

STATE OF MAINE
OFFICE OF SECURITIES

IN THE MATTER OF)
MERRILL LYNCH, PIERCE, FENNER &) CONSENT AGREEMENT
SMITH, INC.)

WHEREAS, Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") is a broker-dealer registered in the State of Maine; and

WHEREAS, the Office of Securities of the State of Maine, (the "Agency") has undertaken an investigation (the "Investigation") into the activities of Merrill Lynch relating to certain research practices at Merrill Lynch; and

WHEREAS, the Attorney General of the State of New York ("New York AG") conducted an investigation (the "New York Investigation") into research practices at Merrill Lynch; and

WHEREAS, the New York AG commenced a proceeding on April 8, 2002, pursuant to Section 354 of the General Business Law of the State of New York (Index No. 02/401522) (the "New York Proceeding"), including submission of the Affidavit of Eric R. Dinallo, Chief of Investment Protection Bureau, New York State Department of Law, containing assertions regarding the research practices of Merrill Lynch (the "Dinallo Affidavit"), which is on file in the New York Proceeding; and

WHEREAS, the New York AG and Merrill Lynch have entered into an agreement, dated May 21, 2002 (the "May 21 Agreement"), a copy of which has been provided to the Office of Securities, which resolved all issues involved in the New York Investigation and the New York Proceeding, prior to the Court making any findings of fact or conclusions of law pursuant to a contested proceeding; and

WHEREAS, pursuant to the May 21 Agreement, Merrill Lynch has agreed to implement certain changes with respect to its Global Equity Research analysts and equity securities covered by such analysts and make certain payments; and

WHEREAS, Merrill Lynch and the Office of Securities are desirous of avoiding multiple

1 investigations in light of the above-referenced changes that are being implemented at Merrill Lynch and
2 Merrill Lynch's agreement to make certain payments; and

3 WHEREAS, Merrill Lynch admits the jurisdiction of the **Office of Securities**;

4 **IT IS HEREBY AGREED:**

5 1. This Agreement concludes the Investigation by the **Office of Securities** and any other action that
6 the **Office of Securities** could commence under applicable state law on behalf of **Maine** as it relates to
7 Merrill Lynch, its affiliates, current or former employees, officers and directors of Merrill Lynch relating to
8 research practices at Merrill Lynch.

9 2. This Agreement is entered into solely for the purpose of resolving the **Office of Securities**
10 Investigation, and is not intended to be used for any other purpose.

11 3. **Merrill Lynch further agrees that:**

12 (a) Merrill Lynch will comply with the **Revised Maine Securities Act**.

13 (b) As of the date hereof, Merrill Lynch will state on each Merrill Lynch Global Equity research
14 report whether Merrill Lynch received or is entitled to receive compensation over the past 12
15 months, or whether Merrill Lynch is entitled to receive compensation from any publicly
16 announced equity underwriting or merger and acquisition transaction for each company covered
17 by the research report (the "Covered Company"). Notwithstanding the foregoing, as of July 8,
18 2002, the disclosures regarding investment banking compensation referred to in Paragraph 3(b)
19 shall be replaced with the disclosures required by NYSE Rule 472(k)(1)(ii) and NASD Rule
20 2711 (h)(2)(A)(ii).

21 (c) As of the date hereof, Merrill Lynch will include a prominent legend on the first page of each
22 Merrill Lynch Global Equity research report that investors should assume that Merrill Lynch is
23 seeking or will seek investment banking or other business from the Covered Company.

24 (d) As of the date hereof, Merrill Lynch will include on each Merrill Lynch Global Equity research
25 report specific disclosure on a percentage basis, the aggregate distribution, calculated quarterly,
26 of the intermediate-term rating category used by Merrill Lynch, for

27 (i) all stocks in the sector or industry group applicable to the Covered
Company;

- 1 (ii) all stocks in the sector or industry group applicable to the Covered Company
2 for which, over the prior 12 months, Merrill Lynch performed services in
3 publicly announced equity underwritings and merger and acquisition
4 transactions for which compensation was received or to which Merrill
5 Lynch is entitled, until the effective date of any applicable rules promulgated
6 by any self-regulatory organization to which Merrill Lynch is subject;
- 7 (iii) all stocks covered by Merrill Lynch Global Equity research; and
8 (iv) all stocks covered by Merrill Lynch Global Equity research for which, over
9 the prior 12 months, Merrill Lynch performed services in publicly
10 announced equity underwriting or merger and acquisition transactions for
11 which compensation was received or to which Merrill Lynch is entitled,
12 until the effective date of any applicable rules promulgated by any self-
13 regulatory organization to which Merrill Lynch is subject.

