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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
GARY PIERCE

Arizona Corporation Commission

DOCKETED

FEB -1 2007

DOCKETED BY nr

In the matter of
WACHOVIA CAPITAL MARKETS, LLC
301 South College Street
Charlotte, North Carolina 28202

Respondent.

DOCKET NO. S-20468A-06-0521

DECISION NO. 69294

ORDER FOR ADMINISTRATIVE PENALTY AND CONSENT TO SAME

BY: WACHOVIA CAPITAL MARKETS, LLC

WHEREAS, Wachovia Capital Markets, LLC, is a dealer registered in the state of Arizona;

and

WHEREAS, a coordinated investigation into activities of Wachovia Capital Markets, LLC, and its predecessors, in connection with certain potential conflicts of interest that research analysts were subject to during the period of January 1, 1999, through December 31, 2002, has been conducted by a multi-state task force (collectively, the "State Regulators"); and

WHEREAS, Wachovia Capital Markets, LLC, has advised the State Regulators of its agreement to resolve the investigations relating to its research practices; and

WHEREAS, Wachovia Capital Markets, LLC, has adopted policies and procedures designed to ensure compliance with all legal and regulatory requirements regarding research

1 analyst independence, including applicable securities laws, regulations and rules of the Securities
2 Exchange Commission, NASD, and New York Stock Exchange; and

3 WHEREAS, Wachovia Capital Markets, LLC, has demonstrated that its organizational
4 structure and some of its policies were already consistent with many of the new structural reforms
5 outlined in the December 2002 Research Analyst Global Settlement agreement-in-principle, and
6 Wachovia Capital Markets, LLC, voluntarily began implementing additional policies and
7 procedures in January 2003 consistent with those structural reforms and completed that
8 implementation by November 2003; and

9 WHEREAS, in November 2002, Wachovia Corporation contracted to upgrade the e-mail
10 retention technology, including content filtering and internal archiving platforms, of its subsidiaries
11 and business units, including Wachovia Capital Markets, LLC, and its predecessors, which upgrade
12 is in the process of being implemented; and

13 WHEREAS, Wachovia Capital Markets, LLC, elects to permanently waive any right to a
14 hearing and appeal under Articles 11 and 12 of the Arizona Securities Act, A.R.S. § 44-1801 *et*
15 *seq.* (“Securities Act”), and Title 14 of the Arizona Administrative Code with respect to this
16 Consent Order (the “Order”);

17 NOW, THEREFORE, the Arizona Corporation Commission (“Commission”), as
18 administrator of the Arizona Securities Act, hereby enters this Order:
19

20
21 **I.**

22 **FINDINGS OF FACT**

23 **JURISDICTION**

24 1. Wachovia Capital Markets, LLC, (CRD No. 126292) is currently, and at all times
25 relevant to this Order was, registered in Arizona as a dealer. As used in this Order, the term
26 “WCM” refers collectively to Wachovia Capital Markets, LLC, and its predecessors.

1 2. The Commission has jurisdiction over this matter pursuant to Article XV of the
2 Arizona Constitution and the Securities Act.

3 3. This action concerns the period of January 1, 1999, to December 31, 2002 (the
4 “Relevant Period”). During the Relevant Period, WCM engaged in both research and investment
5 banking activities as described below.

6 **BACKGROUND**

7 4. Wachovia Corporation, formerly known as First Union Corporation (“First Union”),
8 is a diversified financial services company that provides banking, asset management, wealth
9 management, and corporate and investment banking products and services.

10 5. First Union formed First Union Capital Markets Corp. in 1994. Following the
11 formation of First Union Capital Markets Corp., First Union determined to expand its capital
12 markets business through a series of acquisitions, including Wheat First Butcher Singer in January
13 1998, Bowles Hollowell Connor & Co. in April 1998, EVEREN Capital Corporation in October
14 1999 and Forum Capital Markets, LLC, in June 2000. In conjunction with the acquisition of
15 EVEREN Securities, Inc., First Union Capital Markets Corp. merged with and into EVEREN
16 Securities, Inc., EVEREN’s broker-dealer subsidiary, and changed its name to First Union
17 Securities, Inc. In September 2001, First Union merged with the former Wachovia Corporation.
18 First Union was the surviving entity in the merger. Following completion of the merger, First
19 Union changed its name to Wachovia Corporation and, thereafter, the former Wachovia Securities,
20 Inc., merged with First Union Securities, Inc., and First Union Securities, Inc., the survivor of that
21 merger, changed its name to Wachovia Securities, Inc. Wachovia Capital Markets, LLC, was
22 formed in connection with Wachovia Corporation’s July 2003 joint venture with Prudential
23 Financial, Inc., in which the retail brokerage operations of Wachovia Securities, Inc., and
24 Prudential Securities Inc. were combined. Wachovia Capital Markets, LLC, is the entity that was
25
26

1 created at that time to operate Wachovia Corporation's institutional brokerage and capital markets
2 businesses.

3 6. Wachovia Corporation consists of four business divisions, including Corporate
4 Investment Banking ("CIB"). CIB provides lending, capital markets, treasury and financial
5 advisory services for corporate and institutional customers. CIB's business activities are conducted
6 through several Wachovia Corporation subsidiaries including, but not limited to, WCM.

7 7. Several divisions of CIB including, but not limited to, Investment Banking, Fixed
8 Income and Equity Capital Markets operate, in whole or in part, through WCM. Equity Research,
9 Equity Trading, Institutional Sales and the Equity Capital Markets Desk are the four departments
10 within Equity Capital Markets. The Equity Capital Markets Division, in its present form, was
11 started in 2000.

12 8. From July 1999 through December 1999, the head of Equity Research directly
13 reported to one of the managers of Investment Banking. At all other times during the Relevant
14 Period, the management of the Equity Research Department reported to the head of the Equity
15 Capital Markets Division, who in turn reported to the managers of CIB. In 1999, Investment
16 Banking was the term used to describe the business unit engaged in Investment Banking activity, as
17 well as sales, trading, principal investing and other non-investment banking activities.

18
19 **A. The Investment Banking Function at WCM**

20 9. The Investment Banking Division of CIB at WCM provides financial advice and
21 transactional services to corporate clients regarding, among other things, equity and debt offerings,
22 business combinations and other financing transactions.

23 10. During the Relevant Period, the Equity New Business Committee and the Equity
24 Commitment Committee approved WCM's participation as an underwriter or as a member of a
25 selling syndicate in IPOs or secondary offerings. Prior to the approval, the committees received
26

1 written presentations from the group working on the proposed transaction, setting forth the
2 pertinent information regarding the issuer and the level of WCM's participation in the transaction.

3 **B. The Role of Research Analysts at WCM**

4 11. During the Relevant Period, WCM's Equity Research Department employed
5 approximately 40 Research Analysts to provide research coverage on a broad range of industry
6 sectors and to publish periodic reports on selected companies within those sectors. Equity
7 Research Analysts at WCM ("Research Analysts") were responsible for reviewing the performance
8 of the selected companies, evaluating their business prospects, and providing analyses and
9 projections concerning the investment opportunity presented by the company, commonly referred
10 to as providing research coverage.

11
12 **C. Research Ratings at WCM**

13 12. During the Relevant Period, WCM used several systems to rate the investment
14 opportunity of the companies on which research was published ("Covered Company"):

15 a. From August 1999 through September 2000, WCM used a five-tier system under
16 which companies were classified as follows, from most to least positive:

17 **1 Buy** – Expectations of at least a 20% total return or more in the next 12 months. This
18 rating is for our best ideas both for the short and long terms.

19 **2 Outperform** – Expectations of a 10%-20% total return in one year or more. We believe
20 this stock is a good one for a longer period; we are confident about its fundamentals.

21 **3 Hold** – Potential upside of 10%, but the potential downside is also 10% within a 12-
22 month period.

23 **4 Underperform** – Expectations that the stock could drop by more than 10% in the near
24 term. This rating implies that this stock will not only underperform the market, but it also
25 could drop significantly in price. Ideally, this stock is viewed as a "source of funds."

26 **5 Sell** – This is an outright sale due to fundamental risk or dramatic industry changes.

1 b. In October 2000, WCM implemented a four-tier rating system using the following
2 ratings:

3 **1 Strong Buy** Expectations of at least a 20% total return or more in the next 12 months.
4 This rating is for our best ideas both for the short and long terms.

5 **2 Buy** Expectations of a 10-20% total return in one year or more. We believe this stock is
6 a suitable holding for a longer period; we have a high degree of confidence in the
7 company's fundamentals.

