

## Salomon Used Special Accounts To 'Flip' CEOs' IPOs, Suit Says

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Wall Street firms bar small investors who receive IPO shares from quickly cashing them in. But Salomon Smith Barney, according to a former broker who is suing the firm, curried favor with corporate executives by directing hefty IPO allocations outside their personal accounts, allowing them to flip the shares for fast profits.

The broker, David Chacon, says in a previously disclosed lawsuit that the separate accounts allowed the Citigroup Inc. securities unit to enrich favored executives, who in return gave Salomon investment-banking business.

Salomon strongly denies the allegations and says its initial-public-offering allocations were entirely proper. A Salomon spokeswoman says Mr. Chacon isn't credible because he was fired after being "caught stealing commissions. He engaged in unauthorized trading and was fired for it." The Salomon spokeswoman says that his claims are "completely without merit," and that his complaint contains "gross factual inaccuracies."

Mr. Chacon's lawyer, Jeffrey Liddle, says there is no theft involved, and that a commission was simply put into the wrong account. He adds that Salomon didn't report the allegations against Mr. Chacon to regulators.

Like many other Wall Street firms, Salomon penalizes individual clients who quickly cash out of IPOs. The penalties, triggered when an individual sells anytime from the moment a new stock begins trading to as long as three months afterward, usually also result in the broker losing the commission on the transaction. The penalties are meant to minimize "flipping," as the practice of quickly selling IPO shares is known. Flipping can destabilize new stocks and irks companies that are issuing shares -- the last thing securities firms, hungry for future underwriting business, want.

But Mr. Chacon's suit, filed in a Los Angeles Superior Court, contends Salomon circumvented these rules for influential individual executives through "delivery vs. payment," or DVP accounts. These allowed Salomon to sell IPO shares for the executives' personal portfolios through separate corporate accounts, rather than personal trading accounts, and immediately realize IPO profits. (Wall Street firms routinely allow corporate accounts to flip IPO shares.) DVP accounts aren't intended for this purpose. Rather, they are used primarily by big institutional investors, allowing them to make payment on deliveries involving large stock trades, rather than paying up front.

If the DVP allegations are true, small investors were the losers, says John Coffee, a securities-law professor at Columbia University in New York. "When there is a hot market, the little guy is in about the same position if he asked for Super Bowl tickets," he says.

**The inability to cash out quickly can be costly: Many IPO stocks surge early, but a high proportion of IPOs perform poorly over the long haul, academic studies show. Thus, while corporate accounts are often allowed to cash out, smaller IPO investors are left holding the bag.**

Among the executives who received IPO shares from Salomon: Bernard Ebbers, former chief executive of WorldCom Inc.; Joseph Nacchio, ousted chairman of Qwest Communications International Inc.; James Crowe, chairman of Level 3 Communications Inc.; Stephen Garofalo, chairman of MetroMedia Fiber Networks; and Clark McLeod, the founder of McLeodUSA, the suit says. The suit didn't specify which executives used the DVP accounts, and Mr. Chacon couldn't name any.

In the case of Mr. Ebbers, Mr. Chacon says in the suit that he received 350,000 shares of Rhythms NetConnections Inc. at \$21 when it went public in April 1999, and sold the shares for a profit of \$16 million. A person with knowledge of the matter says Mr. Ebbers received just several thousand shares of the IPO in his personal account and hung onto the stock until months later, which wouldn't have been as profitable, because the stock began sinking after its initial surge. But these shares wouldn't include IPO stock held by Mr. Ebbers in a DVP account.

A lawyer for Mr. Ebbers didn't return calls for comment. Charles Stillman, a lawyer for Mr. Nacchio, said his client "was a customer of the firm. He was allocated new issues. He got some; he didn't get some. He bought; he didn't buy. It was all perfectly appropriate and above board." A spokesman for Mr. Garofalo declined to comment, as did Mr. McLeod and Level 3. The executives were named in Mr. Chacon's suit, but aren't listed as defendants.

Mr. Chacon's allegations have sparked a congressional probe into the process of IPO allocations, which then led to an inquiry by the National Association of Securities Dealers with an initial focus on Salomon, and on Mr. Chacon's new employer, Credit Suisse First Boston. The Credit Suisse Group unit declined to comment.

After being fired from Salomon in 2000, Mr. Chacon filed an employment-discrimination suit, claiming wrongful dismissal. His allegations on how the firm distributed IPO allocations are part of an amended complaint, filed in March, according to his lawyer, Mr. Liddle.

Such alleged IPO spinning, where securities firms set aside shares of hot new stocks for corporate executives in return for business from their firms, was the subject of a number of articles in The Wall Street Journal four years ago. After a broad investigation by the Securities and Exchange Commission, no cases were brought.

Now, there is likely to be a renewed focus on the practice, people on Wall Street say. Many large Street firms are being investigated for issues involving everything from analyst conflicts of interest to controversy surrounding their lending relationships with U.S. corporations.

**Ed Fleischman, senior counsel at Linklaters law firm in New York and a former SEC commissioner, says that while spinning raises ethical questions, it is often not illegal.**

**"It's not like going through a red light," he says. He says it is often difficult to prove that shares were allocated in return for investment-banking business, or on another front that might also raise legal questions, that the firm promised to allocate the shares on a prorated basis and then failed to allocate them evenly.**

**The NASD 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.**

**The alleged activity could add to the investor uncertainty about the trustworthiness of the markets. Jacob Zamansky, who represents a client in an arbitration case against Salomon, says the firm "needs to make public the records so the regulators and the public can make their own judgments about what went on."**