

## SETTLEMENT AGREEMENT

This Settlement Agreement is entered into this 26th day of October 1995, by and among the United States of America, acting by and through the Office of the United States Attorney for the District of Massachusetts, the Commonwealth of Massachusetts, acting by and through the Office of the Attorney General for the Commonwealth of Massachusetts, and Merrill Lynch, Pierce, Fenner & Smith Incorporated, a Delaware Corporation engaged in the municipal securities business with its principal place of business in New York, New York ("Merrill Lynch").

### A. Background

This Settlement Agreement arises from a joint fact finding investigation of the Office of the United States Attorney for the District of Massachusetts (the "United States Attorney") and the Office of the Attorney General of the Commonwealth of Massachusetts (the "Massachusetts Attorney General") relating to, among other things, the contractual relationship between Merrill Lynch and Lazard Freres & Co. ("Lazard") that commenced in late 1989 and terminated in January 1993. A focus of the investigation has been on whether the activities of the participants to this relationship violated any federal or state statutes. The parties hereto agree on certain facts, disagree on other facts, and disagree as to the conclusions to be drawn from what the parties maintain are all the relevant facts and circumstances. This Settlement Agreement represents a compromise among the parties to avoid the risks and costs of litigation. Set forth below, in

Sections B through J, are certain recitals relevant to this Settlement Agreement.

**B. The Participants :**

(1) Merrill Lynch is one of the largest financial services firms in the world. In addition to acting as a broker-dealer, Merrill Lynch is a major underwriter of tax-exempt securities by state and local governments and their agencies. In the mid-1980s, Merrill Lynch began to develop and market interest rate swaps for municipalities and other tax-exempt issuers. By 1989, Merrill Lynch had become an acknowledged industry leader in providing interest rate swaps to municipalities and other tax-exempt issuers. Interest rate swaps are transactions by which an entity may exchange (i.e., swap) its obligation to make periodic payments based on a particular interest rate or index for the right to receive periodic payments based on a different rate or index (e.g., one may swap its obligation to make variable rate payments for the right to receive fixed rate payments).

In the late 1980s, Merrill Lynch, whose swap business had in the past been done primarily with its own clients, sought to expand its swap business and examined methods to market swaps to the clients of other financial services firms. In furtherance of this marketing plan, from time to time, Merrill Lynch affiliated with certain regional and minority financial services firms to jointly market swaps to the clients of these other firms.

(2) During all relevant times, Lazard was an established, reputable financial services firm that also housed a public finance

group which served as financial advisor to certain public and quasi-public entities and as an underwriter to other public and quasi-public entities. In its capacity as financial advisor to public and quasi-public entities, Lazard provided advice concerning: (1) what type of finance transactions the entities should consider; (2) what firms the entities should deal with in finance transactions; and (3) when the entities should engage in finance transactions. Unlike Merrill Lynch, Lazard itself did not engage in swap transactions during the relevant time period.

From April 1988 through early 1993, Lazard, acting through Mark Ferber, who headed Lazard's Boston office and who became a Lazard partner in January 1990, was the financial advisor to the Massachusetts Water Resources Authority ("MWRA"). At other times during the same period, Lazard, acting through Mark Ferber, also served as financial advisor to the District of Columbia ("DC"). As financial advisor to the MWRA and DC, Lazard and Mark Ferber were in a fiduciary relationship with those entities.

C. The MWRA Swaps

In the late 1980s, the MWRA, which had been given responsibility for cleaning up the Boston Harbor and for providing water and sewerage services to over 40 Boston area cities and towns, determined to issue several billion dollars in revenue bonds in the coming years. To assist it in executing its bond transactions, in January 1989, the MWRA put out a request for proposals for the purpose of selecting an underwriting team. In his position as financial advisor to the MWRA, during early 1989, Mark Ferber advised the MWRA throughout the selection process

concerning, among other things, the strengths and weaknesses of the potential underwriters. In 1988 and throughout 1989, Merrill Lynch representatives met and discussed with Mark Ferber MWRA business and business involving non-financial advisory clients of Lazard. During the course of such discussions, Mark Ferber solicited business from Merrill Lynch.

In March of 1989, the Board of Directors of the MWRA, which was being advised by Mark Ferber, unanimously chose Merrill Lynch as one of three senior managing underwriters. The MWRA decided to rotate the senior managing underwriter. From the group of three, Merrill Lynch was chosen to act as the senior managing underwriter for the MWRA's first bond offering, which ultimately was executed in January 1990.

