

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 05-23

January 28, 2005

CITIGROUP GLOBAL MARKETS INC.
F/K/A SALOMON SMITH BARNEY, INC.
MEMBER ORGANIZATION

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Violated Exchange Rule 342, in that it failed to establish a system for follow-up and review with respect to properly training and supervising its employees to recognize or identify e-mail communications that may contain false and misleading content, and their own compliance with then Exchange Rule 473.30(i) – Consent to censure and \$350,000 fine.

Appearances:

For the Division of Enforcement
Myles L. Orosco, Esq.

For the Respondent
Eric F. Grossman, Esq.

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An Exchange Hearing Panel met to consider a Stipulation of Facts and Consent to Penalty entered into between the Exchange's Division of Enforcement and Citigroup Global Markets Inc. f/k/a Salomon Smith Barney, Inc., (the "Firm"). Without admitting or denying guilt, the Firm consented to a finding by the Hearing Panel that it violated Exchange Rule 342, in that it failed to establish a system for follow-up and review with respect to properly training and supervising its employees to recognize or identify e-mail communications that may contain false and misleading content, and their own compliance with Exchange Rule 472.30(i).

For the sole purpose of settling this disciplinary proceeding and without admitting or denying guilt, the Division of Enforcement and the Firm stipulate to certain facts, the substance of which follows:

Background and Jurisdiction

1. The Firm is a member organization of the Exchange. During the relevant period, June 2000, the Firm operated under the name Smith Barney Inc. and subsequently under the name Salomon Smith Barney Inc. The Firm provided services including investment banking, underwriting debt and equity securities and advising corporations, governments and institutions, as well as acting as a full-service global broker-dealer engaged in, among other things, retail brokerage of stocks and market making. In April 2003, Salomon Smith Barney Inc. was renamed Citigroup Global Markets Inc.

2. P. Campbell Hillstrom (“Hillstrom”), see Exchange Hearing Panel Decision 05-17, also the subject of disciplinary action, is currently employed as an Institutional Equity Salesman in the Firm’s Chicago, Illinois branch office. In June 2000, Hillstrom authored and circulated an e-mail to customers and certain employees of the Firm relating to XYZ. Another institutional salesman employed by the Firm, received Hillstrom’s e-mail and forwarded it to customers of the Firm.
3. In the e-mail, Hillstrom stated that a research analyst of the Firm did not cover three of the four companies mentioned, including XYZ. At least one recipient of the e-mail misread it to state that a Firm analyst covered XYZ stock and had downgraded it. This misperception, in addition to certain information in the e-mail, caused an increase in XYZ’s trading volume and a decline in its stock price, both of which differed significantly from the stock’s activity in the prior two-week period.
4. The Division of Market Surveillance (“MKS”), opened an investigation to review the trading activity of XYZ and the circumstances surrounding the publication of Hillstrom’s e-mail. MKS subsequently referred the matter to Enforcement, and by letter dated January 14, 2002, the Firm was notified of the Exchange’s investigation.

Overview

5. In 2000 and prior years, in violation of Exchange Rule 342, the Firm failed to properly train and supervise its employees with respect to the dissemination of electronic communications. Specifically, the Firm failed to have proper procedures and controls in place to prevent employees from disseminating false and misleading electronic communications, as required by Exchange Rule 472.30(i). In this case, Hillstrom, an employee in Firm’s Institutional Sales department, drafted and sent an electronic communication, which contained misleading information that was attributed to a Firm analyst who did not cover the company discussed in the electronic communication. In the e-mail, although Hillstrom stated that the Firm did not cover the stock, the electronic communication resulted in a misperception in the market that a Firm analyst had downgraded the stock. This misperception, in addition to certain information contained in the e-mail, caused a sharp decline in the stock’s price.

Violative Conduct

6. On June 20, 2000, Hillstrom and an equity analyst (“analyst”) for the Firm specializing in the apparel, footwear and textile industries, met at a client meeting in Chicago. After the meeting, Hillstrom and the analyst discussed three or four apparel companies, including XYZ.
7. The analyst told Hillstrom that there was concern in the industry relating to the inventory levels and backlog numbers of XYZ; however, she told Hillstrom that she did not cover or prepare market analyses relating to XYZ.
8. Upon returning to his office at the Firm’s Chicago, Illinois branch, Hillstrom researched the companies discussed with the analyst, including XYZ. He then wrote an e-mail about short ideas related to these companies. Some of the information

contained in the e-mail came from his discussions with the analyst, however, Hillstrom did not verify or confirm the information in the e-mail with the analyst. Hillstrom sent the e-mail in the early afternoon of June 20, 2000.

9. In addition to XYZ, Hillstrom's e-mail referenced three other companies. The subject line of the e-mail was "Short ideas in Apparel Names." In his opening comments, Hillstrom wrote, "Just spent some time with [the analyst], our Apparel & Footwear analyst, and she had several ideas for shorts, listed below in order of urgency. ABC is the only name we have under coverage."
10. Referring to XYZ, Hillstrom wrote the following in his e-mail:

The high-end jeans maker is rapidly trying to grow – adding 30 retail stores by year-end after not adding any for several years. Its jeans are not nearly as hot as they once were, yet they are expanding more rapidly than years past. [She] is confident the two brothers who run the company cannot manage their way during down times. Its sales backlog is grossly inflated because it sends products to its retail stores and books it as backlog. [She] tells me this is unheard of in the industry, and that by definition backlog must come from outside vendors. She thinks it is not unlikely that they miss numbers in the months ahead, and that they will have big problems down the road. She passed on the banking business, as did other major houses, when they were looking to do a secondary this spring, that they later pulled because of market conditions. Stock has fallen a lot, but she thinks it can go a lot lower, as earnings quality further deteriorates.

