SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK
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STATE OF NEW YORK and ELIOT SPITZER, Attorney General of the State of New York, for and on behalf of the People of the State of New York,

Plaintiffs,

-against-

PHILIP F. ANSCHUTZ, BERNARD J. EBBERS, STEPHEN A. GAROFALO, CLARK E. McLEOD and JOSEPH P. NACCHIO,

Defendants.
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COMPLAINT

Index No.

The People of the State of New York and Eliot Spitzer, Attorney General of the State of New York (collectively, "Plaintiff"), allege upon information and belief as follows:

I. PRELIMINARY STATEMENT

1. From the late 1990s through 2001, during a period of high demand for telecommunications stocks, Salomon Smith Barney ("SSB") engaged in a practice called "spinning," whereby it allocated to the defendants herein – top executives of corporations from which SSB sought investment banking business – valuable, nearly risk-free shares of stock in companies that were about to engage in initial public offerings ("IPOs"). The defendants reaped enormous personal profits from selling these "hot" IPO shares in the active market and SSB, in turn, received valuable investment banking business from each defendant's company. In choosing SSB as their companies' investment banker, defendants could be confident that their companies' stocks would secure high ratings from SSB's chief telecommunications analyst, Jack Grubman,

regardless of the true value of those stocks. Grubman fulfilled those expectations, further enabling defendants to reap huge profits on the sale of shares in their own companies. By failing to disclose both their respective allocations of hot IPO shares and the nature of the investment banking relationships described above, defendants unjustly enriched themselves and violated Article 23-A of the General Business Law ("the Martin Act") and section 63(12) of the Executive Law.

2. Plaintiff thus seeks: (a) restitution for investors of all moneys and property obtained directly or indirectly through these fraudulent practices; and (b) damages, fines, penalties, costs and other remedies. Specifically, this lawsuit seeks to require defendants to disgorge over $28 million in profits the defendants' made by selling the IPO shares they were allocated by SSB, and over $1.5 billion obtained through the sale of stock in defendants' respective companies, including through defendants' exercise of their stock options. Plaintiff also seeks to enjoin defendants from further fraudulent practices and other violations of the Martin Act.

3. The basis for such relief is that the defendants have engaged in fraudulent practices, and may still be engaged in fraudulent practices, in violation of the Martin Act, by failing to disclose that they received from SSB hot IPOs, and that SSB was awarding their companies favorable research recommendations regardless of merit. At all relevant times, the defendants' companies issued stock or debt instruments whose market value depended on the market perception of their respective companies.

4. Information material to market perception includes financial statements issued by the corporation, filings by the corporation with the United States Securities and Exchange

Commission ("SEC") and other regulatory bodies, public statements by corporate officers, press reports, releases and statements issued by the corporation, and reports disseminated by ostensibly independent analysts.

5. Purchasers of the securities of the defendants' companies were never informed that the companies' officers received millions of dollars in profit through hot IPO allocations from SSB, the very firm – a vendor – that was performing investment banking services for the defendants' companies, and whose star research analyst was covering the defendants' companies with "buy" recommendations while aware, as evidenced by internal SSB memoranda, of the distribution of the hot IPO shares.

6. The IPO allocations were part of an arrangement that resulted in the unjust enrichment of the defendants, and financially benefitted the investment banking department of SSB and Jack Grubman. Shareholders, meanwhile, lost hundreds of millions of dollars when the stocks in the defendants' companies crashed.

7. While the defendants received from SSB hot IPO stock, which they sold for enormous profits, SSB was rewarded with banking work from the defendants. Grubman performed his role by covering the defendants' companies with unduly optimistic research reports and buy recommendations. Purchasers of securities issued by the defendants' companies were defrauded because this arrangement was never disclosed to them.

II. JURISDICTION AND VENUE

8. This action is brought in the name and on behalf of the people of the State of New York by Eliot Spitzer, Attorney General of the State of New York, pursuant to his authority under the Martin Act, including sections 352, 352(c), 353, 353-a, and 359(g), to seek injunctive

relief, restitution, damages, fines, penalties, costs and other relief, where it is demonstrated that any person or entity has engaged in, is engaged or is about to engage in any fraudulent practices in the offer for sale or sale to, or offer to purchase or purchase of, securities from, the public within or from the state of New York.

9. In addition, as the State of New York's chief legal officer, the Attorney General brings this action pursuant to his *parens patriae* authority. Where, as here, the interests and well-being of the people of the State of New York are implicated, the Attorney General possesses *parens patriae* authority to commence legal actions for violations of state law. The State of New York has a quasi-sovereign interest in upholding the rule of law, in protecting the economic well-being of its residents and, with specific reference to the present action, in ensuring that the marketplace for the trading of securities functions fairly with respect to all persons who participate or consider participating therein.