8 **3 Market Perform** Potential upside is 10% as is the potential downside within a 12 month
9 period. Stock will likely perform in line with the Market.

10 **4 Underperform** Expect that stock price could decline by more than 10% over the next 12
11 months. This stock should be viewed as a source of funds.

12 c. In February 2002, WCM removed all reference to percentages in the definitions of
13 the ratings, which were changed to the following:

14 **Strong Buy:** We believe noticeable upside potential exists. We have high visibility on
15 estimates, and confidence in the company's business model and management's execution
16 abilities. A near-term catalyst should be able to drive the stock higher.

17 **Buy:** We believe the stock is attractively valued. The company has sound or improving
18 fundamentals that should allow it to outperform the broader market.

19 **Market Perform:** We believe the stock may be mispriced. The company may have issues
20 affecting fundamentals that may take some time (perhaps a quarter or more) to resolve or
21 there is a misunderstanding of the company's business fundamentals or growth prospects.
22 (The Street may be too upbeat about the long-term prospects.)

23 **Underperform:** We believe the stock is noticeably mispriced relative to the soundness of
24 the company's fundamentals and long-term prospects. The company has significantly weak
25 fundamentals or a flawed business model.

26 d. In May 2002, WCM modified the definitions of the two lowest rating categories as
follows:

Hold: We believe the stock is fairly valued at the current price. The company may have
issues affecting fundamentals that could take some time to resolve. Alternatively, company
fundamentals may be sound, but this is fully reflected in the current stock price. *Do not
accumulate additional shares*

1 **Sell:** We believe the stock is overpriced relative to the soundness of the company's
2 fundamentals and long-term prospects. The company has significantly weak fundamentals
or a flawed business model. *Sell*

3 (emphasis in original). Thereafter, WCM adopted a three-tier system (Outperform, Market
4 Perform, and Underperform), which is in place today.

5 13. WCM's Research Analysts virtually never used the lowest rating in WCM's stock
6 rating system. During the Relevant Period, WCM publicly stated its rating system had either four
7 or five categories. However, WCM Research Analysts rarely used the "4" or "5" rating. Of 2,038
8 ratings between January 1, 1999, and July 2, 2002, analyzed during the investigation, only 16
9 (.79%) were "4" rated and only 2 (.10%) were "5" rated.

10 14. Some Research Analysts discussed the timing of ratings changes. For example,
11 under areas of development in his 2000 performance evaluation, one Research Analyst stated "In
12 the past, we've been first with meaningful news and 'talked down' stocks without formally
13 changing ratings."

14 15. Although institutional clients were the primary target audience, research reports
15 authored by the Research Analysts and disseminated by WCM were accessible by certain clients
16 through internal websites for clients and to non-clients through First Call, Bloomberg, and
17 subscription services.

18
19 **THE RELATIONSHIP BETWEEN THE INVESTMENT BANKING DIVISION AND**
20 **EQUITY RESEARCH DEPARTMENT OF WCM CREATED POTENTIAL CONFLICTS**
21 **OF INTEREST FOR RESEARCH ANALYSTS**
22

23 16. During the Relevant Period, certain practices at WCM created potential conflicts of
24 interest for the firm's Research Analysts which arose from the inherent tension between the
25 Research Analyst's obligation to provide independent research regarding covered companies and
26 the involvement of the Research Analysts in various aspects of its investment banking business.

1 Periodically, some Research Analysts at WCM identified potential investment banking
2 opportunities in their respective industry sectors, including initial public offerings (“IPOs”).

3 **A. Analysts Participated in Investment Banking Activities**

4 17. Certain Research Analysts supported the efforts of investment bankers at WCM.
5 On occasion, the Investment Banking Division promoted WCM’s research coverage to issuers for
6 whom WCM was seeking to act as an underwriter for investment banking transactions.

7 18. A number of performance evaluations for WCM Research Analysts, and their
8 Associates,¹ assessed the subject’s involvement in investment banking activities for the evaluation
9 year. Some performance evaluations established goals for assistance to investment banking in the
10 following year. Examples include, but are not limited to:

11 a. One Research Analyst, in evaluating the performance of an Associate, stated the
12 Associate “could have accomplished even more without excessive burdens from investment
13 banking.” According to the Associate’s self-evaluation:

14
15 Corporate finance placed significant demands on our time; reviewing pitches, answering
16 inquiries to assist in developing presentations, editing transaction documents and providing
17 support on positioning pieces. Additional staffing may be necessary if we continue to ramp
18 up the banking business, which can sometime [sic] leave us overwhelmed to the detriment
19 of our research effort.

20 b. Another Research Analyst established increased “interaction with investment
21 banking” as a goal for 2002. To accomplish this goal, the Research Analyst promised he would be
22 “available for pitches as necessary” and have “flexibility regarding the companies I chose to
23 cover.”

24 c. On a self-evaluation, an Associate Analyst stated “in response to the marketing trip
25 with JILL, I investigated the dilutive effects of a secondary offering and followed up with

26 ¹ Associates assist the Research Analyst in gathering information on the covered companies in writing reports. Associate positions provide training for becoming a Research Analyst and many Associates at WCM openly discussed what they needed to improve in order to “move to the next level” of becoming a Research Analyst.

1 investment banking to inform [an investment banker for WCM] of the potential for a follow-on in
2 the next year.”

3 d. Another Associate Analyst stated he had exceeded expectations based in part on his
4 “significant involvement in pitching for new equity business and working on the efforts once the
5 business was won.”

6 e. A Research Analyst stated that his “extensive relationship base” had proven critical
7 to (a) institutional sales, (b) research and (c) investment banking. The Research Analyst also noted
8 his “frequent role of assisting investment bankers accessing the tax exempt/institutional equity
9 market for joint venture capital.”

10 f. Under the section entitled “Areas for Development,” one Research Analyst
11 commented “[t]ime management skills are always a challenge in equity research given the
12 obligations to writing, research, sales and banking.”

13 g. A Research Analyst established “[p]articipate in additional corporate finance
14 transactions” as a goal for 2001. The Analyst pledged “to play a crucial part in gaining lead
15 manager status” in investment banking deals which were pending at the time.

16 h. In evaluating the performance of his Associates, one Research Analyst observed his
17 industry sector “seems to be one of the busiest, both in demands from sales/trading as well as
18 banking.”

19 i. In response to a question regarding areas for development in the upcoming year, a
20 Research Analyst included, among other areas, to “[c]ontinue to work closely with Corporate
21 Finance counterparts [to] execute identified projects and pursue new opportunities with a focus on
22 quality.”

23 j. An Associate Analyst identified increasing “investment banking exposure” as one of
24 several areas for development. The Associate went on to state, “I hope to be given the opportunity
25
26

1 to work with banking teams on deal pitches when possible, the IPO process or M&A
2 opportunities.”

3 k. In evaluating his performance for 2001, a new Research Analyst stated

4 On the investment banking side, I feel like I have built strong relationships with both
5 private and public companies. I have been aggressive at getting out to meet with
6 companies, both public and private, and to continue the dialogue on an ongoing basis. I
7 have worked hard to build a strong relationship with my investment banking counterparts.

8 l. In discussing the year's performance, one Research Analyst discussed his
9 involvement with investment banking, citing, as an example, participation in the NetScreen initial
10 public offering. According to the Analyst, he “created a large portion of the NetScreen pitch” and
11 worked closely with company management “in preparing a pro-forma operating model and in
12 preparing the roadshow presentation.”

13 19. Some Research Analysts at WCM organized or participated in meetings where
14 investment banking business was solicited. For example:

15 a. In March 2000, a Research Analyst asked the manager of Equity Capital Markets if
16 he was available to attend a “pitch/dinner” with the executives of a private company. According to
17 the Analyst, the company was close to making an IPO filing and WCM had a chance for the lead
18 position on the transaction. The Analyst stated “[w]e have had to cancel two meetings, so we need
19 to put on the big push. (Cancellations relate to 7 signed up deals so far this year, including 3 org
20 meetings in the last week.)” When the manager was unable to attend the meeting, the Analyst
21 asked for a recommendation of a substitute for the meeting to “fill your large shoes”; the
22 substitutes suggested included a member of Research Management, whom the Analyst invited to
23 the meeting.

1 b. In August 2001, one WCM Research Analyst recommended that the Analyst and the
2 investment bankers in the sector discuss a potential secondary offering in the sector, adding “I
3 would be happy to beg and plead” with the executives of the company being solicited.