Beginning in the fall of 1989, consistent with its usual practice of marketing swaps, where economically appropriate, to public entities it served as a senior managing underwriter, Merrill Lynch attempted to market to the MWRA an interest rate swap in conjunction with the early 1990 underwriting. In this process, Merrill Lynch initially raised the swap idea with Mark Ferber, and then had continuing interaction concerning the possibility of a swap with the MWRA's financial advisor, Mark Ferber, and others at the MWRA.

After being introduced to the swap concept by Merrill Lynch, Mark Ferber expressed an immediate interest in the business potential of swaps. Thereafter, representatives of Merrill Lynch and Mark Ferber discussed the prospect of Merrill Lynch and Lazard engaging in a joint swap marketing agreement. These discussions

culminated in a written contract, dated December 5, 1989, which the law firm of Rogers & Wells drafted at the request of the then head of Merrill Lynch's municipal swaps department. The contract was not presented to in-house counsel at Merrill Lynch. The December 1989 contract provided that Merrill Lynch and Lazard would split fees generated from any successful jointly marketed swaps. The December 1989 contract did not contain any language dealing with the issue of disclosure of the contract to Lazard's financial advisory clients.

D. The 1989 Merrill Lynch Florida Interest Rate Swap

In the late Fall of 1989, Merrill Lynch worked on and eventually closed an interest rate swap with the Indian Trace Community Development District in Broward County, Florida. Merrill Lynch paid Lazard \$90,000 from its compensation on the deal, which represented approximately 10% of Merrill Lynch's overall compensation. The parties disagree with respect to other facts regarding the Indian Trace transaction.

Merrill Lynch did not inquire as to whether specific disclosure was made and did not ensure that Mark Ferber or anyone else at Lazard made full and complete disclosure to the MWRA of the facts and circumstances of the Florida transaction, including Merrill Lynch's payment of \$90,000 to Lazard. Merrill Lynch contends that in early 1990 Mark Ferber told a representative of the MWRA that Lazard had been a joint participant with Merrill Lynch in an out-of-state interest rate swap transaction in late 1989. The United States Attorney and the Massachusetts Attorney

General contend that any disclosure by Mark Ferber to the MWRA concerning the Florida transaction was incomplete and misleading. They further contend that, consequently, the MWRA was deprived of facts relating to Mark Ferber's ability to provide independent advice concerning Merrill Lynch.

E. MWRA Swap Discussion

In the early part of 1990, Merrill Lynch attempted to persuade the MWRA and its financial advisor, Mark Ferber, that the MWRA should enter into an interest rate swap in conjunction with the 1990 MWRA underwriting. During this time, Merrill Lynch solicited the legal opinion of Rogers & Wells as to the propriety and effect of its December 1989 contract with Lazard in the context of its desire to engage in swaps with tax-exempt issuers which, like the MWRA, were financial advisory clients of Lazard.

Merrill Lynch contends that it requested that Rogers & Wells review the December 1989 contractual relationship with Lazard, and was advised by Rogers & Wells that the fact that Lazard was a financial advisor did not nullify the contract so long as Merrill Lynch ensured that no violation of state or local ethical statutes or MSRB rules occurred and that any municipal counterparty to a swap not be induced to execute a swap as the result of a misrepresentation or concealment of any pecuniary interest Lazard may have in the swap. It further contends that Rogers & Wells also advised that confidential information obtained by Lazard in its role as a financial advisor could not be used by Merrill Lynch for a swap from which Lazard profited. Merrill Lynch contends that

after receiving this advice, Merrill Lynch began discussing a successor contractual relationship with Lazard.

**F. The June 1990 Contract**

From sometime in the first quarter of 1990 through the spring of 1990, Merrill Lynch and Lazard, acting principally through Mark Ferber, negotiated a successor contract to the December 1989 contract. Merrill Lynch did not ensure that Mark Ferber or anyone else at Lazard was making adequate disclosure of these negotiations to the MWRA. The new contract was executed on June 26, 1990. Like the December 1989 contract, the June 1990 contract provided that Merrill Lynch and Lazard would participate together in originating, negotiating and arranging interest rate swaps to be entered into between Merrill Lynch and municipal issuers. Also, like the December 1989 contract, the June 1990 contract provided for fee-splitting between Merrill Lynch and Lazard on joint successfully marketed interest rate swaps. But unlike the December 1989 contract, the June 1990 contract further provided that: (1) Lazard would consult generally with Merrill Lynch with respect to the presentation, marketing and sales of municipal interest rate swaps; and (2) Merrill Lynch would pay Lazard an annual fee in the amount of \$800,000 for the period June 26, 1990 through December 31, 1990. No other relationship between Merrill Lynch and any other firm pertaining to municipal or other tax-exempt swaps has included a consulting or annual fee provision.

