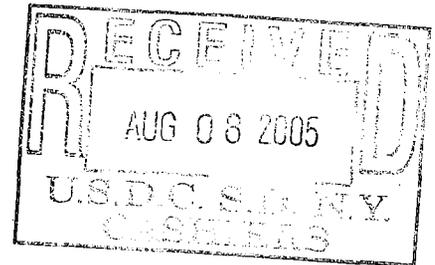


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UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK



SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

-against-

THOMAS W. JONES and LEWIS E. DAIDONE,

Defendants.

05 CV ( )

COMPLAINT

Plaintiff Securities and Exchange Commission (the "Commission"), for its complaint against Thomas W. Jones ("Jones") and Lewis E. Daidone ("Daidone") (together, "Defendants"), alleges as follows:

PRELIMINARY STATEMENT

1. This is an action to hold accountable two corporate executives who were responsible for a scheme by Citigroup Asset Management ("CAM") to siphon off tens of millions of dollars in mutual fund shareholder fees by inter-positioning a small, affiliated transfer agent between the Smith Barney family of mutual funds (the "Funds") and their full-service transfer agent.

2. CAM is a business unit of Citigroup, Inc. ("Citigroup") that provides investment advisory and management services to Citigroup-sponsored funds, including the Funds. CAM

provides those services through investment advisory entities that fall within the CAM business unit, including Smith Barney Asset Management LLC (the “Advisor”), which served as the registered investment adviser to the Funds, and Citigroup Global Markets, Inc. (“Global Markets”), which provided fund management services for the Funds. Jones was in charge of CAM. One of CAM’s roles was to recommend a transfer agent for the Funds to the Funds’ boards of directors.

3. During the 1990s, the Funds used First Data Investment Services Group (“First Data”) as full-service transfer agent (“TA”) pursuant to a long-term contract that was set to expire in June 1999. Jones and Daidone knew that First Data had been making high profit margins on the TA contract, and Jones wanted CAM to realize that profit when the contract came up for renewal. Instead of using CAM’s strong bargaining position to benefit the Funds in the negotiation of a new TA contract, therefore, Jones directed an executive vice president (the “EVP”) and Daidone to negotiate a deal that would allow CAM to keep for itself much of the profit First Data had been making. The EVP and Daidone carried out these directions, eventually negotiating a deal with the Funds’ existing TA, First Data, under which First Data made drastic fee concessions. However, at no point in the process did the Defendants alert the Funds that such a discount was available. Instead, they co-opted all of this benefit for CAM.

4. With Jones’ approval, CAM ultimately recommended to the Funds’ boards of directors that the Funds replace First Data with an affiliate of CAM. The recommended structure called for the affiliated TA (which is now Citicorp Trust Bank, fsb (“CTB”)) to contract directly with the Funds as named TA, perform limited functions and sub-contract with First Data for the bulk of the transfer agent services. Except for a small customer service function that the affiliated TA would undertake, First Data would continue to perform the same work it had

performed under the expiring contract, but at a significant discount from the fees it had been charging the Funds – a discount that would start at 33.5% and increase to as much as 60% over the five-year term of the contract. CAM kept the majority of the savings it had negotiated with First Data for itself, and offered the Funds a limited fee reduction through the institution of fee caps.

5. The Defendants and CAM owed the Funds a fiduciary duty to act in the best interests of the Funds. Consistent with that duty, Defendants should have first offered the substantial savings they had negotiated from First Data to the Funds, as an opportunity belonging to the Funds. At the very least, they should have disclosed this opportunity for significant savings to the Funds. They did neither. Instead, Defendants' intent from the beginning was to submit to the boards only the self-dealing proposal that allowed CAM to reap the enormous benefits. Defendants also understood or recklessly disregarded that if the full facts were candidly disclosed, no reasonable board could approve the proposal.

6. Daidone took the lead in preparing a board presentation that Jones approved. Daidone's presentation spun the facts in a way that made it appear that the affiliated TA proposal was the best deal that the Funds could have achieved, which was not true. The presentation did not disclose that First Data was to perform virtually all of the same work as before, with the affiliated TA taking most of the profit for doing very limited work.

7. CAM's recommendation also contained numerous material misrepresentations about the particulars of the arrangement, including the extent of the benefits CAM would realize. Among other things, Jones and Daidone failed to disclose that CAM had entered into a side letter agreement (the "Side Letter") with First Data, pursuant to which First Data committed to

providing millions of dollars of investment banking and asset management revenue to Citigroup entities (the "Revenue Guarantee").

8. For the period October 1, 1999 through September 30, 2004, CTB received more than \$100 million in net fees for operating a small customer service call center and performing limited additional oversight and quality control functions at a total cost of approximately \$11 million.

9. By engaging in the conduct alleged in this Complaint, the Defendants aided and abetted a fraud perpetrated by CAM, the Adviser and Global Markets. More specifically, Defendants aided and abetted violations of Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act") [15 U.S.C. §§ 80b-6(1) and 80b-6(2)], which impose a fiduciary duty on investment advisers and prohibit them from employing devices, schemes or artifices to defraud clients or prospective clients and from engaging in transactions, practices, or courses of businesses that operated or would operate as a fraud or deceit upon clients or prospective clients..

