

**Disciplinary Panel
American Stock Exchange LLC**

IN THE MATTER
OF
SALOMON SMITH BARNEY

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:
Case Nos. 02-04, 02-26, 03-17, 04-205
Hearing Officer – DMF

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:
DISCIPLINARY PANEL DECISION
December 2, 2004

Digest

In accordance with a Stipulation of Facts and Consent to Penalty, the Disciplinary Panel Chair, presiding without convening a full Disciplinary Panel, pursuant to Section 1(b)(1) of Article V of the Exchange Constitution, determined that Respondent violated Exchange Rule 320(b) by failing to reasonably supervise its employees and by failing to have reasonable policies or procedures in place, as stipulated, and as a penalty, imposed a censure and a fine of \$50,000.

DECISION

I. Introduction

The American Stock Exchange, LLC (Exchange) instituted a formal disciplinary proceeding against Salomon Smith Barney (SSB), a Regular Member Organization of the Exchange. The Disciplinary Panel Chair, presiding without convening a full Disciplinary Panel, pursuant to Article V, Section 1(b) of the Exchange Constitution, held a hearing on November 11, 2004, pursuant to Article V, Section 2 of the Exchange Constitution, to review a Stipulation of Facts and Consent to Penalty (Stipulation), which is attached as Exhibit A. The Exchange and SSB entered into that Stipulation for the purposes of settling this proceeding and concluding all disciplinary actions by the Exchange against SSB based upon or arising out of the facts set forth in the Stipulation.

II. Facts

SSB, without admitting or denying liability, stipulated to the facts set forth in the attached Stipulation. The Disciplinary Panel Chair has determined to accept those facts for purposes of this Decision, and they are incorporated herein.

III. Violation

Based upon the stipulated facts, the Disciplinary Panel Chair concludes that SSB violated Exchange Rule 320(b) by failing to reasonably supervise its employees' entry of multiple odd-lot orders on three separate occasions, as set forth in the Stipulation. Further, SSB violated Exchange Rule 320(b) by failing to have reasonable policies or procedures in place designed to detect or prevent an account, or related accounts, from entering multiple odd-lot orders, rather than one round-lot order, into SSB's X-TRA System, which allows participating money managers to transmit orders electronically to SSB for execution.

IV. Penalties and Publicity

The Stipulation proposes that the Disciplinary Panel Chair impose a censure and a fine of \$50,000 on SSB. At the hearing, the Parties urged the Disciplinary Panel Chair to accept the proposed penalty as being appropriate to the facts and circumstances of this case.

The Chair notes that the Stipulation covers several different odd-lot incidents that took place over an extended period. After the Exchange identified the first odd-lot incident, which took place in December 2000, it notified SSB that it was investigating the actions of the SSB employee involved. Nevertheless, the second incident occurred in November 2001. After the Exchange notified SSB in February 2002, that it was investigating the second incident, SSB issued certain compliance or educational materials in April and May 2002. The third incident, which occurred in October 2002, involved a customer that entered multiple odd-lot orders

through SSB's X-TRA System. Finally, the fourth incident, which occurred in September 2003, again involved an SSB employee.

The number of incidents and the extended time period involved suggest that significant sanctions are required, and the precedents cited by the Exchange at the hearing show that the fine in this case substantially exceeds the fines imposed in similar prior cases. In addition, during the hearing both parties assured the Chair that SSB has adopted or is in the process of adopting various processes and procedures, including technical corrections to SSB's systems, reasonably designed to ensure that such incidents do not recur. After consideration of the Stipulation and the representations of the parties during the hearing, the Chair finds that the proposed penalty is appropriate based on the facts and circumstances, and therefore it will be imposed.

The Disciplinary Chair further finds that the results of this disciplinary proceeding should be publicly disclosed, as provided in Rule 12 of the Exchange Rules on Disciplinary Proceedings.¹

V. Conclusion

The Disciplinary Panel Chair accepts the Stipulation of Facts and Consent to Penalty and hereby imposes upon Salomon Smith Barney a censure and a fine of \$50,000.

FOR THE DISCIPLINARY PANEL

David M. FitzGerald, Chair

Copies to: Nicolle L. Jacoby, Esq. (*via facsimile and first class mail*)
 David E. Rosenstein, Esq. (*electronically and via first class mail*)
 Arlene Collins-Day (*via facsimile and first class mail*)

¹ Rule 12 exempts from publicity those cases where the Panel finds that the offense "related solely to minor administrative requirements of the Exchange and does not materially affect the public interest or the interest of investors." Those exemptions do not apply to the facts of this case.

