

**NASD DISPUTE RESOLUTION AWARD**  
**NASD DISPUTE RESOLUTION**  
Case: 03-00294

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Rick A. Sawyer, Claimant v. Citigroup Global Markets fka Salomon Smith Barney, Inc., and Jack B. Grubman, Respondent

**ATTORNEYS:**

Claimant: Rick A. Sawyer, appeared James Richard Hooper, Esq., & Robert H. Weiss, Esq. of Hooper & Weiss, LLC

Respondent: Citigroup Global Markets fka Salomon Smith Barney, Inc., and Jack B. Grubman, appeared Jeffrey Friedman, Esq. of Salomon Smith Barney and Bradford D. Kaufman, Esq. of Greenberg Traurig

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**NATURE OF DISPUTE:** Customer v. Member and Associated Person

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**DATE FILED:** July 13, 2004

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**CASE SUMMARY:**

Claimant, in its Statement of Claim, asserted the following causes of action: breach of contract, specifically, Respondent's failure to adhere to standards of care, good faith and fair dealing; breach of fiduciary duty, specifically, Respondent's fiduciary duty of care, loyalty, good faith, full disclosure and fair dealing; violation of the Securities Exchange Act of 1934, specifically, Section 10(b) and SEC Rule 10b-5 promulgated there under; Common Law Fraud; Constructive Fraud; violations of SRO Conduct Rules, specifically, Respondents violated NASD Conduct Rules 2110 (Standards of Commercial Honor and Principles of Trade), 2120 (Use of Manipulative, Deceptive or Other Fraudulent Devices), 2210 (Communications with the Public), 2310 (Recommendations to Customers-Suitability), and 3010 (Supervisory System); Violations of Florida Blue Sky Laws (Fla. Stat. Chp. 517); Negligence; Failure to Supervise; Respondent Superior; Rescissory damages in an amount according to proof; Disgorgement and restitution of all earnings, profits, compensation and benefits received by Respondents as a result of their unlawful acts and practices in an amount according to proof; Pre and post judgment interest at the legal rate; Attorney's fees and the costs and expenses of the proceeding; and such other and further relief as the Arbitrator deems just and proper.

Claimant, in its Amended Statement of Claim, asserted the following causes of action: violation of Section 17(a) of the Securities Act of 1933; violation of Chapter 517.301 of the Florida Securities and Investor Protection Act; violation of NASD Rule 2210(d)(1), Communications with the Public-General Standards; breach of respondents' fiduciary duty to Claimant as investor/customer; Respondent Superior;

The answer filed by Respondent sought dismissal of all the causes of action, with prejudice and attorney's fees and costs assessed against the Claimant. In addition, Respondent sought dismissal based on the Statute of Limitations.

The parties have submitted the matter to the NASD for a decision in a simplified arbitration procedure, wherein the case is decided upon the papers and evidence submitted. Accordingly, the report and ruling that follows is based on the Arbitrator's consideration of all the evidence thus submitted.

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**ARBITRATOR'S REPORT:****Breach of Contract**

Claimant contends that Respondents failed to adhere to standards of care, good faith and fair dealing in the sale of the WorldCom stock. However, Claimant failed to show any contractual agreement between Respondent Jack B. Grubman ("Grubman") and Claimant. In the matter of Citigroup Global Markets Inc., fka Salomon Smith Barney Inc. ("Citigroup"), Claimant illustrated the existence of a contractual agreement(s) between the parties. Therefore, did Respondent, Citigroup adhere to standards of care, good faith and fair dealing in the sale of the WorldCom stock and I see no evidence that they didn't.

**Breach of Fiduciary Duty**

Claimant contends that Respondent failed to provide fiduciary duty of care, loyalty, good faith, full disclosure and fair dealing in the sale of the WorldCom stock. There is no direct link between Respondent Grubman and Claimant but it can be assumed that Respondent Citigroup did owe Claimant the duties of care, loyalty, good faith, full disclosure and fair dealing via their mutual agreement(s). Respondent Grubman, as an employee of Citigroup, indirectly owed the same duties of care, loyalty, good faith, full disclosure and fair dealing.

