NASD
OFFICE OF HEARING OFFICERS

Department of Enforcement, Complainant, v. Jack Benjamin Grubman, CRD No. 1505636 Respondent.	Disciplinary Proceeding No. CAF020042 Hearing Officer - DMF **OFFER OF SETTLEMENT**

I.

Respondent Jack Benjamin Grubman ("Respondent") makes this Offer of Settlement ("Offer") to NASD, with respect to the matters alleged by NASD in Disciplinary Proceeding No. CAF020042 filed by it on September 23, 2002 ("Complaint").

This Offer is submitted to resolve this proceeding and is made without admitting or denying the allegations of the Complaint. It is also submitted upon the condition that NASD shall not institute or entertain, at any time, any further proceeding as to Respondent based on the allegations of the Complaint, and upon further condition that it will not be used in this proceeding, in any other proceeding, or otherwise, unless it is accepted by the National Adjudicatory Council ("NAC"), pursuant to NASD Rule 9270.

II.

Pursuant to the conditions set forth herein, Respondent consents to the issuance of an Order of Acceptance ("Order") accepting the Offer and disposing of this proceeding in the following manner:

A. Without admitting or denying the allegations, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, to the entry of findings of facts and violations by Respondent of NASD Rules 2110, 2210(d)(1) and 2210(d)(2) as set forth in the Order; and,

B. Imposing sanctions of:

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

2. A total payment in the amount of $15,000,000 as specified in the Final Judgment ordered in a related action filed by the Securities and Exchange Commission (“Final Judgment”). Of the total amount paid, $7,500,000 constitutes a fine and $7,500,000 constitutes disgorgement of bonuses and other monies. The monetary sanctions imposed by NASD shall be reduced by the amounts paid by Respondent pursuant to the Final Judgment and the N.Y. State Settlement (as defined in the Final Judgment). The payment provisions of the Final Judgment are incorporated by reference herein.

3. Respondent agrees that he shall not seek or accept, directly or indirectly, reimbursement or indemnification, including but not limited to payment made

pursuant to any insurance policy, with regard to all fine/penalty amounts that Respondent shall pay pursuant to Section II of the Final Judgment, regardless of whether such amounts or any part thereof are added to the Distribution Fund Account or otherwise used for the benefit of investors. Respondent further agrees that he shall not claim, assert, or apply for a tax deduction or tax credit with regard to any federal, state, or local tax for any fine/penalty amounts that Respondent shall pay pursuant to Section II of the Final Judgment, regardless of whether such fine/penalty amounts or any part thereof are added to the Distribution Fund Account or otherwise used for the benefit of investors. Respondent understands and acknowledges that these provisions are not intended to imply that NASD would agree that any other amounts Respondent shall pay pursuant to the Final Judgment may be 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 federal, state, or local tax.[1]

Pursuant to IM-8310-2(f), a bar or expulsion is effective upon approval or acceptance of this Offer by the NAC.

III.

In connection with the submission of this Offer, and subject to the provisions herein, Respondent specifically waives the following rights provided by the NASD Code of Procedure:

[1] These sanctions relate to and resolve all NASD matters involving Grubman, including AWC No. CAF030027.

A. any right to a hearing before an Adjudicator (as defined in NASD Rule 9120(a)), and any right of appeal to the NAC, the U.S. Securities and Exchange Commission, or the U.S. Court of Appeals, or any right otherwise to challenge or contest the validity of the Order issued, if the Offer and the Order are accepted;

B. any right to claim bias or prejudgment by the Chief Hearing Officer, Hearing Officer, a hearing panel or, if applicable, an extended hearing panel, a panelist on a hearing panel, or, if applicable, an extended hearing panel, the General Counsel, the NAC, or any member of the NAC; and

C. any right to claim a violation by any person or body of the ex parte prohibitions of NASD Rule 9143, or the separation of functions prohibitions of NASD Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of the Offer and the Order or other consideration of the Offer and Order, including acceptance or rejection of such Offer and Order.

IV.

