

Salomon Used IPOs to Lure Investments From Executives

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Salomon Smith Barney regularly doled out shares of hot IPOs to the personal brokerage accounts of chief executives in a bid to win investment-banking business, according to a lawsuit filed by a former Salomon Smith Barney broker whose job was to help allocate those shares.

The suit, filed in Los Angeles Superior Court by David Chacon, alleges that former **WorldCom** Inc. CEO Bernard Ebbers was one of at least five CEOs that Salomon handed such "free money," allocating 350,000 shares of the initial public offering of Rhythms NetConnections Inc., which soared 229% on its first trading day in April 1999.

Mr. Ebbers's risk was as close to zero as it gets, the suit says, because Salomon didn't allocate the shares to Mr. Ebbers's account until after Rhythms Net's shares had begun trading and were up sharply. After Rhythms Net's newly issued stock quickly soared to about \$90, the suit says, Salomon called Mr. Ebbers and told him that shares of the dot-com company had been set aside for him at the IPO price of \$21. Mr. Ebbers took the stock and later sold it, Mr. Chacon says, reaping a \$16 million windfall.

Salomon, a unit of **Citigroup** Inc., strongly disputes the allegations. "We've examined the allegations and are confident they are without merit," Salomon said in a statement. "The timing and nature of his amended complaint contains gross factual inaccuracies." A lawyer for Mr. Ebbers didn't return calls for comment.

Mr. Ebbers -- who had a close working relationship with star Salomon analyst Jack Grubman -- wasn't alone, according to the suit. Joseph Nacchio, the ousted chairman of **Qwest Communications International** Inc.; James Crowe, chairman of **Level 3 Communications** Inc.; Stephen Garofalo, chairman and former CEO of **MetroMedia International Group** Inc.; and Clark McLeod, the former chairman of Level 3, are among the executives who received shares in sought-after IPOs -- and directed their firms' financing business to Salomon, according to the suit.

"Many of those shares were placed into these clients' accounts, after the stock had risen," according to the suit, which was amended from an early employment-discrimination claim. Mr. Chacon, 31 years old, says he was fired from Salomon in 2000 and now works at Credit Suisse First Boston, a unit of Credit Suisse Group.

A lawyer for Mr. Nacchio said that although his client received allocations in several IPOs, the allegations made by Mr. Chacon are "nonsense." And, he added, "there were no special relationships." In fact, the lawyer said, Salomon Smith Barney didn't advise Qwest on its purchase of U S West, the largest deal under Mr. Nacchio's watch. The transaction was completed in the summer of 2000.

Officials for Messrs. Garofalo and Crowe also didn't return calls. Mr. McLeod said he hadn't seen the suit and declined to comment. The executives were named in Mr. Chacon's suit but aren't listed as defendants.

Such alleged IPO "spinning" -- where securities firms silently allocate chunks of hot new stocks to the personal brokerage accounts they hold for corporate executives -- was temporarily rooted out four years ago, when regulators investigated the practice after disclosures by The Wall Street Journal.

But regulators never brought any charges -- the SEC ended its initial investigation last year, said people familiar with the matter -- and spinning revived in a big way during the later part of the technology-stock bubble. Getting IPO shares during the dot-com boom was akin to being handed a windfall, on paper at least. Thus, it was very difficult for most investors to get shares. Wall Street firms, which have great leeway in deciding who gets the shares, generally reserved much of the stock for their most-favored customers, typically wealthy investors and big mutual funds.

It is no news that underwriters make most of the shares in hot IPOs available not to the small investor but to institutions. But there is a critical difference: Spin shares don't go to the corporate customer itself -- they go to individuals at the corporation who are in a position to sway the company's decisions.

Indeed, the corporate executives who allegedly received IPO shares in their personal brokerage accounts all directed investment-banking business to Salomon. In the case of WorldCom, Salomon in October 1999 advised the firm on its merger with rival Sprint.

Such IPO practices can violate regulatory rules. The National Association of Securities Dealers requires investment banks to make a bona fide distribution of IPO shares and bars them from selling such shares to "any senior officer" of an "institutional-type account" who "may influence or whose activities directly or indirectly involve or are related to the function of buying or selling securities" for such institutional-type accounts.

Many securities firms are being investigated for conflicts involving their research analysts, as well as controversial lending to and relationships with troubled American corporations.

Mr. Chacon's allegations are also the focus of a congressional inquiry into alleged financial fraud on Wall Street, said people familiar with the matter. The IPOs that Mr. Chacon says he had knowledge of -- including those for Radware Ltd., Interwave Communications, Focal Communications, US LEC Corp. and others -- were granted to key corporate chiefs and spun for quick profits, according to the suit.

Salomon's relationship with Mr. Ebbers and WorldCom already has been under scrutiny. Just last week, two House members asked Salomon Smith Barney whether the Wall Street firm doled out hard-to-get shares of hot IPOs to top executives of WorldCom, including Mr. Ebbers, to curry favor with WorldCom. One focus of congressional interest, said people familiar with the request, is Rhythms Net.

The written query to Salomon came from Pennsylvania Democrat Paul E. Kanjorski and Connecticut Republican Christopher Shays. Dated a week ago Monday, it was addressed to Mr. Grubman, who testified recently at the House Financial Services Committee hearing investigating the massive earnings overstatement by WorldCom.

A Salomon spokeswoman said last week that the firm has received the representatives' letter, and "we are reviewing the request for information." Outlining the firm's policy on IPO allocations, she said, "the firm allocates IPO shares broadly among institutional and retail customers based on a variety of factors. To the extent any WorldCom executives had personal accounts at SSB, they, like other SSB individual clients, could have been able to seek IPO investments through their financial consultants, and shares in IPOs would have been allocated consistent with regulatory requirements and internal policies."

However, she said the firm couldn't comment on specific client relationships, client accounts or IPO allocations. But she added: "Neither the research department nor a specific analyst has responsibility for making allocations of IPOs."

Salomon and Mr. Grubman are also under the microscope of New York Attorney General Eliot Spitzer, who is investigating whether the firm and Mr. Grubman misled small investors with overly optimistic recommendations. And the NASD has launched a broad inquiry into the activities of Salomon's IPO-allocation practices, said people familiar with the matter.

When he was asked by Mr. Kanjorski during the congressional hearing whether Salomon had given or steered hot IPO shares to senior WorldCom executives under "friends and family" programs, Mr. Grubman's reply was vague: "I don't recall. I'm not saying 'no.' I'm not saying 'yes.'" Mr. Kanjorski responded, "For an analyst, brilliant as you are, you have a terrible recollection."