

Smith Barney agrees to pay \$50M in suit

By **Dan Jamieson** InvestmentNews

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IRVINE, Calif. - Smith Barney has agreed to settle a class action alleging that the firm loaded up customers of its broker-managed fee-based accounts with stocks of investment banking clients.

Under terms of the proposed deal, the firm would fork over \$50 million to investors who held guided portfolio management accounts between January 1998 and August 2002.

Smith Barney also will pay up to \$9 million in legal fees.

Like most firms with broker-managed fee accounts, Smith Barney generally limits GPM recommendations to securities covered by the firm.

The suit, filed in 2003, claimed that brokers were allowed to purchase only those stocks rated "buy" or "outperform" by Smith Barney research, many of them telecommunications stocks recommended by former analyst Jack Grubman.

He settled a fraud case with regulators in April 2003, paid a \$15 million fine and was barred from the industry.

"We sued under state law principles of fiduciary duty," said Thomas E. Patton, at partner at Tighe Patton Armstrong Teasdale PLLC in Washington and one of the plaintiff's lawyers in the case. "Account holders were never told that [recommendations would be] tainted by conflicts."

GPM accounts were marketed as being driven by "impartial research," Mr. Patton said.

The complaint cited an April 1999 Smith Barney press release in which the firm said that the "breadth and depth of Salomon Smith Barney's research department [was] one of the key drivers behind GPM's success" in gathering assets at the rate of more than \$40 million a week.

The lead plaintiff in the case, W. Caffey Norman of Washington, claimed that he opened his GPM account in November 1999 and that during the next two and a half years, at least two-thirds of the stocks in his account were those of Smith Barney investment banking clients.

About 100,000 current and former Smith Barney clients might be covered by the suit, Mr. Patton said.

By the middle of 2000, about 2,500 Smith Barney representatives were managing accounts under the program, according to the complaint.

Smith Barney, the brokerage unit of New York-based Citigroup Inc., has denied the allegations.

A spokeswoman, Katrina Clay, would say only that "We are pleased to have this matter resolved."

Under terms of the proposed settlement, Smith Barney clients most heavily invested in stocks rated by Mr. Grubman would get the most money.

None of the \$50 million would revert to Smith Barney.

Opting out

Notices to class members went out last month, after the U.S. District Court for the Southern District of New York in Manhattan gave preliminary approval to the settlement in January. A final fairness hearing is scheduled for next month.

The deadline to opt out of the settlement is April 21, and some attorneys have recommended that clients do just that in order to preserve their individual claims against Smith Barney.

Jim Eccleston, an attorney at Shaheen Novoselsky Staat Filipowski & Eccleston PC in Chicago, has an arbitration pending against Smith Barney over a GPM account. He said his client opted out of the class action.

"Someone who lost \$25,000 or more should seriously consider opting out," Mr. Eccleston said.

He has already lost one dispute over a GPM account.

A 2004 decision by an arbitration panel of Washington-based NASD awarded nothing to Mr. Eccleston's client, who claimed damages of more than \$200,000. In a 2-1 vote, the prevailing panelists said the customer wasn't owed a fiduciary duty.

Mr. Eccleston filed a court motion to vacate the award, but that motion was denied.

Brett Alcalá, a San Mateo, Calif., attorney, also has a case pending against Smith Barney related to a GPM account. His client also has opted out of the class action.

One problem with GPM accounts of under \$100,000 is that bonds aren't eligible, which encourages brokers to tilt toward equities, Mr. Alcalá said. A lot of investors in fee accounts are poorly allocated, and their advisers never follow up to make changes, said Christopher Tovar, a lawyer with Shepherd Smith & Edwards LLP in Houston who represents investors.

"We notice in a lot of cases, once a broker has you in a fee-based arrangement, that broker pretty much forgets about you," he said.

"There's a huge conflict of interest" in firms' mixing their distribution role with fiduciary fee accounts, Mr. Alcalá said.

"It's a clash of cultures," he said. "If [brokers] want to be fiduciaries, they should just be fiduciaries."