10. This action also is brought by the Attorney General pursuant to his authority under Executive Law § 63(12) to seek an order: (i) granting injunctive relief to prevent repeated or persistent fraudulent or illegal activities; and (ii) directing restitution and damages.

11. The defendants are subject to New York's jurisdiction since, during the relevant time frame: (a) each received IPO shares from SSB which has its principal place of business in New York County, New York; (b) the IPO shares were allocated to defendants by and from SSB's syndicate department located at SSB's New York headquarters; and (c) each defendant was an officer of a company whose stock was listed and traded on securities markets located within the State of New York.

III. PARTIES

12. Plaintiff State of New York is a sovereign jurisdiction. Plaintiff Eliot Spitzer is the Attorney General of the State of New York.

13. Defendant Philip F. Anschutz, at all relevant times, was the Chairman of the Board of Qwest Communications International, Inc.

14. Defendant Bernard J. Ebbers, at all relevant times, was the Chief Executive Officer ("CEO") of WorldCom, Inc.

15. Defendant Stephen A. Garofalo, at all relevant times, was the Chairman of Metromedia Fiber Networks, Inc.

16. Defendant Clark E. McLeod, at all relevant times, was the CEO of McLeod USA, Inc.

17. Defendant Joseph P. Nacchio, at all relevant times, was the CEO of Qwest Communications International, Inc.

IV. FACTS

A. IPO Overview

18. Wall Street investment banks play a critical role in the complex process through which a company (the "issuer") raises capital and becomes a public company. In addition to filing a registration statement and other documents for review with the SEC and NASD, the issuer enters into an agreement to sell all of its offered securities to an underwriting syndicate composed of one or more investment banks. The syndicate members share the risk and fees and undertake to sell the offered shares to the public at the offering price (or at a discount to dealers who then resell to the public at the offering price).

19. Investment banking firms compete to be selected by the issuer as lead underwriter or "book-running manager" of the syndicate, the rewards being more control and higher fees. The manager assumes responsibility for selling the bulk, usually 70-85%, of the total offering to institutional investors on behalf of the other syndicate members.

20. Each syndicate member also is allocated a portion of the offering ("the retail retention") for direct sales to its own retail customers, with the manager retaining the largest quantity.

21. While the offering documents are under SEC review, each underwriter begins marketing the IPO. Institutional investors are typically invited to presentations where they learn about the pending deal and provide indications of interest in the new issue. At the same time, the retail sales force of each underwriter that received a retail retention contacts its customers and solicits indications of interest. Actual sales cannot occur until the SEC declares the registration statement effective and the offering is priced. Pricing is done by the lead underwriter on the trade date (also known as the "pricing date") after the SEC declares the offering effective. Ordinarily, prior to actual sale of the stock, allocations of share quantity are determined for each institutional and retail investor.

22. To the extent that investors believe that an IPO will become "hot," demand for shares far exceeds supply. This perception feeds a buying frenzy in the secondary market that raises the price.

23. The underwriting syndicate must distribute all of the IPO shares to the public and may not withhold shares for its own benefit. Specifically, the NASD prohibits an underwriter from retaining for the firm's account any shares of a "hot issue," defined as securities of a public

offering that trade at a premium in the secondary market whenever such secondary market begins. By selectively allocating the hot issue shares to prospective investment banking customers, an underwriter can compensate for its inability to profit from the initial offering.

B. Salomon Smith Barney

24. SSB, a subsidiary of Citigroup since 1998, is the nation's second largest retail brokerage firm providing brokerage, investment-banking and asset management services to corporations, governments and individuals world-wide. Since 1996, SSB (which includes Salomon Brothers, which merged in 1997 with Smith Barney, a subsidiary of Travelers Group, Inc.) worked with 81 telecommunications companies to raise approximately $190 billion in debt and equity. In return, SSB received hundreds of millions in underwriting fees and tens of millions of dollars more for advising on mergers and acquisitions.

25. Hidden from public and shareholder view was a system whereby key executives who had personal “private wealth management” accounts at SSB were routinely rewarded with stock allocations in each of SSB's hot IPO offerings. These executives often would sell their allocated shares in short order as the price sky-rocketed in the secondary market, generating huge profits. SSB received coveted investment banking and other business from the companies these executives headed. The executives who received the hot IPO shares were in a position to determine or influence their company's underwriter selection. The purchasers of the securities in the defendants' companies were never informed of this arrangement and that each of the buy recommendations upon which investors relied actually was an integral part of an investment banking package of services marketed to defendants and their companies. They also were not told that SSB’s top telecommunications analyst was providing favorable ratings for the

stocks of defendants' companies as part of an effort to obtain and retain investment banking business, and that he was aware of the structure and purpose of hot IPO stock allocations.

