

**AWARD**  
**NASD Dispute Resolution**

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In the Matter of the Arbitration Between

Name of Claimants

Joseph M. and Karen J. Stockhausen

and

04-03093  
Chicago, Illinois

Name of Respondents

Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a  
Smith Barney  
Jack B. Grubman  
Michael Jay Grace  
Philip L. Spartis

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Nature of the Dispute: Customer vs. Member and Associated Persons.

**REPRESENTATION OF PARTIES**

Joseph M. and Karen J. Stockhausen ("**Claimants**") were represented by Michael Wilner, Esq. and Lori A. Fanning, Esq., Miller Faucher and Cafferty LLP, Philadelphia, Pennsylvania and Chicago, Illinois respectively.

Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney ("**Respondent Smith Barney**"), Jack B. Grubman ("**Respondent Grubman**") and Michael Jay Grace ("**Respondent Grace**") hereinafter referred to as ("**Respondents**") were represented by Lawrence D. Ross, Esq. and Christopher M. Galusha, Esq., Bressler, Amery & Ross, P.C., Morristown, New Jersey. At the time of filing the Motion to Dismiss Statement of Claim and Answer to the Statement of Claim, Respondents were represented by Nancy E. Nunan, Esq. and Jennifer M. Blunt, Esq., Kutak Rock LLP, Washington, D.C.

Philip L. Spartis ("**Respondent Spartis**") was represented by David Greenberger, Esq., Liddle & Robinson, New York, New York.

**CASE INFORMATION**

The Statement of Claim was filed on or about April 28, 2004. Submission Agreement of Claimants Joseph M. and Karen J. Stockhausen was signed on April 23, 2004.

Motion to Dismiss Statement of Claim and Answer to the Statement of Claim was filed by Respondents Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney, Jack B. Grubman and Michael Jay Grace on or about February 8, 2005. Respondents Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney, Jack B. Grubman and Michael Jay Grace Motion to Strike Claimants' Statement of Claim for Failure to Timely Provide Production was filed on or about March 24, 2006. Submission Agreement of Respondent Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney was signed on March 4, 2005 by Jeffrey L. Friedman.

### **CASE SUMMARY**

Claimants asserted the following causes of action: Direct Liability and Respondeat Superior Liability; Negligence; Breach of Express and Implied Contractual Duties; Breach of Fiduciary Duties; Aiding and Abetting Breach of Fiduciary Duties; Fraudulent Misrepresentations and Omissions; and Violation of Illinois and Georgia Law

Claimants also summarized their claims as follows:

As a result of SSB marketing and assurances, the Stockhausens took comfort in engaging the services of financial consultants specially trained and experienced in investment strategies for valuable stock options and backed by the support of telecommunications analyst Jack Grubman and the resources of a large, full-service Wall Street financial firm. The Stockhausens understood that SSB was committed to assuming responsibilities and providing services as described on SSB's website:

- As your Financial Consultant, it is my responsibility to do much more than just take orders to buy or sell securities.
- I will spend the time to understand your financial concerns and work in partnership with you to develop a customized investment program that best meets your needs.
- In today's fast-paced world, few people have the time or resources to dedicate to managing their investments.
- I will help you understand and manage the risks that accompany investing.
- I will aim to establish a long-lasting client relationship with you through maintaining the highest standards of quality, professionalism and integrity.
- It's all part of Salomon Smith Barney's long-term commitment to our clients.

In view of the importance of these issues to the Stockhausens, they had an enormous need for that kind of diligent professional service and long-term commitment. Instead, SSB:

- disregarded its client responsibilities and pursued its own investment banking fee agenda;
- made no bona fide effort to understand the Stockhausens' goals and instead followed a scripted one size fits all anti-diversification approach of "don't sell WorldCom stock";

- failed to develop "a customized investment program" and urge Mr. Stockhausen to consider diversification across market sectors;
- failed to ensure that the Stockhausens identified and understood the enormous uncompensated investment risk that accompanied their undiversified position in a single equity with no stop loss protection or other hedging strategy and failed to ensure that those risks were eliminated or reduced;
- repeatedly recommended continued gross concentration of assets while understating the volatility and investment risk and misrepresenting that aggressive overweighting in WorldCom embodied only moderate investment risks;
- urged the Stockhausens to forbear from diversifying and liquidating WorldCom stock through relentless promotion and emphasis on tainted and unrelenting inflated stock analysis of WorldCom and of the telecommunications sector tainted by massive undisclosed institutional and individual conflict of interest and corruption of shocking proportions.