Respondent understands that:

A. the Order will become part of his permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against him;

B. the Order will be available through the NASD public disclosure program in response to public inquiries about his disciplinary record;

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

D. Respondent may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in the Order or create the impression that the Order is without factual basis. Nothing in this provision affects Respondent's testimonial obligations or right to take legal or factual positions in litigation or other proceedings in which NASD is not a party;

E. Respondent specifically and voluntarily waives any right to claim that he is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter;

F. Respondent understands that if barred or suspended from association with any NASD member, Respondent becomes subject to a statutory disqualification as that term is defined in Section 3(a)(39) of the Securities Exchange Act of 1934, as amended. Accordingly, Respondent may not be associated with any NASD member in any capacity, including clerical or ministerial functions, during the period of the bar or suspension. (See NASD Rule 8310 and IM-8310-1.)

Respondent certifies that he has carefully read this Offer and understands it; that he has agreed to its provisions voluntarily; and that no offer, threat, inducement or promise of any kind or nature, other than the terms set forth herein, has been made to induce him to submit it.

4/21/03
Date

Counsel for Respondent
Lee S. Richards

Respondent
Jack Benjamin Grubman

NASD
OFFICE OF HEARING OFFICERS

Department of Enforcement, Complainant, v. Jack Benjamin Grubman, CRD No. 1505636 Respondent.	Disciplinary Proceeding No. CAF020042 Hearing Officer – DMF **ORDER ACCEPTING OFFER OF SETTLEMENT** Date: April 24, 2003

INTRODUCTION

Disciplinary Proceeding No. CAF020042 was filed on September 23, 2002, by the Department of Enforcement of NASD (Complainant). Respondent Jack Benjamin Grubman submitted an Offer of Settlement (Offer) to Complainant on April 21, 2003.[1] Pursuant to Code of Procedure Rule 9270(e), the Complainant and the National Adjudicatory Council ("NAC") or the Office of Disciplinary Affairs ("ODA") have accepted the uncontested Offer. Accordingly, this Order now is issued pursuant to Code of Procedure Rule 9270(e)(3). The findings, conclusions and sanctions set forth in this Order are those stated in the Offer as accepted by the Complainant and approved by the NAC.

Under the terms of the Offer, Respondent has consented for the purpose of this proceeding only, without admitting or denying the findings of the Order, and solely for the purposes of this proceeding and any other proceeding in which NASD is a party, to the entry of findings of facts and violations consistent with the allegations of the Complaint, and to the

[1] The Complaint was issued against Respondent Grubman and against Christine Gochuico. This Order makes findings only with respect to Grubman and not with respect to any allegations against Gochuico.

imposition of the sanctions set forth below, and fully understands that this Order will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by NASD.

BACKGROUND

Grubman, age 49, was first associated with a member firm in January 1985, and he became registered as a general securities representative in approximately September 1999. He was associated with Salomon from March 1994 until August 2002. During the relevant time period, he was a Managing Director and a senior analyst in the U.S. Equity Research Division of Salomon Smith Barney Inc. (Salomon)

FINDINGS AND CONCLUSIONS

It has been determined that the Offer be accepted and that findings be made as follows:[2]

OTHER PARTIES

Salomon has been registered as a member since 1936. The firm has more than 700 retail branches and employs over 23,000 registered persons. Salomon's income is derived from a full line of services, and during the first half of 2001, twenty-five percent of its revenue came from investment advisory and underwriting fees.

Winstar Communications, Inc. (Winstar), which traded on the Nasdaq National Market using the symbol WCII, was a provider of broadband telecommunications services. It competed in the capital-intensive competitive local exchange carrier, or CLEC, industry with "Baby Bells" to provide "last-mile" networks to businesses. Winstar offered local and long distance voice

[2] The findings herein are pursuant to Respondent Grubman's Offer of Settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

services, broadband data services and web hosting, among other services. It specialized in fixed wireless technology and was attempting to build a national network.

During the period relevant to this proceeding, Winstar suffered significant losses, needed large amounts of capital to operate and was heavily dependent on external sources for financing. As Winstar explained in its November 14, 2000, Form 10-Q:

> “We have incurred significant operating and net losses, due in large part to the development of our network and the growth of our sales and marketing organization. We anticipate that such losses will continue over the near term as we execute our growth strategy. We are pursuing the continued expansion of services offered to our current 60 U.S. markets. We are also planning to offer our services in up to 50 foreign markets by the end of 2004. This expansion will require significant amounts of capital to finance capital expenditures as well as anticipated losses.”