4 c. In a December 2001 e-mail message, a member of Research Management
5 congratulated Research Analysts who had been involved in recent investment banking deals. Each
6 Research Analyst was asked to provide two to three points that made WCM stand out on the deal
7 “either in [WCM’s] performance on the deal [or WCM’s] positioning on the cover.” The Research
8 manager indicated the information would be used in an upcoming research conference call “as [a]
9 learning experience for the research department.” As an example of what was expected, the
10 manager said of one Research Analyst’s impact on a deal:

11 1) He visited the company several times in the 12 month [sic] prior to the bake-off, 2) he
12 wrote about the company in industry reports and notes on public company competitors that
13 he covers, and 3) he exhibited an expertise in this sector of security that exceeded that of
14 even the lead manager.

15 20. Investment banks, including WCM, competed to be selected by issuers as
16 underwriters for investment banking transactions. Issuers selected underwriters based on
17 presentations by the competing investment banks, during which the investment banks described
18 their qualifications, outlined a selling strategy, and offered investment banking and other services
19 to the issuer. As part of these presentations, investment banks, including WCM, often provided
20 issuers with a “pitchbook” describing the credentials of their investment bankers and services that
21 the investment bankers could provide.

22 21. The pitchbooks prepared and used by WCM’s Investment Banking Division to
23 solicit investment banking business frequently referenced the Research Department of WCM and
24 the WCM Research Analyst who covered the issuer’s industry sector. One or more of the
25 following was found in a number of pitchbooks:
26

1 a. The Research Analyst for the company's sector was identified under the heading,
2 "Transaction Team," along with the investment bankers who were soliciting the business, as well
3 as staff from the institutional sales and equity syndication responsible for the marketing and pricing
4 of the transaction;

5 b. Equity Research Analysts were referred to in a chart labeled "Provides a Full Array
6 of Investment Banking Products";

7 c. The growth in WCM's Research Department was cited, along with the Trading
8 Desk, as support for the statement that WCM was "Building a dominant investment banking
9 platform for growing companies"; and

10 d. "Sales/sales trading/research/banking alignment" was listed as one of seven "core
11 competencies" of WCM's Equity Capital Markets Division, along with "focused, in-depth
12 research" and other characteristics.

13
14 22. Memoranda on prospective investment banking deals submitted to the Equity
15 Commitment Committee and Equity New Business Committee for approval were put together by
16 the investment bankers responsible for soliciting the business. On some memoranda, the Research
17 Analyst for the issuer's industry sector was listed as a member of the transaction team and/or as a
18 submitter of the memoranda.

19 23. Some pitchbooks implied that, if WCM was selected as an underwriter on the
20 investment banking transaction, the issuer would receive research coverage from WCM. Examples
21 include, but are not limited to:
22

23 a. Inclusion of time lines which indicated when the Research Analyst would initiate
24 coverage and stated the Analyst would issue follow-up research reports as necessary.

25 b. Notations to past favorable coverage by the Research Analyst and emphasis of its
26 enthusiastic support for the issuer.

1 c. References to the WCM Research Analyst's ratings for the issuer's industry sector,
2 highlighting favorable comparisons to the ratings of analysts from other investment banks. For
3 example, one pitchbook stated the WCM Research Analyst "continues her emphatic support of the
4 wireless sector with stronger ratings on covered companies than her peers."

5 d. Identification of the Research Analyst's history of ratings.

6 e. Inclusion of charts showing the historical price and volume of the issuer's stock.
7 When such information was not available, the WCM pitchbooks used historical price and volume
8 information for other companies in the issuer's industry. The price and volume charts given to
9 prospective investment banking clients noted the dates that WCM had published research reports,
10 along with other news events.

11
12 24. Specific instances where the pitchbook for an investment banking solicitation
13 emphasized that WCM's equity research was related to its investment banking activities include,
14 but are not limited to:

15 a. Under the topic "RAPIDLY EXPANDING HEALTHCARE INVESTMENT
16 BANKING PRACTICE", a December 2000 pitchbook for a transaction involving Natus stated,
17 among other things, "Hired an additional six Healthcare equity research analysts in the last 12
18 months" and "Dedicated research analysts work closely with corporation finance professionals to
19 help meet client needs."

20 b. A January 2000 pitchbook for a presentation to E-PLUS listed WCM's Research
21 Department, with other departments, under the heading "SOLID INVESTMENT BANKING
22 PLATFORM."

23
24 c. An August 2001 pitchbook for a presentation to Alamosa Personal Communications
25 Services stated "[WCM] has built a full service investment banking platform," which included
26 "Proactive research coverage in equity" markets. The pitchbook further stated that WCM had

1 “committed significant capital and resources,” including equity research, towards the success of
2 Alamosa.

3 25. Certain communications between WCM’s Research Analysts and supervisors in
4 Investment Banking demonstrate that some Research Analysts attempted to promote WCM’s
5 investment banking and suggest that the Research Analysts believed that they would benefit if
6 WCM received investment banking mandates. For example:

7 a. In August 2001, one Research Analyst contacted the head for WCM’s Investment
8 Banking industry group in the Analyst’s sector, to suggest a change in investment bankers assigned
9 to Nextel Partners and AirGate. At the time, the Analyst covered both companies with “Strong
10 Buy” ratings.

11
12 i. The Analyst suggested the change due to “the slip up with Nextel Partners which we
13 all have belabored over the past few weeks and some recent developments with AirGate.”

14 ii. With regard to Nextel Partners, the Analyst alluded to a recent “mix-up” between
15 the WCM banker and the company, stating “Obviously, you know I was very frustrated
16 with that situation given that I was clearly told by the CFO that we would have been in the
17 deal had that never happened.”

18 iii. The Analyst also referenced recent difficulties between AirGate and the WCM
19 banker assigned to the company. The Analyst informed the investment banking group
20 head:
21

22 AirGate plans to do a secondary sometime in the first half of 2002. I feel I have a
23 good enough relationship with that management team to hopefully win them over (I
24 will beg if needed) and try & get us in the deal. The treasurer seemed to imply to
[the WCM investment banker] that if a relationship manager change would be put in
place – it may help our case.

25 iv. The Analyst concluded the e-mail message by saying:
26

1 I hope you do not think I am budding [sic] in where I should not be, it is just I
2 obviously have a vested interest in getting both deals done. In my mind, my team
3 has devoted the effort from the research side and we are now getting penalized for
4 something we had no control over or involvement with in the first place.

5 b. In November 1999, a Research Analyst sent an e-mail message to a senior member
6 of Investment Banking Management, praising the work of the investment banker working in the
7 Analyst's industry sector.

8 i. The Analyst informed the investment banking manager that "[w]e seem to be
9 identifying several opportunities a week as well as traveling to a pitch a week."

10 ii. According to the Analyst, he had been concerned before starting with WCM that he
11 would not have "adequate support on the banking side. This has proven not to be the case.
12 [The investment banker] has proven to be far more focused, responsive and productive than
13 any banking counterpart that I ever worked with at [a previous employer]. . . . [The
14 investment banker] has been, and will be crucial to monetizing my research franchise."

15 iii. After identifying investment banking transactions which were completed, in
16 process, or "in pursuit for 2000",² the Analyst concluded by saying "We both remain
17 focused on jointly developing a credible, sustainable and highly profitable [sector]
18 franchise. We look for our economics to only improve further as the FUSI institutional
19 brand, particularly in this space, takes hold."³

20 26. Supervisors at WCM expected Research Analysts to be supportive of investment
21 banking. For example:

22 a. According to an article in SmartMoney magazine entitled "What's an Analyst to
23 Do?" in June of 2000, a member of Equity Capital Markets Management is quoted as saying that
24 "[m]ost [banks] would say, 'our analysts are here just to do great research and follow companies,'
25

26 ² The Analyst stated these were "More than I can count."

³ References by Research Analysts to "space" mean the industry sector which the analyst covers.

1 but that's not the reality. They have a lot of responsibilities – and investment banking is becoming
2 more essential.”

3 b. In the article referenced in paragraph 26(a), a Research Analyst at WCM is quoted
4 as saying that “[i]t’s a fact of life. I’ve got three different hats to wear. There’s the research, but
5 then there’s the banking and marketing. I’ve got an obligation to all three.” In the article, the
6 Analyst estimated that research-related tasks occupied only one-third of the Analyst’s time, and the
7 rest was spent on banking and marketing.