**Disciplinary Panel
American Stock Exchange LLC**

**IN THE MATTER
OF
SALOMON SMITH BARNEY**

**STIPULATION OF FACTS
AND
CONSENT TO PENALTY
Case Nos. 02-04, 02-26, 03-17, 04-205**

This proceeding was instituted by the American Stock Exchange LLC (the "Exchange" or "AMEX") against SALOMON SMITH BARNEY ("Salomon" or the "Firm") (CRD # 7059), a Regular Member Organization of the Exchange. This Stipulation of Facts and Consent to Penalty is entered into pursuant to Article V, Section 2 of the Exchange Constitution, in order to settle and conclude all disciplinary actions by the Exchange against Salomon based upon or arising out of the facts hereinafter stipulated. Salomon, without admitting or denying the facts, allegations and conclusions contained in this Stipulation of Facts and Consent to Penalty, hereby consents to the finding of violations of the Exchange Rules and to the imposition of the penalties hereinafter provided. Salomon understands that this settlement is subject to approval by an Exchange Disciplinary Panel and the Amex Adjudicatory Council and that, if so approved, shall constitute a final decision, which may not be appealed by the parties. Salomon understands and acknowledges that the Disciplinary Panel's decision in this matter will become part of Salomon's disciplinary record, and may be considered in any future proceeding brought by the Exchange.

STIPULATED FACTS:

- 1.0 At all times relevant herein, Salomon was a Regular Member Organization of the Exchange.
- 1.1 During all relevant periods herein, JC ("JC") was a registered employee at Salomon.
- 1.2 During all relevant periods herein, PD ("PD") was a registered employee at Salomon.
- 1.3 During all relevant periods herein, DD ("DD") was a registered employee at Salomon.
- 1.4 During all relevant periods herein, NA, Inc. ("NA") was a registered investment advisory firm located in Reno, Nevada.¹
- 1.5 During all relevant periods herein, NA contracted with Salomon to use Salomon's X-TRA System ("X-TRA"). X-TRA allows participating money managers to transmit orders electronically to Salomon for execution.
- 2.0 During all relevant periods herein, Salomon was subject to Exchange Rule 208, which provided that:

"A member or member organization may not combine the orders given by several customers to buy or sell odd-lots² of the same stock into a round lot order without the prior approval of all of the customers interested. When a person gives, either for his own account, for various accounts in which he has an actual monetary interest, or for accounts over which such person is exercising investment discretion, buy or sell odd-lot orders which aggregate one or more round lots, a member or member organization shall not accept such orders for execution unless they are, as far as possible, consolidated into round lots, except that selling orders marked "long" need not be so consolidated with selling orders marked "short."

¹ NA is not a member of the American Stock Exchange.

² Exchange Rule 204 defines an odd-lot order as any order less than the unit of trading. Exchange Rule 204 further states that an odd-lot order "shall be executed ... at a price based on the price of a transaction in the round-lot market on the Floor of the Exchange, plus or minus, if any differential is charged the amount of such differential." Odd-lot orders are not printed to the tape, i.e. such orders are not displayed to the market.

- 2.1 Pursuant to Exchange Rule 205, Specialists on the Exchange are required to execute an odd-lot market order at the prevailing offer (in the case of an order to buy) or bid (in the case of an order to sell). Pursuant to Exchange Rule 205, Specialists on the Exchange are required to execute an odd-lot stop order at the prevailing offer (in the case of an order to buy) once a round lot transaction takes place at or above the stop price, or at the bid (in the case of an order to sell) once a round lot transaction takes place at or below the stop price. Pursuant to Exchange Rule 205, Specialists on the Exchange are required to execute an odd lot limit order at the price of the first round lot transaction which is at or below the specified limit (in the case of an order to buy), or at the price of the first round lot transaction which is at or above the specified limit (in the case of an order to sell).
- 2.2 During all relevant periods herein, Salomon was subject to Exchange Rule 320(b), which provided that:
- "Each office, department or business activity of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility. The person in charge of a group of employees shall reasonably discharge his duties and obligation in connection with supervision and control of the activities of those employees related to the business of their employer including compliance with securities laws and regulations."
- 2.3 During all relevant periods herein, The ABC Co. ("ABC") stock was listed for trading on the Exchange.
- 2.4 During all relevant periods herein, DEF, Inc. ("DEF") stock was listed for trading on the Exchange.
- 2.5 During all relevant periods herein, GHI Corp. ("GHI") stock was listed for trading on the Exchange.