In addition, Winstar’s Form 10-Q disclosed a number of specific risk factors, including:

> “the willingness of the marketplace to accept fixed wireless services generally, and our Wireless Fiber(SM) services in particular, as an acceptable alternative to other available communications technologies and rapid technological innovation bringing on constant enhancements in communications;
>
> “our ability to penetrate our targeted markets, which are dominated by much larger entrenched competitors, and attract and retain a sufficient revenue-generating customer base;
>
> “our ability to obtain sufficient capital to finance the buildout of our domestic and international telecommunications network, fund our projected operating losses and service our debt obligations, which may be dependent on the state of the financial and capital markets;
>
> “the general condition of the economy and the financial markets, particularly within the telecommunications and technology sector which has historically been even more volatile than the markets as a whole;
>
> “changes in the regulatory environment which may directly affect: the breadth of services which we and our competitors may offer and the terms of those services, the size and number of our competitors, our ability to

> obtain necessary access to customer buildings in order to provide our services, and our use of our spectrum assets;
>
> "the impact of capital market volatility and other events or circumstances affecting our customers, including those of our large accounts solutions business, and our major suppliers."

Winstar sustained significant losses. As of September 30, 2000, Winstar had over $2 billion in accumulated deficits. Moreover, for the quarter ended September 30, 2000, it reported a loss of $227.4 million or ($2.50) per share. For the year ended December 31, 2000, Winstar had revenue of $759.3 million, a net loss of $894.2 million, and ($9.67) in earnings per share. Net loss to common stockholders totaled more than $1 billion.

On April 5, 2001, Winstar announced a scaled-back business plan, and the layoff of 2,000 employees, or 44% of its work force. Grubman acknowledged that this scale back came about because of Winstar's funding situation. According to Grubman's April 5, 2001, report, this action was "a step in the right direction in addressing [Winstar's] funding gap. . . ." On April 18, 2001, Winstar filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code.

THE RELATIONSHIP BETWEEN SALOMON, GRUBMAN AND WINSTAR

The Investment Banking Relationships

Salomon had significant investment banking relationships with Winstar. During the period from February 1999 through July 2001, Salomon was lead manager, joint manager or advisor on ten Winstar equity, bond and financing transactions worth more than $5.6 billion. For those services, Salomon received fees of approximately $24 million.

Indeed, even as Winstar's prospects were falling and its stock plummeting, Salomon worked with Winstar to address its funding needs. In March 2001, Winstar retained Salomon to assist it with respect to a proposed acquisition. Thereafter, Salomon and Winstar worked together in connection with a number of other actual and potential transactions. On April 2, Salomon and Winstar began to discuss a potential debtor-in-possession (DIP) financing transaction. In July 2001, Salomon served as Lead Bookrunner for a $175 million DIP financing, receiving $500,000 for its services.

The Research Relationship

Grubman initiated research coverage of Winstar with a Buy rating in January 1998.[3] At that time, Winstar's market capitalization was almost $1 billion. Grubman maintained a Target Price for Winstar of $50 per share from October 3, 2000, when Winstar's market capitalization was worth approximately $2.8 billion, until April 17, 2001. By that time, Winstar's market capitalization had fallen to approximately $13 million, a loss of approximately $2.787 billion, or more than 99 percent. At that point, Grubman finally downgraded the stock from a Buy rating to an Underperform rating and suspended the Target Price.

Grubman had known several of Winstar's senior managers since the 1980s when those managers had worked for other telecommunications companies. The Chairman and CEO of Winstar spoke at a Salomon conference in January 2001 on telecommunications, media and entertainment.

Grubman and analysts who reported to him worked closely with Winstar management, relying on and seeking approval from Winstar's management prior to

[3] Grubman included in each Winstar report a risk rating of S(Speculative).

drafting research reports and models, which purportedly reflected independent judgment and analysis.

OVERVIEW OF WINSTAR REPORTS

From January 25, 2001 through April 17, 2001, Grubman authored research reports that recommended the purchase of Winstar stock with a Buy rating and a Target Price of $50 per share. During this time, Winstar's stock price fell more than 99 percent -- from approximately $20 per share on January 24, 2001 to $0.14 per share on April 17, 2001.