The initial draft of the June 1990 contract, drafted by Rogers & Wells at the request of the then head of Merrill Lynch's municipal swaps department, contained a confidentiality clause,

which provided that Lazard would "not at any time without the express prior consent of Merrill Lynch divulge the existence, substance or text of this Agreement to any other person." After at least one partner in Lazard's New York headquarters pointed out that the confidentiality provision, as drafted, would not permit adequate disclosure of the existence of the contract and the kinds of compensation to be paid Lazard, Rogers & Wells, at the request of the then head of Merrill Lynch's municipal swaps department, redrafted the contract. The redrafted contract permitted Lazard to disclose, without Merrill Lynch's consent, the "substance" of the Merrill Lynch/Lazard agreement to jointly originate, negotiate and arrange interest rate swaps. The United States Attorney and the Massachusetts Attorney General contend that, as redrafted, the contract did not permit Lazard, unless it first obtained Merrill Lynch's consent, to disclose the existence of the contract or that Merrill Lynch would pay a fee to Lazard in the amount of \$800,000 (from June 26, 1990 to December 31, 1990). Merrill Lynch contends that the contract permitted Lazard to disclose whatever it felt necessary to its financial advisory clients unimpeded by the standard proprietary confidentiality clause.

**G. The MWRA Swaps**

In May and June of 1990, the MWRA and Merrill Lynch entered into two swaps of a combined notional amount of \$168,000,000. The MWRA decided to execute swaps and to do the swaps with Merrill Lynch, as opposed to any other entity, without putting out a request for proposals. The MWRA's decisions were based, at least in part, upon the initial recommendation of Mark

Ferber in January 1990, and subsequent input and advice from Mark Ferber through the spring of 1990. Neither Merrill Lynch nor Lazard gave a copy of the June 1990 contract to the MWRA prior to 1993. Merrill Lynch contends that Mark Ferber advised both Merrill Lynch and Lazard that disclosure of the relationship to the MWRA had been made.

No disclosure of the negotiations leading to the execution of the June 1990 contract, including no disclosure of the \$800,000 annual fee component of the contract, was made by Mark Ferber to the MWRA prior to the swaps the MWRA executed with Merrill Lynch in May and June 1990. Merrill Lynch did not ensure that Mark Ferber made full disclosure of the negotiations. The United States Attorney and the Massachusetts Attorney General contend that, consequently, the MWRA was not able to properly evaluate the initial recommendation and later advice of Mark Ferber concerning Merrill Lynch and its swaps; was deprived of facts relating to Mark Ferber's ability to provide independent advice; and by failing to solicit other swap bids, or other ideas concerning finance options, may have been deprived of more advantageous finance options available.

Merrill Lynch contends that the terms of the swaps were fair and equitable to the MWRA; that the swaps were very beneficial for the MWRA and saved the MWRA interest; and that given Merrill Lynch's dominant market position in the municipal swaps market at that time, it is unlikely that any other proposals would have been more advantageous to the MWRA.

H. Renewal of the Contract

The June 1990 contract initially covered only calendar year 1990. In December 1990, before the contract terminated by its own terms, the contract was renewed in writing to cover calendar year 1991. Later, Merrill Lynch and Lazard, acting through Mark Ferber, orally extended the contract to cover the year 1992 (hereinafter collectively with the June 1990 contract and the December 1990 contract, the "Contract"). Under the Contract, for 1991 and 1992, the annual fee that Merrill Lynch paid Lazard was increased from \$800,000 to \$1,000,000. The Contract effectively remained in place until, at the behest of Merrill Lynch, it was terminated by agreement in January 1993.

I. MWRA and DC

During the existence of the Contract, DC became a financial advisory client of Mark Ferber. The MWRA remained one of Mark Ferber's financial advisory clients through the termination of the Contract in January 1993.