10. Jones, CAM's chief executive officer, made the decision to recommend the affiliated TA proposal to the Funds' boards, fully aware that the affiliated TA would make a huge windfall through the self-interested proposal. Jones performed only a cursory review of the memo to the Funds' boards and took no meaningful steps to ensure that the Funds' boards were informed of the material terms of the TA proposal.

11. Daidone is the person who sold the proposal to the affiliated TA proposal to the Funds' boards. Daidone intentionally spun the board materials in a way that masked the economic reality of the transaction and gave the Funds' boards the false impression that the proposal was in the best interests of the Funds.

12. Unless the Defendants are each restrained and enjoined by this Court, they will again engage in the acts, practices, and courses business set forth in this Complaint and in acts, practices and courses of business of similar type and object. By this action, the Commission seeks judgments that, among other things: (a) permanently enjoin each Defendant from future violations of the above provisions and from engaging in the acts, practices and courses of business alleged herein, (b) require the Defendants each to disgorge any and all ill-gotten gains together with prejudgment interest, and (c) require the Defendants each to pay civil money penalties, which should be based upon, among other things, the fact that the Defendants' conduct caused harm to millions of mutual fund shareholders.

#### **JURISDICTION AND VENUE**

13. The Court has jurisdiction over this matter pursuant to Sections 209(d) and 214 of the Advisers Act [15 U.S.C. §§ 80b-9(d) and 80b-14].

14. Venue is proper in this district pursuant to Section 214 of the Advisers Act [15 U.S.C. § 80b-14]. The acts and transactions constituting the violations occurred within the Southern District of New York.

#### **THE DEFENDANTS**

15. **Jones**, age 56, is a resident of New Canaan, Connecticut. During the relevant period, Jones served as chief executive officer of CAM and as chairman and chief executive officer of Citigroup's Global Investment Management and Private Banking Group. Jones was forced to resign from Citigroup in October 2004.

16. **Daidone**, age 48, is a resident of Holmdel, New Jersey. Daidone was a senior vice president of the Adviser, a managing director of Global Markets, and the treasurer and chief

financial officer of the Funds. Daidone served as head of fund administration for the North American region for CAM, and reported to the EVP.

### **RELEVANT ENTITIES**

17. **The Adviser** is a limited liability company organized under the laws of Delaware and a subsidiary of Citigroup Global Market Holdings, Inc. The Adviser is registered with the Commission as an investment adviser pursuant to Section 203(c) of the Advisers Act, and serves as investment adviser to the Funds. The Adviser is part of CAM, the Citigroup business unit that provides investment advisory and management services to Citigroup-sponsored funds, including the Funds.

18. **Global Markets** is a New York corporation and a direct subsidiary of Citigroup Global Markets Holdings, Inc., and an indirect subsidiary of Citigroup. Formerly known as Salomon Smith Barney Inc., Global Markets is a registered investment adviser and broker-dealer. The asset management segment of Global Markets falls within the CAM business unit.

19. **Citigroup** is a global financial services company that was organized under the laws of Delaware and maintains its headquarters in New York, New York. Citigroup was formed in October 1998, by the merger of Citicorp and Travelers Group Inc. (“Travelers”). Prior to the merger, the Adviser, Global Markets and CAM (which was formerly known as Salomon Smith Barney Asset Management), were divisions or subsidiaries of Travelers.

20. **The Funds** consist of more than 105 open-end management investment companies registered with the Commission, and include equity, money market, fixed income, municipal, and various specialty funds. During the relevant period, the Funds had more than \$90 billion in assets. At all relevant times, the chairman of the Funds’ boards was an employee and officer of the Adviser.

21. CAM is the Citigroup business unit that provides investment advisory and management services to Citigroup-sponsored funds, including the Funds. Various Citigroup entities fall within and comprise CAM, including the Adviser, the asset management operations of Global Markets, and the other registered investment advisers for the Citigroup-sponsored funds. Although the investment advisers, including the Adviser, are separate juridical entities, with their own officers and employees, they are limited in size and function. The bulk of the administrative services that the advisers provide to their respective fund families are performed by Global Markets employees who fall within the CAM unit.

### **FACTS**

#### **The TA Function and First Data Contract**

22. From 1994 through September 30, 1999, First Data served as full-service TA for the Funds. As transfer agent, First Data performed a variety of functions for the Funds, including processing buy and sell transactions in Fund shares, processing dividend transactions, calculating daily net asset value, calculating sales charges and commissions, operating a customer service call center, distributing proxy and other materials, and performing a variety of additional accounting functions, including year-end tax reporting.

23. The Fund business was very profitable to First Data as a result of a favorable fee schedule and the low cost of servicing the Funds. Because the Funds are proprietary – sold mostly by Smith Barney brokers – many of the TA functions are, and at all relevant times were, highly automated. In addition, Smith Barney brokers performed most of the customer service work; shareholders typically called them with questions and requests. Accordingly, First Data's customer service function was limited, and consisted primarily of a small call center of

approximately eight to twelve people who fielded inquiries from Smith Barney brokers and shareholders who did not have brokers (who constitute a small minority of Fund shareholders).