The reports omitted material facts and failed to disclose risks of investing in Winstar. In addition, the reports contained repeated statements of strong praise for Winstar while belittling and attacking other analysts who were critical of the company. For example, the January 25, 2001 note attacked an analyst from another firm who had written, among other things, that Winstar "may not be as well funded as many believe." Grubman countered that the analyst, whom the report referred to as a "competitor" who "actually does NOT follow Winstar," made statements that were "highly irresponsible" and "unfounded." After rebuking the other analyst, Grubman sang the praises of Winstar, stating that "we do not anticipate any negative changes in 2001 guidance" from the company and Winstar "remains one of our favorite CLEC names." Grubman went on to say that "we would take advantage of any weakness in [the] stock."

Similarly, in March 2001, another analyst expressed several concerns about Winstar, including concerns about its funding. Grubman attacked that analyst in the March 9, 2001 report, stating that the analyst "lacks an understanding of the CLEC industry," that the concerns were "misplaced" and "misguided," and that the report "contained certain information that were [*sic*] either incomplete, inaccurate or inconsistent with our analysis." Grubman's report concluded by stating that Winstar "continues to remain one of our favorite names in the CLEC space, and would buyers [*sic*] at these levels – nearly their 52 week low."

GRUBMAN'S NON-PUBLIC COMMUNICATIONS REGARDING WINSTAR

E-mails and other non-public documents demonstrate that the reports' assumptions were in many cases unreasonable or without basis. Grubman used the wrong inputs and assumptions to calculate the $50 Target Price in March 2001. If Grubman had used the discount rate produced by his own weighted average cost of capital calculation, the Target Price would have been reduced by 10%, to $45. In addition, if Grubman had used the then-current average cost of debt, the Target Price would have been reduced by more than 30%, to the mid-$30s. As explained further below, Grubman drafted a report for publication on April 6, 2001, that would have lowered the Target Price to $1. However, because of Salomon's investment banking activities with Winstar, the report was not published and the Target Price remained at $50.

In various private communications, Grubman highlighted risks of investing in Winstar and expressed doubts about Winstar's ability to obtain funds. Those risks and doubts were never disclosed to the investing public.

On April 4, 2001, Salomon issued a report entitled "Don't Panic – Emerging Telecom Model is Still Valid (MORE DETAILS)." The report was published without any references to Winstar because of Salomon's investment banking activities with Winstar. The April 3 draft, which was not publicly disseminated, disclosed risks about investing in Winstar that were not publicly disclosed in previous reports. The April 3 draft report disclosed for the first time:

> "pressing liquidity issues"
>
> the need to "shor[e] up [Winstar's] capital structures"
>
> "an unfortunate situation where its overleveraged balance sheet and dependency on [Lucent] has overwhelmed what had been one of the better operational stories in the CLEC space over the last 2 years"
>
> "its funding gap to free cash flow positive is the primary issue given the credit issues at [Lucent], which we had assumed would provide WCII with $400 million of vendor financing during 2001, and as WCII's stock continues to reach new lows each day"
>
> "as the stock continued its downward spiral, its opportunities for sources of funding has diminished and the stock remains speculative"

On April 18, 2001, Grubman sent the following e-mail to a registered representative privately suggesting that investing in Winstar was risky but that investors could make money on another stock in their "basket":

> . . . I got shutdown on WCII otherwise we would have adjusted the Target Price. To be honest we would hagve [*sic*] stayed iwth [*sic*] the stock but you know my attitude is always to have a basket of aggressive names with the notion that the one of ten who makes it (a la MCI a generation ago) will create value which dwarfs the unfortunate loss of value elsewhere[.]

While this "basket" approach was referred to in the March 2001 Telecom Industry reports discussed below, it was not disclosed to the public in any of the Winstar-specific reports. Those reports consistently awarded Winstar a "Buy" rating, Salomon's highest.

An April 17, 2001, e-mail from Grubman to the Salomon analyst who assisted Grubman in drafting the Winstar reports indicated that they had not performed sufficient research on Winstar:

> After spending evening with [an institutional client] it is clear the buyside scours 10Ks et al which is why he always thought WCII was a fraud thinks [another CLEC] is fake and discovers [that another telecommunications company] owes $600 million in unpaid cap ex. Point is we should have [our junior analyst] do this and really dig dirt. Also we do really need to examine true life cycle ROIC [return on invested capital] for our stocks taking into account sunk costs.