SSB's recommendations over months and years against liquidation of the value of the Stockhausens' WorldCom options and the concentrated position held in WorldCom stock after March 2000 were grossly unsuitable. Respondents disregarded the rights of Mr. Stockhausen in favor of their own conflicting financial incentives. SSB and its representatives put their personal financial interests ahead of the rights and interests of their trusting client. The breach of loyalty was not an isolated event. It was relentless and pervasive.

At no time did SSB ever act to cure the harm. Respondents never urged that the Stockhausens should sell any WorldCom stock. SSB ratings on the risk of investing in WorldCom held fast at "moderate" rather than warn of the true volatility and risks embodied by WorldCom. SSB failed to urge the Stockhausens to assume a more sensible asset allocation strategy and diversify across market sectors and out of a single volatile equity. After expressly touting its expertise and special services and benefits for WorldCom optionees, it is indefensible that SSB never even recommended any strategy to hedge against downside loss from this super concentrated position. Instead, SSB's unbridled promotion of holding a concentrated investment in WorldCom continued unabated - - even as WorldCom's market prices eroded and then collapsed and it was arranging secret loan bailouts for Mr. Ebbers.

Motivated by stunning corruption and pervasive conflicting interests in generating hundreds of millions of dollars in investment banking fees, the SSB/Grubman Wall Street cheerleading for WorldCom grossly understated the volatility and investment risk of aggressive holdings in WorldCom that SSB urged, while exaggerating the underlying value and economic fundamentals. In addition to unsuitable recommendation to purchase or sell, recommendations to hold a security (forbear from selling) are actionable. *See, e.g. AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202 (2d Cir. 2000) (finding liability for

misrepresentation based on inducing the plaintiff to continue to hold stock); *Marbury Mgmt. Inc. v. Kohn*, 629 F. 2d 705 (2d Cir. 1980) (broker and firm liable for fraud inducing non-action); *Small v. Fritz Cos.*, 132 Cal. Rptr. 2d 490 (Cal. April 07, 2003) (finding viable claims for fraud or negligent misrepresentation that induces forbearance to refrain from selling stock); *Continental Insurance Co. v. Joseph Mercadante*, 222 A.D. 181, 183, 225 N.Y.S. 488 (N.Y.A.D. 1 Dept. 1927) (recognizing claim for "fraud in inducing, not the purchase of the bonds, but their retention after purchase").

In a one-two punch of SSB greed and breach of loyalty, the gross misconduct and lack of broker supervision at the retail brokerage level made Mr. Stockhausen even more vulnerable to great losses from SSB's pervasive Wall Street fraud. SSB's unsuitable recommendations were made without fair disclosure of facts that were material to the Stockhausens' investment decisions. Among other grave disclosure failures and breaches of its duty of candor, SSB did not mention the enormous uncompensated investment risk that accompanied the aggressive over weighting SSB urged. SSB omitted mention of the massive and conflicting financial dealings material to the Stockhausens' decision and views of SSB and Mr. Grubman as an objective stock analyst.(footnote deleted)

The Stockhausens did not know that there were virtually no circumstances or conditions under which Respondents would back away from their aggressive promotion of WorldCom, Rhythm NetConnections or other stocks of SSB's telecom banking clients. If SSB had been candid about these material facts and its massive conflicts, the Stockhausens never would have relied on SSB/Grubman reports and analysis and instead would have sold his stock and diversified his portfolio.

Respondents denied the allegations set forth in the Statement of Claim. Respondents specifically stated

Completely disregarding the significance of WorldCom, Inc.'s ("WorldCom") massive internal accounting fraud, Claimants now seek to hold Smith Barney responsible for Claimants' own decision to delay exercising Mr. Stockhausen's vested options, the purported delay in their subsequent decision to exercise and sell to cover, while holding some of Mr. Stockhausen's options WorldCom shares, in the non-discretionary Smith Barney account. In addition, while it is not completely clear from the Statement of Claim, Claimants also further appear to seek too impose liability on Smith Barney for shares they held in Mr. Stockhausen's 401k account, an account that was held at Merrill Lynch, and outside Smith Barney. Claimants also disregard that Mr. Stockhausen was employed by WorldCom, Inc. in the finance area, first in accounting MFS Telecom Corp., and then in what he terms "project planning," but what Smith Barney's records show to be a Finance Analyst, at the same time his fellow employees in his own department were beginning to perpetrate their fraud on the public. Finally, Claimants ignore the fact that prior to opening any account at Smith Barney, Mr. Stockhausen exercised and sold more than 8,000 WorldCom options, netting almost