J. Merrill Lynch's Swap Transactions with Mark Ferber's Financial Advisory Clients

While the Contract was in place, Mark Ferber provided financial advisory services to the MWRA and DC concerning swap transactions between those entities and Merrill Lynch, including the following:

- (1) the MWRA, with advice from Mark Ferber, selected Merrill Lynch to execute interest rate swap transactions in May 1990 (notional amount: \$90,000,000) and June 1990 (notional amount: \$78,000,000); and

- (2) DC, with advice from Mark Ferber, selected Merrill Lynch to execute interest rate swap transactions in September 1991 (notional amount: \$230,000,000) and March 1992 (notional amount: \$299,800,000).

For the transactions identified immediately above, Merrill Lynch received total compensation of \$5,701,540.06 from the MWRA and DC during the term of the Contract. In addition, during the term of the Contract Merrill Lynch was selected to senior manage a \$717,000,000 MWRA underwriting in March 1992.

Merrill Lynch did not, prior to 1993, ensure that Mark Ferber made full disclosure of the contractual arrangements, including the existence of the Contract and the \$800,000 to \$1,000,000 annual fee payments, to the MWRA or DC. The United States Attorney and the Massachusetts Attorney General contend that any disclosures by Mark Ferber concerning the Merrill Lynch/Lazard contractual arrangements to the MWRA or DC from the summer of 1990 through January 1993, when the Contract was terminated, were inadequate and misleading and did not accurately describe the true nature of the Contract. They further contend that, consequently, during that same time period, the MWRA and DC were not sufficiently informed of the relationship between Merrill Lynch and Lazard to enable those entities to properly evaluate any advice of Mark Ferber concerning Merrill Lynch and were deprived of facts relating to Mark Ferber's ability to provide independent advice.

**K. Civil Litigation**

As a consequence of the investigation, the United States of America, acting by and through the United States Attorney, has

filed a civil complaint (copy attached) against Merrill Lynch in federal court in Boston, and the Commonwealth of Massachusetts has simultaneously filed a civil complaint (copy attached) against Merrill Lynch in Massachusetts state court (collectively, the "Litigation"). In the federal Complaint, the United States Attorney alleges a claim under 18 U.S.C. § 1345. The United States Attorney maintains that Merrill Lynch's conduct, as outlined in the federal Complaint and in recitals B through J above, also gives rise to potential claims under 31 U.S.C. §§ 3729 - 3733 and common law, all of which potential claims are released herein in Paragraph 6 below. Merrill Lynch denies the validity of any such potential claims.

The United States Attorney and the Massachusetts Attorney General have determined that it is appropriate to initiate the Litigation for at least the following reasons: (i) Merrill Lynch did not ensure that Mark Ferber disclosed to the MWRA that Mark Ferber solicited business from Merrill Lynch before and after the 1989 MWRA underwriter selection process; (ii) Merrill Lynch did not ensure that Mark Ferber or anyone else at Lazard disclosed to the MWRA that Merrill Lynch paid Lazard \$90,000 of its fees from the Florida interest rate swap transaction while Merrill Lynch was trying to interest the MWRA in a swap transaction with Merrill Lynch during late 1989 and early 1990; (iii) Merrill Lynch did not ensure that Mark Ferber or anyone else at Lazard disclosed to the MWRA that Merrill Lynch and Lazard, acting primarily by and through Mark Ferber, were negotiating the June 1990 contract, the consulting provision, and the \$800,000 annual fee payment at the

same time that Merrill Lynch was trying to interest the MWRA in engaging in a swap transaction with Merrill Lynch during the spring of 1990; and (iv) Merrill Lynch did not ensure that Mark Ferber disclosed to the MWRA and DC the existence of the Contract, the consulting provision and the \$800,000 to \$1,000,000 annual fee before Merrill Lynch proposed, negotiated and/or engaged in swap transactions with those public entities during 1990 and the years 1991 and 1992.

L. Basis for Settlement of Civil Litigation

To avoid the risks and costs of litigation, the parties have agreed that it is in their interests to settle these civil claims. It is also noted that:

(i) Merrill Lynch has provided valuable cooperation throughout the investigation, and has represented and warranted that it will continue to provide such cooperation as to any continuing investigation and further proceedings;

(ii) Merrill Lynch has entered into settlement agreements with the MWRA and DC, refunding to those entities a significant portion of the fees that it earned from the aforementioned swap transactions;

(iii) Merrill Lynch has agreed to make an administrative payment to the United States of America of additional fees it received from the MWRA and DC, reimburse the United States of America and the Massachusetts Attorney General for certain costs of the investigation, and pay a civil penalty;

(iv) The subject matter of the investigation had no bearing whatsoever upon the overwhelming majority (meaning greater than 95%) of Merrill Lynch's business and personnel; and

(v) In 1993 and 1994 Merrill Lynch's Municipal Department adopted new compliance policies and procedures, which Merrill Lynch warrants have been designed to ensure that in the future, full disclosure of all contracts with other securities firms is made in writing to all necessary parties.