Grubman stated in an April 20, 2001 e-mail: "Don't get me wrong I should be held accountable for WCII." In a May 18, 2001, e-mail, he stated: "If anything the record shows we support our banking clients too well and for too long."

THE PRICE TARGET

During 2001, as the price of Winstar's stock plummeted, Grubman maintained a Target Price for Winstar of $50 per share. The following list shows the dates of Salomon's Winstar research reports and the price of Winstar on those dates:

Report Date	Target Price	Actual Price	Recommendation
1/25/01	$50	$17	Buy
2/23/01	$50	$10.0625	Buy
2/27/01	$50	$13.125	Buy
3/9/01	$50	$9.218	Buy
3/15/01	--	$7.625	Buy
3/21/01	--	$2.513	Buy
4/3/01 (Never Issued)	--	$0.31	Buy
4/6/01 (Never Issued)	$1.00	$0.40	Neutral
4/17/01	Suspended	$0.14	Underperform

The Winstar reports written by Grubman stated that a discounted cash flow (DCF) analysis had been used to determine the Winstar Target Price. When using a DCF analysis to compute the theoretical value per share, analysts must estimate a company's cash flow for a given number of years into the future, estimate the additional value of the company at the end of that period (using a terminal multiple) and then discount those values back to the present using a discount rate. The discount rate is derived from, among other things, the weighted average cost of capital which is a function of the cost of debt and cost of equity.

From February 23, 2001 forward, the Winstar research reports written by Grubman failed to have a reasonable basis for the Winstar Target Price and failed to disclose material information regarding the Target Price. Moreover, as described below, given factors such as Winstar's deteriorating stock price, its funding gap, its overleveraged balance sheet, its dependency on Lucent, and the bleak capital markets environment, the Target Price had no reasonable basis.

THE 2001 WINSTAR REPORTS

The January 25 and February 23, 2001 Reports:

The January 25, 2001, report was titled "Believe Competitor Report Unfounded; See Weakness As Buying Opportunity." As noted above, this report criticized an analyst from another firm who had stated that Winstar "may not be as well funded as many believe." The report stated that the other analyst's comments were "highly irresponsible." With regard to funding, the report discussed financing that Winstar had arranged in November 2000, and concluded that those arrangements "should fund them into 2002."

On February 23, 2001, when the market price was approximately $10, Grubman wrote two versions of a report titled "Reiterate Solid Outlook & Funding; View Weakness as Buying Opp." The report was written in advance of Winstar's anticipated February 27 fourth quarter 2000 earnings announcement. The report stated that "we wanted to remind investors that Winstar is currently funded into 2002 . . . as we believe the company continues to suffer from general market concerns over its funding situation and potentially onerous interest payments on vendor financing." In the report, Grubman "reiterat[ed] our solid outlook" for Winstar and "the company's fully funded position," stating that Winstar "remains one of our favorite names in the CLEC sector, and we believe it is dramatically oversold at current levels. We would use any weakness to be aggressive buyers. . . ."

The January 25 and February 23 reports failed to disclose any risks of investing in Winstar stock. In particular, the reports failed to disclose any risks related to funding, including Winstar's need to raise additional funds, when it would need to do so, how much additional funds would be needed, and the risk that Winstar might not be able to raise the necessary funds.

<u>The February 27, 2001 Report</u>:

The February 27, 2001, report disclosed for the first time that Winstar would need to raise $1 to $1.5 billion. However, in doing so, Grubman downplayed the significance of the funding gap. The report was titled "Q4 Beats Expect; Pervasive Connectivity Drives Growth & Profitability" and it contained effusive praise for Winstar, including statements that Winstar:

> "reported very strong 4Q'00 results";
>
> "continues to perform above expectations and in fact, is driving metrics that are quickly becoming the accepted industry standard";

> has a "facilities-based footprint unmatched in terms of expansiveness of network versus the vast majority of the industry"; and
>
> "continues to perform superbly."

While the report announced, for the first time, that Winstar had funding needs, it omitted any discussion of the risks associated with a need to raise such a large amount of capital:

> "[W]e all understand that WCII does need to raise $1.0-$1.5 billion at some point in 2H'02 in order to get them to free cash flow positive by 2004. We fully expect that if WCII's results continue to perform as they've been doing, there will be no issue with WCII being able to obtain needed external financing over the course of the next 4-5 quarters."