\$176,000 in after-tax dollars, taking the proceeds by check. In addition, after Claimant opened his account with Smith Barney, he exercised and sold (not exercised and sold to cover) an additional 33,200 options, netting over \$886,000 after tax dollars, taking the proceeds either by check or by a deposit directly into their Smith Barney account, for a total of over \$1,000,000.00 acquired as a result of exercising Mr. Stockhausen's WorldCom options.

Rather than accepting responsibility for their own investment decisions, Claimants now spuriously allege that they followed the representations and recommendations of Jack Grubman, Smith Barney and Smith Barney financial consultants in "delaying the exercise of his options and then avoid[ing] or at least minimizing any necessary sale of WorldCom stock," (Claim, p. 3), thus failing to sell their shares of WorldCom as their value declined to cents on the dollar. Claimants, however, are not only misrepresenting what they did with Mr. Stockhausen's WorldCom stock options, but were well aware that their account at Smith Barney was non-discretionary and that they alone were responsible for making the investment decisions in that account. Further, Claimants understood that they alone controlled the 401K account outside of Smith Barney, and that Smith Barney had no responsibility for their independent decisions in that account.

Claimants' decision to [sic] as to the time to exercise Mr. Stockhausen's WorldCom options and to either sell or hold the shares, was entirely independent of Smith Barney and its financial consultants. Claimants came to Smith Barney with Mr. Stockhausen's WorldCom options and stock already in place. Smith Barney and its financial consultants never recommended that Claimants buy shares of WorldCom, exercise WorldCom options, or hold concentrated positions in that company. Moreover, Claimants watched the tremendous appreciation of WorldCom's value during the 1990's, and watched the commensurate increase in their own wealth, based on the value of their options. That fact, combined with an employee culture at WorldCom that encouraged its employees to hold, rather than sell, shares of the company's stock, guided Claimants' decision to delay the exercise of some of Mr. Stockhausen's options, and to hold some of their WorldCom stock.

Smith Barney respectfully submits that Claimants alone are responsible for their alleged "losses." Their meritless allegations will fail for at least the following reasons: First, Claimants alone chose to delay the exercise of Mr. Stockhausen's options, and the sale of their WorldCom shares in their Smith Barney account until the positions had declined significantly. The evidence will demonstrate that Claimants often effected WorldCom transactions in their Smith Barney account that were contrary to Smith Barney's ratings and opinions. Second, Claimants completely controlled their accounts outside of Smith Barney. Any delay in selling their WorldCom shares in those accounts is not due to Smith Barney's conduct. Third, the "losses" in Claimants' Smith Barney account were due to historic market declines, not to any alleged wrongdoing by Smith Barney and its representatives. Finally,

Claimants' "losses" were caused by WorldCom's massive internal fraud perpetrated upon the public, of which Smith Barney had no prior knowledge.

### **RELIEF REQUESTED**

Claimants requested an award against all of the Respondents, jointly and severally, for:

Compensatory damages pursuant to Illinois law (estimated at \$500,000.00); exemplary and punitive damages pursuant to the Restatement (Second) of Torts Section 908(2) or, in the alternative, treble damages pursuant to the Illinois Consumer Fraud Act, 815 ILCS 505/1, *et seq.*; disgorgement of all fees and profits earned by SSB or any of its agents; prejudgment interest at the maximum rate permitted by Illinois law; the cost of this arbitration, expert fees, and other disbursements and costs necessary to bring this action together with reasonable attorneys' fees pursuant to the NASD Code, the Illinois Consumer Fraud Act, 815 ILCS 505/1, *et seq.*, and other applicable law; and such other relief, including equitable relief, as determined to be just by the Panel.

Respondents requested that Claimants' claims be dismissed, that Respondents be awarded its fees and costs incurred in defending this action and that the Panel award any further relief as it deems just and proper.

