a 3 (Neutral). None of the Notes published between April 18 and the date of each downgrade disclosed the pressure investment bankers had exerted on Grubman and Grubman's yielding to such pressure. These Notes were inconsistent with the views Grubman had expressed, as reflected in the emails above, concerning these stocks.

E. SSB and Grubman Published Fraudulent Research That Promoted Focal Communications and Metromedia Fiber, Two of SSB's Investment Banking Clients

53. SSB and Grubman published certain fraudulent research reports on Focal Communications and Metromedia Fiber, two investment banking clients of SSB. As described below, certain research reports on these companies were contrary to Grubman's private views and those of his team. Moreover, certain research reports on these two companies presented an optimistic picture that overlooked or minimized the risk of investing in these companies and predicted substantial growth in the companies' revenues and earnings without a reasonable basis.

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1. SSB and Grubman Published Fraudulent Research Reports on Focal

54. Focal was a CLEC – a broadband telecommunications provider of limited reach. As of December 31, 1999 it operated in 16 locations nationwide and as of December 31, 2000 it operated in 20 locations nationwide. Focal was never profitable. Focal's net loss was approximately $500,000 in 1996, $3 million in 1997, $8 million in 1998, $22 million in 1999, and $105 million in 2000.

55. Focal was an investment banking client for SSB. SSB underwrote Focal's initial public offering in July 1999. It also assisted the company in other investment banking transactions. In total, SSB earned approximately $11.8 million in investment banking fees from Focal.

56. Shortly after SSB underwrote Focal's initial public offering, it initiated coverage with a Buy (1) rating and maintained that rating until August 12, 2001. Grubman was responsible for SSB's Reports and Notes on the company.

57. SSB and Grubman published two Notes on Focal that were fraudulent – one issued on February 21, 2001 and one issued on April 30, 2001. The February 21 Note "reiterated" a Buy recommendation. It left the target price unchanged from $30 (approximately twice the stock price of $15.50). The Note reported overall results that were "in line" with expectations, and a revenue mix that "continues to improve." It also reported that Focal "continues to gain a stronger foothold in the large

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business market and continues to grow sales of existing customers with existing and new products and also into multiple markets." The February 21 Note reported EBITDA (earnings before interest, taxes, depreciation, and amortization) that improved over the previous quarter and was in line with estimates; it advised investors that Focal expected to be EBITDA breakeven sometime in 2001. Finally, the Note thought the company could continue to perform well and grow and, if it did, the target price and estimates would be increased:

> The quarter's results were in line with our expectations. The revenue and line mix is improving but the fact remains that FCOM still has exposure to recip comp and exposure to ISPs, which are areas of concern for investors. While FCOM is collecting recip comp and is good at reviewing its customer credit profiles with ISPs, which are areas of concern for investors, we believe it is prudent to see a few more quarters of good execution and growth before we change numbers. We continue to remain prudent and thus, we don't think we should raise our price target to above $30 when the stock is only trading at $15. But, as we stated in our 3Q note, if [Focal] management continues to execute and also delivers on

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> its data strategy, we believe this will be reflected in its stock price, and thus, we will be in a better position to raise numbers.

58. The same day as the February 21 Note, however, Grubman stated that he believed Focal should be rated an Underperform (4) rather than a Buy(1), that “every single smart buysider” believed its stock price was going to zero, and that the company was a “pig.” Focal apparently complained about the February 21 Note. When Grubman heard of the complaint, he e-mailed two investment bankers:

> I hear company complained about our note. I did too. I screamed at [the analyst] for saying “reiterate buy.” If I so much as hear one more fucking peep out of them we will put the proper rating (ie 4 not even 3) on this stock which every single smart buysider feels is going to zero. We lose credibility on MCLD and XO because we support pigs like Focal.

59. Also on February 21, an institutional investor e-mailed a research analyst who worked for Grubman, “Mcld [McLeod USA, Inc.] and Focal are pigs aren’t they?” and asked whether Focal was “a short.” The analyst responded to the e-mail: “Focal definitely . . . .”

60. Grubman continued to express his true view of Focal in

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a subsequent communication. As described in Section D above, he stated on April 18, 2001 that the company needed to be downgraded in the aftermath of the Winstar bankruptcy.

61. Contrary to these negative views of Grubman and his colleague, the April 30 Note on Focal again advised investors to buy Focal. By April 30, the stock price had fallen to $6.48. Although the April 30 Note lowered the target price to $15, calling the previous target price of $30 "stale," the new target price was still more than twice the stock price. The April 30 Note stated that the company had reported quarterly results in line with estimates, repeated that Focal's "revenue mix is improving towards telecom," and noted the "line mix" continued to improve.

62. Neither the February 21 Note nor the April 30 Note disclosed the actual views of Grubman and his colleague about Focal. Indeed, both Notes contradicted such views. Neither Note described the company as a "pig" or a "short," disclosed that "smart buysiders" were predicting that Focal's stock price was going to zero, or indicated that the proper rating for Focal was an Underperform (4). The February 21 Note and the April 30 Note did not provide any other reason the stock should be downgraded. To the contrary, both Notes advised investors to buy the stock, predicted that the company's stock price could at least double over the next 12 to 18 months, and indicated that the company's numbers were "in line" and in some respects improving. Accordingly, the Notes issued on February 21, 2001

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and April 30, 2001 were fraudulent.

2. SSB and Grubman Issued Fraudulent Research Reports on Metromedia Fiber

63. Metromedia Fiber built and operated fiber optic systems nationally and in Europe. It intended to provide telecom services to CLECs and large telecom companies, cable companies, internet service providers, and Fortune 500 companies in large metropolitan areas. As of the end of 2000, Metromedia Fiber was increasingly unprofitable, spent substantial amounts of cash to construct its fiber optic systems and required even more capital to complete its planned network.

64. Metromedia Fiber was an investment banking client for SSB. SSB underwrote Metromedia Fiber's IPO in 1997 and a secondary offering in November 1999. In addition, SSB engaged in other investment banking transactions for the company. In total, SSB earned approximately $49 million in investment banking fees in Metromedia Fiber deals. After Metromedia Fiber's IPO, SSB and Grubman initiated coverage of the company with a Buy (1) rating and maintained that rating until July 25, 2001.

65. In 2001, the company entered into an agreement with Citicorp USA, Inc. (an SSB affiliate) to provide it with a credit facility that it needed to fund its operations. The deadline for closing on the facility was extended twice and, in the end, the facility was completed for less than half its full

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amount. The Notes on Metromedia Fiber issued between April 2001 and July 2001 did not adequately disclose the red flags concerning the credit facility or Grubman's view that the company might not get the funding. Moreover, in June 2001, a research analyst working for Grubman told him that while the company had funds through the end of 2001, thereafter the company's fundamentals would deteriorate. This contradicted the ratings and price targets SSB and Grubman published on the stock in a Note dated June 28, 2001. For these reasons, the Notes dated April 30, 2001, June 6, 2001, and June 28, 2001 were fraudulent and misleading.

66. Metromedia Fiber announced on January 8, 2001 that it had "obtained a commitment for a fully underwritten credit facility for $350 million from Citicorp USA, Inc., which it expects will fully fund its current business plan of building 3.6 million fiber miles . . . by the end of 2004."

67. As of March 2001, Metromedia Fiber faced a risk of not obtaining financing for its operations, had sufficient funds for its operations through the end of 2001, and may not have had sources for additional capital to finance its operations after the end of 2001. In particular, the company stated at the time that it may not be able to close on the pending $350 million credit facility from Citicorp USA.

68. In an April 18, 2001 e-mail to a senior investment banker, Grubman indicated he was aware that Metromedia Fiber might not close the credit facility and would downgrade the

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Telephone: (503) 378-4387

company should it not obtain the additional funding: "If MFNX [Metromedia Fiber] does not get credit facility they too get downgraded [from a buy]."

69. Nevertheless, on April 30, 2001, SSB and Grubman issued a Note that reiterated a Buy (1) rating for Metromedia Fiber, stating: "We want to make it very clear that [Metromedia Fiber] remains one of our favorite names." Regarding funding for the company, the Note stated:

> As noted in our previous note, MFN has obtained a commitment for a fully underwritten credit facility for $350 million from Citicorp USA, Inc., which it expects will fully fund its current business plan....

70. The April 30 Note failed to disclose that the company believed it might not consummate the credit facility and that Grubman had expressed doubt that the company might get funding.