Grubman concluded by stating that: "We continue to view WCII as one of our top core holdings in the CLEC space and we would be aggressive buyers of the stock." The report failed to disclose any risks of investing in Winstar stock, including the risks associated with the need to raise additional funds.

<u>The March 9, 2001 Report</u>:

The March 9, 2001 report was titled "Contrary to Other Opinions, We Believe WCII has Ability to Finance Debt." As described above, another analyst had expressed concerns about Winstar's funding. In response, Grubman stated that "We are reiterating our belief that WCII is well funded into 2002 in response to a press release from [another analyst] who has concerns about WCII's funding." Grubman repeated the statement that he had made previously regarding Winstar's need for additional funds and its ability to obtain that capital:

> "It is not a secret that WCII needs to raise $1.0-$1.5 billion in order to get to free cash flow positive by 2004. We fully expect that operationally if WCII's continue [*sic*] to perform as they've been doing, there will be no issue with WCII being able to obtain needed external financing over the course of the next 4-5 quarters."

The other analyst had written that the “distressed prices [of Winstar’s high yield debt] imply serious default concerns despite the bonds being subordinated only to the credit facility.” According to the other analyst, Winstar’s “high-yield junk bonds” were at that time trading at yields exceeding 22%. Moreover, Winstar’s specific bond issues were then trading at yields between 20% to 58%. Grubman replied by stating “we do not believe that there are serious default concerns.”

The other analyst, according to Grubman, had written that Winstar had “’toxic’ preferreds that are convertible into an undeterminable and unlimited amount of common shares based on the stocks’ future market price, and thus, dilutes the current holdings of the common stockholders.” Grubman replied that this analysis was “simply inaccurate. One can estimate the number of shares issued from the convertible preferred stocks based on the terms of each of the preferreds which we detail below.” The report asserted that the Series A preferred stock matured on February 11, 2002, and was convertible at a price of $16.67 per share, which meant that the company would have to issue roughly 7.2 million shares.

By March 12, 2001, Grubman knew or should have known that it could not be determined how many shares of common stock would need to be issued as a result of the conversion of the preferred stock because it was impossible to know what the price of the common stock would be in February 2002. However, Grubman never issued a report to correct the previous false and misleading statements or to explain accurately the nature of the dilutive effect of the Series A preferred stock.

The March 9, 2001 report concluded by stating: "We believe that WCII remains well funded into 2002, and that the funding concerns of the [other analyst] are misguided. . . . WCII continues to remain one of our favorite names in the CLEC space, and would be buyers at these levels – nearly their 52 week low."

The March 9, 2001 report made inaccurate statements regarding the dilutive effect of the Series A preferred stock and failed to disclose any risks of investing in Winstar stock, including risks related to funding, the risk that Winstar might not be able to raise the necessary funds, and the risks of bankruptcy.

<u>The March 2001 Telecom Industry Reports</u>:

Grubman issued two versions of a "State of the Union" report on the telecommunications industry titled: "Telecom: a Growth Industry, but Structure Needs to be Worked Through." One version was dated March 15 when Winstar's price was approximately $7.60 per share; another slightly different version was dated March 21, when Winstar's price per share was approximately $2.50. The later version also included the title: "Grubman's State of the Union – Does he ever stop talking?"

The reports highlighted "A basket of [Winstar and 3 other firms as] the four CLECs we truly believe will be long term survivors and players in this industry." Three of the four CLECs subsequently filed for bankruptcy protection.

The reports acknowledged, for the first time, that Winstar was "over leveraged" but nonetheless stated that Winstar had assets and business that "at current levels, are not being valued appropriately and should result in value creation over the next 12-18 months." The reports failed to disclose any risks of investing in Winstar stock. In particular, the reports failed to disclose any risks related to funding, including the risk that Winstar might not be able to raise the funds.