11. Without discussing or confirming the content of the e-mail with the analyst, Hillstrom sent the e-mail to two of his clients who had previously expressed interest in short ideas, particularly relating to the apparel industry. He also sent the e-mail to several other salesmen in the Firm and to his direct supervisor, the Firm's Illinois branch office manager, who was on vacation. One of the salesman to whom Hillstrom sent the e-mail thereafter forwarded Hillstrom's e-mail to approximately 13 clients at seven financial services companies interested in retail stocks.

The E-mail and its Market Affect

12. Hillstrom's e-mail contained certain inaccurate and misleading information related to XYZ. For example, Hillstrom asserted in his e-mail that XYZ was "adding more than 30 retail stores after not adding any for several years." The company, however, had opened many stores over the past few years. Further, Hillstrom's assertion that XYZ "jeans are not nearly as hot as they once were," was misleading in that, according to the analyst, during 2000 the jeans were selling very well in status denim.
13. Moreover, in the e-mail, Hillstrom stated that XYZ's sales backlog was "grossly inflated," whereas the analyst had stated that there was some confusion as to what the company included in its backlog numbers.

14. On June 20, 2000, XYZ opened at a price of $15^{15/16}$. After Hillstrom sent the e-mail, the price of XYZ began to decline and closed at $15^{14/16}$, or .625 cents lower than its opening price. On the morning of June 21, 2000, the price of XYZ opened at $15^{10/16}$, or .25 cents lower than its closing price on June 20, 2000. Thereafter, during the day on June 21, XYZ fell \$5.625 before beginning a recovery. XYZ traded at a low of $11^{2/16}$ and closed at a price of $13^{8/16}$, or \$2.375 lower than its opening price. The volume of the stock on the Exchange was approximately ten times its average volume for the two-week period immediately preceding June 21, 2000.
15. Hillstrom's e-mail resulted in a misperception in the market that the analyst had downgraded the stock. On June 21, 2000, Dow Jones news service issued a news report quoting analysts and a XYZ spokesperson, each of whom had received Hillstrom's e-mail. Each attributed the activity in the XYZ stock to Hillstrom's e-mail.

Failure to Supervise

16. Exchange Rule 342 requires member firms and organizations to provide for appropriate procedures for supervision and control over their business activities and to establish a system for follow-up and review with respect to their compliance with Exchange Rules and federal securities laws.
17. In pertinent part, Exchange Rule 342.17 requires member firms and organizations to develop written policies and procedures for review of communications with the public.
18. Exchange Rule 472.10, defines "communication" to "include, but is not limited to advertisements, market letters, research reports, sales literature, electronic communications, communications in and with the press and wires and memoranda to branch offices or correspondent firms which are shown or distributed to customers or the public."
19. Under "General Standards for All Communications," as specified in Exchange Rule 472.30(i), which was in force and effect in June 2000, "[n]o member or member organization shall utilize any communication which contains any untrue statement or omission of a material fact or is otherwise false or misleading." (In August 2003, this Rule section was codified as Exchange Rule 472(i)).
20. In June 2000, the Firm had written policies and procedures relating to the content of e-mail and other communications disseminated by its employees. Nonetheless, with respect to personnel in the Firm's Institutional Sales department and the manner in which the department conducted its business relating to e-mail communications with clients, these employees monitored their own compliance with Exchange Rule 472.30(i).
21. As a result, Hillstrom sent to customers of the Firm an electronic communication without first conferring with the analyst, and that communication contained

misleading content that was attributed to the analyst who did not cover the company discussed in the electronic communication. The electronic communication resulted in a misperception in the market that the Firm had downgraded the stock, which ultimately caused a sharp decline in the stock's price for two days.

22. Accordingly, as set forth above, the Firm was in violation of Exchange Rule 342, in that it failed to provide adequate training for and supervision of certain employees to ensure identification of electronic communications that contain false and misleading content.

Prior Discipline

23. In HPD 03-09, the Firm stipulated to findings that it violated SEC Rules 17a-3 and 17a-4 and Exchange Rules 440 and 410 by preparing and maintaining books and records for orders that did not accurately reflect the terms of orders; and violated Exchange Rule 342 by failing to maintain appropriate procedures for the supervision of its order entry system and its block trading desk. The Firm consented to a censure and \$90,000 fine.
24. In HPD 03-62, the Firm stipulated to findings that it violated the Exchange's Market-On-Close order entry cancellation procedures and policy. The Firm consented to a censure and \$65,000 fine.
25. In HPD 03-182, the Firm stipulated to findings that it violated Exchange Rule 342 in that it failed to adequately ensure reasonable supervision of certain brokers' activities regarding WorldCom employee stock option plans, including electronic communications to the public, completion of new account documents, and the review of margin usage in customer accounts. The Firm consented to a censure and a \$1,000,000 fine.
26. In HPD 04-91, the Firm stipulated to findings that it violated Exchange Rule 342 in that it did not have adequate systems and procedures in place to prevent and detect improper order handling procedures in the Miami branch office. These delays resulted in significant delays in the allocation of customer trades over a four-year period. As a result of the failures of the Miami branch, the Firm also failed to make and preserve accurate records related to the designation of customer orders and timely records related to the receipt and execution of customer orders. The Firm consented to a censure and a \$250,000 fine.

DECISION

The Hearing Panel, in accepting the Stipulation of Facts and Consent to Penalty, found the Firm guilty as set forth above by unanimous vote.

PENALTY

In view of the above findings, the Hearing Panel, by unanimous vote, imposed the penalty consented to by the Firm of a censure and a \$350,000 fine.

For the Hearing Panel

Vincent F. Murphy – Hearing Officer

Panelists:

Barry J. Cohen

Frank J. DeCongelio