24. As a result of a favorable fee schedule and the low cost of servicing the Funds, First Data realized high profit margins throughout the 1990s, particularly in the late 1990s, when the fee structure changed from a per-account fee to a fee based on a percentage of assets. As a result of strong markets of the late 1990s, the Fund assets, and thus TA fees, increased.

25. Jones and Daidone knew that First Data made high profit margins from serving as TA to the Funds.

#### **The TA Review Process**

26. Pursuant to a non-compete agreement with First Data, CAM was prevented from offering TA services until the expiration of that non-compete agreement in 1999.

27. With the First Data contract and the non-compete provision due to expire in June 1999, CAM retained Deloitte & Touche Consulting (“Deloitte”) in July 1997 to assist it in reviewing the TA function and options going forward. Jones, who became CEO of CAM in August 1997, made the TA review project a top priority of CAM. From the outset, the focus of the TA review project was on maximizing profits to CAM.

28. The Deloitte team worked closely with representatives of CAM, including Daidone. The Deloitte team worked on location at CAM, and used a conference room located on the same floor as Daidone’s office as its base of operations.

29. Jones was actively involved in the TA review process from the beginning. Jones reviewed certain presentations by the Deloitte team and received regular briefings on the progress of the TA review project.

30. At the beginning of the review process, Deloitte and Defendants established several objectives, but Defendants' primary goal was to capture the profits that First Data was making on the TA contract. Defendants determined that CAM would enter the TA business and directed Deloitte to develop a variety of options to accomplish this.

31. A draft Deloitte presentation dated November 4, 1997 reflected Defendants' awareness that First Data had been charging high fees, its belief that the fees were above market, and its view of the opportunity presented by the fee structure:

First Data earns high margins as Transfer Agent for Smith Barney mutual funds. The current fee schedule appears to offer First Data above-market prices, creating a unique opportunity for Smith Barney to divert those profits to the Firm, while enhancing its flexibility and customer service.

(Emphasis added.)

32. During the first phase of the review process, Deloitte and the CAM team, including Daidone, analyzed different structural alternatives to determine which model was most appropriate in light of CAM's established objectives. The alternatives considered included a "full-service" option, a "remote vendor" option, and full internalization.

- a. The full-service option called for CAM to create an affiliated TA unit of approximately fourteen people to perform oversight and control functions and to contract with DST, a competitor of First Data, to provide the bulk of transfer agent functions. Under the full-service option, DST would receive the bulk of the fees; Deloitte projected that CAM would realize annual profits of approximately \$8.3 million. The November 4, 1997 draft presentation noted: "DST full service provides little cost advantage over the current state" (under which CAM received no revenue).
- b. The remote vendor alternative called for CAM to create an affiliated TA unit to handle customer service and operations and to contract with DST, First Data or SunGard for technology only. Deloitte estimated that the internal TA unit would require 121 full-time employees. The November 4 presentation noted that the remote vendor option required a greater initial investment and conversion effort than the DST full service option, but offered greater annual profit to CAM (between \$16.1 and \$22.8 million).

- c. The full-internalization option called for CAM to assume responsibility for all aspects of the TA function, including technology (by acquiring software). Although full-internalization would have offered the highest projected profit – approximately \$48 million per year – the option would have taken more than eighteen months to implement and would have required a staff of approximately 236 full-time employees. Because of the long implementation time and extensive start-up costs required by this option, Deloitte and CAM decided not to pursue it.

33. The CAM team, including Daidone, concluded that the remote vendor option, which offered significantly greater profit to CAM than the full-service option, was the preferred alternative. Accordingly, Deloitte and CAM solicited remote vendor bids from First Data, DST and SunGard.

34. DST and SunGard responded with remote vendor proposals. First Data declined to submit a remote vendor bid, and instead proposed to renew as full-service TA with a modest fee discount of its rate under the existing contract of approximately ten percent.

**Deloitte and CAM's Recommendation to Contract with DST**

35. After analyzing the specific proposals it received from the vendors, in February 1998, Deloitte recommended that CAM contract with DST as remote service provider. The DST proposal, as of February 1998, called for CAM to create an affiliated TA unit of approximately 100 employees to handle customer service and operations, and to contract with DST for technology. The CAM affiliate would be the named TA, receive fees from the Funds and pay DST a per account fee for technology. Deloitte projected that the CAM affiliate would receive more than \$40 million per year in profit under the proposal.

36. Deloitte concluded that DST's proposal was superior to other options, including options utilizing First Data, in terms of both pricing and technology. Because First Data had not submitted a remote vendor proposal and had offered only a modest fee discount, the DST

proposal was greatly superior in terms of the profit potential it offered to CAM. As for technology, Deloitte found that DST offered industry-leading technology (superior to that of First Data) and that switching to DST would better position the Funds for the future.

37. After learning that it was at risk of losing the business, First Data offered significant fee discounts. By letter to CAM dated March 12, 1998, First Data offered a \$25 million annual “fee concession” to CAM if the Funds renewed with First Data as full-service TA.