<u>The April 3, 2001 Report</u>:

On April 3, 2001, Grubman proposed publishing an industry report titled "Don't Panic – Emerging Telecom Model is Still Valid (MORE DETAILS)." At that time, Winstar's price per share was approximately $0.31. The report stated that Winstar and one other firm (which has also subsequently declared bankruptcy) "have management teams that are likely to find solutions that allow these companies to continue to grow their businesses while shoring up their capital structures." Although nothing had changed with regard to Winstar's business or financing arrangements from the time of the issuance of the other reports described above, this report disclosed for the first time the following risks:

> "Winstar has gotten into an unfortunate situation where its overleveraged balance sheet and dependency on [Lucent] has overwhelmed what had been one of the better operational stories in the CLEC space over the last 2 years. . . . However, its funding gap to free cash flow positive is the primary issue given the credit issues at [Lucent], which we had assumed would provide WCII with $400 million of vendor financing during 2001, and as WCII's stock continues to reach new lows each day. For WCII, as the stock continued its downward spiral, its opportunities for sources of funding has diminished and the stock remains speculative."

On April 4, the report was published without any references to Winstar. References to Winstar were deleted because of Salomon's investment banking activities with Winstar.

The April 5, 2001 Report:

On April 5, 2001, Grubman published a global alert with the title "WCII announces plan to halt network expansion and reduce workforce headcount." The report stated:

> "Given current market conditions, we believe this is a step in the right direction in addressing WCII's funding gap; however, until the company discloses the details surrounding this plan (ie. costs savings, effect on growth rates, etc.), we continue to believe that WCII's funding gap remains a risk and the stock remains a speculative investment."

Grubman had not previously disclosed that the funding gap was a risk.

The April 6, 2001 Report:

On or about April 6, 2001, Grubman proposed publishing a report titled "WCII: Halts Network Expansion & Reduces Workforce; Lowering Target." The report would have downgraded the stock from Buy to Neutral and lowered the Target Price from $50 to $1 per share. At that time, the price of Winstar's stock was approximately $0.44 per share. Grubman wrote the report as a reaction to Winstar's announcement on the previous day that it was going to layoff approximately 44% of its workforce. The report disclosed that "we continue to believe that the funding gap remains a risk," although, other than the April 5 report, Grubman had not previously disclosed that Winstar's need for additional funding was a "risk." Because of Salomon's investment banking activities with Winstar, the April 6 note was not published.

The April 17, 2001 Report:

On April 17, 2001, Grubman wrote a report downgrading Winstar from a Buy rating to Underperform and withdrawing the Target Price. The report followed Winstar's announcement that it had not made an interest payment on a senior debt, that Lucent had declared it in default of a credit facility, that it had hired a firm to advise it on restructuring, that it was considering reorganizing under Chapter 11, and that it was not going to file its Form 10-K on a timely basis. The report noted that Winstar's "funding gap may prove to be an insurmountable obstacle that could drive WCII to Chapter 11."

THE "BLAST" VOICEMAIL MESSAGE

As part of his job, Grubman created blast voicemail messages for distribution to certain clients of Salomon.

In a February 23, 2001, blast voicemail message regarding Winstar, Grubman stated the following:

> Regarding their funding, their liquidity and all that, okay, first, these guys have about $600 million in the bank, $900 million is available for credit, and you will get their balance sheet, which was restructured about a year ago.

Winstar's financial situation on February 23, 2001, was not, in fact, as described in Grubman's blast voice mail message. The information contained in the voicemail was based on Winstar financial statements that were almost five months old as of February 23, 2001. Winstar's cash position did not remain static and would have deteriorated given Winstar's cash burn rate. In fact, according to the financial model for Winstar created by Grubman, the company was projected to have cash of approximately $396 million as of February 23, 2001.

<u>FIRST VIOLATION</u>
MISLEADING STATEMENTS AND OMISSIONS
REGARDING WINSTAR
Violations of Conduct Rules 2110,
2210(d)(1), and 2210(d)(2)

The reports written by Grubman concerning Winstar from January 25, 2001 until Grubman downgraded the stock on April 17, 2001, were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts regarding Winstar's business prospects and the risks of investing in Winstar, including funding risks, the risks of bankruptcy and risks regarding the dilutive effect of the Series A preferred stock. In addition, the reports contained exaggerated, unwarranted or misleading statements or claims about Winstar, and opinions for which there was no reasonable basis, while omitting material facts or qualifications causing the reports to be misleading. The treatment of risks and potential benefits in the reports was not adequately balanced.