### **OTHER ISSUES CONSIDERED & DECIDED**

Respondents Jack B. Grubman and Michael Jay Grace did not file with the NASD Dispute Resolution properly executed submissions to arbitration but are required to submit to arbitration pursuant to Rule 10301 of the NASD Code of Arbitration Procedure (the "Code") and having answered the claim, and having appeared through counsel at the hearing are bound by the determination of the arbitration panel on all issues submitted.

On November 4, 2004, Claimants withdrew the claims asserted against Philip L. Spartis without prejudice.

The parties have agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered. In either case, the parties have agreed to receive conformed copies of the award while the original(s) remain on file with the NASD Dispute Resolution (the "NASD").

### **AWARD**

After considering the pleadings, the testimony, and the evidence presented at the hearing, the undersigned arbitrators have decided in full and final resolution of the issues submitted for determination as follows:

1. Respondents Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney, Jack B. Grubman and Michael Jay Grace are hereby jointly and severally liable for and shall pay to Claimants Joseph M. and Karen J. Stockhausen the sum of \$325,000.00 (**Three Hundred Twenty Five Thousand Dollars and No Cents**) as compensatory damages.
2. Interest at the rate of 9% per annum is awarded on the above stated sum from April 28, 2004 to May 2, 2006.
3. Respondents Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney, Jack B. Grubman and Michael Jay Grace are hereby jointly and severally liable for and shall pay to Claimants Joseph M. and Karen J. Stockhausen the sum of \$97,500.00 (**Ninety Seven Thousand Five Hundred Dollars and No Cents**) as attorneys' fees. The undersigned arbitrators find that they have the authority to make this award of attorneys' fees under the terms of the contract between the parties.
4. Respondents Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney, Jack B. Grubman and Michael Jay Grace are hereby jointly and severally liable for and shall pay to Claimants Joseph M. and Karen J. Stockhausen the sum of \$29,863.64 (**Twenty Nine Thousand Eight Hundred Sixty Three Dollars and Sixty Four Cents**) as costs.
5. That to the extent not specifically awarded or otherwise provided for above, all other claims and requests for relief by any party hereto are denied with prejudice.
6. Other than the Forum Fees noted below, the parties shall each bear all other costs and expenses incurred by them in connection with this proceeding, including but not limited to attorneys fees, not specifically awarded or otherwise provided for above.

#### **FEES**

Pursuant to the Code, the following fees are assessed:

##### **Filing Fees**

NASD Dispute Resolution will retain or collect the non-refundable filing fees for each claim:

Initial claim filing fee = \$300.00

##### **Member Fees**

Member fees are assessed to each member firm that is a party in these proceedings or to the member firm(s) that employed the associated person(s) at the time of the event(s) giving rise to the dispute. In this matter, the member firm(s) is Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney.

Member surcharge	\$	1,700.00
Pre-hearing process fee	\$	750.00
Hearing process fee	\$	2,750.00
Total Member Fees	\$	5,200.00

### **Forum Fees and Assessments**

The Arbitration Panel assesses forum fees for each hearing session conducted. A hearing session is any meeting between the parties and the arbitrator(s), including a pre-hearing conference with the arbitrator(s), that lasts four (4) hours or less. Fees associated with these proceedings are:

1	Pre-hearing session(s) with Panel	x	1,125.00	\$	1,125.00
	March 7, 2005	1	session		
12	Hearing sessions	x	1,125.00	\$	13,500.00
	March 27, 2006	2	sessions		
	March 28, 2006	2	sessions		
	March 29, 2006	2	sessions		
	April 17, 2006	2	sessions		
	April 18, 2006	2	sessions		
	April 19, 2006	2	sessions		
	Total Forum Fees			\$	14,625.00

The Arbitration Panel has assessed \$14,625.00 of the forum fees jointly and severally to Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney, Jack B. Grubman, and Michael Jay Grace.