71. Metromedia Fiber subsequently announced that the deadline for closing on the credit facility had been extended from May 15 to June 30, 2001.

72. In a June 6, 2001 Note, SSB and Grubman continued to state that the stock was "exceptionally inexpensive" and opined that the company had "good visibility in its core fiber business." Grubman began and ended the Note with: "We strongly reiterate our Buy . . . and we would be aggressive at current prices." Regarding the funding for the company, Grubman wrote:

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> We continue to believe the $350 million bank loan, which will bring MFNX to fully-funded status, will close by the end of June.
>
> * * *
>
> ...The lack of available capital for MFNX-lookalikes only strengthens MFNX's position. Most recently private companies, such as OnFiber and other metro builders, have failed in getting private financing and other companies in the metro space have an extremely difficult time.
>
> * * *
>
> MFNX has a business plan that is fully funded and many "would-be" competitors are never getting to the market.

73. The Note did not disclose that (a) the deadline for consummating the bank loan had been extended from May 15 to the end of June; or (b) after announcing the funding commitment, the company had determined that it may not be able to successfully consummate the senior credit facilities. The Note also did not reflect Grubman's opinion that Metromedia Fiber might not secure the financing. As described above, the Note emphasized and recognized the importance of Metromedia Fiber's fully-funded position.

74. In its June 28, 2001 Note, two days before the expiration of the funding commitment, SSB and Grubman disclosed that Metromedia Fiber had not consummated the bank loan and that the deadline had been extended from May 15 to June 30. SSB and

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Grubman minimized the funding problem by advising investors that the company had other options for financing, but added that they "can only guess on the nature or terms of the alternative financing [Metromedia Fiber] would agree to." Nevertheless, the Note analyzed the company's financing needs assuming the company could secure the $350 million in additional funds under the loan or by other means and therefore would be fully funded through 2003. The Note continued to project a positive EBITDA for 2003 and reiterated its Buy (1) rating.

75. The Notes published from April to July 2001 on Metromedia Fiber minimized the risks facing the company, assumed the company was going to be fully funded, and estimated that the company would enjoy explosive growth in revenues and earnings. The $25 price target issued on April 30, 2001 assumed that the company would have estimated revenue in 2010 of $10.6 billion and EBITDA of $4.4 billion. The June 6, 2001 target price of $15 assumed the company would have $8.7 billion in revenue nine years out and EBITDA of $3.2 billion. The June 28, 2001 target price of $10 maintained the estimate of future revenue and EBITDA.

76. These reports, and the ratings and price targets included in them, reflected SSB's and Grubman's publicly expressed opinion that the company's future was secure. This view was contrary to the actual views of SSB's analysts, which were expressed privately and not disclosed. On June 21, 2001, a research analyst who reported to Grubman discounted the

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prospects of the company, telling Grubman in an e-mail that while the company had funding through the end of 2001, its fundamentals would deteriorate thereafter:

> I have received over 50 calls today on MFNX (its down $0.20 again to $1.51). . . . Most people have written off this stock saying that it will go bankrupt, even if they could get an equity infusion here it would be massively dilutive. At lease [sic] they have some cash through the end of the year but I doubt the fundamentals recover which is actually the important thing. I think downgrading right now is not advisable since everyone would say "gee thanks." I think we need an exuse [sic] from the company, we should have done it the day they lowered guidance but of course we were restricted.

77. SSB did not downgrade Metromedia Fiber until July 25, 2001 and even then only downgraded the stock to a Neutral (3) rating. By then, the company's stock price had sunk to 98 cents, more than a 33 percent drop from its price on June 21, 2001, when the analyst who reported to Grubman disparaged the company's future.

F. SSB Issued Misleading Research Reports on Level 3, Focal, RCN, Adelphia, WCG, and XO

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Telephone: (503) 378-4387

78. Research reports must not contain misleading statements, analysts must have a reasonable basis for their recommendations, and reports must present a fair, balanced picture of the risks and benefits of investing in the covered companies and avoid exaggerated or unwarranted claims regarding the covered companies. As described below, certain research reports issued on Level 3, Focal, RCN, Adelphia, WCG, and XO violated these requirements.

1. SSB Issued Misleading Research on Focal

79. As stated above, on February 21, 2001 and April 30, 2001, SSB and Grubman published fraudulent research reports on Focal. In addition to those reports, SSB and Grubman published four misleading research reports on Focal, dated April 10, 2000, April 18, 2000, April 26, 2000, and July 31, 2000.

80. In April 2000, Focal selected SSB to be the joint book runner for a secondary offering of its stock. Focal also announced a major expansion of its business plan. At the time, the company had significant capital expenditures and required additional capital to complete its new business plan. It faced the risks that it could not raise such capital and could not complete its new plan, and that, because of its capital expenditures, it would potentially have substantial negative operating cash flow and substantial net operating losses for the foreseeable future, including through 2000 and 2001. Nevertheless, the Notes SSB and Grubman published on April 10,

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Telephone: (503) 378-4387

2000, April 18, 2000, April 26, 2000, and July 31, 2000 either did not disclose these risks or did not fully address them. In addition, these Notes published a target price that did not have a reasonable basis.

81. On April 10, 2000 SSB and Grubman issued a Note that reiterated a Buy (1) recommendation on Focal and increased the target price for Focal from $60 to $110. The Note discussed Focal's planned expansion, describing it as "sexy" and "providing the sizzle in this story." Based on Focal's expanded business plan, SSB and Grubman predicted that the company's revenue within 10 years would increase to $6 billion and EBITDA would increase to $2.4 billion. The Note described Focal management as "stellar." The Note did not disclose the additional capital expenditures that would be necessary to fund Focal's expanded business plan or the risk the company may not be able to obtain such capital. It did not disclose the likelihood that the expanded business plan would increase the company's substantial negative operating cash flow and substantial net operating losses.

82. On April 18, 2000, SSB and Grubman issued a Note reiterating the $110 price target and Buy rating. The April 18 Note stated that "[Focal] is expanding its business plan to 24 markets and aggressively pursuing data opportunities . . . The name of the game in value creation is to drive geographic footprint & service capabilities. Focal is dramatically increasing the latter w/its data initiative while increasing its

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geographic footprint by 15-20% . . . We reiterate our Buy rating & $110 target & would be aggressive buyers." The April 18, 2000 Note did not disclose the additional capital expenditures that would be necessary to fund Focal's expanded business plan or the risk the company may not be able to obtain such capital. It did not disclose the likelihood that the expanded business plan would increase the substantial negative operating cash flow and substantial net operating losses the company faced in the foreseeable future.

83. On April 26, 2000, SSB and Grubman issued a Note that reiterated a Buy recommendation, the $110 target price, and Grubman's predictions of substantial growth in the company's revenues and EBITDA. By this time, Focal's share price had dropped to $34.00. The Note repeated Grubman's earlier comments that Focal's new data initiative "is the real sizzle in this story . . . we believe that [Focal's] recent geographic & data expansion will enable [Focal] to become one of the critical path points in what is the next evolution in the Internet." The Note stated:

> From a liquidity standpoint, no matter what happens with the capital markets, between the money [Focal] has on hand and its bank facilities commitments, we believe that [Focal] will be fully funded through mid- to late-2001. During the first quarter, [Focal] completed a $275 million offering of

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> 11 7/8% senior notes due 2010 through a private placement.

84. The Note concluded with another recommendation for investors to buy the stock: “We continue to be very bullish on [Focal] and believe the stock is undervalued at current levels.” The Note did not disclose the additional capital expenditures that would be necessary to fund Focal’s expanded business plan or the risk the company may not be able to obtain such capital. It did not disclose the likelihood that the expanded business plan would increase the substantial negative operating cash flow and substantial net operating losses the company faced in the foreseeable future.

85. The Note SSB and Grubman published on July 31, 2000 left the rating and target price unchanged. The Note extolled the virtues of Focal’s management, stating that the reported strong earnings for second quarter 2000 “highlights the execution abilities of FCOM management . . . .” It repeated earlier advice to investors that “the stock is undervalued at current levels.” The July 31 Note stated:

> From a liquidity standpoint, [Focal] received a commitment for $300 million of senior secured credit facilities during the quarter. Capital expenditures totaled $77 million this quarter and we still expect [Focal] to spend $300 million and $305 million in 2001. We estimate that with the

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> cash on hand of $342 million and the available credit, [Focal] will be fully funded through 2001.