1. SSB Research's Ratings Were Not Independent, Objective or on the Merits

26. From 1998 through 2001, SSB published a five-category stock rating system:

1	Buy
2	Outperform
3	Neutral
4	Underperform
5	Sell

27. In actuality, the rating system was a three-category system with no Sell or Underperform categories. From 1998 through 2000, SSB research analysts issued virtually no Sell or Underperform ratings for the more than 1000 stocks they rated. John Hoffmann, head of SSB's Global Equity Research Management, acknowledged that institutional investors and sophisticated retail investors knew SSB's "Neutral" rating meant "Sell" and not Neutral, conceding in effect that the SSB rating system was seriously misleading as to the average retail investor.

28. Hoffmann raised this issue of research integrity directly with SSB's then CEO Michael Carpenter. In a memorandum to Carpenter entitled "2000 Performance Review, " Hoffmann admitted that there was "legitimate concern about the objectivity of our analysts which we must allay in 2001."

29. Hoffmann also acknowledged the misleading nature of the research ratings at a senior management meeting held at Citigroup's Armonk Conference Center. Hoffmann made a

presentation regarding the SSB "Stock Recommendations as of 1/29/01," which showed that out of a total of 1179 stock ratings, there were zero Sell ratings and one Underperform rating. In handwritten notes attached to this presentation, Hoffmann described these ratings in the U.S. as the " worst" and "ridiculous on face." He observed that there was a "rising issue of research integrity" and a "basic inherent conflict between IB [investment banking], equities and retail." As if to emphasize the conflict between independent, objective research ratings and investment banking, part of Mr. Hoffmann's presentation included a lengthy list of "Platinum Accounts" which comprised the largest investment banking and Citigroup banking clients.

30. In or about February 2001, Jay Mandelbaum, the global head of SSB's retail stock-selling division, told Hoffmann that SSB's "research was basically worthless" and threatened to terminate his division's contribution to the research budget. However, SSB did not change its rating systems, and the de facto three-category rating system remained throughout 2001. Out of over 1000 U.S. equity ratings, SSB research had no Sell ratings and only 15 Underperform ratings (1.4%).

2. Investment Bankers and Investment Banking Fees Influenced The Ratings

31. Investment bankers wanted the highest research rating for their banking clients or potential clients to enhance their ability to garner additional banking fees in the future. SSB's structure and compensation procedures encouraged investment banking to exercise its influence over analysts and their research ratings.

32. In January 1998, for a presentation for senior management at Travelers, the then parent of SSB, Hoffmann wrote: "There is a continuing shift in the realization that an analyst

is the key element in banking success." Underscoring the same theme two years later, on December 8, 2000, Hoffmann wrote Michael Carpenter, former CEO of SSB, that one of Hoffmann's goals since becoming global director of research was "to better integrate our research product with the business development plans of our constituencies, particularly investment banking . . . ."

33. In further reviewing his performance for 2000, Hoffmann stated:

> We have become much more closely linked to investment banking this year as a result of participating in their much-improved franchise review process this year. There has been a yearend [sic] cross review of senior analysts and bankers particularly in the U.S. and Europe and with the development of the Platinum Program in the investment bank, the analyst's understanding of the relative importance of clients for IB and GRB [global relationship bank] is much improved.

34. This operational integration of research analysts with investment banking involved each step of the typical underwriting transaction.

35. It began with the analysts working with the investment bankers to develop a priority list of potential investment banking clients. Each year from 1999 through 2001, U.S. Research Management requested year-end performance assessment from research analysts. It was "suggested" that the analysts "obtain collaborative feedback from their investment banking counterpart regarding establishing and modifying a list of coverage priorities."

36. Having jointly developed potential investment banking clients, the analyst would participate, as a key player, in the investment banker's sales pitch for the investment banking business. Once SSB obtained the investment banking business (the "mandate"), analysts

would participate in road shows and conversations with institutional investors to sell the underwritten stock.

37. In short, once the investment bankers obtained the mandate as a lead underwriter, the research analyst had to take “ownership” of the transaction, become a proponent of the company and “sell” the deal to institutional buyers of the stock. It was this package of services that was “sold” to defendants when they selected SSB as an underwriter.

38. In January 2000, SSB held a “Best Practices Seminar,” which was hosted by Kevin McCaffrey, head of U.S. Research Management, and Jeffrey Waters, the Associate Director of U.S. Equity Research. At the seminar, analysts learned how to manipulate their financial models to support underwriting by SSB’s investment banking division.

39. It was important for the success of a transaction that the subject company meet the earnings projected in the analyst’s model for the first two quarters. To ensure this, the analysts were instructed at the Best Practices Seminar to manipulate those figures downward – to be “conservative.” Specifically, the analysts were told: “Overall we’ve got to remember that those first two quarters have got to be hit and have nothing to do with how we’re gonnna really probably do valuation of the company.”