In Respondent's Answer, it is pointed out that; "The Eleventh Circuit Court of Appeals in *Gochmayer v. A.G. Edwards & Sons, Inc.*, 810 F2d 1042, 1049 (11<sup>th</sup> Cir. Cir 1987), enumerated the full extent of the fiduciary duties owed by a broker to a customer:

1) the duty to recommend [an investment] only after studying it sufficiently to become informed as to its nature, price, and financial prognosis; 2) the duty to perform the customer's orders promptly in a manner best suited to serve the customer's interests; 3) the duty to inform the customer of the risks involved in purchasing or selling a particular security; 4) the duty to refrain from self-dealing; 5) the duty not to misrepresent any material fact to the transaction; and 6) the duty to transact business only after receiving approval from the customer."

It is agreed that Claimant's WorldCom trades were accurately and fairly executed, WorldCom securities were suitable for Claimant, Claimant approved all WorldCom trades and Claimant was fully informed of all risks involved, based upon the knowledge then available to Claimant. However, Respondent Citigroup and indirectly, Respondent Grubman, based on the evidence illustrated in this case, failed to disclose to Claimant their conflicts of interest and self dealing with WorldCom. For Respondent Citigroup to hide behind their diminutive disclosure on the back of their research reports is insufficient. Respondent's Grubman and Citigroup had a duty and an obligation to disclose, to each and everyone of its client's, the satiated relationship that existed between WorldCom, Citigroup and Grubman. Claimant trusted Respondent Citigroup and had confidence in what Citigroup represented in its research reports. Accordingly, Respondent Citigroup and Grubman violated their fiduciary duty to Claimant by engaging in self-dealing with respect to the WorldCom stock.

**Violation of the Securities Exchange Act of 1934, specifically, Section 10(b) and Rule 10b-5**

Claimant contends that each Respondent violated the anti-fraud provisions of the federal securities laws by intentionally: 1) failing to meaningfully and objectively disclose the true value and condition of WorldCom; and 2) failing to meaningfully and objectively disclose the conflicts of interest that are purported to have existed between Citigroup, Grubman and WorldCom. Respondents counter that in order to state a claim pursuant to Section 10(b) and Rule 10b-5, Claimant must plead and prove: a

misstatement or omission of a material fact made with full knowledge or awareness upon which Claimant reasonably relied and which proximately caused Claimant's loss.

After reviewing the facts presented in this case, it can not be determined if Respondents misstated or omitted material facts with full knowledge or awareness within their research reports of WorldCom. However, what is evidentiary in this case is that Respondents held out their research to be independent, objective and unbiased and that investors could rely upon it to make sound investment decisions. Based on the feedback and review issued by Respondent Citigroup's retail brokers, Respondent Grubman's research was unacceptable and causing great damage with their retail clients as it did not appear to be independent, objective or unbiased. Comments such as "Jack Grubman cannot be trusted... he's more concerned with his income and loyalties to corporate accounts than he is to retail."; "We can not afford an overpriced cheerleader like Grubman."; and "I do not want to single out one analyst, however, there appears to be glowing contradictions contained in the research reports of Jack Grubman.", are evidentiary that his reports were not independent, objective, or unbiased and his views were not widely shared. Respondents' failure to meaningfully and objectively disclose the conflicts of interest that existed between Citigroup, Grubman and WorldCom is a material fact. Claimant doesn't have to show or prove that the research reports were ever received much less reviewed but only that Respondents published the research reports with full knowledge and awareness of the misstatement or omission of a material fact. Accordingly, Respondents violated the Securities Exchange Act of 1934, specifically, Section 10(b) and Rule 10b-5.

#### **Common Law Fraud and Constructive Fraud**

Claimant contends that Respondents misrepresented the accuracy of the research reports for WorldCom and the relationship with Respondent Grubman and then President of WorldCom, Bernard Ebbers. Claimant further contends that had it known of the relationship of the two and accurate research reports been issued, Claimant would have never purchased the WorldCom stock. Respondent countered that in order to establish a fraud claim, Claimant must plead and prove that Respondents made a false statement of material fact which they communicated to the Claimant while knowing at the time it was made that such statement was false and intending the false statement to induce the Claimant to act upon it; and that Claimant justifiably relied on the false statement proximately causing damages to the Claimant. Claimant has failed to illustrate any evidence that would indicate that Respondents made any material misrepresentations of fact within the research reports. While the accuracy of any report may be called into question, Claimant has failed to show that the nepotism that has been purported to have existed between Respondents and WorldCom President, Bernard Ebbers, resulted in a basis for a Common Law or Constructive Fraud claim.