86. Missing from the July 31 Note, however, were sufficient risk disclosures adequate to warn investors of the funding needs facing Focal. The Note did not disclose the additional capital expenditures that would be necessary to fund Focal's expanded business plan or the risk that the company may not be able to obtain such capital. It did not disclose the likelihood that the expanded business plan would increase the substantial negative operating cash flow and substantial net operating losses the company faced in the foreseeable future.

87. By October 17, 2000, Focal's stock price had plummeted to $18. That day, SSB and Grubman issued a Report on Focal and other CLECs entitled "CLECs: Clean Up of Ratings, Price Targets & DCFs." In this Report, SSB and Grubman maintained a Buy (1) rating on Focal, but lowered Focal's target price from $110 to $30, noting that the previous target price was "a clearly stale number." Despite advising investors for months prior to October that Focal's new business strategy was "sexy" and "the sizzle to the story" and would raise Focal's stock price by $50, Grubman decreased Focal's price target in part by substantially reducing the revenue expected from the new business strategy.

2. Level 3, Focal, RCN, Adelphia, WCG and XO

88. As described above in Section D, in April 2001 Grubman

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Telephone: (503) 378-4387

expressed the need to downgrade Level 3, Focal, RCN, Adelphia, WCG, and XO in the aftermath of the Winstar bankruptcy. Investment bankers pressured Grubman not to change the Buy ratings on these stocks and he did not downgrade them until months later.

89. None of the following Notes for these companies issued between April 18, 2001 and the date the stocks were downgraded disclosed the pressure the investment bankers had exerted on Grubman or the fact that he had acceded to it; these Notes were inconsistent with the views Grubman had expressed, as reflected in the e-mails described in Section D. above, concerning these stocks:[3]

Level 3: Report issued on April 18, 2001.

WCG: Reports issued on May 1, 2001, August 1, 2001, and September 21, 2001.

XO: Reports issued on April 26, 2001, and July 25, 2001.

Adelphia: Report issued on May 14, 2001.

RCN: Report issued on May 3, 2001.

3. WCG

90. The May 1, 2001 Note on WCG lacked a reasonable basis because it did not disclose the contrary private views of Grubman and a member of his team. On May 1, 2001, SSB and Grubman issued a Note that failed adequately to disclose the

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[3] For the additional reasons set forth in Section E, the Note on Focal for April 30, 2001 was fraudulent.

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views of Grubman and another analyst of the funding risks facing WCG. Before the issuance of that Note, Grubman and the analyst commented privately that the company "need[s] money." These funding concerns were so acute that the analyst warned an institutional investor to "be careful with WCG." Similarly, Grubman explained to a SSB retail broker who complained about Grubman's target price for WCG that WCG was a "tough one. They still need money. I think business is ok . . . ."

91. The May 1 Note, however, reiterated a Buy recommendation on the stock. It noted that "visibility on funding better vs. 6 mos. ago." It reassured investors that WCG had adequate funds "into 2003." The Note stated that the company had reduced capital expenditures and "has made steps to improve its funding situation since the beginning of the year and have [sic] raised additional liquidity of more than $2 billion." While predicting that the company may need $1 billion to fund its operations in 2003, the Note stated "frankly, if the second tranch of the bank facility gets fully syndicated out, and WCG does perform as it expects . . . then our funding gap will be cut dramatically."

92. The May 1 Note failed to accurately describe the negative view of Grubman and the analyst who reported to him of the company's funding concerns. Rather than informing investors that WCG's business was merely "ok" or a "tough one," the May 2001 Note advised investors to "be more aggressive on [WCG]." The Note did not warn investors to "be careful" with WCG and did

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not fully reflect the analysts' views on the company's funding needs.

G. Undisclosed Conflicts of Interest Pervaded Grubman's Upgrade of AT&T in November 1999

1. AT&T Complained About Grubman's Views of the Company

93. From 1995 through November 1999, Grubman maintained a Neutral (3) rating on AT&T. Though at times he offered qualified approval of AT&T's strategy, he also repeatedly disparaged the company in his research and his public comments.

94. Beginning in July 1998 and continuing through the relevant period, Sanford Weill, then co-CEO and Chairman of Citigroup, was a member of the AT&T Board of Directors. Prior to November 1999, AT&T management complained to Weill and other SSB representatives about the tone of Grubman's comments. In particular, the AT&T CEO told Weill that Grubman's unprofessional tone and comments about AT&T made it difficult for AT&T to do business with SSB.

95. At an October 1998 industry trade show, Grubman failed to mention AT&T as one of the important telecommunications companies of the future. AT&T complained to Weill, and Weill relayed the complaint to senior SSB investment bankers. As a result, Grubman wrote a letter of apology dated October 9, 1998 to Weill and the heads of SSB's investment banking and equities departments. Before it was finalized, the letter was reviewed and approved by Weill and several members of senior management.

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350 Winter Street NE, Suite 410
Salem, OR 97301-3881
Telephone: (503) 378-4387

Grubman's apology stated, in part:

> It has come to my attention that a speech I made offended AT&T. I want to make it perfectly clear that the last thing I want to do is embarrass the firm or myself or for that matter have AT&T put in an awkward position in dealing with Salomon Smith Barney. To the extent I have done so, I apologize to you and to the firm. I will also find the appropriate time and place to apologize directly to AT&T.
>
> Despite our current investment stance on AT&T, I view AT&T as one of the most significant companies in this industry, a company that I hope we can build a long and valued relationship with and one where I truly am open-minded about changes in investment views.

96. In his cover memo to the head of SSB investment banking, and the SSB investment banker covering AT&T, Grubman indicated that his letter was suitable to send to AT&T. On October 12, Weill and the investment banker covering AT&T traveled to AT&T's Basking Ridge, NJ headquarters and met with AT&T's CEO.

2. Weill Asked Grubman to "Take a Fresh Look" at AT&T

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Salem, OR 97301-3881
Telephone: (503) 378-4387

97. A few months later, in late 1998 or early 1999, Weill asked Grubman to "take a fresh look" at AT&T in the hope that Grubman might change his opinion of the company. Weill had a positive view of AT&T and its CEO whom Weill had known personally for years. AT&T's CEO was a member of Citigroup's Board of Directors during the relevant period and, prior to the merger of Citicorp and Travelers Corporation (SSB's corporate parent), had been a member of the Travelers' Board of Directors since 1993.

98. Thereafter, on April 5, 1999, Grubman sent AT&T a seven-page questionnaire seeking further information about its business. On June 11, 1999 Grubman sent Weill a memorandum noting that AT&T had not responded to his questionnaire. Weill apparently then spoke to AT&T's CEO about the questionnaire. AT&T asked Grubman to re-send the questionnaire, and Grubman wrote Weill: "Maybe this time we can actually make some progress in closing the deal with [AT&T's CEO]." On July 19, 1999, AT&T sent an eleven-page response to Grubman.

99. On August 5, 1999 Grubman and Weill traveled to AT&T's headquarters for a meeting with AT&T's CEO that Weill had arranged. On August 19, 1999, Grubman wrote to AT&T's CEO:

> I am writing to follow up on our meeting with Sandy. . . . I thought it was important to write to you directly to lay-out what I think we agreed to in order to get this process going. . . . I need to get

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Telephone: (503) 378-4387

> to a level of specificity well beyond what's on the street today and I will need your help getting to the right people. . . . Wall Street is lacking analysis that comes remotely close to answering the detailed economic, technical, and operational questions that investors are demanding answers to regarding the roll-out of the bundled service platform using the cable plant . . . . When my analysis is complete and if the results are in line with what you and I are both anticipating, once I'm on board there will be no better supporter than I. . . . As I indicated to you at our meeting, I would welcome the role of being a "kitchen cabinet" member to you.

100. Grubman sent a copy of his August 19, 1999 letter to Weill, SSB's head of investment banking, and the SSB investment banker covering AT&T.

3. Grubman Requested Weill's Assistance to Get His Children Accepted to the 92nd St. Y Preschool and AT&T Considered Issuing a Tracking Stock for Its Wireless Unit

101. In September 1999, Grubman began his efforts to get his children admitted to the prestigious and competitive preschool at the 92nd Street Y in New York City.