8 **B. Some WCM Pitchbooks Prepared by WCM’s Investment Banking Division**
9 **Referenced Past Research in the Context of Seeking Future Business**

10 27. In a pitch to one company in October 2000, WCM listed the services that it had
11 provided to the company as:

12 Significant capital commitment since the Company’s IPO

13 #1 Trader of [the company’s] Stock

14 Strong Buy equity coverage⁴

15 Institutional and retail distribution capabilities equal to that of Wall Street firms[.]

16 WCM contrasted these services with the benefit WCM had received from the company saying:

17 but . . .

18 ➤ Only \$800,000 in equity fees since Company’s IPO, behind, Donaldson, Lufkin &

19 Jenrette Securities Co., J.P. Morgan Securities, Inc., Bear, Stearns & Co. Inc.,

20 PaineWebber Inc., and Banc of America Securities

21 ➤ No lead mandate[.]

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⁴ The evidence does not indicate that the prior research ratings were influenced by Investment Banking.

1 28. In an October 2000 pitch to another company, WCM again contrasted services
2 provided to the company and the benefits WCM received from the company. According to the
3 pitch, WCM delivered:

4 \$200 million of total capital commitment

5 #1 trader of [the company's] Stock

6 Strong Buy equity coverage⁵

7 Institutional and retail distribution capabilities equal to that of Wall Street firms

8 Willingness to provide access to retail brokers as mezzanine loan origination source

9 Open to potential bought deal in 2001[.]

10 These services were contrasted with the benefits WCM had received from the company, which
11 were listed as:

12 ➤ Only \$700,000 in equity fees since Company's IPO, behind Merrill Lynch & Co., Banc
13 of America Securities, U.S. Bancorp Piper Jaffray, Inc., William Blair & Company, and
14 A.G. Edwards & Sons, Inc.

15 ➤ No lead mandate[.]

16
17 **C. On Occasion, Investment Banking Concerns Were Considered in WCM's Decisions**
18 **Whether to Initiate or Continue Research Coverage**

19 29. The decision to initiate or continue research coverage of certain companies was
20 influenced, at least in part, by whether those companies were actual or prospective investment
21 banking clients of WCM. For example, in evaluating the performance of one Research Analyst, a
22 member of Research Management noted that the Analyst was "very flexible in adding coverage
23 where investment banking has had a sense of urgency."
24

25
26 _____
⁵ The evidence does not indicate that the prior research ratings were influenced by Investment Banking.

1 30. In the article referenced in paragraph 26(a), a WCM Research Analyst discussed her
2 “Strong Buy” rating of Ask Jeeves during a time of significant price decline. The Analyst
3 remained bullish on the company’s prospects and was quoted as saying that “[i]t’s ‘positioned to be
4 the most profitable business model in our group.’” Further, according to the Analyst, early in the
5 freefall in the price of Ask Jeeves stock, its CFO told her that the company was unhappy with its
6 investment bank and was “looking to create new relationships.” However, WCM was not included
7 as an underwriter on the Ask Jeeves secondary offering. According to the article, the Analyst said
8 “I’ve done a lot of marketing of this stock and invested a lot of time. Ask Jeeves choosing to go
9 elsewhere with the deal has definitely been the biggest disappointment.”

10 31. Each Research Analyst at WCM was required to prepare an annual Business Plan,
11 for internal use. These Business Plans were sometimes discussed during the annual performance
12 evaluation. In the Business Plan, each Research Analyst was required to: (a) give an account of the
13 approach that the Research Analyst had to the industry sector they covered, (b) identify significant
14 trends within that sector, and (c) set forth coverage plans for the upcoming year. According to a
15 member of Research Management, the function of the Business Plan was to require each Research
16 Analyst to identify those stocks under consideration for coverage over the next twelve months, to
17 compel the Research Analyst to set forth and commit to specific actions to take in order to procure
18 additional business from institutional investors, and to inform WCM what the Research Analyst
19 thought “the level of activity of investment banking is going to be in that space” for the next year.
20
21

22 32. During the Relevant Period, the Business Plan included a section entitled Coverage
23 Plans, which asked the Research Analyst to provide a rationale for issuing research coverage for
24 companies. Some Research Analysts completed the Coverage Plan section by citing the
25 investment banking potential of the companies as a reason for research coverage. The following
26 are some examples of comments by Research Analysts in their Coverage Plans:

1 a. One WCM Research Analyst stated he intended to “[a]dd 1-2 names in 2001,
2 reflecting investment/real estate banking relationships” in one sector and to “[a]dd 2-3 names,
3 reflecting investment/real estate banking need to retain coverage of this sector after [another
4 Analyst’s] departure.” The Research Analyst listed eight companies that were being considered as
5 additions to his coverage list, and ranked each company according to its importance to Research
6 and to Investment Banking. A review of the Analyst’s initiation of coverage reveals the following:

- 7 1) WCM initiated coverage on three companies that Investment Banking ranked as
8 higher in importance than Research, one of which had been previously covered by
9 WCM.
10 2) WCM did not initiate coverage on any company Research ranked highest as a target
11 for coverage that was not previously covered; Investment Banking ranked each of
12 these companies as lower in importance.
13

14 b. Another Research Analyst stated “Before committing to any specific direction, I
15 need to understand what my investment banking situation is so I can work closely with the lead
16 banker to develop a plan which we both believe we can successfully execute.”

17 c. One Research Analyst at WCM stated that any new company for which he would
18 initiate coverage in 2001 should (1) have “a strong management team,” (2) be “uniquely positioned
19 in a market niche that has good underlying fundamentals,” (3) be “under-followed,” and (4) include
20 “an opportunity to provide corporate finance.”
21

22 d. Another Research Analyst at WCM identified three specific companies which he
23 was considering for coverage, each of which was expected to do an equity offering. The Analyst
24 stated “the bulk of our focus going forward will be on small, under-followed, value names, where
25 we have an existing relationship and the company has a near-term (6-12 months) need to tap the
26

1 capital markets. I have been working closely with our [sector] corporate finance head . . . to
2 develop this list of names.”

3 e. One Research Analyst identified several companies for which coverage would be
4 dropped because “These are not attractive stocks and have little investment banking potential.”

5 f. After identifying the companies for which coverage would be initiated, a Research
6 Analyst noted that his list of companies on which he planned to initiate coverage had “the full
7 support of banking.”

8 g. In identifying planned coverage initiations for 2002, another Research Analyst
9 stated, “[w]e plan to role [sic] out 3-4 stocks in 2002 to add mid-stream natural gas companies to
10 our coverage and further support our corporate finance effort.” The Analyst identified another
11 company as a potential addition “based on investment banking requests.”
12

13 33. In some instances, investment bankers participated in discussions about adding or
14 dropping coverage on companies covered by WCM’s Research Analysts. For example:

15 a. In preparation for a meeting in October 2000 to review the list of companies
16 covered by WCM, a member of Research Management told Research Analysts, in an e-mail
17 message, “[b]e prepared to answer why we are covering it (banking client, banking prospect,
18 institutional importance).” The manager further instructed the analysts to “Make sure you and your
19 banker have discussed this in advance. You will be on at the same time. The committee is the ‘tie
20 breaker’ (i.e., you want to drop a stock and the banker does not).”
21

22 b. Following the October 2000 screening meeting, the same manager sent a follow-up
23 e-mail to the Research Analysts which instructed “[p]lease do not take any action as it relates to
24 dropping stocks that were discussed during the screening process. Instead, we must first finalize
25 communication with investment banking.”
26

1 c. Following screening meetings in May and June 2001, a member of Research
2 Management sent an e-mail message to the Research Analysts which stated “[c]ontinue to
3 appreciate that there is a hard dollar cost and opportunity cost to every stock that we follow, and
4 that your mandate as an analyst is to continually look for companies that can be monetized from an
5 institutional and/or investment banking perspective.”

6 d. In an e-mail message in October 2001, one Research Analyst informed members of
7 Research Management about plans to initiate coverage on AT&T Wireless, UbiquiTel and US
8 Cellular.

9 i. With regard to US Cellular, the Analyst stated “we actually used to follow the name
10 but dropped it (mostly because of my bankers).”

11 ii. With regard to AT&T Wireless, the Analyst specifically noted there was “no real
12 banking opportunity” from the company.

13 e. In the SmartMoney article referenced in paragraph 26(a), a WCM Research Analyst
14 described initiating coverage on Marketwatch despite the Analyst’s own reservations about the
15 rapid cash consumption the company was showing after the Analyst’s Investment Banking partner
16 told her that it was a good one to cover because “there’s a real opportunity on the banking side.”