### **Fee Summary**

Claimants, Joseph M. and Karen J. Stockhausen are jointly and severally liable for:

Initial Filing Fee	= \$	300.00
Total Fees	= \$	300.00
<u>Less payments</u>	= \$	-1,425.00
Balance to be refunded by NASD Dispute Resolution	= \$	-1,125.00



NASD Dispute Resolution  
 Arbitration No. 04-03093  
 Award Page 9 of 9

Respondent, Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney is liable for:

Member Fees	= \$	5,200.00
Total Fees	= \$	5,200.00
Less payments	= \$	-7,650.00
Balance applied to fees below	= \$	-2,450.00

Respondents, Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney, Jack B. Grubman, and Michael Jay Grace, are jointly and severally liable for:

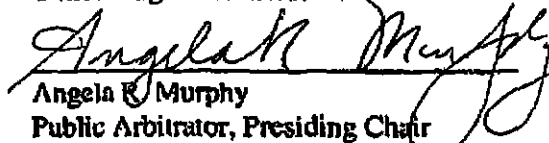
Forum Fees	= \$	14,625.00
Total Fees	= \$	14,625.00
Less payments	= \$	-2,450.00
Balance Due NASD Dispute Resolution	= \$	12,175.00

All balances are due to NASD Dispute Resolution

### ARBITRATION PANEL

Angela R. Murphy - Public Arbitrator, Presiding Chair  
 Irving A. Chesler, Esq. - Public Arbitrator  
 Doris H. Geck - Non-Public Arbitrator

Concurring Arbitrators:

  
 Angela R. Murphy  
 Public Arbitrator, Presiding Chair

5-5-06  
 Signature Date

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 Irving A. Chesler, Esq.  
 Public Arbitrator

\_\_\_\_\_  
 Signature Date

\_\_\_\_\_  
 Doris H. Geck  
 Non-Public Arbitrator

\_\_\_\_\_  
 Signature Date

5/5/06  
 Date of Service (For NASD office use only)

NASD Dispute Resolution  
 Arbitration No. 04-03093  
Award Page 9 of 9

Respondent, Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney is liable for:

Member Fees	= \$	5,200.00
Total Fees	= \$	5,200.00
<u>Less payments</u>	= \$	-7,650.00
Balance applied to fees below	= \$	-2,450.00

Respondents, Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney, Jack B. Grubman, and Michael Jay Grace, are jointly and severally liable for:

<u>Forum Fees</u>	= \$	14,625.00
Total Fees	= \$	14,625.00
<u>Less payments</u>	= \$	-2,450.00
Balance Due NASD Dispute Resolution	= \$	12,175.00

All balances are due to NASD Dispute Resolution

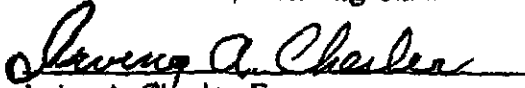
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Angela R. Murphy - Public Arbitrator, Presiding Chair  
 Irving A. Chesler, Esq. - Public Arbitrator  
 Doris H. Geck - Non-Public Arbitrator

Concurring Arbitrators:

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 Angela R. Murphy  
 Public Arbitrator, Presiding Chair

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 Signature Date

  
 Irving A. Chesler, Esq.  
 Public Arbitrator

5/4/06  
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 Doris H. Geck  
 Non-Public Arbitrator

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NASD Dispute Resolution  
Arbitration No. 04-03093  
Award Page 9 of 9

Respondent, Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith Barney  
is liable for:

Member Fees	= \$	5,200.00
Total Fees	= \$	5,200.00
<u>Less payments</u>	= \$	-7,650.00
Balance applied to fees below	= \$	2,450.00

Respondents, Citigroup Global Markets, Inc. f/k/a Salomon Smith Barney Inc. d/b/a Smith  
Barney, Jack B. Grubman, and Michael Jay Grace, are jointly and severally liable for:

Forum Fees	= \$	14,625.00
Total Fees	= \$	14,625.00
<u>Less payments</u>	= \$	-2,450.00
Balance Due NASD Dispute Resolution	= \$	12,175.00

All balances are due to NASD Dispute Resolution

**ARBITRATION PANEL**

Angela R. Murphy - Public Arbitrator, Presiding Chair  
Irving A. Chesler, Esq. - Public Arbitrator  
Doris H. Geck - Non-Public Arbitrator

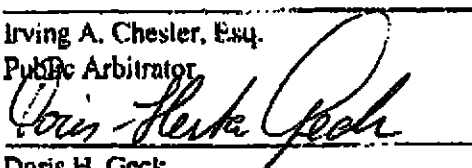
Concurring Arbitrators:

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Angela R. Murphy  
Public Arbitrator, Presiding Chair

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Public Arbitrator

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