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Salem, OR 97301-3881
Telephone: (503) 378-4387

102. On October 20, 1999, the AT&T Board of Directors began discussing whether to issue a tracking stock for its wireless unit. That day, Weill attended an all-day meeting of the AT&T Board, at which AT&T's management presented a number of strategic alternatives, including issuing a tracking stock for AT&T's wireless business.

103. On October 29, 1999, Weill and Grubman had a 14 minute telephone conversation during which they discussed the status of Grubman's "fresh look" at AT&T. In that conversation or one shortly thereafter, they also discussed Grubman's desire to send his children to the 92nd Street Y preschool in New York City.

104. By November 2, AT&T had taken its first steps towards issuing a tracker stock for its wireless unit. That day, an investment banking firm advising AT&T on financial strategies met with AT&T's outside counsel to discuss a proxy statement for AT&T shareholder approval of the wireless tracker.

105. On November 5, 1999, Grubman sent a memo to Weill entitled "AT&T and 92nd Street Y." In it, Grubman updated Weill on his progress in "taking a fresh look" at AT&T and outlined the future steps he would take to reexamine the company. He referred to his earlier meeting with AT&T's CEO and to his scheduled meetings in Denver with the head of AT&T's cable operations and in Basking Ridge with AT&T's network operations personnel. Grubman also sought Weill's assistance in getting his children admitted to the 92nd Street Y preschool. Noting the difficulty in getting into the school, Grubman stated that

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"there are no bounds for what you do for your children. . . . it comes down to 'who you know.'" In the last paragraph of his memo, Grubman concluded: "Anyway, anything you could do Sandy would be greatly appreciated. As I mentioned, I will keep you posted on the progress with AT&T which I think is going well."

4. Grubman Kept Weill Apprised of His Reevaluation of AT&T in November 1999; AT&T Management Recommended That AT&T Issue a Tracking Stock

106. During November 1999, Grubman intensified his "fresh look" at AT&T. He met and spoke by telephone with AT&T's CEO and traveled to AT&T's Denver and New Jersey offices to meet with company officials and view AT&T's operations. Grubman reported on his efforts to Weill during an unprecedented number of telephone calls on November 3, 11, 17, 22, 24 and 30.

107. On the morning of November 17, Weill attended an AT&T board meeting at which senior AT&T management recommended that the board approve the issuance of a tracking stock for the wireless business. Grubman called Weill from Milan, Italy late that night and the two discussed the status of Grubman's "fresh look" at AT&T. During a call on November 22 or November 24, Grubman informed Weill that he soon would be issuing a report upgrading AT&T.

5. Grubman Upgraded AT&T and Subsequently Stated He Did So to Get His Children Into the 92nd St. Y Preschool

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Salem, OR 97301-3881
Telephone: (503) 378-4387

108. Grubman announced on November 29, 1999 that he was upgrading AT&T from a Neutral (3) to a Buy (1) rating. The same day, Grubman sent an e-mail to the SSB publications department, with a copy to Research Management, stating:

> The AT&T Report must be edited and mailed out to the printers today so that it can be distributed in time to meet Sandy Weill's deadline (before the AT&T meeting.)

109. The next day, Grubman issued a 36-page Report setting forth his new rating and rationale. In his November 30 Report, Grubman wrote that his upgrade rested largely on two points: (1) the "real economics" of AT&T's cable strategy and (2) AT&T's ability to upgrade its cable technology to deliver a range of different services to consumers' homes. Grubman commented positively in his report about the widely-reported wireless tracking stock but denied upgrading because of the possible IPO.

110. After issuing the report, Grubman told an analyst who reported to him and an institutional investor, in separate conversations, that he upgraded AT&T to help get his children into the 92nd St. Y preschool.

111. Roughly a year after the upgrade, on January 13, 2001, in an e-mail to a friend, Grubman stated:

> You know everyone thinks I upgraded T [AT&T] to get lead for AWE [AT&T Wireless tracker]. Nope. I used Sandy to get my kids into 92nd

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Salem, OR 97301-3881
Telephone: (503) 378-4387

> St Y pre-school (which is harder than Harvard) and Sandy needed [the AT&T's CEO's] vote on our board to nuke [John] Reed in showdown. Once coast was clear for both of us (ie Sandy clear victor and my kids confirmed) I went back to my normal negative self on T. [AT&T's CEO] never knew that we both (Sandy and I) played him like a fiddle.

112. The following day, Grubman e-mailed the same friend: "I always viewed T [AT&T] as a business deal between me and Sandy."

6. After the AT&T Upgrade, Weill Helped Facilitate the Admission of Grubman's Children to the 92nd St. Y Preschool

113. After Grubman issued his November 1999 report on AT&T, Weill helped gain admission for Grubman's children to the 92nd St. Y preschool. On or about December 17, 1999, Weill called a member of the 92nd St. Y board and told her he would be "very appreciative" if she would help Grubman, a "valued employee" at Citigroup. Weill did not explicitly offer a donation to the Y during this phone call. By indicating that he would be "very appreciative," he understood that he was implicitly offering such assistance.

114. In March 2000, Grubman's children were admitted to the Y preschool. Subsequently, the board member called Weill, suggested a donation be made to the Y, and may have suggested

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the amount. Weill agreed. Weill was one of three corporate officers who approved charitable donations from Citigroup or the Citigroup Foundation. During a subsequent conversation with the president of the Citigroup Foundation, Weill indicated that the Foundation should make a $1 million donation to the Y and instructed the Foundation president to work with the Y to develop a suitable program with the donation. The program that was subsequently developed consisted of a series of 10 events per year that had cultural, artistic, and educational aims. Weill, the president of the Foundation, and another Citigroup corporate officer approved the donation on July 24, 2000[4] and the first installment of the donation ($200,000) was sent to the Y in September 2000. The president of the Foundation understood the donation was a "thank you" for the admission of the Grubman children to the preschool at the 92nd St. Y.

7. After Grubman's Upgrade of AT&T, AT&T Selected SSB as a Lead Underwriter in the AT&T Wireless IPO

115. Grubman's upgrade of AT&T assisted SSB in being selected as a lead underwriter and joint book-runner for the IPO of a tracking stock for AT&T's wireless subsidiary.

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[4] Because of certain tax considerations, and in light of benefits Citigroup employees received from the program supported by the donation, Citigroup, not Citigroup Foundation, made the donation to the Y. The $1 million donation was payable in equal amounts over five years.

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Telephone: (503) 378-4387

116. The AT&T Board approved the IPO during its December 5, 1999 Board meeting. AT&T announced its plans at a meeting with analysts the following day.

117. In January 2000, SSB competed to be named a lead underwriter and book-runner for the offering. In its pitch book, it highlighted the experience, prominence, and support for AT&T of Grubman and the SSB wireless analyst. Among other things, SSB's pitch book contained numerous statements about Grubman's views regarding the positive impact the wireless tracking stock would have on AT&T's shares, as well as promises about the role he would play in marketing the deal to investors.

118. In evaluating the various proposals from SSB and other investment banks, AT&T assigned significant weight (55%) to its views of each investment bank's wireline and wireless telecommunications analysts. Because Grubman was a highly rated and highly respected analyst, had a "strong buy" on AT&T stock, and was a "strong supporter" of the company, AT&T gave him the highest possible score in the internal matrix it used to rank the competing investment banks. In February 2000, based in large part on this positive evaluation of Grubman, AT&T named SSB as one of three joint book-runners for the AT&T Wireless IPO. The IPO occurred on April 27, 2000. It was the largest equity offering ever in the United States, and SSB earned $63 million in fees as lead underwriter for the offering.

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8. Grubman Downgraded AT&T

119. On May 17, 2000, three weeks after the IPO, two months after his children were admitted to the 92nd St. Y preschool, and after AT&T announced disappointing earnings, Grubman issued a research report in which he compared AT&T with WorldCom. While Grubman did not change his Buy ratings on the two companies, he lowered his target price for AT&T from $75 to $65 per share and made a number of negative comments about AT&T.

120. Institutional investors viewed Grubman's report as a "virtual downgrade" because of his unfavorable comparisons of AT&T to WorldCom. An internal AT&T document also reported that Grubman was privately making comments to investors that were considerably more critical than those in his written reports.

121. Grubman subsequently downgraded AT&T twice in October 2000: on October 6 he downgraded the stock to an Outperform (2) and on October 25 he downgraded it to a Neutral (3), citing what he described as negative news from the company.