17 f. Also, in the SmartMoney article referenced in paragraph 26(a), the same Research
18 Analyst described a situation with the initiation of coverage on CNet. According to the Analyst,
19 the investment banker in the sector asked “why I would take up a research spot with a company
20 with a billion in cash and no need for investment banking.” The investment banker commented in
21 the article “We have these kinds of conversations all the time, about many companies,” and
22 acknowledged that a Research Analyst has to cover bellwether stocks in a sector, even if the
23 potential for banking business with those companies is slim.
24
25
26

1 34. The annual Business Plan prepared by analysts included a section “New Equity
2 Business” where analysts were asked “What stocks that you are *recommending* are the most likely
3 to raise equity in the next 12 months? What are your plans to insure that we are involved in these
4 deals (i.e., fresh company reports, non-deal roadshow with senior management, sponsored investor
5 visits, etc.)” [emphasis in original] Examples of responses from analysts in this section include,
6 but are not limited to:

7 a. In a 2001 Business Plan, one Research Analyst for WCM claimed “EMI approached
8 me for advise [sic] on listing in the U.S. and doing a secondary in conjunction with that listing.
9 They made it clear that they would need my research since there are few that knew the music
10 business well.”

11 b. Another Research Analyst identified two companies which he expected would need
12 capital and stated the Analyst was “scheduling non-deal roadshows with both companies. In
13 addition, the publishing of a comprehensive industry report will highlight both companies as well
14 managed leaders in their respective market niches with favorable financial characteristics to other
15 strategic information providers.” According to the Analyst, that fact, combined with an effort by
16 WCM to demonstrate its distribution capabilities and breadth of services, would leave WCM “well
17 positioned for significant participation in any capital market transactions by either firm.”

18 c. With regard to a company for which WCM was involved in an IPO, one Research
19 Analyst stated “I have stayed visible with management in an effort to potentially **improve our**
20 **position** relative to the other underwriters.” [emphasis in original] On another company with the
21 potential for investment banking business, the Analyst stated he planned “on **initiation of coverage**
22 to gain visibility.” [emphasis in original]

23 d. Another Research Analyst noted that equity issues were not an important source of
24 revenue in his sector, but went on to say “[i]f there is a fee event associated with any of my
25
26

1 companies, I'll do whatever it takes to make sure we participate in a meaningful way. Conversely,
2 If [sic] we are getting paid in ways above and beyond equity, and it's due to my coverage/efforts, I
3 expect to get credit for it."

4 e. One Research Analyst noted "planned new coverage will be on companies that offer
5 good investment opportunity and are capital intensive businesses. These companies will have
6 potential for investment banking penetration if our bankers also establish relationships."

7 f. Another Research Analyst referenced a company which had done an IPO with
8 WCM as co-manager and which the Analyst said was the most likely to raise equity in the
9 upcoming year, noting "Given the potential business and because I like the story a lot, I have been
10 actively writing on the company (recently upgrading the stock)."

11 g. A Research Analyst noted his efforts on two specific companies. The Research
12 Analyst also stated "[w]e plan to pick up coverage of a number of companies that have investment
13 banking potential in 1Q01."

14 h. In a 2002 Business Plan, one Research Analyst stated that he intended to initiate
15 coverage of a new sector, which was described as having the potential to be "a very valuable
16 source of revenue for Wachovia from both a commissions and banking standpoint." Later in the
17 plan, under "New Equity Business," the Analyst stated that the investment banking group "believes
18 there are real opportunities for banking assignments if Wachovia can provide research coverage of
19 the sector."
20

21
22 35. In an informal business plan for the second half of 2000 and first half of 2001, a
23 Research Analyst commented:

24 Like most research analysts, I would like to have an equal amount of 'banking related'
25 names and pure research/institutional ideas on my coverage list. By doing this, I believe it
26 will allow me to establish credibility with the buy side and institutional sales force while, at
the same time, generate corporate finance fees for the firm.

1 **D. Investment Banking Input was a Factor in Decisions Regarding Participation at**
2 **Certain WCM's Research Conferences**

3 36. In an e-mail to Equity Research and the industry group heads in investment banking
4 regarding a conference in 2000, a member of Research Management stated, "[w]e would now like
5 each industry group (banking and research together) to take the names they submitted and complete
6 one final review to ensure that the top 5 names reflect the companies you would like to invite."

7 [emphasis in original]

8 37. One Research Analyst identified 12 companies as possible presenters at a Research
9 conference. His e-mail forwarding the list to the member of Research Management responsible for
10 determining the final list of presenters identified 11 of the 12 companies as Investment Banking's
11 clients.
12

13 38. In commenting about a specialty conference planned by a Research Analyst during
14 1999, a member of Research Management told a member of Investment Banking Management: "I
15 think this is a great idea. So do the corporate finance bankers, who also believe it would pay for
16 itself quickly."

17 39. In his 2000 performance evaluation, one Research Analyst stated he planned on
18 hosting a specialty conference for his sector during the first quarter of 2001, noting he would "need
19 support from banking and Equity Capital Markets to produce a successful conference."
20

21 **E. Investment Banking Was a Factor in Determining Some Research Analysts'**
22 **Compensation**

23 40. During the Relevant Period, participation in investment banking activities was a
24 factor in determining the total compensation awarded to some WCM Research Analysts.

25 41. Research Analysts at WCM received set salaries plus annual bonuses; the bonuses
26 accounted for the majority of their total compensation. The compensation of some Research

1 Analysts was set by the terms of individual employment contracts, which generally included a
2 guaranteed minimum incentive. When the bonus amount was not set by contract, the amount of
3 each Research Analyst's bonus was determined by Research Management.

4 a. For the years 2000 and 2001, members of Research Management created Equity
5 Research Performance Summaries for each Research Analyst, which showed, among other items,
6 the revenue generated for WCM from equity investment banking fees and equity commissions on
7 the companies that the Research Analyst covered.

8 b. According to a November 2000 e-mail, year-end bonuses for Research Analysts
9 were to be based on institutional votes, sales force ranking, commission volume, stock picking and
10 investment banking fees.

11 c. In November 2000, members of Research Management asked the Research Analysts
12 to provide information regarding closed investment banking deals, which included the amount of
13 the fee earned and the "Degree of Involvement/Participation (H, M, L)" by the Research Analyst in
14 each deal.

15 d. For the year 2000, summaries were prepared by Research Management which
16 ranked the Research Analysts by commissions, banking & other fees, and total revenue.

17 e. For the years 2001 and 2002, members of Research Management created Equity
18 Research Performance Summaries for each Research Analyst, which showed, among other items,
19 the revenue, both equity investment banking fees and equity commissions, generated for WCM
20 from Covered Companies. Research Management also gathered information for 2001 and 2002 for
21 all investment banking activity as well as retail and institutional sales.

22 42. Prior to 2000, some Research Analysts at WCM expected to receive a portion of the
23 management fee earned by WCM on each investment banking transaction in which the analyst
24 participated. According to a member of Research Management at the time, "[i]f an analyst was a
25
26

1 finder on a deal, on an IPO, they [sic] would get 15 percent of the management fee. If they [sic]
2 worked on the deal, they'd [sic] get 10 percent of the management fee.” This Research manager
3 also testified that a similar formula existed to compensate Research Analysts on secondary
4 offerings in which WCM participated. These amounts were paid to the Research Analysts as part
5 of the year-end bonuses; year-end bonuses also included a share of commissions earned on both
6 retail and institutional sales (1% and 5% of the commissions respectively). The manager testified
7 that these amounts were not paid to Research Analysts while they were subject to guaranteed
8 compensation agreements.

9 43. The bonuses paid in early 1999 to WCM Research Analysts that related to their
10 work in 1998 were approved by the heads of what was then called Investment Banking. In 1999,
11 Investment Banking was the term used to describe the business unit engaged in Investment
12 Banking activity, as well as sales, trading, principal investing and other non-investment banking
13 activities.

14 44. The 1999 Incentive Compensation Program For Equity Capital Markets provided:
15 Subject to approval from the President/Head of Capital Markets, in consultation with the
16 Co-Heads of Investment Banking, a subjectively determined Bonus pool will be established
17 for utilization by all Equity Capital Markets organizations. The Co-heads of Investment
18 Banking will allocate the resulting total incentive dollars to the appropriate groups within
19 Equity Capital Markets, and work with the various equity group managers to determine the
allocation of incentive award monies within the respective groups.