#### **Violations of SRO Conduct Rules**

Claimant contends that Respondents violated NASD Conduct Rules 2110 (Standards of Commercial Honor and Principles of Trade), 2120 (Use of Manipulative, Deceptive or Other Fraudulent Devices), 2210 (Communications with the Public), 2310 (Recommendations to Customers-Suitability), and 3010 (Supervisory System). Claimant has failed to show that Respondents violated any industry rules.

#### **Violations of Florida Blue Sky Laws (Fla. Stat. Chp. 517)**

Claimant contends that Respondents violated the anti-fraud provisions of the Florida Blue Sky laws (Fla. Stat. Chp. 517) by intentionally: 1) failing to meaningfully and objectively disclose the true value and condition of WorldCom; and 2) failing to meaningfully and objectively disclose the conflicts of interest between Citigroup, Grubman & WorldCom. Respondent contends that there are five elements that Claimant must prove under the anti-fraud provision of the Florida Blue Sky Laws (Section 517):

- 1) Respondents made a misrepresentation or omission of a material fact;
- 2) Claimant justifiably relied on Respondents' misrepresentation or omission;
- 3) Respondents' misrepresentation or omission was made in connection with a purchase or sale of securities;
- 4) Respondents acted with scienter or reckless disregard or negligence as to the truth of the communication; a
- 5) Respondents "untruth" was the direct proximate cause of the Claimant's actual loss.

As to the first count, Claimant has failed to prove that Respondents misrepresented or omitted any material facts from the research reports of the WorldCom stock. As to the second count, Claimant has shown that it relied upon the reports to make their investment decisions and the reliance upon those reports led to the purchase of the WorldCom stock. Claimant has shown that Respondents failed to succinctly inform the public of its conflict of interest between Citigroup, Grubman & WorldCom, which misrepresentation or omission was a material fact and that Respondent acted with scienter or reckless disregard or negligence as to the truth of the matter leading to Claimant's actual loss. Accordingly, Respondents violated the anti-fraud provision of the Florida Blue Sky Laws (Section 517).

#### Negligence

Claimant contends that Respondents provided negligent advice, negligent research, and negligent supervision of Respondent Grubman, which resulted in damages to Claimant. Respondents contend that the elements of a cause of action for negligence under Florida law are: 1) the existence of a duty of reasonable care owed to Claimant by Respondents; 2) a breach of that duty by Respondents; 3) the breach proximately caused the injury to Claimant; and 4) Claimant suffered damages as a result. Claimant has failed to show much less prove a claim for negligence.

#### Failure to Supervise

Claimant contends that Respondent Citigroup failed to adequately supervise its employees and establish procedures to ensure compliance with applicable laws, rules and policies. Specifically, 1) Respondent Citigroup failed to adequately supervise Respondent Grubman and ensure that his WorldCom research reports were in compliance with applicable laws, rules, regulations, policies and procedures; 2) Respondent Citigroup intentionally dismantled and/or failed to enforce its own compliance and supervisory policies and procedures (including but not limited to the policies and procedures governing the "Chinese Wall" required to separate the investment banking department and the firm's research and sales force). Respondents agree that they were required to adequately supervise their employees and maintain a system of written procedures to supervise the activities of its employees which would lead to the compliance of applicable laws and regulations. It has been shown that investment banking fees for Respondent Citigroup generated substantial fees and that the investment banking divisions of Respondent Citigroup needed the services of the research department to support their investment banking clients with favorable reviews. Moreover, Respondent Grubman's compensation was greatly influenced by the production of favorable research reports for the investment banking division of Respondent Citigroup. Respondent Citigroup's investment banking division had tremendous influence over its research department to provide favorable ratings for its investment banking clients. Respondent Citigroup had a responsibility and an obligation to maintain a "Chinese Wall" between its research department and the rest of its company provided services. Respondent Citigroup failed to monitor and manage the "Chinese Wall" that was supposed to be in place to prevent such inappropriate influence and instead ignored conflicts of interest that were grossly obvious for the benefit of the investment banking division. Accordingly, Respondent Citigroup failed to adequately supervise its employees and establish procedures

to ensure compliance with applicable laws, rules and policies and intentionally dismantled and/or failed to enforce its own compliance and supervisory policies and procedures.