9. SSB's Policies Were Not Reasonably Designed To Prevent The Potential Misuse Of Material, Non-Public Information

122. During the relevant period, SSB had general policies in place requiring its employees to obtain approval before becoming a director of another company and to keep non-public information about that company confidential. SSB did not, however, have adequate policies and procedures in place to ensure that communications between a person associated with SSB who served as a director of another company and the SSB research

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Salem, OR 97301-3881
Telephone: (503) 378-4387

analyst who covered that company would not result in the misuse of material, non-public information by the research analyst. For example, one such step SSB could have taken would have been to require that a company be placed on its watch list if a person associated with SSB served as a director of that company. Such a procedure would have helped SSB to monitor whether a research analyst, before publishing research on a company, had received material non-public information on it from a person associated with SSB who also served as one of the company's outside directors.

H. SSB Failed to Supervise Adequately the Activities of Its Research Analysts

1. SSB Failed to Respond Adequately to Red Flags Regarding Research

123. Members of research management received copies of research reports and call notes when they were issued and routinely reviewed research. Based on this review, complaints from SSB employees and customers, and otherwise, SSB was aware of problems with its research. Indeed, as described in Section B above, members of research management themselves expressed reservations about SSB's research. Nevertheless, SSB did not take steps to supervise the activities of research analysts adequately.

124. By early 2001, one of Grubman's supervisors believed that Grubman's ratings were inconsistent with the performance

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Salem, OR 97301-3881
Telephone: (503) 378-4387

and prospects of the some of the companies he covered.

125. Moreover, on July 2, 2001, a Director who provided Research Management Support sent an e-mail to all research personnel, and others, warning that the models SSB analysts, including Grubman, used to predict future revenues and earnings and generate target prices **"must make sense"** (emphasis in original) and must be "smell tested." He criticized these models for using "aggressive inputs to arrive at a predetermined valuation/outcome." He concluded by noting that, **"Clearly, projected long-term growth rates for many of our companies are too high and would benefit from a thoughtful reappraisal."** (Emphasis in original.) At least one recipient of this e-mail thought he was referring to Grubman ("Amen! You should have cc'd this to Grubman just to make sure.") The author of the e-mail did not disabuse the recipient of this assumption: "No comment on that, at least not in writing."

126. The same person specifically criticized Grubman's research in a later e-mail to a senior member of research management, implying that the research had been compromised by investment banking concerns and acknowledging that SSB's lax supervision of Grubman was at least partly to blame. He focused in particular on Grubman's coverage of Metromedia Fiber and the June 6, 2001 Note (discussed above). He stated:

> Explaining this isn't easy. My candid opinion is that, until quite recently, Jack Grubman's team had not yet come to terms

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> with the debacle in this sector. While share prices plummeted, they remained convinced of the longer-term potential of their group and were unwilling to cut ratings and adopt a more cautious stance. *When you add the heavy layer of banking involvement into the mix this very problematic situation gets easier to understand.* (Emphasis added.)

127. He criticized Grubman's coverage of Metromedia Fiber in particular. He noted that Grubman's

> [e]xcessive optimism led to unattainable target prices that should have been brought down much more quickly and earlier, than they had been. . . . [T]he target prices were cut again and again, but never enough to bring them into a more rational alignment with the share price. The 6/6/01 note talks about reducing projected 2010 revenue and EBITDA to $8.7BB and $3.2BB from $10.68BB and $4.4BB respectively. *How anyone could think those levels could be attained I cannot explain.* This only underscores the absurd assumptions pervading many [discounted cash flow] models. (Emphasis added.)

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128. He concluded by acknowledging that SSB's supervision of Grubman had been inadequate:

> What could have prevented this? . . . Even with all notes going through an SA [supervising analyst] and many being scrutinized by research legal as well, we clearly rely on senior analysts to do careful work, disclose all important data and denote all material risks. In the case of MFNX, and in other telecom situations that I could name, our approach was inadequate. There was a failure of analysis and, it pains me to confess, *a failure of management*. This is the only explanation I can offer. (Emphasis added.)

2. SSB Knew SSB Investment Bankers Pressured Research Analysts

129. SSB knew that its business practices, which intertwined research and investment banking, created a conflict of interest between investment banking and research, that investment banking pressured research analysts, and that investment banking concerns had the potential to affect, and, as described above with respect to Grubman, did affect, the decisions of research analysts on ratings and coverage. Nevertheless, SSB failed to take adequate steps to prevent such pressure or ensure that SSB's research was independent and objective.

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Salem, OR 97301-3881
Telephone: (503) 378-4387

130. SSB was aware that investment bankers pressured Grubman to maintain positive ratings or change negative ratings on companies. Moreover, on November 17, 2000, shortly after SSB was named in a private securities action relating to the AT&T Wireless IPO, Grubman e-mailed the head of Global Equity Research:

> I think all legal stuff on ATT should be forwarded to Sandy [Weill] and [the head of SSB Investment Banking] as Exhibit A on why research needs to be left alone. These guys never understand the lingering consequences.

I. SSB Engaged in Improper Spinning and IPO Distribution Practices

131. SSB engaged in improper spinning practices whereby it provided preferential access to valuable IPO shares to the executives of corporations from which SSB sought or had obtained investment banking business. During the years 1999 and 2000, SSB earned over $6.6 billion in investment banking revenue. Obtaining this investment banking business was critical to SSB's success. For example, investment banking fees comprised over 21% of SSB's revenue in 1999, and over 22% in 2000.

132. SSB failed to appropriately administer numerous Issuer Directed Share Programs ("DSPs") it managed during this same period. Further, SSB engaged in significant "as of" trading in IPOs and failed to ensure that its distribution of IPO shares,

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Salem, OR 97301-3881
Telephone: (503) 378-4387

both through DSPs and its branch offices, was timely and accurately reflected in its books and records.

1. SSB Established a Special Branch to Facilitate Its Spinning Practices

133. SSB employed two registered representatives ("RRs") whose primary function was to open and service accounts for high net worth individuals who were founders, officers or directors of current and potential banking clients ("Executive Accounts"). The two RRs had begun servicing these types of accounts at Salomon Brothers and continued to perform this function after Salomon merged with Travelers in 1997 to create SSB. SSB took steps and entered into written agreements to provide these two RRs with preferential, special, and unusual treatment including the following:

- SSB gave each of these two RRs special compensation, including a draw of $1 million for the first 6 months of their employment and a minimum of $500,000 for the second 6 months;
- SSB provided office space for one of the two RRs on SSB's equities trading floor in New York;
- SSB treated the business of the two RRs, designated "Private Wealth Management," as if it were a separate SSB branch office ("PWM Branch") for the purpose of determining IPO allocations, when it was actually only 2

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Salem, OR 97301-3881
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brokers;[5]

- SSB provided the two RRs with unique access to hot IPO shares to distribute to the Executive Accounts that was far above and beyond that of any other broker or branch; and
- SSB provided the two RRs with access to IPO shares for distribution to the Executive accounts from (i) the SSB Branch retail allocation, with PWM being treated as a "branch office"; and (ii) the institutional pot, In some cases, the two RRs were able to obtain access to DSP shares from issuers for distribution to the Executive Accounts.

2. SSB Provided Preferential Treatment to Executive Accounts in the Allocation of Hot IPOs

134. SSB distributed its IPO shares by dividing the firm's allocation between its retail and institutional clients. Generally, SSB allocated to its retail clients, as a group, approximately 20-30% of the firm's allotment in any specific IPO, with a majority of the remaining shares designated for allocations to institutional clients. Those shares set aside for retail clients were designated as the "retail retention," and the remaining shares were designated as the "institutional pot."

[5] The two RRs ended their partnership in 1999 after which each operated as a separate branch and the practices described herein continued. However, the two RRs are referred to as the "PWM Branch."

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135. The retail shares were distributed to specific accounts through SSB's branch managers. For every IPO, SSB gave each branch manager a specific number of shares, and the manager determined which retail brokers received shares and how many shares each retail broker received. The retail broker then determined the allocation of shares among his or her retail accounts, subject to the branch manager's final approval.