38. In the March 12 letter, First Data committed to increasing the level of resources it dedicated to the Funds and to offering Smith Barney brokers use of SuRPAS, First Data’s proprietary sub-accounting system. The SuRPAS system would permit Smith Barney brokers to charge investors a processing fee on sales of non-proprietary (non-Smith Barney) funds, and generate an additional \$40 million in annual revenue. In addition, by the middle of March 1998, First Data had pointed out to CAM that First Data Corporation provided \$9 million in revenue to various Citigroup (then Travelers) entities through investment banking fees, asset management fees and the purchase of insurance and other products.

39. CAM did not pursue the option of renewing with First Data as full-service TA and passing along the proposed discount directly to the Funds. Nor did anyone within CAM inform the Funds’ boards that First Data had made the offer to renew as full-service TA at deeply discounted rates. Instead, CAM pursued a deal that would allow CAM to benefit financially from the TA function.

40. Later in March, First Data improved its bid and offered a deeper discount, measured as a percentage of the total annual TA fees that First Data would receive from the Funds. The discounts would start at 32% in 1999 and increase by two percentage points each year, reaching 40% of total TA fees in 2003. Deloitte and CAM projected that the percentage

discounts would translate into \$21 million the first year and grow to \$39 million in the final year of the contract.

41. Deloitte questioned whether the discount offered by First Data would be passed along to the Funds or kept by an internal affiliated TA, which would perform only limited management and oversight duties. In a presentation dated March 24, 1998, Deloitte wrote:

Clarify the "Discount" proposed  
A true discount would go to the funds, not SSB TA.

This relationship will be extremely difficult to sell to the fund boards.

(Emphasis in original.)

42. After considering First Data's improved offer, the CAM team, including Daidone, concluded, along with Deloitte, that contracting with DST as remote service provider was the best option for CAM. The EVP made a formal recommendation to Jones, by memorandum dated April 2, 1998, to create an internal TA unit and sub-contract with DST for technology.

43. The April 2 memo stated that the DST proposal was superior to the First Data proposal in terms of technology and pricing. The memo reiterated Deloitte's findings regarding technology, and indicated that the DST proposal offered \$139 million more in profit to CAM over the projected five-year contract period than the First Data proposal offered. The April 2 memo noted that there was conversion risk with switching to DST, but concluded that the conversion risk was minimal.

44. The April 2 memo also noted that switching to DST could cost affiliates of Citigroup – then Travelers – \$8 to \$10 million annually in lost revenues from First Data Corporation. The memo concluded:

Based on economics and technology, our recommendation is to move the Transfer Agency processing to DST. We realize that a corporate relationship exists between First Data and [Travelers] and that relationship should be considered before any decision is made.

**CAM Continued Negotiating With First Data**

45. Jones agreed with the recommendation, but sometime after April 2, 1998, the chairman of Travelers asked Jones to negotiate further with First Data. Accordingly, Jones instructed the EVP to resume negotiating with First Data.

46. In a letter to the EVP dated June 5, 1998, First Data set forth an improved offer, which increased the discount First Data was willing to offer. The June 5 letter included the following fee schedule:

|                               |   |
|-------------------------------|---|
| June 1, 1999 to Dec. 31, 2000 | 32% discount on total fee revenue   |
| Jan. 1 to Dec. 31, 2001       | 35% discount on fee revenue up to \$80 million<br>60% discount on fee revenue over \$80 million |
| Jan. 1, 2002 to Dec. 31, 2003 | 50% discount on fee revenue up to \$80 million<br>60% discount on fee revenue over \$80 million |
| Jan. 1, 2004 to Dec. 31, 2004 | 55% discount on fee revenue up to \$80 million<br>60% discount on fee revenue over \$80 million |

**Deloitte's Renewed Warnings Regarding First Data Proposal**

47. Deloitte again questioned the structure of First Data's proposal. At a June 10, 1998 luncheon meeting in CAM's offices, Deloitte made a presentation entitled "Transfer Agency Project: Lunch and Learn – Financial Model Review." In the presentation, Deloitte questioned the structure in two respects. First, Deloitte questioned whether CAM could justify receiving TA fees for operating a fourteen-person TA unit. Deloitte's written presentation stated:

We Anticipate a Larger Organization Would be Needed to Satisfy the Fund Boards in the First Data Scenario.

\* \* \*

We believe at a minimum, the SSB TA would have to assume responsibility for Customer Service and Transaction Processing to justify receiving TA fees. This would require at least 65 [full-time employees] (rather than 14)

48. Second, Deloitte questioned the legality of the discount taking the form of a rebate to be paid to CAM, not the Funds:

First Data's proposal requires that First Data remains the TA; First Data receives full revenues of TA fees, providing a "rebate" to SSB (proposed as a "discount" by First Data)

This legal structure is questionable at best. Our advisers indicate that this arrangement would in no way be acceptable to the fund boards and may not be legally viable.

49. Deloitte's team leader personally presented the Lunch and Learn presentation to address the issues raised by the structure of the First Data proposal. Deloitte considered the issues to be very significant and had raised them with CAM representatives, including Daidone, prior to the Lunch and Learn meeting. CAM's failure to address the issues prompted Deloitte to schedule the June 10 meeting.