**Respondent Superior**

Claimant contends that Respondent is liable under the doctrine of *respondent superior* for the acts of each of its employees, officers, and agents that were performed in the course of their employment. Respondent contends that Claimant's claim fails. As Claimant has pointed out, Respondent Citigroup had a duty to enforce its rules, which would include the supervision and compliance of its "Chinese Wall" that was supposed to have been established and maintained between its research department and investment banking division preventing any conflicts of interest. Respondent Citigroup disregarded its rules of conduct and is liable under the doctrine of *respondent superior*.

**Violation of Section 17(a) of the Securities Act of 1933**

Claimant contends that the sale of the WorldCom stock by Respondent was not achieved by honest presentation and therefore violated Section 17(a) of the Securities Act of 1933. Respondent contends that no private right of action exists under the act, and that violations of Section 17(a) may only be enforced through injunctions and criminal proceedings by law enforcement agencies and the courts. Claimant has failed to show that Respondents violated Section 17(a) of the Securities Act of 1933.

**Violation of Chapter 517.301 of the Florida Securities and Investor Protection Act**

See Violations of Florida Blue Sky Laws (Fla. Stat. Chp. 517) above.

**Violation of NASD Rule 2210(d) (1), Communications with the Public-General Standards**

See Violations of SRO Conduct Rules above.

**Breach of respondents' fiduciary duty to Claimant as investor/customer**

See Breach of Fiduciary Duty above.

**CLAIM DATA**

Claim: \$19,750.00  
 Claim: Rescissory/disgorgement/restitution  
 Punitive: Unspecified  
 Interest: Pre & Post Judgment

Attorney Fees: Unspecified

Filing Fees: Unspecified  
 Other: Unspecified

**AWARD DATA**

Award: \$19,750.00  
 Award: \$0.00  
 Punitive: \$0.00  
 Interest: Compounded at the Florida  
 Statutory Rule

Attorney Fees: Collectable under the Florida  
 Blue Sky Laws (Fla. Stat. Chp.  
 517)

Filing Fees: \$425.00  
 Other: \$0.00

**AWARD**

The undersigned arbitrator has decided and determined in full and final resolution of the issues submitted for determination, without prejudice, as follows: 1) Respondents breached their fiduciary duty to Claimant; Respondents violated the Securities Exchange Act of 1934, specifically, Section 10(b) and Rule 10b-5; Respondents violated the Florida Blue Sky Laws (Fla. Stat. Chp. 517); Respondent Citigroup failed to Supervise; and Respondent Citigroup is liable under the doctrine of respondent superior 2) All other claims are denied and dismissed in their entirety. 3) Respondents' request for dismissal of all causes of action, with prejudice and attorney's fees and costs assessed against the Claimant are denied. 4) Respondents' request for dismissal based on the Statute of Limitations is denied. 5) Respondents are jointly and severally liable and shall pay Claimant damages in the amount of \$19,750.00 together with pre and post award interest, which is to be computed at the Florida Statutory rate. 6) Claimant's request for punitive damages is denied. 7) Respondents Grubman and Citigroup are liable and shall pay to the Claimant \$425.00 as reimbursement of the filing fee. 8) Claimant is entitled to the reimbursement of reasonable attorney fees to the extent such is collectable under the Florida Blue Sky Laws (Fla. Stat. Chp. 517) and not already collected from Claimant, Rick A. Sawyer. 9) All other claims for relief are denied.

**OTHER FEES**

Pursuant to Rule 10333 of the Code, Respondent Citigroup has paid to NASD Dispute Resolution the \$425.00 Member Surcharge previously invoiced.

**ARBITRATOR**

Bernard Y. Cockrell II -- Sole Public Arbitrator  
Arbitrator ID: A14662

**AFFIRMATION**

I, Bernard Y. Cockrell II do hereby affirm, upon my oath as arbitrator that I am the individual described herein who executed this instrument, which is my oath and award.



Bernard Y. Cockrell II

11/16/04  
Signature Date

November 22, 2004  
Date of Service (For NASD-DR office use only)