136. The PWM Branch and its clients, however, were treated differently. As noted, the two RRs' client base consisted primarily of high net worth individuals whose companies were potential investment banking clients or had provided investment banking business to SSB, and these two individual brokers were designated as a special branch with a separate profit and loss assessment. The PWM Branch received favorable treatment in the allocation of hot IPO shares. Although SSB's written procedures for the distribution of IPO shares specifically prohibited favoritism for the personal accounts of corporate executives, SSB in fact provided preferential treatment to Executive Accounts in connection with the distribution of hot IPO shares throughout the relevant period.

a. Special Access to Retail and Institutional Shares

137. While other SSB retail branches were ordinarily limited to receiving IPO shares for clients from the retail retention, in many instances the two RRs in the PWM Branch obtained shares from both the retail retention and the

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institutional pot. This arrangement enabled them to consistently provide the Executive Accounts with larger numbers of shares in lucrative hot IPOs than were allocated to other retail accounts.

138. For example, from June 1996 through August 2000, WorldCom's then-President and CEO received IPO allocations in 9 offerings from Salomon and 12 offerings from SSB. He made profits of $10,612,680 and $923,360 respectively, totaling $11,536,041 on these IPO allocations. From 1996 through 2000, WorldCom paid $75,955,000 in investment banking fees to SSB.

139. During 1999 and 2000, the two RRs in the PWM Branch received 35% of the total IPO shares allocated for distribution to SSB's ten largest branches and PWM combined. During this same period, these two brokers generated less than 3% of this combined group's commission revenue and had less than 5% of the group's assets under management. In 5.3% of the IPOs during this period, the two PWM brokers alone received a greater IPO allocation than the total shares distributed to SSB's ten largest branches.

b. PWM's Solicitation of Syndicate for Additional IPO Shares

140. In addition to the arrangement that provided the two PWM brokers with special access to large numbers of IPO shares for its client base, these two RRs aggressively solicited the Syndicate Department for additional shares in order to give preferential treatment to founders, officers, and directors of

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investment banking clients. PWM brokers regularly requested additional shares from Syndicate, while retail brokers did so rarely. This occurred as early as 1996 and continued throughout the relevant period. For example, in a June 7, 1996 facsimile to the Syndicate Department, one of the RRs requested shares in the McLeod USA IPO for "Salomon Brothers Investment Banking Relationships to receive preferential treatment."

c. Special Access to DSP Shares

141. As well as obtaining hot IPO shares for Executive Accounts from the retail retention and institutional pot, a PWM broker sought access, on at least one occasion, to shares reserved for an Issuer's Directed Share Program for allocation to Executive Accounts.[6]

142. In a July 6, 1999 letter, one of the two PWM Branch RRs solicited the President and CEO of Focal for the inclusion of various favored Executive Accounts in Focal's DSP. Of the seventeen listed PWM clients who were Focal bondholders requesting equity shares, at least thirteen were telecom company executives. One of these seventeen PWM clients, the former CEO of McLeod USA, received 100,000 shares through Focal's DSP.

143. SSB also directly allocated issuers' DSP shares to the Executive Accounts. When trades through an Issuer's DSP program

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[6] In each IPO, shares were set aside for distribution to a group of individuals designated by the Issuer through its Directed Share Program, sometimes referred to as the "friends and family" program.

could not be confirmed, SSB used those shares for its own clients and distributed them to its favored accounts. For example, one of the PWM RRs was assigned by SSB to administer the KQIP DSP. KQIP began trading in the aftermarket on November 9, 1999. Several days later, the issuer's CFO contacted the PWM RR and stated that 20,000 shares of IPO stock were left over from the DSP, and asked if the RR would like to allocate the shares to one of his clients. The RR took the DSP shares and in turn gave them to another broker who had assisted him with the KQIP DSP for allocation to that broker's favored customers. On November 12, 1999, the second broker allocated 5,000 shares of KQIP IPO stock to a customer, who was able to purchase them at the IPO price. On November 16, 1999, the broker allocated the remaining 15,000 shares of KQIP IPO stock to the same customer at the IPO price. On December 24, 1999 the customer sold all 20,000 shares of KQIP for a profit of $832,540.

144. Additionally, several Executive Accounts serviced by the PWM brokers received IPO shares from a significant number of DSPs. For example, DSP shares were allocated in more than one-third of the SSB IPOs awarded to the former Executive Vice President of Qwest Communications International from May 1998 through September 2000. Likewise, DSP shares were allocated in half of the SSB IPOs awarded to the President of Qwest

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Salem, OR 97301-3881
Telephone: (503) 378-4387

Communications International from June 1999 through September 2000.

3. Both SSB and Executives of the Firm's Investment Banking Clients Profited Significantly From SSB's Spinning Practices

145. The spinning practices engaged in by Salomon before the merger with Citigroup, and then by SSB after the merger through the PWM Branch proved very lucrative to both the firm and the executives of the firm's investment banking clients. Executives of five telecom companies made approximately $40 million in profits from approximately 3.4 million IPO shares allocated from 1996 – 2001, and SSB earned over $404 million in investment banking fees from those companies during the same period.

Company	IPO Shares to Company Executives Pre-Merger (1/96-11/97)	IPO Shares to Company Executives Post-Merger (12/97-12/01)	Net Profits of Executives on Pre-Merger IPO Shares (1/96 – 11/97) (to nearest 000)	Net Profits of Executives on Post-Merger IPO Shares (12/97 – 12/01) (to nearest 000)	Investment Banking Fees Paid to SSB, Pre-Merger (1/96 – 11/97) (to nearest 000)	Investment Banking Fees Paid to SSB, Post-Merger (12/97 – 12-01) (to nearest 000)
Global Crossing	0	37,000	$ 0	$254,000	$0	$121,049,000
Metromedia Fiber Network	3,000	98,300	$11,000	$1,511,000	$5,243,000	$43,865,000
McLeodUSA	198,500	459,500	$4,849,000	$4,582,000	$23,071,000	$48,810,000
Qwest	254,654	838,822	$1,272,000	$7,763,000	$13,998,000	$32,810,000
WorldCom	1,236,400	262,000	$20,146,000	($273,000)	$17,631,000	$97,857,000
Totals	1,692,554	1,695,622	$26,278,000	$13,837,000	$59,943,000	$344,391,000

4. SSB Could Not Rely on Its Records to Determine if IPOs Were Fully Distributed

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146. SSB's record keeping and its system of assessing whether the IPO distribution was completed were totally inadequate. The records failed to timely and accurately record the firm's distribution of IPO shares to its clients. As a result, the firm could not rely on these records to ensure that the distribution was complete. This faulty record keeping was particularly evident in the areas of "as of" trades and the distribution of DSP shares. These "as of" trades frequently provided immediate profits to the recipients.

a. "As Of" Trades

147. In the Metromedia Fiber offering, SSB booked approximately 68% of all allocations on an "as of" basis two days or more after the IPO date and well after secondary market trading had begun in each stock. In the Juniper Networks offering, over 80% of all allocations booked by SSB were booked on an "as of" basis two days or more after the IPO date. In at least 10 offerings, over 10% of the offering was booked on an "as of" basis two or more days after the IPO date.

148. SSB placed a number of these "as of" IPO trades in Executive Accounts. In addition, SSB's inadequate record keeping led to the appearance that certain IPO allocations were sold short in violation of industry regulations. For example, Juniper Networks ("JNPR") IPO stock went public on Thursday, June 24, 1999 at $34 per share. Trade tickets for the purchase of 5000 shares by WorldCom's former President and CEO were

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Salem, OR 97301-3881
Telephone: (503) 378-4387

marked on the day after the IPO, Friday, June 25 at 3:12 p.m., and the shares were not booked into the account until the following Tuesday, June 29. SSB recorded this transaction on an “as of” basis. Though the shares had not yet been booked into the client’s account and the tickets for the IPO trades were not yet written and time stamped, the CEO sold 4,000 JNPR shares on June 25 at 12:03 p.m., at prices of $100 and $100.31 per share, for a profit of $264,125. The CEO sold the remaining 1,000 shares of JNPR on April 4, 2000 at $210 per share, following a 3:1 stock split, for a total profit of $860,125.

149. Similarly, the former Chairman of Qwest Communications also received several “as of” IPO allocations that traded at a substantial profit in the aftermarket. For example, SSB booked 5000 JNPR IPO shares into the account of the Qwest Chairman on June 29, 1999, even though the IPO trade tickets were time stamped at 3:12 p.m. on June 25, one day after the IPO date. At 11:59 a.m. on June 25, the Qwest Chairman sold 2000 shares of JNPR for a profit of $132,063, even though the tickets for the IPO trades had not yet been written and time stamped, once again giving the appearance that the IPO shares were sold short. In addition, on June 5, 2000, SSB booked 10,000 shares of ONI Systems Corp. (“ONIS”) IPO stock into this same client’s account at the IPO price, even though ONIS had begun trading in the aftermarket on June 1, 2000. The Qwest Chairman ultimately sold the ONIS IPO stock for a profit of more than $562,000.