50. Instead of heeding Deloitte's warnings, CAM largely ignored them. The CAM team informed Deloitte that instead of receiving a rebate, the CAM affiliate would serve as named TA and sub-contract with First Data. Under this structure, all TA fees would pass through the CAM affiliate, so First Data would not be collecting fees and "rebating" them to CAM. In addition, CAM decided that the affiliated TA would assume some minimal operational responsibility. Specifically, the affiliated TA would assume from First Data responsibility for operating a small telephone call center to handle customer service calls.

51. These adjustments, however, were cosmetic in nature and did not address the substance of Deloitte's concerns -- the affiliated TA unit would still be extremely limited in size and would not perform sufficient functions to justify receiving TA fees. In addition, even though there would be no "rebate" in a strict sense of the word, the affiliated unit would still be taking the fee discount offered by First Data for itself, instead of passing it along to the Funds.

#### **First Data Sweetened the Pot**

52. In July 1998, First Data improved its offer in three respects. First, it increased the fee discount. Second, it agreed to migrate the Funds from its old technology to its more modern Full Service Retail ("FSR") platform. Third, by letter dated July 14, 1998, First Data offered the Revenue Guarantee. The July 14 letter stated:

First Data Corporation and Travelers will agree on a "basket of services" from which First Data Corporation will generate \$8 million of revenue to Travelers annually. A "make-whole" provision will be included which commits First Data Corporation to a fee credit on transfer agent services for any shortfall to the \$8 million. The credit will be 50 cents on each dollar of revenue shortfall.

53. First Data's Revenue Guarantee offered no benefit to the Funds. It was a benefit to CAM and its affiliates, intended to sway CAM to recommend First Data. The EVP had previously informed Jones that First Data was willing to commit to providing certain level of business to Travelers. Jones did not question the propriety of the offer, but instead told the EVP to get the commitment in writing.

#### **CAM Decided to Recommend First Data**

54. Despite Deloitte's warnings regarding the structure of the First Data proposal, by memorandum to Jones dated July 24, 1998, the EVP recommended that CAM establish an affiliated TA unit of approximately fifteen people to assume responsibility for the customer

service call center and contract with First Data for the bulk of the transfer agency services. The memo estimated the salaries of the fifteen call center employees would be \$1 million per year.

55. Although the structure of the proposal had been changed so that First Data would not pay a “rebate” to CAM, in substance the fee arrangement remained largely the same as in the prior proposals – First Data would be sharing its profits with CAM. The July 24 memo set forth the following fee arrangement, which was referred to in the memo as a “revenue sharing arrangement”:

|        | Percentage that is earned by [CAM] on: |                                 |
|--------|--|---------------------------------|
|        | First \$80MM                           | Over \$80 MM [in total TA fees] |
| Year 1 | 33.5%                                  | 33.5%                           |
| Year 2 | 40                                     | 60                              |
| Year 3 | 55                                     | 60                              |
| Year 4 | 55                                     | 60                              |
| Year 5 | 58                                     | 60                              |

56. The memo projected that CAM would earn the following profit under the revenue sharing arrangement (taking into account the \$1 million in salaries projected for new staff):

|        |              |
|--------|--------------|
| Year 1 | \$29 million |
| Year 2 | \$40 million |
| Year 3 | \$57 million |
| Year 4 | \$62 million |
| Year 5 | \$70 million |

57. The July 24 memo paid lip service to the Defendants’ fiduciary obligations, noting that, because of CAM’s fiduciary obligations to the Funds, it was obligated to implement a fee reduction. The recommended reduction called for the Funds to continue to pay the same asset-based fees that were being charged by First Data, subject to caps that limited TA fees to the lesser of the asset-based fee or a set amount (which ranged from \$13 to \$14.50 per account). The July 24 memo projected the caps would result in an annual fee reduction of \$6-\$8 million. Thus, the proposal was that CAM would reap \$258 million over the five-year contract period and the

Funds would get \$35 million. The Defendants understood that the true economics would never be candidly disclosed to the Funds' boards.

58. With respect to the Revenue Guarantee, the July 24 memo indicated that First Data had committed to:

- Providing CAM with additional assets to manage sufficient to generate \$1.5 million per year in asset management fees.
- Making Salomon Smith Barney First Data's investment banker of choice and generating at least \$3 million per year in investment banking fees.
- Paying 50 cents for every dollar of shortfall of investment banking fees and 90 cents for every dollar of shortfall of asset management fees, by way of credit on TA fees paid by CAM to First Data.

The memo stated that the Revenue Guarantee would generate at least \$22.5 million in revenue or \$14 million of "pre-tax bottom line" over the five years of the agreement.

59. Finally, in a section entitled "Mutual Fund Board Issues," the memo stated that the chairman of the Funds' boards, who was an officer of CAM, was "comfortable that the new First Data arrangement is supportable to the Fund boards." The memo noted that service levels, "while good, will improve," and the Funds would receive a fee reduction.

60. Jones approved this self-dealing transaction, focusing on the profit that CAM would make. In all, the proposal was projected to generate for Citigroup between \$29 and \$70 million in fees from the Funds each year for doing minimal work at an annual cost of a few million dollars. Jones took no action to ensure that the independent directors of the Funds' boards were fully aware of the terms of the First Data proposal and found them acceptable. Jones also failed to instruct anyone to make certain the Revenue Guarantee was fully disclosed to the Funds' boards. In short, Jones acted in complete disregard of his fiduciary responsibilities to the Funds and their shareholders.