40. Analysts were required to advise investment banking in advance of dropping research coverage of an investment banking client.

41. At the Best Practices Seminar, Waters of Research Management summed up for the analysts the investment banking-analyst relationship as follows:

> When you look at the market share gap between us and the three competitors who are trying to close. When I just eyeballed it, it looked like to me there is something like roughly a billion dollars

> of, maybe not Equity Capital Markets but Investment Banking revenues, on the table for this firm. And that's a lot of money.
>
> And its clear...that Research is driving a lot of this increasingly. And therefore, as a [research] department our goal has to be, to be a really effective partner in terms of helping drive initiation, execution and everything else. Because there is a lot of money on the table for this company. And we'll all benefit from it.

3. Research Analysts' Compensation Was Driven By Their Contribution To Investment Banking Revenues

42. The SSB structure for analyst compensation allowed Waters to advise the analysts at the seminar that they could "all benefit" if SSB obtained a larger share of the investment banking "money on the table."

43. In 1997, SSB (then Smith Barney) paid "helper's fees" to analysts as a set percentage of the investment banking fees generated by transactions on which the analysts worked. During that year alone, eleven million dollars in helper's fees were included in the analysts' "incentive compensation" checks, and each analyst was told "the amount contributed [to the check] from the helper's fee allocation."

44. Hoffmann had set up the system and supported it. Following the merger of Smith Barney and Salomon, he urged its continuance in a February 19, 1999 memorandum: "We would argue strongly that maintaining a helper's fee system, if only on a shadow basis, is in the best interest of the firm as a whole and for IBD [investment banking department] and the research division specifically." He explained that

> 1) It provides us with a rational basis for calculating analysts' compensation . . . .
>
> 2) It makes the analysts more responsive to the investment bank . . . .

> . . . .
>
> 4) The 'real time' grading system [i.e., the helper's fees] with respect to analyst performance on specific deals allowed research management to critique and correct problems before they got out of hand.

45. Instead of following Hoffmann's recommendation explicitly, SSB opted to modify the helper's fees device in several ways. First, scorecards for analyst performance included as a specific metric the amount of investment banking fees SSB earned in each analyst's sector of coverage and, for recent years, also included the SSB investment bankers' evaluation of the analysts. The Performance Assessment and Business Plan Memoranda distributed annually by Research Management to research analysts required the analysts to "list in detail your involvement in Investment Banking Transactions over the past year" or similar language. Each analyst's response to this inquiry, and the amount of investment banking fees reflected on the Scorecard were significant factors in determining the analyst's compensation. Thus, the direct financial incentive for analysts to generate and participate in investment banking business remained.

C. Jack Grubman

46. Until August 2002, Jack Grubman was SSB's top telecommunications ("telecom") research analyst, and was an important factor in SSB's success in telecom investment banking. His "buy" ratings and optimistic research on these companies helped propel the prices of the telecom stocks to stratospheric heights. Although presented to the public as an objective and independent research analyst for these covered companies, Grubman was, in reality, an investment banker. Although Grubman testified that he averaged approximately $20 million in compensation

per year from 1998 to 2001, he had the distinction in 2000 and 2001 of being the worst of SSB's more than 100 analysts, as rated by SSB's retail sales force.

1. Grubman's Use of the Truncated Rating System

47. Consistent with his view that "what used to be a conflict is now a synergy," Grubman issued misleading ratings of stocks in favor of investment banking clients, including defendants' companies.

48. Because Grubman limited his ratings to SSB's de facto three-category rating system, his ratings were misleading. For the period January 1998 through June 2002, Grubman at various times covered from 20 to 36 stocks. The stock prices of many of those companies dropped dramatically and 16 went bankrupt. Yet, during the time period at issue, Grubman never issued any Sell ratings and assigned only two Underperform ratings.

2. SSB's Structure And Compensation System Caused Grubman's Ratings To Be Driven By Investment Banking Concerns

49. Grubman's contribution to investment banking revenues was part of the basis for determining his compensation. For instance, Research Management requested Grubman's performance assessment for 2001, including a "detailed list of [his] involvement in Investment Banking transactions over the past year." Grubman and his team responded by describing certain highlights of the investment banking transactions:

> We were a lead manager in a $450 million overnight convertible offering of XOXO and a $750 million high yield offering for MCLD in January. We were a joint-lead manager for FON's secondary offering of $3 billion and we were a book-running manager of WCOM's 12 billion debt deal in April/May. In addition, we were a

> joint lead in a $300 million equity and $450 million convertible offering for Citizens Communications, an S&P 500 Company, on which we initiated coverage on June 20 following the offerings. We received the mandate for joint books on AT&T's current $5 billion debt offering.