20 This Incentive Compensation Program was not executed due to changes in the management
21 structure of Equity Capital Markets at the end of 1999.

22 **F. Participation in Investment Banking was a Factor in Evaluating the Performance of**
23 **Some WCM Research Analysts**

24 45. During the Relevant Period, WCM’s process for annual performance evaluations of
25 employees required the employees to perform a self-evaluation and the employee’s manager to
26

1 evaluate the employee on the same criteria. Some performance evaluations of Research Analysts
2 and their Associates, as well as Research Management, considered investment banking activity,
3 among other things, as a criterion for assessing whether the employee had fulfilled the job
4 requirements.

5 Research Analysts

6 46. For the year 2000, 46 of 52 evaluations for Research Analysts contained comments
7 by managers of Research. Twenty-three of the forty-six evaluations (50%) discussed investment
8 banking. Comments by the managers include:

9 a. Under areas for development, analysts were told to take a "Proactive approach to
10 investment banking."

11 b. Research Management commented that one Research Analyst was "Very flexible in
12 adding coverage when investment banking had a sense of urgency."

13 47. Forty-two performance evaluations for 2000 included a self-evaluation by the
14 Research Analyst. Thirty-four of the forty-two evaluations (80%) contained comments relating to
15 the analysts' investment banking activities. Examples of comments from the analysts' self-
16 evaluations include, but are not limited to:

17 a. One Research Analyst responded to the question "How have the employee's
18 performance/business results compared to the accountabilities/ expectations established at the
19 beginning of the review period?" by declaring "my performance has exceeded expectations, both in
20 a quantitative and qualitative way, particularly given the meaningful contribution to First Union's
21 equity issuance calendar in the early stages."

22 b. Another Research Analyst stated "my banker and I have generated a good [amount]
23 of fees for the firm." The Analyst identified goals for 2001, which included "increase banking fees
24 by at least 20%."
25
26

1 c. In citing reasons for feeling positive about his performance during 2000, one
2 Research Analyst stated, “[i]n a tough market, we were productive on the banking front. I helped
3 FUSI win co-manager roles with 20%+ economics in HAKI secondary offering and VVVV IPO.”
4 The Analyst identified several other deals on which WCM had been co-manager. Under areas of
5 development, the Research Analyst stated “I need to raise my profile with public and private
6 companies that we don’t cover. This will lead to more invitations for banking business.”

7 d. Under quantitative and qualitative goals for 2001, one WCM Research Analyst
8 stated as a goal to “Work with banking to give them ideas of companies to pitch and [to] pitch with
9 them.”

10 48. For the year 2001, 36 of 42 performance evaluations for Research Analysts
11 contained comments by Research Management. On 31 out of the 36 evaluations (86%), the
12 manager discussed investment banking. In doing so, the manager used phrases such as:

- 13
- 14 • “Proven ability to win and execute quality business”;
 - 15 • “Has shown ability to monetize research franchise through quality IB business”;
 - 16 • “Deal performance has met/exceeded expectations.”

17 In some instances, the manager commented that the Research Analyst was “Supportive of the
18 broader CIB effort,” adding the caveat that “deal performance has been below expectations” or
19 “capital raising in sector remains lackluster.”

20
21 49. Forty of the forty-two evaluations for 2001 contained self-evaluations by the subject
22 Research Analyst. In assessing their own performance in 2001, 32 of these 40 evaluations (80%)
23 included comments regarding investment banking activities. Examples of comments by the
24 analysts include, but are not limited to:

25 a. In the self-assessment for areas for development, one Research Analyst wrote:
26

1 I believe I was negative[ly] impacted by the First Union/ Wachovia brand (lack of) in the
2 largest banking deal this year.... Bulge bracket bias runs deep during market downturns,
3 and I believe we received little support from executive management to brake [sic] down
4 those barriers. We understand that the executive management of JP Morgan put on an
5 aggressive campaign to be added as one of the four underwriters of the KCIN deal.
6 Hopefully, the successful hiring of a rainmaking head of tech banking will resolve this issue
7 (but the new org structure may hurt those efforts). Through aggressive research and
8 relationship building post-IPO, we believe we are well-positioned for a run at some form of
9 "co" slot in the future.

6 b. In assessing her own performance, another Research Analyst wrote:

7 Banking has been somewhat disappointing; ... [I]n two specific examples (AirGate and
8 Nextel Partners), we were told we were not included in investment banking deals due to an
9 'issue' or problem with the First Union bankers. This hurt the most as we were clearly told
10 by the CFO in both these companies that there was no problem with the reseach [sic] effort
11 and we would have been on the deal had these banking issue [sic] not come up.

11 c. One Research Analyst complained "it has been difficult to formulate a cohesive
12 strategy with investment banking for additional coverage."

13 d. A Research Analyst noted that, on the positive side of his performance, he had
14 "[w]orked closely with banking to identify and market to both public and private companies" and
15 said he "[e]stablished close relationship with Marvell, which is on the firm's investment banking
16 focus list." In assessing his strengths, the Analyst wrote "I believe my industry contacts continue
17 to make my job easier both with respect to equity research and investment banking. I have been
18 able to leverage these contacts into both making the right call on individual stocks as well as being
19 able to identify potential banking business."

20 e. As a specific goal for improving performance in the upcoming year, one Research
21 Analyst recognized that, if he wanted to advance, he would need to break from the patterns
22 followed in his first years as an Analyst. The Research Analyst stated that he "sought to implement
23 the procedures and methodology put in place in equity research to the letter. I am pleased with the
24 results." The Analyst also stated: "Rather than following companies that corporate finance
25 believes are prospects, I need to develop the ability and credibility within the industry." The
26

1 Analyst stated that he would “work to develop a strong partnership with the new investment
2 banking structure in Charlotte, and insure that my product compliments their business” and do his
3 “best to help investment banking enhance its client relationships.”

4 50. Annual Business Plans were prepared by the Research Analysts. The Business Plan
5 format included a section in which Research Analysts were asked to identify 2 to 3 things needed
6 from a resource standpoint or things the analyst would change that would noticeably improve their
7 business. Research Analysts sometimes commented that they wanted or needed an investment
8 banker or increased investment banking resources in their sector. One Research Analyst stated he
9 wanted “Support from senior management on IPO pitches to demand business.”

10 51. In March 2000, a member of Research Management wrote a memorandum to a
11 Research Analyst regarding the Analyst’s possible promotion from Director to Managing Director
12 (the highest title for a Research Analyst). In addressing the Analyst’s compliance with criteria for
13 promotion, the Research manager stated “[I]f you were to deliver a co-lead or lead managed deal to
14 the firm sometime this year (as you suggested you might) it would certainly solidify this view [that
15 the Analyst met many of the criteria for promotion], assuming of course that you continued to
16 function at your current high level.”

17 Associates

18 52. Evaluations of certain Associates also made reference to investment banking.
19 Examples of such references include, but are not limited to:
20

21 a. In the performance evaluation for 2000, one Research Analyst identified four
22 “Areas for Development” for her Associate, including “Get more involved in investment banking
23 pitches.”
24

25 b. In a self-evaluation, an Associate Analyst identified flexibility as one of her
26 strengths. The Associate stated, “I have supported [the Research Analyst] and my other

1 'customers' at every turn and have abandoned projects in which I had invested much time and
2 energy to focus and concentrate on the priority project of the moment." The Associate stated she
3 assisted with priority projects, including, among other things, "helping corporate finance in their
4 pitchbook development."

5 c. Under quantitative and qualitative goals for the upcoming year, an Associate
6 Analyst listed "Grow my contact list as well as improve upon the current year's investment
7 banking business in my space."

8 d. Another Associate Analyst was instructed by the Research Analyst to have "more
9 interaction with investment banking" during the upcoming year. The Associate Analyst was told
10 "to go on at least six banking calls" during that year.

11 Research Management

12 53. Performance evaluations of members of Research Management for 2001 mentioned
13 investment banking. For example:

14 a. One Research manager was praised for exceeding expectations for 2001. According
15 to the supervisor conducting the manager's evaluation, "[t]hroughout 2001, changes were made in
16 our research department to better create a balance to support our insti'l [sic] ranking as well as
17 investment banking." The manager's supervisor identified "Increased integration and support for
18 evolving investment banking platform" as an area which the manager needed to develop.