## **The Sub-TA Agreement and Side Letter**

61. On August 4, 1998, First Data sent the first draft of the Side Letter to CAM. The first draft addressed the Revenue Guarantee and other significant commitments between the parties, including First Data's commitment to migrate the Funds to FSR.

62. Daidone reviewed the draft of the Side Letter and provided comments on it.

63. At the same time the Side Letter was being negotiated and revised, representatives of CAM and First Data prepared a formal sub-TA agreement (the "Sub-TA Agreement") between First Data and Mutual Management Corp., the Citigroup entity initially chosen by CAM to serve as the affiliated TA. Daidone reviewed the Sub-TA Agreement.

64. The Sub-TA Agreement and Side Letter were finalized on November 20, 1998. Daidone signed the Side Letter and Sub-TA Agreement on behalf of Mutual Management Corp.

65. The Side Letter, which specifically referenced the Sub-TA Agreement, contained the following provisions:

- the Revenue Guarantee;
- First Data's commitment to provide its SuRPAS system for sub-accounting;
- CAM's commitment to treat First Data as "favored nation vendor" for proxy and fulfillment services (which required CAM to solicit a bid from First Data when proxy and fulfillment services were required and to recommend First Data if CAM determined in good faith that its bid was competitive with the other bids received);
- CAM's agreement, subject to its fiduciary duties, to "use all reasonable and lawful means to encourage the Funds" to continue [First Data] as sub-transfer agent for existing Funds and any or all subsequent expansion, consolidation, affiliation, or addition to the Funds for which CAM provides investment management services"; and
- CAM's agreement to consider in good faith retaining or recommending First Data to provide other services to the Funds.

66. The Sub-TA Agreement included an integration clause, which provided that the Agreement, "including Schedules, Addenda and Exhibits" thereto, constituted the parties' entire agreement about the subject matter of the Sub-TA Agreement and superseded all prior and

contemporaneous agreements regarding the subject matter. Despite the obvious significance to the Funds of the benefits to CAM affiliates contained in the Side Letter, the Side Letter (or its substance) was not provided to the Funds' boards or filed with the Commission as part of the Funds' registration statements.

### **Spinning the Presentation to the Funds' Boards**

67. In or around mid-to-late February 1999, Daidone began to prepare materials regarding the TA proposal for the Funds' boards of directors in anticipation of upcoming meetings.

68. Although Daidone sought assistance from Deloitte, the leader of the Deloitte team had left Deloitte and was unavailable to assist. Deloitte assigned a technology specialist who had been a member of the Deloitte TA review team at the very beginning, but who lacked personal knowledge of the critical stages of the negotiations.

69. During an initial meeting, Daidone told the Deloitte representative the information that should be included in the Board Memo and how to spin it to make the proposal attractive to the Funds' boards. Daidone gave the Deloitte representative several "themes" to emphasize. For example, Daidone told the Deloitte representative to emphasize that the Funds would receive an immediate fee reduction under the recommended proposal and that the establishment of an affiliated TA would put the Funds in a position to obtain future fee reductions. Daidone gave the instruction even though he knew that First Data would have offered the Funds the full benefit of the fee reduction it was offering to CAM.

70. Daidone also told the Deloitte representative to emphasize that the fees to be charged to the Funds under the new TA contract would be below industry average. Daidone knew that the Funds' boards placed great weight on how fees charged to the Funds compared to

the industry average in determining whether to approve fee proposals and that a key to obtaining board approval was assuring the boards that the TA fees being charged were in line with or below the industry average.

71. The Deloitte representative prepared an initial draft of the Board Memo in accordance with Daidone's instructions.

72. Daidone made substantial revisions to the original draft and was responsible for the final content of the Board Memo as it pertained to the terms of the proposal.

73. The Deloitte representative also prepared an initial draft of a Power Point presentation for the Funds' boards, which Daidone revised substantially.

#### **The Materially Misleading Board Materials**

74. The final Board Memo was materially misleading. It was intentionally spun by Daidone to sell the proposal to the Funds boards. Consistent with Daidone's initial instructions, the Board Memo emphasized the fee savings the Funds would receive while obscuring the profit that the affiliated TA would receive and the minimal work it would perform.

75. The Board Memo did not candidly present the proposal in terms that would have made clear to the boards that First Data would continue to perform almost all of the TA functions, leaving CTB with a tremendous profit for manning a fifteen-person call center and performing limited additional oversight and quality control functions. The Board Memo did not explain in a meaningful way how duties were to be divided between CTB and First Data. To the contrary, the Board Memo gave the misleading impression that First Data was providing "technology" only, which was not true, and that CTB would be a much more substantial operation than it actually would be.

76. The board materials also stated that CAM approached the TA review process by looking at all available alternatives to provide the Funds with better service at lower prices. This was also untrue. From the beginning, CAM approached the review process with the goal of maximizing profit to CAM and, in order to attain its own goals, CAM did not pursue options that would have provided much greater value to the Funds. Contrary to representations in the board materials, the only options CAM ever seriously considered were options that involved making a CAM affiliate the TA.