By virtue of this conduct, Grubman violated Conduct Rules 2110, 2210(d)(1) and 2210(d)(2).

<u>SECOND VIOLATION</u>
UNREASONABLE PRICE TARGET
Violations of Conduct Rules 2110,
2210(d)(1) and 2210(d)(2)

Grubman's reports containing a Target Price of $50 per share that were issued from February 23, 2001 until Grubman downgraded the stock on April 17, 2001, were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts regarding Winstar's Target Price. In addition, those reports contained exaggerated, unwarranted or misleading statements or claims about Winstar's Target Price, and opinions for which there was no reasonable basis, while omitting material facts or qualifications causing the Target Price to be unreasonable.

By virtue of this conduct, Grubman violated Conduct Rules 2110, 2210(d)(1) and 2210(d)(2).

THIRD VIOLATION
JUST AND EQUITABLE PRINCIPLES OF TRADE AND STANDARDS OF COMMERCIAL HONOR
Violations of Conduct Rule 2110

As described above, Grubman publicly recommended Winstar while privately expressing doubts and discussing risks. Such actions were not consistent with just and equitable principles of trade and high standards of commercial honor.

By virtue of this conduct, Grubman violated Conduct Rule 2110.

FOURTH VIOLATION
MISREPRESENTATIONS AND OMISSIONS IN BLAST VOICEMAIL
Violations of Conduct Rules 2110, 2210(d)(1) and 2210(d)(2)

Grubman's statement in the February 23, 2001, blast voicemail message regarding Winstar's "$600 million in the bank" was not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts regarding Winstar's financial situation. In addition, the blast voicemail message contained exaggerated, unwarranted or misleading statements or claims about Winstar's financial situation, and opinions for which there was no reasonable basis, while omitting material facts or qualifications causing the statement to be unreasonable. The treatment of risks and potential benefits in connection with the Winstar's financial situation was not adequately balanced.

By virtue of this conduct, Grubman violated Conduct Rules 2110, 2210(d)(1) and 2210(d)(2).

Based on these considerations, the sanctions hereby imposed by the acceptance of the Offer are in the public interest, are sufficiently remedial to deter Respondent from any future misconduct, and represent a proper discharge by NASD, of its regulatory responsibility under the Securities Exchange Act of 1934.

SANCTIONS

It is ordered that the following sanctions be imposed upon Grubman:

1. A bar.

2. A payment in the amount of $15,000,000. Of the total amount paid, $7,500,000 constitutes a fine and $7,500,000 constitutes disgorgement.

3. The total amount to be paid shall be reduced by a payment of $7,500,000 to the Office of the New York Attorney General pursuant to a settlement entered into with that Office. Grubman shall pay the remaining amount of $7,500,000 pursuant to the provisions of the Final Judgment entered into in connection with the related action between Grubman and the Commission ("the Final Judgment"). The payment to the Court shall be administered pursuant to the provisions of the Final Judgment.

4. Respondent agrees that he shall not seek or accept, directly or indirectly, reimbursement or indemnification, including but not limited to payment made pursuant to any insurance policy, with regard to all amounts that Respondent shall pay pursuant to Section II of the Final Judgment, regardless of whether such amounts or any part thereof

are added to the Distribution Fund Account or otherwise used for the benefit of investors. Respondent further agrees that he shall not claim, assert, or apply for a tax deduction or tax credit with regard to any federal, state, or local tax for any penalty/fine amounts that Respondent shall pay pursuant to Section II of the Final Judgment, regardless of whether such penalty/fine amounts or any part thereof are added to the Distribution Fund Account or otherwise used for the benefit of investors. Respondent understands and acknowledges that these provisions are not intended to imply that NASD would agree that any other amounts Respondent shall pay pursuant to the Final Judgment may be the basis for any tax deduction or tax credit with regard to any federal, state, or local tax.No portion of the total amount paid of $15,000,000 may be indemnified.[4]

The sanctions imposed herein shall be effective on a date set by the Association staff. A bar or expulsion is effective upon service of this disciplinary action.

SO ORDERED.

NASD

By:________________________
Roger B. Sherman
Director, Department of Enforcement
on behalf of the Director of ODA, pursuant to delegated authority

[4] These sanctions relate to and resolve all NASD matters involving Grubman, including AWC No. CAF030027.