NOW, THEREFORE, in consideration of the foregoing and of the terms and conditions set forth hereinafter, Merrill Lynch, the United States of America, by and through the United States Attorney, and the Commonwealth of Massachusetts, by and through the Massachusetts Attorney General, agree as follows:

Terms and Conditions

1. Settlement Payment -- Merrill Lynch has paid, or is paying by check, or by electronic funds transfer at the request of any authorized recipient who has provided Merrill Lynch with written instructions prior to the date hereof, simultaneously with the execution of this Settlement Agreement, the following amounts:

(a) Restitution in the amount of \$3,800,000, which represents a portion of the fees paid to Merrill Lynch in 1990, 1991 and 1992 by Lazard's financial advisory clients, the MWRA and DC. The recipients of these compensatory, restitutionary payments will be: the MWRA (\$2,000,000); and DC (\$1,800,000);

(b) An administrative payment (not a fine or penalty) to the United States of America in the amount of \$4,910,000, which represents additional money obtained by Merrill Lynch in connection with transactions with the MWRA and DC on which Lazard and Mark Ferber acted as financial advisor. (A federal investigative agency that has worked on this matter at the direction of the United States Attorney will dispose of this money through an administrative proceeding);

(c) A civil penalty of \$2,500,000 to the United States of America, and of \$500,000 to the Commonwealth of Massachusetts; and

(d) Reimbursement of \$250,000 to the United States of America and \$50,000 to the Massachusetts Attorney General for certain costs and expenses associated with the investigation.

2. Representations and Warranties Regarding Remedial Actions Undertaken by Merrill Lynch -- Merrill Lynch represents and warrants that it undertook substantial remedial actions in 1993 and 1994. On August 16, 1993, Merrill Lynch issued a new, comprehensive and detailed set of procedures governing interaction between Merrill Lynch's Municipal Markets employees and third parties such as consultants and broker-dealers. On June 6, 1994, Merrill Lynch supplemented those procedures.<sup>1</sup> The Procedures summarized herein provide that Merrill Lynch will use the

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<sup>1</sup> The August 16, 1993 procedures and June 6, 1994 supplement thereto are hereinafter referred to as "the Procedures".

assistance of consultants to obtain or retain public finance business only in limited circumstances and only under specific guidelines, including the following:

(a) Use of Consultants Generally

(i) Disclosure -- Whenever Merrill Lynch decides to use a consultant to assist in obtaining or retaining public finance business, it will now as a matter of course disclose in writing its retention of the consultant to the governing body of all existing or prospective potentially affected public finance clients. The basic terms of the consulting agreement, including the compensation to be paid to the consultant, either must be included in the written disclosure or made available to the public finance clients upon request.

(ii) Review and Approval -- Whenever a Municipal Markets employee wishes to retain a consultant, the employee must prepare a memorandum for internal supervisory review and approval explaining the services sought from the consultant and indicating the compensation to be paid. When supervisory approval is granted, Merrill Lynch in-house counsel must review and approve all public finance consulting agreements before they are executed. As to specific payments under a consulting agreement, the Municipal Markets employee responsible for the agreement now must prepare a billing memorandum indicating the services performed and the amount of compensation to be paid. Management level review and written approval of the payments are required before payment will be made.

(b) Consultants Who Are Also Municipal Financial Advisors

(i) Disclosure -- In cases in which the consultant also may act as a financial advisor to other issuers of municipal securities, Merrill Lynch is to obtain a list of the consultant's municipal financial advisory clients, which, by contract, the consultant is required to update quarterly. The Merrill Lynch Municipal Markets Consultant Relationship Manager responsible for the consultant's retention is required to promptly notify, in writing, the governing body of each of the consultant's financial advisory clients of the consultant arrangement. The written notification must include a general description of the arrangement, including the compensation.