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b. Directed Share Programs

150. In many instances in which SSB was retained to administer the issuer’s DSP, a large number of allocations were booked into customers’ accounts after the stock began trading in the secondary market, resulting in a substantial number of “as of” trades. Some of these instances resulted directly from SSB’s failure to ensure that orders for DSP shares were confirmed prior to the start of secondary market trading. In fact, one of the PWM brokers acknowledged that, if he could not confirm a DSP allocation with a program participant, he would continue to attempt to contact participants even after secondary market trading had begun in the stock. SSB’s inadequate record keeping left the firm unable to ensure that the distribution of DSP shares had been completed before the stock began trading in the secondary market.

151. Moreover, SSB did not appropriately administer DSPs. For example, SSB relied upon branch offices and their staff to manage these labor-intensive programs without adequate central supervision and coordination. Further, despite managing numerous DSPs, SSB had no written procedures or supervisory system in effect to ensure the appropriate administration of these programs and the complete and timely distribution of DSP shares.

5. SSB Failed to Supervise Reasonably the Activities of the PWM Branch and Others to Prevent Spinning

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Telephone: (503) 378-4387

152. SSB failed to have supervisory procedures and systems in place to (i) prevent spinning; (ii) create records it could reasonably rely upon to assess whether or not the distribution of IPO shares was completed in compliance with applicable law; and (iii) ensure that issuers' DSP programs were managed in conformance with all applicable industry rules and regulations.

153. By establishing the PWM Branch and providing the two RRs with several special considerations, including the ability to obtain significantly larger hot IPO allocations than other brokers, SSB ensured favorable treatment for the Executive Accounts. Moreover, SSB management failed to adequately supervise the allocation process and specifically failed to take steps to ensure that the PWM Branch complied with SSB's policy prohibiting favoritism for the personal accounts of corporate executives. SSB also failed to accurately and timely record its distribution of IPO shares and failed to have a system to ensure that IPO distributions were completed, and recorded as completed, prior to the initiation of aftermarket trading. Finally, SSB failed to adopt written supervisory procedures and a supervisory system sufficient to ensure that the firm appropriately administered DSPs.

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CONCLUSIONS OF LAW

1. The **Director** has jurisdiction over this matter pursuant to **ORS Chapter 59**.

2. SSB Published Fraudulent Research on Focal and Metromedia Fiber

As described in the Findings of Fact above, SSB publicly issued the following fraudulent reports on Focal Communications and Metromedia Fiber that contained misstatements and omissions of material facts about the companies covered, contained recommendations that were contrary to the actual views of its analysts, overlooked or minimized the risk of investing in these companies and predicted substantial growth in the companies' revenues and earnings without a reasonable basis:

- Focal: Reports issued on February 21, 2001 and April 30, 2001; and
- Metromedia Fiber: Reports issued on April 30, 2001, June 6, 2001, and June 28, 2001.

As a result, SSB violated **ORS 59.135.**

3. SSB Published Exaggerated, Unbalanced or Unwarranted Statements and Made Recommendations Without a Reasonable Basis

As described in the Findings of Fact above, SSB issued certain research reports for Focal, RCN Communications, Level 3 Communications, XO Communications, Adelphia Business Solutions, and Williams Communications Group that did not disclose the pressure exerted by investment banking on Grubman not to downgrade those stocks, did not disclose other relevant facts, and did not provide a sound basis for evaluating facts regarding these companies business prospects. In addition, certain of the reports for Williams and Focal contained exaggerated or unwarranted statements or claims about these companies, and opinions for which there was no reasonable basis. The treatment

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Telephone: (503) 378-4387

of risks and potential benefits in the reports also was not adequately balanced. As a result, SSB violated **ORS 59.205(2)** as it relates to dishonest or unethical practices in publishing the following misleading reports, as described in paragraphs 78 – 92:

- Focal: Reports issued on April 10, 2000, April 18, 2000, April 26, 2000, and July 31, 2000.
- Level 3: Report issued on April 18, 2001.
- WCG: Reports issued on May 1, 2001, August 1, 2001, and September 21, 2001.
- XO: Reports issued on April 26, 2001, and July 25, 2001.
- Adelphia: Report issued on May 14, 2001.
- RCN: Report issued on May 3, 2001.

4. <u>SSB Published a Misleading Recommendation on AT&T</u>

As described in the Findings of Fact above, SSB did not, in the November 1999 research report upgrading AT&T, disclose that Grubman’s objectivity had been compromised by the facts described above in paragraphs 93 – 122. This would have been material to investors. As a result, such report was misleading and SSB violated **ORS 59.205(2)** as it relates to dishonest or unethical practices.

5. <u>SSB’s Business Practices Created Conflicts of Interest</u>

As described in the Findings of Fact above, SSB’s business practices allowed investment bankers to wield inappropriate influence over research analysts. SSB failed to manage, in an adequate or appropriate manner, the conflicts of interest these

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practices generated. These SSB business practices fostered the flawed research reports described Sections I.E. and I.F above. Accordingly, SSB violated **ORS 59.205(2)** as it relates to dishonest or unethical practices.

6. <u>SSB's Policies Were Not Reasonably Designed To Prevent The Potential Misuse Of Material, Non-Public Information</u>

As described in the Findings of Fact above, during the relevant period SSB did not maintain written policies and procedures reasonably designed to prevent the sharing and misuse of material, non-public information between an affiliated person of SSB who served as a director of another company and an SSB research analyst covering that company. By reason of the foregoing, SSB violated **59.205(2)** as it relates to dishonest or unethical practices.

7. <u>SSB Engaged in Spinning</u>

As described in the Findings of Fact above, SSB provided favorable and profitable allocations of hot IPO shares to officers of existing or potential investment banking clients who were in a position to direct their companies' investment banking business to SSB. The officers sold the shares provided to them for substantial profit. Subsequently, the companies for which the officers worked provided SSB with investment banking business. As a result of these actions, SSB violated **ORS 59.205(2)** as it relates to dishonest or unethical practices.

8. <u>SSB Maintained Inaccurate Books and Records in Connection with its Spinning Activities and IPO Distribution Practices</u>

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Telephone: (503) 378-4387

As described in the Findings of Fact above, SSB allowed its employees to engage in “as of” trading and otherwise failed to maintain accurate books and records with respect to spinning. SSB also failed to maintain adequate books and records to ensure that its distributions of IPO shares were completed prior to the initiation of secondary market trading. As a result, SSB violated **59.205(2)** as it relates to dishonest or unethical practices.

9. SSB Failed to Supervise

As described in the Findings of Fact above, SSB failed to establish and maintain adequate procedures to protect research analysts from conflicts of interest from its investment banking operation. Moreover, SSB failed adequately to supervise the activities of its research analysts: it failed to respond to indications that SSB research was misleading and failed to have a system to provide reasonable assurances that its research reports complied with applicable law. SSB also failed adequately to supervise the employees engaged in spinning. Finally, SSB failed to establish and maintain adequate procedures to ensure the proper administration of Issuer Directed Share Programs. As a result, SSB violated **ORS 59.205(13)**.

10. The **Director** finds the following sanctions appropriate and in the public interest.

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ORDER

On the basis of the Findings of Fact, Conclusions of Law, and Respondent Citigroup Global's consent to the entry of this Order, for the sole purpose of settling this matter, prior to a hearing and without admitting or denying any of the Findings of Fact or Conclusions of Law,

IT IS HEREBY ORDERED:

1. This Order concludes the Investigation by the **Director** and any other action that the **Director** could commence under the **ORS Chapter 59** on behalf of the **State of Oregon** as it relates to Respondent Citigroup Global, or its affiliates, or the current or former directors, officers or employees of Citigroup Global or its affiliates arising from or relating to the subject of the Investigation, provided however, that excluded from and not covered by this paragraph 1 are any claims by the **Director** arising from or relating to enforcement of the "Order" provisions contained herein.