50. Further elaborating the investment banking activities of Grubman is his four-page, single-spaced investment banking schedule attached to his Memorandum, which listed 22 merger and acquisition transactions, 15 equity transactions, 6 private equity transactions, 21 investment grade debt transactions, 12 bank loans, 4 derivative transactions, 15 high yield transactions and 2 other type transactions.

51. The total investment banking revenues claimed by Grubman were $166,486,000. For other years, SSB's "Scorecards" for Grubman, used in compensation determinations, show investment banking revenues in Grubman's telecommunications sector as follows:

1998	$255,735,000
1999	$359,189,000
2000	$331,142,000

3. Due to Investment Banking Pressures, the Ratings Assigned by Grubman Were Misleading

a) Investment Bankers Discouraged Grubman From Downgrading Investment Banking Clients As They Slid Into Bankruptcy

52. Because Grubman's compensation was determined by his participation in investment banking, the ratings Grubman issued were not independent, objective or on the merits. As detailed below, email exchanges between Grubman and others document the misleading nature of his ratings.

53. Grubman failed to timely downgrade stocks of investment banking clients. Sherlyn McMahon, the senior research analyst under Grubman, sent an e-mail to Grubman relating a conversation with an institutional investor:

> She [the investor] just thinks that we make ourselves look stupid by recommending names right up to the point of bankruptcy like WCII [Winstar], XOXO [XO Communications], MFNX [Metromedia Fiber Networks], etc. She understands the banking relationship aspect.

54. Later that afternoon, Grubman, in an e-mail to Kevin McCaffrey, head of U.S. Research Management, made clear why stocks were not downgraded by him:

> [M]ost of our banking clients are going to zero and you know I wanted to downgrade them months ago but got huge pushback from banking. I wonder of what use bankers are if all they can depend on to get business is analysts who recommend their banking clients.

55. The damage inflicted by Grubman's misleading ratings was far-reaching. For example, the following charts demonstrate how Grubman rated the stocks mentioned in the e-mail exchange between McMahon and Grubman:

Winstar (WCII)		
Date	Price	Rating
June 16, 2000	$40	Buy
January 4, 2001	$16	Buy
April 2, 2001	$1	Buy
April 18, 2001	Bankruptcy	

XO Communications (XOXO) [formerly Nextlink]		
Date	Price	Rating
July 28, 2000	$33	Buy
January 4, 2001	$21	Buy
April 2, 2001	$5	Buy
June 1, 2001	$3	Buy
November 2, 2001	$1	Neutral
November 30, 2001	Acquired to avoid bankruptcy	

Metromedia Fiber Network, Inc. (MFNX)		
Date	Price	Rating
June 30, 2000	$40	Buy
January 4, 2001	$16	Buy
June 1, 2001	$4	Buy
July 25, 2001	$0.79	Neutral
March 19, 2002	$0.08	Discontinued coverage
May 20, 2002	Filed for bankruptcy	

b) Focal Communications

56. Focal Communications (FCOM) was an investment banking client that SSB had taken public as the lead underwriter. As of February 21, 2001, SSB had done at least three more transactions with Focal generating further investment banking fees of $9,551,560.

57. On February 21, 2001, Grubman issued a research note on Focal reiterating his Buy rating at the then current price of $15.50. When he learned that Focal complained about some aspects of the note, he emailed the two SSB investment bankers that evening:

> If I so much as hear one more f---ing peep out of them [Focal] we will put the <u>proper</u> rating (ie 4 not even 3) on this stock which every single smart buysider [institutional investor] feels is going to zero. We lost credibility on MCLD and XO because we support pigs like Focal.

(Emphasis added)

58. In an email earlier that day, McMahon, had received an inquiry from an institutional investor, asking: "Focal and McLeod are pigs aren't they ?" McMahon replied: "FCOM definitely MCLD hold not sell." On April 18, 2001, Grubman again expressed his view to an investment banker that Focal "must not remain" a Buy; but it did.

59. Grubman maintained his Buy rating on Focal until August 13, 2001, even while the price proceeded to crash from $15.50 to $1.24. During that same period, prior to the downgrade, SSB earned approximately $11,809,560 in additional investment banking fees from Focal.

c) Level 3, Williams Communications, XO Communications, Adelphia Business Solutions, and RCN Corporation

60. Level 3 Communications (LVLT), Williams Communications (WCG), XO Communications (XOXO), Adelphia Business Solutions (ABIZ) and RCN Corporation (RCNC) were all investment banking clients of SSB, and by April 18, 2001, had generated, respectively, investment banking revenues of approximately $136,009,995, $8,109,387, $63,486,618, $13,432,059 and $18,811,006.