(ii) Fee-Splitting -- Merrill Lynch Municipal Markets will not pay, directly or indirectly, or split a fee with any consultant in connection with an assignment for which the consultant is the financial advisor to the municipal issuer.

(iii) The Consultant's Contract -- All agreements with Merrill Lynch public finance consultants are to be in writing. Consultants who may act as financial advisors to public entities during the pendency of the consulting agreement must acknowledge in the written agreement that they are not at the time of the agreement, and will not during the term of the agreement, be retained as financial advisors or financial consultants to any municipal issuers for whom Merrill Lynch is seeking to be retained as a result of the consultants' activities under the consulting agreement. Consultants who act as financial advisors to public

entities must further acknowledge in the written agreement, that no payment under the agreement will be made in connection with an assignment for which the consultants are the financial advisor to the public entity.

(c) Compliance Meetings -- During 1993, 1994 and 1995, Merrill Lynch has conducted in-house compliance meetings for its Municipal Markets employees throughout the United States during which the employees have been instructed as to various compliance issues including Merrill Lynch's procedures governing interaction with third parties such as consultants.

3. Representations and Warranties Regarding Cooperation Undertaken by Merrill Lynch -- Merrill Lynch represents and warrants that it already has performed, among other things, the following acts of cooperation:

(a) Merrill Lynch responded promptly to requests for business records, and has waived the attorney-client privilege to the extent necessary to permit production of certain otherwise privileged business records created in connection with the negotiation, review, execution and termination of the Contract; and

(b) Merrill Lynch made numerous personnel available for interviews, and has waived the attorney-client privilege to the extent necessary to permit inquiry into certain otherwise privileged communications occurring in connection with the negotiation, review, execution and termination of the Contract.

4. Future Cooperation -- Merrill Lynch agrees to fully cooperate with any investigation through its conclusion and any subsequent proceedings. If testimony of, or information from, any present or former Merrill Lynch employee is requested, Merrill Lynch will use its best efforts to ensure that such individual is available and will testify truthfully and completely before any grand jury, and at any hearing or trial. Furthermore, without cost to any law enforcement agency, Merrill Lynch agrees (i) to preserve and, upon reasonable request and notice, to furnish to the United States Attorney and the Massachusetts Attorney General all nonprivileged documents in its possession, custody or control that the United States Attorney and the Massachusetts Attorney General deem relevant to the investigation; (ii) to preserve all privileged documents that may be relevant to the investigation and provide, upon reasonable request and notice, the United States Attorney and the Massachusetts Attorney General with a log of those documents; and (iii) to perform, upon reasonable request and notice, searches on its computerized database of documents already produced, as well as of all other relevant or potentially relevant documents, and expeditiously to provide the complete results of such searches to the United States Attorney and the Massachusetts Attorney General.

5. Dismissal of Litigation -- Subject only to the terms and conditions set forth in paragraphs one through four and six through seven of this section, the United States of America, by and through the United States Attorney, and the Commonwealth of Massachusetts, by and through the Massachusetts Attorney General, will immediately file appropriate Notices of Dismissal in the

United States District Court for the District of Massachusetts and in Massachusetts state court dismissing the Litigation with prejudice. Except for the dismissal of the Complaints, Merrill Lynch intended to file an answer to each Complaint challenging certain of its factual and legal allegations.

6. Decision Not to Prosecute -- Subject only to the terms and conditions set forth herein (paragraph six) and in paragraphs one through four and paragraph seven of this section, the United States of America, by and through the United States Attorney, and the Commonwealth of Massachusetts, by and through the Massachusetts Attorney General and the Secretary of the Commonwealth, Securities Division, agree not to prosecute Merrill Lynch or bring any criminal or civil action or proceeding against Merrill Lynch other than the Litigation, concerning any matter relating to the relationship between Merrill Lynch and Lazard that commenced in late 1989 and terminated in January 1993 and that involved Mark Ferber or other employees of the then Boston office of Lazard (the "Release").

The United States of America, by and through the United States Attorney, and the Commonwealth of Massachusetts, by and through the Massachusetts Attorney General, also agree not to use this Settlement Agreement against Merrill Lynch in any case except a case based upon an alleged breach by Merrill Lynch of this Settlement Agreement. Notwithstanding anything in this Settlement Agreement to the contrary, the United States of America, by and through the United States Attorney, and the Commonwealth of Massachusetts, by and through the Massachusetts Attorney General,

specifically reserve the right to bring an action, if required, to seek enforcement of the Settlement Agreement.