19 b. In assessing his own performance for 2001, one of the Research Managers
20 commented that, as part of Research Management, he was "responsible for . . . the success of our
21 analysts' involvement in investment banking." The manager further stated "Our interaction and
22 support of investment banking increased in 2001" and commented that Research Management
23 "continue[d] to work closely with [Investment Banking Management] and his team. They rely
24 heavily on us for input, views on strategic direction and personnel assessment."
25
26

1 c. In a 2001 performance evaluation, a member of Research Management was
2 complimented for having “Begun stronger communication and strategy with IB.” “Support and
3 communication for IB management” was identified as an area that the Research manager needed to
4 develop. In a personal evaluation, the Research-manager stated that he planned on “Spending more
5 time understanding investment banking’s strategic objectives and spending more time in
6 Charlotte.”⁶

7 **WCM FAILED TO REASONABLY SUPERVISE ITS RESEARCH ANALYSTS**

8 54. During the Relevant Period, WCM’s management failed to maintain and enforce
9 adequate policies, procedures and systems reasonably designed to manage the potential conflicts of
10 interest outlined above. Among other things, this failure to supervise gave rise to and perpetuated
11 the above-described violative conduct.
12

13 **WCM FAILED TO MAINTAIN AND PRODUCE IN A TIMELY MANNER CERTAIN**
14 **BOOKS AND RECORDS REQUIRED BY A.A.C. R14-4-132**

15 **A. WCM Did Not Have Adequate Systems or Procedures in Place to Ensure that All**
16 **Electronic Mail Communications Were Maintained and Were Readily Accessible**

17 55. On October 16, 2002, WCM was required to produce, pursuant to a larger request
18 for access to its books and records: “The electronic mail files, including incoming, outgoing, draft
19 and deleted files, for [six specified Research Analysts], wherever stored, from January 1, 1999,
20 through October 16, 2002, including all electronic files and attachments thereto.” The request was
21 later modified to request the electronic mail files for the six analysts for the following dates:
22 January 1, 1999; April 10, 2002; and the last day of each quarter from January 1, 1999, through the
23
24
25

26 ⁶ During the Relevant Period, Investment Banking was headquartered in Charlotte; Equity Research and Equity Capital Markets were headquartered in Baltimore. No research analysts were located in Charlotte.

1 date of production. WCM produced compact discs containing a total of 71 e-mail folders⁷
2 pursuant to the request. Of the 90 folders that should have been produced (taking into account
3 dates for which the identified analysts were not employed by WCM), 19 e-mail folders (20% of the
4 requested folders) could not be produced.

5 56. On January 10, 2003, State Regulators requested the e-mail folders for the six
6 identified Research Analysts for the 15th day of each month beginning January 1999 through June
7 2000. WCM produced compact discs containing e-mail folders for 42 days, some of which had
8 been produced previously. Of the 87 folders which should have been produced (taking into
9 account dates for which the identified analysts were not employed by WCM) 37 e-mail folders
10 (42% of the folders requested) were not produced initially.⁸

11 57. WCM represented to the State Regulators that, if the e-mail folders for a particular
12 day could not be restored, it attempted to restore the next closest date but, in many instances, the
13 closest available date was a date for which the e-mail folder had already been provided.

14 58. On February 24, 2003, the State Regulators requested information, in the form of an
15 affidavit, regarding the difficulties encountered by WCM during the production of the electronic
16 mail files. The information provided by WCM in response to the affidavit request was not fully
17 responsive.
18

19 59. Through the affidavit, WCM provided several explanations for its inability to
20 produce the e-mail folders, including representations that some tapes were not readable by the tape
21 drive, some tapes contained no data, some tapes could not be located by the outside storage
22

23
24 ⁷ For purposes of this Order, "e-mail folder" refers to the file produced by WCM for a specified analyst retrieved from
25 a back-up tape for a specific date. The folder contained e-mail messages sent and received through the e-mail address
26 assigned to a particular analyst; WCM represented that the folder would also contain all messages deleted by the
analyst during a period of seven days prior to the date of the back-up tape from which the folder was pulled. In
addition, a folder may contain an address book of contact information for frequent correspondents, calendar entries,
and a journal of activities, depending on the set-up for the particular analyst.

⁸ Six of the missing folders subsequently were produced on December 2, 2003.

1 facility, or computer catalogs of the back-up tapes could not be located on the server. The State
2 Regulators attempted to obtain additional information from WCM's affiant regarding the provided
3 explanations for the production problems; however, the affiant did not have sufficient personal
4 knowledge about the search procedures and document production of electronic mail folders to
5 provide all of the specific information requested. WCM contends the information could have been
6 obtained from other WCM employees.

7 60. As a result of these failures, WCM did not maintain readily accessible books and
8 records as required by A.A.C. R14-4-132.

9 **B. WCM Failed to Maintain An Organized System to Locate and Retrieve Tapes which**
10 **Purportedly Contained the Back-up for the Electronic Mail System**

11 61. WCM did not maintain, and/or could not produce upon request, documents showing
12 which tapes containing the daily back-ups of the electronic mail systems were transferred to its
13 third party storage facility.

14 62. According to an affidavit provided by WCM, in some instances, the computer
15 catalog for the software used to backup the electronic mail system contained no reference to a
16 back-up having been done for a particular date. This catalog was used to identify back-up tapes to
17 be retrieved for purposes of compliance with previously described requests throughout the course
18 of the investigation. Based on the information provided, no reference in the catalog exists for
19 more than 25% of the time period covered by the January 10, 2003, request.
20

21 63. The failure to maintain records regarding the transfer of tapes to the storage facility
22 and the failure of the computer catalog to have a reference to all back-ups was a significant
23 contributing factor in WCM's inability to retrieve tapes necessary to fully respond to the requests.
24
25
26

II.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction over this matter pursuant to Article XV of the Arizona Constitution and the Securities Act.
2. WCM failed to reasonably supervise its agents or employees.
3. WCM failed to preserve for a period of three years, and/or preserve in an accessible place for two years, all internal and external electronic communications relating to the business of WCM in violation of A.A.C. R14-4-132.
4. WCM's conduct is grounds for administrative penalties under A.R.S. § 44-2036(A).
5. WCM's conduct is grounds for a cease and desist order under A.R.S. § 44-2032(1).
6. This Order is necessary and appropriate in the public interest and for the protection of investors, and is consistent with the purposes fairly intended by the policy and the provisions of the Securities Act.

III.

ORDER

On the basis of the Findings of Fact, Conclusions of Law, and Respondent WCM's consent to the entry of this Order, for the sole purpose of settling this matter, prior to a hearing and without admitting or denying any of the Findings of Fact or Conclusions of Law,

IT IS HEREBY ORDERED:

1. This Order concludes the Investigation by the Commission and any other action that the Commission could commence under the Securities Act on behalf of the state of Arizona as it relates to Respondent WCM, or any of its affiliates, and their current or former officers, directors, and employees, arising from or relating to the subject of the Investigation, including certain research and investment banking practices at WCM and the failure by WCM to maintain all

1 electronic communications during the Relevant Period, provided, however, that excluded from and
2 not covered by this paragraph are any claims by the Commission arising from or relating to
3 enforcement of the Order provisions contained herein.

4 2. WCM will cease and desist from violating A.R.S. § 44-1961(A)(12) in connection
5 with the research practices referenced in this Order, and will comply with A.R.S. § 44-1961(A)(12)
6 in connection with the research practices referenced in this Order.

7 3. This Consent Order shall become final upon entry.

8 4. As a result of the Findings of Fact and Conclusions of Law contained in this Order,
9 WCM shall pay assessments as follows:

10 a. Three Hundred Forty-two Thousand Three Hundred Forty-eight Dollars (\$342,348)
11 to the Commission as an administrative monetary penalty pursuant to A.R.S. § 44-2036, to
12 be deposited in the state general fund, pursuant to A.R.S. § 44-2036(B), which amount
13 constitutes Arizona's proportionate share of the state settlement amount for failing to
14 supervise its employees in connection with potential conflicts of interest between Equity
15 Research and Investment Banking and for failing to preserve certain books and records
16 required by A.A.C. R14-4-132, which shall be payable to the Commission within ten (10)
17 business days of the date on which this Order becomes final. The total amount to be paid
18 by WCM to state securities regulators may be reduced due to the decision of any state
19 securities regulator not to accept the state settlement offer. In the event another state
20 securities regulator determines not to accept WCM's state settlement offer, the amount of
21 the state of Arizona payment shall not be affected, and shall remain as stated in this Order.
22

23 b. WCM shall comply with the attached Consent to Entry of Order.