61. On April 18, 2001, Winstar filed for bankruptcy. Frank Yeary, an investment banker at SSB e-mailed, among others, four SSB investment bankers and Grubman, recommending that they revisit the financial position of certain telecommunications companies,

including LVLT, WCG , XOXO and determine "if we have a cross firm consensus on prospects and potential risks." Grubman immediately e-mailed Yeary back:

> Agreed. . . . Also to be blunt we in research have to downgrade stocks lest our retail force . . . end up having buy rated stocks that go under. So part of this call will be our view that LVLT WCG XOXO FCOM ABIZ RCNC <u>must not remain buys</u>.

(Emphasis added)

62. The further email exchanges indicate that the call among the investment bankers, Grubman and perhaps others, occurred early the next morning.

63. Yet Grubman failed to downgrade LVLT, WCG, ABIZ or RCNC until from two to six months later.

d) Punishing Analysts Who Downgrade Investment Banking Clients

64. A technical analyst had twice downgraded Winstar's rating, causing an institutional investor to email Grubman on February 19, 1999 and ask that Grubman have the analyst punished. (In contrast to qualitative analysts like Grubman who review prices and company fundamentals, technical analysts review stock prices to interpret the market.) Grubman reacted favorably to punishing the analyst for being independent, emailing the heads of Global Equity Research and U.S. Equity Research as follows:

> These are sentiments shared by many investors who we are waiting on to buy Level 3 also. Here is yet another request that we should punish the technical analyst so that it does not impact us on Level 3. On the roadshow, I want to be able to say we are taking action on the technical analyst, otherwise investors will be afraid that the same thing will happen to Level 3. . . .

4. SSB's Retail Brokers Believed That Grubman's Stock Ratings Were Misleading and The Product of Conflict

65. SSB's retail brokers believed that Grubman's stock ratings were based not on an objective analysis of stock value, but instead were compromised by his interest in generating investment banking revenues. The following are representative examples of comments that SSB's retail brokers made about Grubman during 2000 and 2001:

<u>Year 2000</u>

- "Jack Grubman is not an analyst - he is an investment banker. He sold us a bill of goods on WCOM & T, and now we're bleeding red in our clients' accounts. How about sharing some the $25MM salary with our clients who bought into his glorified stories? Whose team is Grubman on?"

- "Grubman is an absolute disgrace to our firm as an 'analyst'. Maybe as a 'banker' he makes the firm a lot of money, but on the retail side the damage he has caused is a disgrace! I hope many clients sue!"

- "I have nearly 24 years with the firm. It is obvious to many of us in the field that the 'Chinese Wall' between service to retail FC's and to Institutional Investment banking activities is not working out for many Retail FC's and their clients in this case. Pacific Gateway Exchange (PGEX) and AT&T(T) are but two examples of this. *Suggestion*: Allow Grubman to decide whether he wants to be a Research Analyst or an Investment Banker and give us in Retail segment independent analysis, uncluttered by anything other than whether or not a company's stock constitutes a good, great or terrible investment."

- "He put me as an advisor to clients in a very difficult position. My clients now question me if a stock we are recommending is an investment banking client. They asked me if we are recommending the stock because we want their banking business. Our blind support of banking (a la WCOM/T) is hurting our retail clients. With recent SEC company communication restrictions, analysis is more important than ever. We can not afford an overpriced cheerleader like Grubman."

- "Has cost millions of dollars for SSB clients, I am appalled that he is now in a position to profit from our clients' losses, through his WCOM invsetment (sic) banking function. This sends a strong message that retail clients and retail brokers don't matter."

- "[T]o represent himself as an analyst is an egregious act by the management of this firm. Clearly many of his Buy and table-pounding Buys were directly related to investment banking $ for him and his firm . . . Shame on him, shame on the banking division, shame on the senior management of this firm."

- "Grubman is an investment bank whore! When is the firm going to stop pimping him?"

- "A perfect example of the unethical connection between research and investment banking."

<u>Year 2001</u>

- "[W]e've hired this person who has little regard for retail clients so the firm management reap higher banking revenues. Shame on us. It's time to separate research analysis from investment banking as a policy of the firm. We have given our retail clients poor service by not adequately addressing the conflict of interest inherent in overlapping functions. Mr. Grubman is the most egregious example. He could not comment on Global Crossing as he was in the throes of a deal. When his commentaries came they were not timely and reflected little insight that was otherwise unavailable from public sources. Examples such as this make one less willing to use SSB research if you can't fix it. I'm not going to inflict it on my clients, and then provide cover for you by trying to maintain confidence."