14 **Research Changes**

15 4. Merrill Lynch agrees to adopt and enforce policies implementing the practices and procedures set
16 forth in Paragraphs 5-15 with respect to its U.S.-based equity research analysts and equity securities
17 covered by such analysts by no later than July 1, 2002, unless otherwise set forth below.

18 **Analyst Compensation**

19 5. Merrill Lynch will separate completely the evaluation and determination of compensation for U.S.-
20 based equity research analysts from Merrill Lynch's investment banking business by complying with
21 Paragraphs 6-9 below. Going forward, Merrill Lynch will consider the implementation of such additional
22 procedures as it deems appropriate to further effectuate the provisions of Paragraphs 6-9. All research
23 analyst employment contracts entered into starting as of the date hereof will make specific reference to the
24 Merrill Lynch policies implemented to effectuate the prohibitions set forth in Paragraph 7 of this
25 Agreement.

26 6. Merrill Lynch agrees that research analysts will be compensated for only those activities and
27 services intended to benefit Merrill Lynch investor clients. The activities and services that research
analysts are expected to perform for the benefit of Merrill Lynch investor clients include:

- 1 (a) formulation of research recommendations and preparation of research reports;
- 2 (b) communication of investment information to investor clients;
- 3 (c) cooperation, accessibility and responsiveness consistent with serving investor clients; and
- 4 (d) participation in the identification and evaluation of potential investment opportunities,
- 5 including providing input into whether a potential investment opportunity is appropriate for
- 6 Merrill Lynch investor clients.

7 7. With respect to analyst compensation, Merrill Lynch will prohibit:

- 8 (a) anyone responsible for determining research analysts' compensation from soliciting from
- 9 any analyst, or considering in determining any analyst's compensation, either (i) the amount
- 10 of investment banking revenue received from clients covered by such analyst, or (ii) the
- 11 analyst's participation in investment banking transactions, except to the extent such
- 12 activities and services are intended to benefit investors, as specifically contemplated by
- 13 Paragraph 6 above;
- 14 (b) research analysts from being evaluated by investment bankers for any work such analysts
- 15 may do to generate investment banking business, including participation in investment
- 16 banking client solicitations;
- 17 (c) investment bankers from communicating with research analysts or with anyone responsible
- 18 for determining analysts' compensation for the purpose of calculating or influencing an
- 19 individual analyst's compensations; and
- 20 (d) consideration of any such input from investment bankers by anyone responsible for
- 21 determining research analysts' compensation.
- 22

23 8. Merrill Lynch agrees that managers in Merrill Lynch's Research Department ("Research

24 Management") and those executive officers more senior to Research Management, subject to review at its

25 discretion by the Board of Directors, will have exclusive responsibility for determining research analyst

26 compensation and will evaluate analysts for compensation purposes based primarily upon:

- 27 (a) quality of analysts' research and performance of their investment recommendations;
- (b) competitive compensation factors;

- 1 (c) surveys and input from investor clients; and
2 (d) surveys and input from Merrill Lynch's institutional sales, equity trading, and private client
3 divisions, but not from the investment banking division.

4 9. Executive management may discuss with Research Management overall costs, budgets, resource
5 allocation and the retention and recruitment of research analysts.

6 **Research Recommendations Committee**

7 10. On or before September 1, 2002, Merrill Lynch will establish a Research Recommendations
8 Committee (the "RRC"). The RRC will monitor performance of and supervise equity research
9 recommendations for objectivity, integrity, and a rigorous analytical framework in the development of all
10 recommendations.