2.6 During all relevant periods herein, JKL Fund ("JKL") stock was listed for trading on the Exchange.

Odd-Lot Transactions By JC and PD

JC

3.0 Between December 4, 2000 and December 14, 2000, JC solicited customer sell orders for ABC. After soliciting his customers, JC, using time and price discretion, entered seventy-one (71) odd-lot sell orders for fifteen (15) different *public* customer accounts in sizes of 30, 45, 60, 75, 90 and 95 shares.

3.1 On December 13, 2000 and December 14, 2000, JC entered sell orders for ABC in family accounts over which he directly traded. JC, using discretion, entered twelve (12) odd-lot sell orders for two (2) family accounts in sizes of 90 and 95 shares.

3.2 On January 22, 2001, the Exchange notified Salomon, by letter, of its investigation into JC's odd-lot activity.

PD

3.3 On November 15, 2001, PD received a 2500 share buy order for DEF.

3.4 On November 15, 2001, PD entered the 2500 share buy order for execution. At 15:10:23, 100 shares of the 2500 share buy order were executed. At 15:31:05, another 1200 shares of the 2500 share buy order were executed.

3.5 Following the partial execution of the 2500 share order, PD unbundled the remaining 1200 shares and thereafter entered eleven (11) buy orders of 99 shares and one (1) buy order of 111 shares in DEF.

3.6 By entering multiple odd-lot orders as described in above paragraphs 3.1 through 3.5, JC and PD circumvented the execution of round lot orders, which would have appeared on the Exchange tape, thereby failing to publicly reflect actual market interest by JC and PD

in ABC and DEF, respectively. Additionally, by entering multiple odd-lot orders rather than round lot orders, participation on the execution of the odd-lot orders was limited to the specialist, thereby depriving public customers the opportunity for price improvement in the auction market for ABC and DEF.

- 3.7 By entering multiple odd-lot orders in ABC and DEF, JC and PD compelled the Specialist to execute the multiple odd-lot orders at the prevailing offer or bid. The prevailing offer in ABC stock at the time of entry of the odd-lot sell orders between December 4, 2000 and December 14, 2000 ranged from 11 3/4 to 14 7/8. The prevailing bid in DEF stock at the time of entry of the odd-lot buy orders on November 15, 2001 was \$24.80.
- 3.8 Between January 22, 2001 and January 2002, despite the Exchange's notification to Salomon of its investigation into activity by JC, and additional odd-lot activity by PD on November 15, 2001, Salomon failed reasonably to alert its employees of the requirements of Exchange Rule 205 or otherwise implement policies or procedures concerning odd-lot orders. Part of the delay was attributable to the tragedy of September 11, 2001.
- 3.9 On or about November 2001, Salomon began testing a systematic exception report to display potential order-splitting incidents. Salomon did not, however, implement the system until January 2002.
- 3.10 On February 27, 2002, the Exchange notified Salomon, by letter, of its investigation into PD's odd-lot violation.
- 3.11 On April 19, 2002 and May 2, 2002, respectively, Salomon issued Compliance Education Memoranda relating to odd-lot activity to its trading and supervisory personnel.

Odd-Lot Transactions By NA

- 4.0 On October 17, 2002, NA, a money manager, entered multiple odd-lot sell orders in GHI using X-TRA. NA entered seventeen (17) sell orders ranging from 20 to 90 shares for a total of nine hundred ten (910) shares. The orders were entered between 11:45:43 and 11:47:16.
- 4.1 By entering multiple odd-lot sell orders in GHI, NA circumvented the execution of a round lot order which would have appeared on the Exchange tape, thereby failing to publicly reflect actual market interest by NA in GHI. Additionally, by entering multiple odd-lot orders rather than round lot orders, participation on the execution of the odd-lot orders was limited to the specialist, thereby depriving public customers the opportunity for price improvement in the auction market for GHI.
- 4.2 By entering multiple odd-lot sell orders in GHI, NA compelled the Specialist to execute multiple odd-lot sell orders at the prevailing bid in GHI. The prevailing bid in GHI at the time of the entry of the odd-lot sell order was \$14.43.
- 4.3 During the relevant time period, Salomon did not detect or prevent the entry of multiple odd-lot orders through X-TRA in the manner described above in paragraphs 4.1 and 4.2.