- "In my 16 years in the retail brokerage business, NEVER have I received such misguided, horrific recommendations from an analyst. . . . Some of his calls may, perhaps, put us in positions where we have to defend ourselves legally. Why does management and our research department continually defend his advice. Your justification of the millions he brings to the firm in underwriting fees only reduces our confidence in our own research department but widens the conflict in interest gap between the brokers and the believability of our research opinions. Perhaps, as brokers, we should subscribe to Morningstar or Valueline where research opinions are not based on influence by underwriting fees or the interest of the firm but on the best interest."

D. The Defendants

66. Each of the defendants personally benefitted from the business operations described above. As senior corporate officer of his company, each was in a position to influence investment banking decisions of the company. In addition to the large IPO allocations from SSB, defendant's company received from SSB investment banking services of which artificially optimistic research coverage was an integral part. Each defendant made substantial profits not only by selling IPO shares but also reaped additional profits by selling shares touted by Grubman that the defendant held in his own company, including those obtained through company stock options.

1. Defendant Ebbers (WorldCom)

67. Defendant Bernard J. Ebbers, one of the original investors in WorldCom, Inc. ("WorldCom") in 1983, became the company's CEO in 1985, and held that post until his ouster in April 2002. WorldCom is a Mississippi-based company that became one of the nation's largest long-distance and data carriers. The SEC currently is investigating WorldCom for inflating earnings by more than $3.8 billion dollars. WorldCom filed for Chapter 11 bankruptcy protection on or about July 21, 2002.

68. Jack Grubman was SSB's chief analyst for WorldCom. In the fall of 1997, Grubman attended two special meetings of the WorldCom board of directors and a subcommittee meeting called to discuss WorldCom's eventual merger with MCI. Two years later, Grubman again was invited to a board meeting, the agenda of which included discussion of the proposed merger with Sprint.

69. Between October 1997 and February 2002, SSB advised WorldCom on approximately 23 investment banking deals and garnered investment banking fees of approximately $107,078,477.

70. Ebbers' receipt of IPO shares predated WorldCom's retention of SSB for banking services. Between June 10, 1996 and August 2, 2000, Ebbers accepted 21 hot IPO allocations from SSB and sold them over time for a personal profit totaling approximately $11,536,040.

71. Grubman's stock ratings on WorldCom since June 2000 were as follows:

WorldCom		
Date	Price	Rating
June 30, 2000	$46	Buy
January 4, 2001	$19	Buy
June 1, 2001	$18	Buy
January 2, 2002	$15	Buy
March 18, 2002	$7	Buy
April 21, 2002	$4	Neutral
June 24, 2002	$0.91	Underperform
July 21, 2002	Filed for bankruptcy	

72. Ebbers made at least $23 million by selling his WorldCom holdings.

2. Defendants Anschutz and Nacchio (Qwest)

73. Defendant Philip F. Anschutz, former Chairman, founded Qwest Communications International, Inc. ("Qwest") in 1988 by building a nationwide fiber-optic network after purchasing a railroad company and laying fiber-optic cable along the rails. In 1997,

Defendant Joseph P. Nacchio, a former AT&T Executive, was as Qwest CEO, and the company went public that year. Qwest is a Denver based company that provides voice and data services, including Internet access and multimedia transmission. It is the fourth largest long distance company in the United States and employs approximately 61,000 people.

74. At the request of the company's board of directors, Nacchio resigned as CEO in 2002 and Anschutz resigned as chairman.

75. Between January 1998 and July 2001, SSB advised Qwest on approximately 18 investment banking deals and billed Qwest approximately $37,457,732. Anschutz's receipt of IPO shares predated Qwest's turning to SSB for banking services. From March 21, 1996 until June 12, 2001, Anschutz received 57 hot IPO allocations and sold his allocations over time for a personal profit totaling approximately $4,832,591.

76. Nacchio also received the first of his 42 hot IPO issues prior to SSB's banking relationship with Qwest. These IPO shares were allocated from September 16, 1997 until June 12, 2001. Nacchio sold his IPO shares over time for a personal profit totaling approximately $1,064,256.

77. In late 1999 or early 2000, Grubman attended a Qwest meeting at the invitation of Nacchio, the purpose of which was to discuss strategic planning.

78. Grubman’s stock ratings on Qwest since June 2000 were as follows:

Qwest		
Date	Price	Rating
July 5, 2000	$58	Buy
January 4, 2001	$46	Buy
June 1, 2001	$37	Buy
January 2, 2002	$14	Buy
March 6, 2002	$10	Neutral
May 22, 2002	$5	Neutral

79. While investors who held onto their Qwest stock saw the value of their holdings melt away, Anschutz and Nacchio made enormous profits selling their holdings. Anschutz made the astounding profit of $1.45 billion; Nacchio gained $226 million.