77. The Board Memo did not disclose that First Data had made a series of offers to perform all TA services at deeply discounted rates -- including the initial \$25 million annual fee discount offer and the later percentage-based discount offers -- all proposals that, if offered directly to the Funds, would have provided greater savings than the proposal CAM recommended.

78. Even with respect to the alternatives that CAM actually considered, CAM did not disclose that Deloitte and CAM management had initially recommended DST; that CAM resumed negotiating with First Data only after Travelers management had requested that they do so because First Data was an investment banking client; and that CAM decided to recommend First Data only after First Data had increased the value of its proposal to CAM and offered the Revenue Guarantee. In fact, CAM failed to disclose the Side Letter or any of its terms.

79. Instead of making full and accurate disclosure regarding the TA review process and CAM's interest in the proposal, the Board Memo gave the incorrect impression that CAM was acting in the Funds' best interest and had expended significant effort and money to identify and negotiate the best deal for the Funds. The introduction of the Board Memo contains the following statement:

[I]n anticipation of the expiration of the non-compete agreement [with First Data], SSB began an exhaustive study in late 1997 utilizing the services of Deloitte Consulting to examine transfer agency alternatives to First Data with the goal of reducing fees, improving service and offering the Smith Barney Funds access to alternative channels of distribution (e.g., 401k) to promote further growth. This effort was completed in mid-1998 at a cost of \$2.5 million.

80. This paragraph is inaccurate and misleading. Reducing fees was not a goal of the review process. The idea of a fee reduction was first raised in the summer of 1998, by the chairman of the Funds' boards, and was separate from the decision on how to structure the TA function. Daidone, who negotiated a fee reduction with First Data in July 1998, knew or was reckless in not knowing that the idea of a fee reduction was not raised until the summer of 1998.

81. The Board Memo bolstered the case for the recommended proposal by giving the incorrect impression that no viable alternatives existed. The following paragraph, entitled "Change of Transfer Agent Vendor," was intended to describe all remote TA vendor proposals, including the DST proposal.

Results showed that the internalization of transfer agency functions and engagement of another technology vendor could reduce the fees paid by the Smith Barney Funds and also be the most profitable alternative to SSB. However, full internalization of the transfer agent functionality would have entailed the creation of an organization of 150 employees. In addition, the conversion and software modifications required to migrate to a new technology and services provider would have taken at least two and a half years. In short the Smith Barney Funds would not realize any cost savings for several years under this scenario.

82. The paragraph above is materially misleading. The paragraph failed to discuss the DST proposal in any detail or to disclose that Deloitte had recommended it.

83. In addition, to the extent that the figures contained in the paragraph were intended to describe the DST proposal, they were inaccurate. The DST proposal would have required

CAM to hire approximately 100 employees, not 150; the conversion to DST would have taken twelve to eighteen months, not thirty; and under the DST proposal the Funds would have realized savings in the first year after conversion.

84. Moreover, the paragraph falsely suggested that CAM was foregoing some profit and recommending First Data in order to pass along fee reductions to the Funds. The First Data proposal, however, was economically superior – for CAM and its affiliates – to the DST proposal.

85. In a separate paragraph, the Board Memo reinforced the false impression that CAM was sacrificing its own interests to the benefit of the Funds:

The decision to remain with First Data and establish an internal transfer agency capability was made with the recognition that although not the most favorable option financially to SSB, it represented a prudent course of action with immediate results. The revenue shortfall as a result of accepting the proposed First Data contract over our most attractive alternative was approximately \$16.0 million.

86. These statements are false. The First Data proposal was projected to provide greater profit to CAM than the DST proposal, not \$16 million less.

87. Although the Board Memo disclosed that the affiliated TA would make a profit, the disclosure regarding the economic benefit to CAM was limited and misleading. The only paragraph of the Board Memo that discussed the projected profit to CAM appears in a section entitled “Proposed Transfer Agency Fee and Fund Savings Analysis,” and states:

SSB commits to reviewing the transfer agent service and fees on an annual basis with the Smith Barney Fund boards. SSB anticipates that the SSB transfer agency business unit will operate on a 33% margin based on the June 1, 1999 First Data fee schedules. While First Data discounts may increase over the life of the contract, it is expected that expenses will rise on a commensurate basis as SSB adds to its transfer agent capabilities.

88. At the time, CAM was projecting that it would earn tens of millions of dollars in profit each year for operating a fifteen person call center and performing limited additional oversight and quality control functions. The Board Memo did not even include a profit projection in dollars. In addition, there was no meaningful disclosure about how limited the services were that CTB was to contribute in return for the profit it would make.

89. Because virtually all of the work was to be done by First Data, the 33% profit margin figure was itself misleading. The margin was based on an analysis that treated sub-TA payments to First Data as expenses of CTB. The economic reality would have been more accurately portrayed by deducting payments to First Data from revenue – not treating them as expenses of CTB. CTB is essentially a pass-through for those payments. In fact, internally, CAM described the fee arrangement with First Data as a revenue sharing agreement. Had payments to First Data not been treated as an expense of CTB, the projected pre-tax profit margin would have been approximately 70%.