- 11 (a) The RRC will be composed of representatives of Merrill Lynch's institutional and private
12 client sales management, Research Management and research strategists. It will be chaired
13 by an individual who will be compensated in a fixed amount plus a bonus based primarily
14 on how research recommendations (i.e., currently defined as strong buy, buy, neutral,
15 reduce/sell), perform for investors. Performance will be measured over relevant periods of
16 time by, among other things, absolute price performance against the recommendation
17 definitions included in the research reports and price performance relative to industry and
18 market benchmarks.
- 19 (b) Initiation of, or change to, any equity research recommendation will require approval by the
20 RRC. Changes to research recommendations may be approved by a member of the RRC
21 and ratified by the RRC.
- 22 (c) Upon presenting a research recommendation at a meeting of the RRC, the relevant
23 research analyst shall disclose to the RRC any participation by the analyst with
24 investment bankers in an investment banking transaction for the subject company within
25 the last 12 months.
- 26 (d) A member of the RRC or a member of Research Management, or a compliance manager
27 in the Research Department shall be present at any meeting of Merrill Lynch's Equity

1 Commitment Committee or any other group authorized to commit Merrill Lynch to a
2 public equity underwriting.

3 (e) The RRC Chairperson will report to the Director of Global Research.

4 11. As soon as practicable, but no later than December 31, 2002, Merrill Lynch will implement a
5 system to monitor electronic communications between investment bankers and equity research analysts.

6 **Solicitation of Investment Banking Business**

7 12. Merrill Lynch agrees that:

8 (a) Research analyst participation with investment bankers in solicitations for any potential
9 investment banking transaction must be approved in advance by Research Management.

10 (b) Effective September 1, 2002, before any research analyst participates in a solicitation
11 with investment bankers for any potential investment banking transaction, such analyst
12 must disclose such intended participation to a member of the RRC.

13 (c) Effective September 15, 2002, each equity research report covering a particular company
14 will disclose whether, since July 1, 2002, any research analyst covering such company
15 has participated in a solicitation with or at the request of investment bankers for an
16 investment banking transaction underwritten by Merrill Lynch. Commencing on July 1,
17 2003, such disclosure will be made for the immediately preceding 12 month period.

18 (d) Upon execution of this Agreement, Merrill Lynch will prohibit analysts, investment
19 bankers, or any other employees of Merrill Lynch from promising, implying, offering, or
20 communicating in any way that a specific recommendation or change of an existing
21 recommendation will be made in exchange for the awarding of an investment banking
22 transaction to Merrill Lynch.

23 (e) Upon execution of this Agreement, Merrill Lynch will prohibit analysts from changing
24 any research recommendation because of the subject company's decision not to retain
25 Merrill Lynch for investment banking services.

26 **Disclosure During Solicitation of Public Equity Underwriting**

27 13. On or before September 1, 2002, Merrill Lynch will establish a policy requiring that the materials
used in connection with any solicitation for a public equity underwriting will include a written disclosure

1 that:

- 2 (a) Merrill Lynch prohibits employees from, directly or indirectly, offering a favorable
3 research rating or specific price target, or offering to change a rating or price target to a
4 subject company as consideration or inducement for the receipt of business or for
5 compensation; and
6 (b) Merrill Lynch prohibits research analysts from being compensated for involvement in
7 investment banking transactions except to the extent that such participation is intended to
8 benefit investor clients.

9 **Termination of Coverage**

10 14. Whenever Merrill Lynch terminates coverage of any issuer, Merrill Lynch will publish a report
11 disclosing:

- 12 (a) Merrill Lynch's termination of coverage;
13 (b) the rationale for the decision to terminate coverage; and
14 (c) that, effective upon the termination of coverage, the last recommendation issued for the
15 particular stock should not be relied upon going forward.

16 **Compliance Monitor**

17 15. Merrill Lynch agrees that:

- 18 (a) Starting on or before September 1, 2002 and continuing for a period of one year, Merrill
19 Lynch will designate an employee (the "Compliance Monitor") whose assignment will be
20 to ensure compliance with the policies required by this Agreement.
21 (b) The Compliance Monitor will be appointed by Merrill Lynch subject to the acquiescence
22 of the New York AG, which acquiescence will not be unreasonably withheld.
23 (c) The Compliance Monitor will be available to research analysts to address issues of actual
24 or perceived undue influence or pressure from investment banking or any other source.
25 (d) The Compliance Monitor will report directly to the General Counsel for Litigation,
26 Compliance, Regulatory and Governmental Affairs.

27 16. Nothing herein shall be construed to require that Merrill Lynch or any of its affiliates, agents, or
employees, act in any manner inconsistent with any laws, rules, or regulations, including those imposed

1 by their governing self-regulatory organizations.