3. Defendant Garofalo (Metromedia)

80. Defendant Stephen A. Garofalo founded Metromedia Fiber Network, Inc. ("MFN") in 1993. MFN is a New York based company that owns high-speed communication networks in and around large US and European cities. Garofalo serves as Chairman of MFN, and also served as MFN’s CEO from October 1996 to September 2001. On or about May 20, 2002, MFN filed for Chapter 11 bankruptcy protection.

81. Between October 1997 and October 2001, SSB advised MFN on approximately 15 investment banking deals and billed MFN approximately $47,150,185.

82. Garofalo received the first of his 37 hot IPO allocations from SSB in September 1997, one month prior to SSB's first banking fee from MFN. The allocations

continued until October 26, 2000. Garofalo sold his IPO shares over time for a personal profit totaling approximately $1,521,222.

83. Grubman's stock ratings on Metromedia since June 2000 were as follows:

Metromedia		
Date	Price	Rating
June 30, 2000	$40	Buy
January 4, 2001	$16	Buy
June 1, 2001	$4	Buy
July 25, 2001	$0.79	Neutral
March 19, 2002	$0.08	Discontinued coverage
May 20, 2002	Filed for bankruptcy	

4. Defendant McLeod (McLeodUSA)

84. Defendant Clark E. McLeod founded McLeod Telecommunications in 1991. McLeod Telecommunications later became McLeodUSA ("McLeodUSA") when the company went public in 1996. McLeodUSA is an Iowa based company that provides local and long distance telephone service and Internet access in 25 western states. On January 30, 2002, the company filed for Chapter 11 bankruptcy protection.

85. Between October 1997 and January 2001, SSB advised McLeodUSA on approximately 16 investment banking deals and billed McLeodUSA approximately $49,957,185 in fees.

86. A month prior to the initial investment banking deal between McLeodUSA and SSB, defendant Clark McLeod received the first of his 32 hot IPO allocations. He continued

to receive allocations until September 21, 2000. McLeod sold his IPO shares over time for a personal profit totaling approximately $9,430,901.

87. Some time in the middle of 2001, Grubman attended a board of directors meeting at the request of McLeod.

88. Grubman's stock ratings on McLeodUSA since June 2000 were as follows:

McLeodUSA		
Date	Price	Rating
June 30, 2000	$21	Buy
January 4, 2001	$20	Buy
June 1, 2001	$5	Buy
November 1, 2001	$0.71	Neutral
December 5, 2001	$0.34	Discontinued coverage
January 30, 2002	Filed for bankruptcy	

89. Despite the bankruptcy of the company, McLeod managed to gain $15.8 million in sales of his company holdings.

FIRST CAUSE OF ACTION
(Material Misstatements and Omissions)

90. By failing to disclose his allocation of hot IPOs by SSB, each defendant made misstatements or omissions of material facts regarding the sale of securities to the public.

91. The foregoing acts and practices of each defendant consisted of material misstatements or omissions and constitute fraudulent practices in violation of Article 23-A of the General Business Law.

92. Plaintiff and the public have been, and are being, irreparably harmed by the aforesaid acts and practices.

SECOND CAUSE OF ACTION
(Unjust Enrichment)

93. By failing to disclose the details of his IPO allocation and the nature of his company's investment banking relationship with SSB, each defendant has unjustly enriched himself and deprived the investing public of a fair marketplace.

THIRD CAUSE OF ACTION
(Repeated and Persistent Fraudulent Activity)

94. Each defendant's activities described above constitute repeated and persistent fraudulent and illegal acts in the carrying on, conducting or transaction of business, in violation of Executive Law § 63(12).

95. Plaintiff and the public have been, and are being, irreparably harmed by the aforesaid acts and practices.

WHEREFORE, plaintiff demands judgment against the defendants as follows:

A. That each of the defendants be permanently restrained and enjoined from violating the Martin Act or committing any fraudulent practices within or from this State;

B. That each of the defendants make restitution pursuant to GBL § 353 (3), § 353-a and § 359(g) of all moneys and property obtained directly or indirectly by the fraudulent practices complained of herein;

C. That each of the defendants make restitution and pay damages pursuant to Executive Law § 63(12) for all moneys and property obtained and all damages caused directly or indirectly by the fraudulent acts complained of herein;

D. That each of the defendants pay plaintiff costs and additional allowances in the maximum amount allowable under GBL § 353 (1) and Civil Practice Law and Rules § 8303(a)(6);

E. That Plaintiff be permitted to make further applications for such other and further relief as it appears to Plaintiff is proper and necessary for the enforcement of the judgment; and

F. That the Court award such other and further relief to Plaintiff as the Court may deem just and proper.

Dated: New York, New York
September 30, 2002

ELIOT SPITZER
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State of New York
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By:____________________________

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