Merrill Lynch understands and agrees that notwithstanding anything in this Settlement Agreement to the contrary, should any of the representations or warranties as contained in paragraphs two, three, four, seven and nine in this Settlement Agreement turn out to be materially false or misleading, the Release shall be null and void and the United States of America, by and through the United States Attorney, and the Commonwealth of Massachusetts, by and through the Massachusetts Attorney General, have, and specifically reserve, the right to use against Merrill Lynch at any trial, hearing, or other proceeding, this Settlement Agreement and any statements made by Merrill Lynch, and any information, materials, documents or objects provided by Merrill Lynch to the United States Attorney and/or the Massachusetts Attorney General in connection with this Settlement Agreement or the investigation. In the event the release shall be deemed null and void, the administrative payment as well as all monies paid as a penalty pursuant to this agreement shall be returned to Merrill Lynch.

Nothing in this Settlement Agreement is intended to or does settle the liability, if any, that Merrill Lynch has or may have arising under Title 26, United States Code (Internal Revenue Code), or the regulations thereunder. As of this date, no such liability relating to this investigation is known to any party to this Settlement Agreement.

Nothing in this Settlement Agreement is intended to or does settle the liability, if any, that Merrill Lynch has or may have to

the Massachusetts Department of Revenue. As of this date, no such liability relating to this investigation is known to any party to this Settlement Agreement.

Merrill Lynch agrees that all costs (as defined in the Federal Acquisition Regulations ("FAR") § 31.205-47) incurred by or on behalf of Merrill Lynch, and their officers, directors, agents and employees in connection with (1) the matters covered by this Settlement Agreement, (2) the government's audit and investigation(s) of the matters covered by this Settlement Agreement, (3) Merrill Lynch's investigation and defense of the matters covered by this Settlement Agreement and Merrill Lynch's corrective actions of the matters covered by this Settlement Agreement, (4) the negotiation of this Settlement Agreement, and (5) the payments made pursuant to this Settlement Agreement shall be unallowable costs for government contract accounting purposes.

7. Continuing Remedial Measures -- The compliance policies and procedures that Merrill Lynch has implemented in its Municipal Department will remain in effect and will continue to be enforced. Nothing in this Settlement Agreement precludes Merrill Lynch from amending or changing its policies and procedures in the future so long as said amendments or changes do not diminish the disclosure policies or procedures alluded to above in paragraph two of this section. Merrill Lynch will also continue to hold periodic compliance training sessions for all of its Municipal Department personnel.

8. Effect of Agreement -- This Agreement shall be binding upon the parties hereto, their respective successors and assigns, and will inure only to the benefit of the parties hereto, and their respective successors and assigns, and no other person shall be entitled to any benefits hereunder.

9. Execution in Counterparts -- This Settlement Agreement may be executed in counterparts each of which shall constitute an original and all of which shall constitute one and the same agreement.

10. Effective Date -- This Settlement Agreement is effective on the date of signature of the last signatory to it.

11. No Admissions -- This Settlement Agreement is entered into for the purpose of compromise. Neither the fact of the Settlement Agreement nor any of its provisions shall constitute an admission by Merrill Lynch of criminal or civil liability by Merrill Lynch, or be utilized by any person for any purpose other than as specifically provided for in this Settlement Agreement; provided, however, that this Settlement Agreement shall be publicly available.

12. Signatories' Powers -- Each of the signatories to this Settlement Agreement represents that he or she has the full power and has been duly authorized to execute this Settlement Agreement.

13. Entire Agreement -- This writing, and the settlement agreement and release entered into between the MWRA and Merrill Lynch, constitute the entire agreement of the parties hereto. (Merrill Lynch has entered into a separate release and settlement agreement with DC relating to the relationship between Merrill Lynch and Mark Ferber.) It may not be modified or amended except

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by a written agreement that is signed by all the parties and specifically refers to this Settlement Agreement.

ON BEHALF OF THE UNITED STATES  
OF AMERICA

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Acting United States Attorney  
District of Massachusetts

By:

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ON BEHALF OF THE COMMONWEALTH OF  
MASSACHUSETTS

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By:

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WILLIAM FRANCIS GALVIN  
Secretary of the Commonwealth  
Securities Division

ON BEHALF OF MERRILL LYNCH,  
PIERCE, FENNER & SMITH, INC.

By:

\_\_\_\_\_  
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DATED: \_\_\_\_\_