2. Respondent Citigroup Global will CEASE AND DESIST from engaging in acts in violation of **ORS Chapter 59** in connection with the research practices referenced in this Order and will comply with the **provisions of ORS Chapter 59** in connection with the research practices referenced in this Order and will comply with the undertakings of Addendum A, incorporated herein by reference.

3. **IT IS FURTHER ORDERED that:**

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Telephone: (503) 378-4387

As a result of the Findings of Fact and Conclusions of Law contained in this Order, Respondent Citigroup Global shall pay a total amount of $400,000,000.00. This total amount shall be paid as specified in the final judgment in the related action by the Securities and Exchange Commission against Respondent Citigroup Global ("SEC Final Judgment") as follows:

a) $150,000,000 to the states (50 states, plus the District of Columbia and Puerto Rico) (Respondent Citigroup Global's offer to the state securities regulators hereinafter shall be called the "state settlement offer"). Upon execution of this Order, Respondent Citigroup Global shall pay the sum of **$1,581,736** of this amount to **the Oregon Department of Consumer and Business Services** as a civil monetary penalty pursuant to **ORS 59.995**, to be deposited in the **General Fund.** The total amount to be paid by Respondent Citigroup Global to state securities regulators pursuant to the state settlement offer may be reduced due to the decision of any state securities regulator not to accept the state settlement offer. In the event another state securities regulator determines not to accept Respondent Citigroup Global's state settlement offer, the total amount of the **Oregon** payment shall not be affected, and shall remain at $1,581,736;

b) $150,000,000 as disgorgement of commissions, fees and other monies as specified in the SEC Final Judgment;

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c) $75,000,000, to be used for the procurement of independent research, as described in the SEC Final Judgment;

d) $25,000,000, to be used for investor education, as described in Addendum A, incorporated by reference herein.

Respondent Citigroup Global agrees that it 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 amounts that Respondent Citigroup Global shall pay pursuant to this Order or Section II of the SEC Final Judgment, regardless of whether such penalty amounts or any part thereof are added to the Distribution Fund Account referred to in the SEC Final Judgment or otherwise used for the benefit of investors. Respondent Citigroup Global further agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with regard to any state, federal or local tax for any penalty amounts that Respondent Citigroup Global shall pay pursuant to this Order or Section II of the SEC Final Judgment, regardless of whether such penalty amounts or any part thereof are added to the Distribution Fund Account referred to in the SEC Final Judgment or otherwise used for the benefit of investors. Respondent Citigroup Global understands and acknowledges that these provisions are not intended to imply that the **Director** would agree that any other amounts Respondent Citigroup Global

Division of Finance and Corporate Securities
Labor and Industries Building
350 Winter Street NE, Suite 410
Salem, OR 97301-3881
Telephone: (503) 378-4387
DEPARTMENT OF CONSUMER AND BUSINESS SERVICES
State of Oregon

shall pay pursuant to the SEC Final Judgment may be reimbursed or indemnified (whether pursuant to an insurance policy or otherwise) under applicable law or may be the basis for any tax deduction or tax credit with regard to any state, federal or local tax.

No portion of the payments for independent research or investor education shall be considered disgorgement or restitution, and/or used for compensatory purposes.

4. If payment is not made by Respondent Citigroup Global or if Respondent Citigroup Global defaults in any of its obligations set forth in this Order, the **Director** may vacate this Order, at its sole discretion, upon 10 days notice to Respondent Citigroup Global and without opportunity for administrative hearing and Respondent Citigroup Global agrees that any statute of limitations applicable to the subject of the Investigation and any claims arising from or relating thereto are tolled from and after the date of this Order.

5. This Order is not intended by the Department of Consumer and Business Services to subject any Covered Person to any disqualification under the laws of any state, the District of Columbia or Puerto Rico (collectively, "State"), including, without limitation, any disqualification from relying upon the State registration exemptions or State safe harbor provisions. "Covered Person" means Respondent Citigroup Global, or any of its officers, directors, affiliates, current or former

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employees, or other persons that would otherwise be disqualified as a result of the Orders (as defined below).

6. The SEC Final Judgment, the NYSE Stipulation and Consent, the NASD Letter of Acceptance, Waiver and Consent, this Order and the order of any other State in related proceedings against Respondent Citigroup Global (collectively, the "Orders") shall not disqualify any Covered Person from any business that they otherwise are qualified, licensed or permitted to perform under the applicable law of the **State of Oregon** and any disqualifications from relying upon this state's registration exemptions or safe harbor provisions that arise from the Orders are hereby waived.

7. For any person or entity not a party to this Order, this Order does not prohibit, limit or create: (1) any private rights or remedies against Respondent Citigroup Global; (2) liability of Respondent Citigroup Global; or (3) defenses of Respondent Citigroup Global to any claims. Nothing herein shall be construed to prohibit the use of any e-mails or other documents of Respondent Citigroup Global or of others.

8. Nothing herein shall preclude the State of Oregon, its departments, agencies, boards, commissions, authorities, political subdivisions and corporations, other than the **Director** and only to the extent set forth in paragraph 1 above, (collectively, "State Entities") and the officers, agents or employees of State Entities from asserting any claims, causes of action, or applications for compensatory, nominal and/or

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350 Winter Street NE, Suite 410
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punitive damages, administrative, civil, criminal, or injunctive relief against Respondent Citigroup Global arising from or relating to the subject of the Investigation.

9. This Order and any dispute related thereto shall be construed and enforced in accordance with, and governed by, the laws of the **State of Oregon** without regard to any choice of law principles.

10. Respondent Citigroup Global agrees not to take any action or to make or permit to be made any public statement denying, directly or indirectly, any finding in this Order or creating the impression that this Order is without factual basis. Nothing in this Paragraph affects Respondent Citigroup Global's: (i) testimonial obligations, or (ii) right to take legal or factual positions in defense of litigation or in defense of other legal proceedings in which the **Director** is not a party.

11. Respondent Citigroup Global, through its execution of this Consent Order, voluntarily waives their right to a hearing on this matter and to judicial review of this Consent Order under **ORS 59.295, 59.305 and ORS 183.310 to 183.550.**

12. Respondent Citigroup Global enters into this Consent Order voluntarily and represents that no threats, offers, promises, or inducements of any kind have been made by the **Director** or any member, officer, employee, agent, or representative of the **Director** to induce Respondent Citigroup Global to enter into this Consent Order.

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350 Winter Street NE, Suite 410
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13. This Order shall be binding upon Respondent Citigroup Global and its successors and assigns. Further, with respect to all conduct subject to Paragraph 2 above and all future obligations, responsibilities, undertakings, commitments, limitations, restrictions, events, and conditions, the terms "Citigroup Global" and "Citigroup Global's" as used herein shall include Respondent Citigroup Global's successors and assigns (which, for these purposes, shall include a successor or assign to Respondent Citigroup Global's investment banking and research operations, and in the case of an affiliate of Respondent Citigroup Global, a successor or assign to Respondent Citigroup Global's investment banking or research operations).

14. This Consent Order shall become final upon entry.

Dated this 30th day of SEPTEMBER, 2003.

BY ORDER OF CORY STREISINGER

DIRECTOR, DEPARTMENT OF CONSUMER AND BUSINESS SERVICES

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350 Winter Street NE, Suite 410
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CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY CITIGROUP GLOBAL

Respondent Citigroup Global hereby acknowledges that it has been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

Respondent Citigroup Global admits the jurisdiction of the Director, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order by the Director as settlement of the issues contained in this Order.

Respondent Citigroup Global states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

Richard Ketchum represents that he/~~she~~ is General Counsel of Respondent Citigroup Global and that, as such, has been authorized by Respondent Citigroup Global to enter into this Order for and on behalf of Respondent Citigroup Global.

Dated this 4 day of September, 2003.

Citigroup Global

By: [signature]

Title: General Counsel

SUBSCRIBED AND SWORN TO before me this 4th day of September, 2003.

MARK A. RHODES
Notary Public, State of New York
No. 31-4964241
Qualified in New York County
Commission Expires ~~March 26, 1994~~ May 13, 2006

[signature]
Notary Public

Division of Finance and Corporate Securities
Labor and Industries Building
350 Winter Street NE, Suite 410
Salem, OR 97301-3881
Telephone: (503) 378-4387

My Commission expires:______________________

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Labor and Industries Building
350 Winter Street NE, Suite 410
Salem, OR 97301-3881
Telephone: (503) 378-4387