90. The Power Point disclosed that “Revenue Generation” was one of CAM’s goals, and included a table that contained profit projections in dollar amounts. The table, however, was not provided to the directors in advance of the meeting. Had board members received the projections in advance and had the opportunity to scrutinize them, they at least would have had a chance to understand that CAM expected to earn tens of millions in profit. But they still would not have understood just how limited CAM’s proposed contribution to the venture really was.

91. Finally, the Board Memo incorrectly indicated that the fees charged to the Funds by First Data were significantly below industry average.

92. Jones approved the Board Memo before it was sent to the Funds' boards, but took no steps to confirm its accuracy, such as reviewing the EVP's July 24, 1998 memo, which set forth the material terms of the proposal.

93. CAM included the final version of the Board Memo and the Sub-TA Agreement in the materials that it sent to board members in advance of the meetings. Neither the Side Letter nor the Power Point was included in the packet of materials that was sent to board members.

**CTB Has Made High Profits for Performing Limited Work**

94. At regularly scheduled meetings during the first half of 1999, Daidone presented the proposal to the Funds' boards. Like the Board Memo, Daidone's Power Point presentation was spun to sell the proposal to the Funds' boards and failed to make full and accurate disclosure regarding the material terms of the proposal.

95. All of the Funds' boards approved the recommendation during the meetings at which it was presented.

96. On October 1, 1999, a CAM affiliate, now CTB, became the named TA for the Funds, and assumed responsibility for the customer service function; First Data – now PFPC, Inc. ("PFPC") continued to perform the bulk of the TA services as sub-TA. As named TA, CTB receives 100% of the fees and makes sub-TA payments to PFPC and to Primerica Financial Services, a Citigroup affiliate that sells certain of the Funds and performs sub-TA work.

97. From the inception of the TA contract through September 30, 2004, approximately fifteen CTB employees performed work for the Funds. Of those fifteen, only seven spent 100% of their time doing Fund-related work.

98. As intended, CTB has realized high profits for performing limited work. The one function that CTB assumed from First Data/PFPC was the customer service function, which

consists primarily of a call center. From the inception of the CTB TA contract through September 30, 2004, the call center was staffed by approximately seven full-time employees who are dedicated to Fund business. Five of those employees answered calls; two were supervisors. The seven call center staff members were the only CTB employees who spent all of their time on Fund-related work.

99. For the period October 1, 1999 through September 30, 2004, CTB earned net pre-tax revenues of approximately \$104 million from Fund business. The profit is lower than the originally projected profit due to, among other things the downturn in the market that began in 2001. Over the same period, CTB had total operating expenses (excluding sub-TA payments) of approximately \$11.5 million, justly slightly more than \$2 million per year. In addition, CAM and its affiliates received approximately \$17 million under the Revenue Guarantee.

100. CAM representatives supervise the TA operations of CTB, which are part of the CAM business unit for budget and reporting purposes. For purpose of setting compensation, Jones received credit for the revenue that CTB's TA operations generated.

### **CLAIM FOR RELIEF**

#### **Aiding and Abetting Violations of Sections 206(1) and 206(2) of the Advisers Act [15 U.S.C. §§ 80b-6(1) and 80b-6(2)] (Against both Defendants)**

101. The Commission realleges and incorporates by reference paragraphs 1 through 100 above.

102. By reason of the foregoing, the Adviser and Global Markets violated Sections 206(1) and 206(2) of the Advisers Act in that they employed devices, schemes or artifices to defraud clients or prospective clients and engaged in transactions, practices, or courses of businesses that operated or would operate as a fraud or deceit upon clients or prospective clients.

103. By reason of the foregoing, Defendants aided and abetted the Adviser and Global Markets' violations of Sections 206(1) and 206(2) of the Advisers Act.

104. Jones substantially assisted the violations by, among other things, approving the decision to recommend the First Data proposal to the Funds' boards and approving the materially misleading Board Memo.

105. Jones knew that the recommended proposal was a self-interested transaction and knew or was reckless in not knowing that the board materials were materially misleading and failed to make adequate disclosure regarding, among other things, the amount of profit CTB would make and the limited work it would perform.

106. Daidone substantially assisted the violations by, among other things, misleading the Funds' boards regarding the TA proposal.

107. Daidone intentionally spun the Board Memo and Power Point to make the affiliated TA proposal attractive to the Funds' boards and knew or was reckless in not knowing that the Board Memo and Power Point were materially misleading.

108. Unless restrained and enjoined, Jones and Daidone will continue to aid and abet violations of Sections 206(1) and 206(2) of the Advisers Act.

**WHEREFORE**, the Commission respectfully requests that the Court enter a Judgment:

**I.**

In a form consistent with Fed. R. Civ. P. 65(d), permanently enjoining each Defendant from violating or aiding and abetting violations of Sections 206(1) and 206(2) of the Advisers Act.

**II.**

Ordering each Defendant to disgorge all ill-gotten gains from his illegal conduct.

**III.**

Ordering the Defendants to pay civil penalties under Section 209(e)(1) of the Advisers Act [15 U.S.C. § 80b-9(e)(1)].

**IV.**

Retaining jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

**V.**

Granting such other and further relief as this Court may determine to be just and necessary.

Dated: New York, New York  
August 8, 2005



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