Odd-Lot Transactions By DD

- 5.0 On September 11, 2003, DD, using trading discretion, entered six (6) Good-til-Canceled ("GTC") odd-lot stop sell orders, and four (4) mixed orders³ (hereinafter the "orders"), for ten (10) separate customer accounts, in JKL. The orders ranged from 29 shares to 230

³ A mixed order is a combination of a round lot and an odd lot (i.e. 512 shares = a round lot of 500 shares and an odd lot of 12 shares).

shares for a total of 1,177 shares. The stop price for the orders was \$44.50. The orders were entered between 14:18:07 and 14:21:22.

- 5.1 On October 29, 2003, DD, using trading discretion, cancelled the September 11, 2003 orders in JKL and replaced the orders with new GTC odd-lot/mixed stop sell orders with a stop price of \$48.00. The orders were entered between 12:54:57 and 13:01:01. DD did not alter the size of the orders.
- 5.2 On November 21, 2003, DD, using trading discretion, entered two (2) additional GTC odd-lot/mixed stop sell orders in JKL with a stop price of \$48.00. These orders, of 69 and 110 shares, were entered at 13:51:03 and 14:04:49, respectively.
- 5.3 On January 27, 2004, DD, using trading discretion, cancelled the October 29, 2003 and November 21, 2003 orders in JKL and replaced the orders with new GTC odd-lot/mixed stop sell orders with a stop price of \$52.00. The orders were entered between 11:12:43 and 11:25:01 a.m. DD did not alter the size of the orders.
- 5.4 On February 19, 2004, DD, using trading discretion, cancelled the January 27, 2004 orders in JKL and replaced the orders with new GTC odd-lot/mixed stop sell orders with a stop price of \$60.00. The orders were entered between 11:12:43 and 11:42:58. DD did not alter the size of the orders.
- 5.5 On February 24, 2004, the orders in JKL entered by DD on February 19, 2004 were executed at \$59.94 at 11:38:07 and 11:42:58.
- 5.6 DD entered the orders in Salomon's NEXTGEN System, which failed to aggregate the orders into a round lot. However, because DD had trading discretion, the odd-lot orders and odd lot components of any mixed orders should have been consolidated into a round lot.

5.7 By entering multiple odd-lot orders in JKL, DD circumvented the execution of a round lot order which would have appeared on the Exchange tape, thereby failing to publicly reflect actual market interest by DD in JKL. Additionally, by entering multiple odd-lot orders rather than round lot orders, participation on the execution of the odd-lot orders was limited to the specialist, thereby depriving public customers the opportunity for price improvement in the auction market for JKL.

CONCLUSION:

By reason of the foregoing Stipulated Facts, an Exchange Disciplinary Panel may conclude that:

6.0 Salomon violated Exchange Rule 320(b) by failing to reasonably supervise its employees entry of multiple odd-lot orders on three separate occasions in that:

(a) Salomon failed to reasonably supervise JC in that JC entered multiple odd-lot orders between December 4, 2000 and December 14, 2000, as set forth in above paragraphs 3.0 through 3.2;

(b) Salomon failed to reasonably supervise PD in that PD entered multiple odd-lot orders on November 15, 2001, as set forth in above paragraphs 3.3 through 3.5; and

(c) Salomon failed to reasonably supervise DD in that DD entered multiple odd-lot orders between September 11, 2003 and February 19, 2004 as set forth in above paragraphs 5.0 through 5.7.

6.1 Salomon violated Exchange Rule 320(b) in that the firm failed to have reasonable policies or procedures in place designed to detect or prevent an account or related accounts from entering multiple odd-lot orders, rather than one round lot order, into the firm's X-TRA System, so as to reasonably detect or prevent the entry of multiple odd-lot

orders in an abusive manner and allowing a customer to circumvent the round lot auction market, as described in above paragraphs 4.0 through 4.3.

DISCIPLINARY ACTION:

A Disciplinary Panel may impose the following penalties upon Salomon:

- a) a censure, and
- b) a \$50,000 fine

AMERICAN STOCK EXCHANGE LLC

By: _____
David Rosenstein
Vice President and Chief Counsel

Agreed to this ____ day of _____, 2004.