2 **No Disqualifications**

3 17. Neither this settlement, nor any acts performed and documents executed in furtherance of this
4 Agreement: (a) may be deemed or used as an admission of, or evidence of, the validity of any
5 wrongdoing or liability including, but not limited to the assertions in the Dinallo Affidavit, or anything
6 contained in the New York State Supreme Court Order, dated April 8, 2002; or (b) may be deemed or
7 used as an admission of, or evidence of, any such alleged fault or omission by Merrill Lynch & Co.,
8 Henry Blodget, Justin Baldauf, Kirsten Campbell, Virginia Syer Genereux, Sofia Ghachem, Thomas
9 Mazzucco, Edward McCabe and Deepak Raj, or any of them, in any civil, criminal, or administrative
10 proceeding in any court, administrative agency, or other tribunal; nor shall this Agreement confer any
11 rights upon any persons or entities who were not a party to this Agreement.

12 18. This Agreement is not intended to indicate that Merrill Lynch or any of its affiliates or current or
13 former employees should be subject to any disqualifications contained in the federal securities law, the
14 rules and regulations thereunder, the rules and regulations of self regulatory organizations or various
15 states' securities laws including any disqualifications from relying upon the registration exemptions or
16 safe harbor provisions, and this Agreement is not intended to form the basis of any such disqualification.

17 19. For any person or entity not a party to this Agreement, this Agreement, including, but not limited
18 to Paragraph 17 above, does not limit or create any private rights or remedies against Merrill Lynch
19 including, without limitation, the use of the Dinallo Affidavit, any e-mails or other documents of Merrill
20 Lynch or of others for research practices, limit or create liability of Merrill Lynch, or limit or create
21 defenses of Merrill Lynch to any claims.

22 20. Nothing herein is intended to or shall be construed to have created, compromised, settled or
23 adjudicated any claims, causes of action, or rights of any person whomsoever, other than as between **Office**
24 **of Securities** and Merrill Lynch in accordance with this Agreement.

25 21. Any violation of the May 21 Agreement shall be deemed violation of this Agreement. Should
26 Merrill Lynch fail to abide by the terms and conditions of this Agreement or the May 21 Agreement,
27 nothing contained herein shall be construed to prevent the **Office of Securities** from exercising the
authority to impose any remedy under **Revised Maine Securities Act** against Merrill Lynch.

1 22. This Agreement shall not disqualify Merrill Lynch or any of its affiliates or current or former
2 employees from any business that they otherwise are qualified or licensed to perform under applicable
3 state law and this Agreement is not intended to form the basis for any disqualification.

4 23. Merrill Lynch shall pay the sum of \$500,000, to the State of Maine Office of Securities.

5 24. This payment is contingent upon written agreement, by the appropriate securities Agency of all
6 50 states, the District of Columbia and Puerto Rico, that the respective payment (referenced in Paragraph
7 24 of the May 21 Agreement) is made to each such Agency in consideration of the conclusion of any
8 investigation by each such respective Agency, the District of Columbia and Puerto Rico and any action
9 that each such respective Agency, the District of Columbia, and Puerto Rico could commence with
10 respect to research practices at Merrill Lynch. Merrill Lynch agrees and acknowledges that as to the **State**
11 **of Maine Office of Securities** this Agreement fully satisfies and complies with such contingency and with
12 the contingency set forth in the third sentence of paragraph 24 of the May 21 Agreement, which is fully
13 incorporated into this Agreement.

14 25. If payment required pursuant to paragraph 23 is not made by Merrill Lynch for failure of any
15 contingency set forth in paragraph 24, the **Office of Securities** may vacate this Agreement at its sole
16 discretion, upon 10 days notice to Merrill Lynch.

18 **General Provisions**

19 26. This Agreement and any dispute related thereto shall be construed and enforced in accordance with,
20 and governed by, the laws of the **Maine**.

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

WHEREFORE, the following signatures are affixed hereto this 21 day of October, 2002.

Merrill Lynch, Pierce, Fenner & Smith, Inc.

Maine Office of Securities

By: _____

Andrew Kandel
First Vice President, Assistant General Counsel

By: _____



Christine A. Bruenn
Securities Administrator