24 5. If payment is not made by WCM, the Commission may vacate this Order, at its sole
25 discretion, upon 10 days notice to WCM and without opportunity for administrative hearing and
26

1 WCM agrees that any statute of limitations applicable to the subject of the Investigation and any
2 claims arising from or relating thereto are tolled from and after the date of this Order.

3 6. WCM agrees that it shall not seek or accept, directly or indirectly, reimbursement or
4 indemnification, including, but not limited to payment made pursuant to any insurance policy, with
5 regard to any administrative monetary penalty that WCM shall pay pursuant to this Order. WCM
6 further agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with regard to
7 any state, federal or local tax for any administrative monetary penalty that WCM shall pay
8 pursuant to this Order. WCM understands and acknowledges that these provisions are not intended
9 to imply that the state of Arizona would agree that any other amounts WCM shall pay pursuant to
10 this Order may be reimbursed or indemnified (whether pursuant to an insurance policy or
11 otherwise) under applicable law or may be the basis for any tax deduction or tax credit with regard
12 to any state, federal or local tax.
13

14 7. This Order is not intended by the Commission to subject any Covered Person to any
15 disqualifications under the laws of the United States, any state, the District of Columbia or Puerto
16 Rico, including, without limitation, any disqualifications from relying upon the state or federal
17 registration exemptions or safe harbor provisions. "Covered Person" means WCM or any of its
18 affiliates and their current or former officers, directors, employees, or other persons that would
19 otherwise be disqualified as a result of the Orders (as defined below).
20

21 8. This Order and the order of any other State in related proceedings against WCM
22 (collectively, the "Orders") shall not disqualify any Covered Person from any business that they
23 otherwise are qualified, licensed or permitted to perform under applicable law of the state of
24 Arizona and any disqualifications from relying upon this state's registration exemptions or safe
25 harbor provisions that arise from the Orders are hereby waived.
26

1 9. For any person or entity not a party to this Order, this Order does not limit or create
2 any private rights or remedies against WCM including, without limitation, the use of any e-mails or
3 other documents of WCM or of others regarding research practices or limit or create liability of
4 WCM or limit or create defenses of WCM to any claims.

5 10. Nothing herein shall preclude the state of Arizona, its departments, agencies,
6 boards, commissions, authorities, political subdivisions and corporations, other than the
7 Commission and only to the extent set forth in paragraph 1 above, (collectively, "State Entities")
8 and the officers, agents or employees of State Entities from asserting any claims, causes of action,
9 or applications for compensatory, nominal and/or punitive damages, administrative, civil, criminal,
10 or injunctive relief against WCM in connection with certain research and/or banking practices at
11 WCM.

12 11. This Order and any dispute related thereto shall be construed and enforced in
13 accordance, and governed by, the laws of the state of Arizona, without regard to any choice of law
14 principles.

15 12. The parties represent, warrant, and agree that they have received independent legal
16 advice from their attorneys with respect to the advisability of executing this Order.

17 13. WCM agrees not to take any action or to make or permit to be made any public
18 statement denying, directly or indirectly, any finding in this Order or creating the impression that
19 this Order is without factual basis. Nothing in this Paragraph affects WCM's: (i) testimonial
20 obligations or (ii) right to take legal or factual positions in defense of litigation or in defense of a
21 claim or other legal proceedings in which the Commission is not a party.

22 14. This Order shall be binding upon WCM and its successors and assigns. Further,
23 with respect to all conduct subject to Paragraph 2 above and all future obligations, responsibilities,
24 undertakings, commitments, limitations, restrictions, events, and conditions, the terms "WCM" and
25
26

1 "WCM's" as used here shall include WCM's successors and assigns (which, for these purposes,
2 shall include a successor or assign to WCM's investment banking and/or equity research
3 operations, and in the case of an affiliate of WCM, a successor or assign to WCM's investment
4 banking or equity research operations).

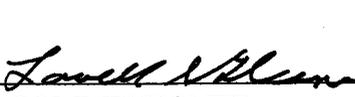
5 15. WCM, through its execution of this Consent Order, voluntarily waives its right to a
6 hearing on this matter and to judicial review of this Consent Order under Articles 11 and 12 of the
7 Securities Act and Title 14 of the Arizona Administrative Code.

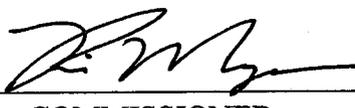
8 IT IS FURTHER ORDERED that this Order shall become effective immediately.

9
10 BY ORDER OF THE ARIZONA CORPORATION COMMISSION

11 
12 CHAIRMAN

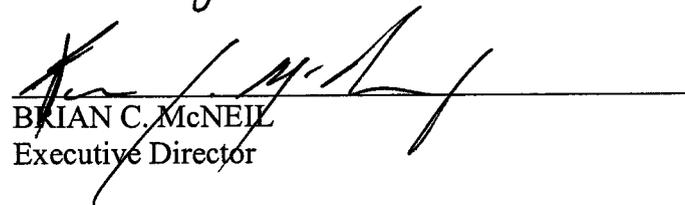

13 COMMISSIONER

14 
15 COMMISSIONER


16 COMMISSIONER


17 COMMISSIONER

18 IN WITNESS WHEREOF, I, BRIAN C. McNEIL,
19 Executive Director of the Arizona Corporation
20 Commission, have hereunto set my hand and caused the
21 official seal of the Commission to be affixed at the
22 Capitol, in the City of Phoenix, this 1st day of
February, 2007.


23 BRIAN C. McNEIL
24 Executive Director

25 _____
26 DISSENT

1 DISSENT

2 This document is available in alternative formats by contacting Linda Hogan, Executive Assistant
3 to the Executive Director, voice phone number 602-542-3931, E-mail lhogan@azcc.gov.

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**CONSENT TO ENTRY OF
ORDER BY
WACHOVIA CAPITAL MARKETS, LLC**

1. WCM hereby acknowledges that it has been served with a copy of this Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

2. WCM admits the jurisdiction of the Commission, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order by the Commission as settlement of the issues contained in this Order.

3. WCM states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

4. Charles S. Neal represents that he is Vice President of WCM and that, as such, has been authorized by WCM to enter into this Order for and on behalf of WCM.

5. WCM understands that the state of Arizona may make such public announcement concerning this Order and the subject matter thereof as the state of Arizona may deem appropriate.

6. WCM represents that as part of the negotiated settlement of the investigations of the State Regulators WCM will deposit Forty-seven Thousand Four Hundred Thirty-nine Dollars (\$47,439), which amount constitutes the portion of the state settlement amount of Three Million Dollars (\$3,000,000) to be used for investor education in the state of Arizona, with the Investor Education Fund (the "Fund") of the Investor Protection Trust, 919 18th Street N.W., Suite 300, Washington, D.C. 20006.

i. This payment shall be made within ninety (90) days of the date on which this Order becomes final by wire transfer to the Investor Protection Trust at SunTrust Bank for credit to the Investor Protection Trust Account, together with a cover letter identifying WCM as a

1 respondent in this action and the payment designated for the Investor Education Fund. The
2 firm shall simultaneously transmit photocopies of its payment and letter to the Commission.
3 By making this payment, the firm relinquishes all legal and equitable right, title, and
4 interest in such funds, and no part of the funds shall be returned to the firm. The Fund shall
5 be administered in accordance with the terms of the Investor Education Plan.

6 ii. The Fund shall be used to support programs designed for the purpose of investor
7 education and research and education with respect to the protection of investors, and to
8 equip investors with the knowledge and skills necessary to make informed investment
9 decisions and to increase personal financial literacy. The Investor Protection Trust, in
10 cooperation with NASAA, has established an investor education plan designed to achieve
11 these purposes.
12

13 iii. No principal or income from the Fund shall:

14 1) inure to the general fund or treasury of any State; or

15 2) be utilized to pay the compensation or expenses of state officials or state
16 employees except such expenses as are necessary to fulfill the purposes of the Fund.

17 iv. Monies in the Fund may also be used to pay any taxes on income earned by such
18 Fund. WCM shall provide the Investor Protection Trust with relevant information and
19 otherwise cooperate with the Investor Protection Trust in fulfilling the Fund's obligations
20 under applicable law.
21

22 v. All fees, costs, and expenses incurred by the Investor Protection Trust in connection
23 with and incidental to the performance of its duties under this Order, including the fees,
24 costs, and expenses of any persons engaged to assist it and all administrative fees, costs,
25 and expenses related to the investor education plan shall be paid out of the Fund.
26

7. The total amount to be paid by WCM to the Investor Education Fund of the Investor

